Q3 2019 Earnings Call

Company Participants

- Richard Galanti, Executive Vice President, Chief Financial Officer and Director

Other Participants

- Christopher Mandeville, Analyst
- Chuck Grom, Analyst
- Edward Kelly, Analyst
- Erica Eiler, Analyst
- Gregory Melich, Analyst
- John Heinbockel, Analyst
- Joshua Kamboj, Analyst
- Karen Short, Analyst
- Michael Lasser, Analyst
- Scot Ciccarelli, Analyst
- Scott Mushkin, Analyst
- Steve McManus, Analyst

Presentation

Operator

Good afternoon. Ladies and gentlemen, my name is Jerome and I will be your conference operator today. At this time I would like to welcome everyone to the Costco Third Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

Now it's my pleasure to hand the call over to Mr. Richard Galanti, Chief Financial Officer. The floor is yours.

Richard Galanti {BIO 1423613 <GO>}

Thank you, Jerome and good afternoon to everyone. I'll start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements. The risks and uncertainties include, but are not limited to, those outlined in today's call as well as other risks identified from time to time in the Company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made and the Company does not undertake to update these statements except as required by law.

In today's press release, we reported operating results for the third quarter of fiscal 2019, the 12-weeks ended May 12. Our reported net income for the quarter came in at $906 million or $2.05 per share as compared to $750 million or $1.70 per share last year. As mentioned in the release, this year's third quarter benefited from a non-recurring tax item of $73 million or $0.16 per share. Excluding this item, our earnings for the fiscal third quarter were up 11% year-over-year.

Net sales for the quarter came in at $33.96 billion, a 7.4% increase over the $31.62 billion sales for the last year in the quarter. Comparable sales for the third quarter were as follows. For the 12 weeks, on a reported basis, US was 7.0%. Excluding gas inflation, FX and rev rec, it would have been a 5.5%, Canada reported at 1.3%, ex those items, a 5.1% positive. Other International reported 1.7%, ex those items, 6.9% to the positive. So total Company, we reported a 5.5% comp sales for year for the 12 weeks. Excluding those three items, almost negated each other coming in at 5.6% excluding those items.

e-commerce was 22% for the quarter on a reported basis and 19.5% ex those items. In terms of Q3 comp sales, our third quarter traffic or shopping frequency increased by 3.7% worldwide and up 3.4% in the US. In terms of the impact of the items of gas, FX, rev rec, weakening foreign currencies relative to the US dollar negatively impacted sales by about 130 basis points. Gasoline price inflation impacted sales by a small amount, plus 10 basis points and rev rec benefited comp sales by about 110 basis points. So the net of the three, about minus 10 basis points.

Our average front-end transaction or ticket was up 1.8% during the third quarter and excluding the impacts from gas, FX and rev rec, our average ticket was up approximately 1.9%.

Next on the income statement, membership fee income, we reported membership fee income in the third quarter of $776 million or 2.29% of sales. This is up $39 million or 5.3% from last year's $737 million. FX had a negative impact on that number, that impacted that $39 million increase would have been about just under $10 million higher than that ex FX.

Our reported membership fee revenue, again, was up $39 million or 5.3%. In addition to FX impacting that to the negative, it does have the benefit of the fee increases we took almost two years ago, really the last fiscal quarter of that -- those increases that we took in June of 2017 in the US and Canada. We now have effectively completed that 23-months cycle it takes to recognize the incremental benefit from the fee increases that the benefit to our P&L in Q4 will be very small, less than $1 million.

In terms of renewal rates, at Q3-end our membership renewal rates remained strong and the US and Canada membership renewal rates came in at 90.7%, the same as it was a quarter ago and worldwide the rate was 88.3%, that figure also the same as of Q2 end. In terms of number of members, at Q3-end, the number of member households we had was

53.1 million at Q3-end, that's up from 52.7 million 12 weeks earlier. In terms of total cardholders, we came in at 97.2 million, up from 96.3 million 12 weeks earlier at Q2-end.

During the quarter, we opened three new warehouses, one each in the United States, Korea and Australia. At Q3-end, in terms of paid executive members, they stood at 20.4 million, which was an increase of 406,000 during the quarter or 34,000 per week. Korea was actually a very small piece of that increase. So we've had good continuing -- Executive Member penetration in other countries as well, most notably US and Canada.

Going down the gross margin line, our reported gross margin in the third quarter was lower year-over-year by 6 basis points coming in at 10.99% versus last year's 11.05%. Now, excluding the items that I've excluded before, FX, rev rec and like, the 6 basis point lower number would be actually plus 5 basis points, excluding gas inflation and rev rec.

Financially, to jot down a couple of numbers here. Two columns, both reported and then ex gas inflation and revenue recognition for the third quarter of 2019 as compared to a year earlier. The first line item here would be core merchandise. On a reported basis year-over-year in the quarter it was reported 1 basis point lower. Ex gas and rev rec, it was 9 basis points positive. Ancillary businesses, minus 3 and minus 1 basis points; 2% reward, minus 2 and minus 3, and summing all those up, you would have the reported number 6 basis points lower and ex gas and rev rec, 5 basis points to that higher.

One thing I will note compared to last -- the second quarter, in the second quarter we had a big increase in ancillary business margin as we pointed out last quarter's earnings release. The core merchandise component here, again, lower by 1 basis point. If you look at the core merchandise categories in relation to their own sales, core on core, if you will, margins year-over-year were higher in Q3 year-over-year by 21 basis points.

The sub categories within the core, all four main subcategories, food, sundries, hardlines, softlines and fresh foods were all up year-over-year in the third quarter on their own sales and that's a trend that we've seen last quarter. It was up less than that amount in Q1, down a little bit year-over-year. Ancillary, the other business gross margin, again lower by 1 basis point on the ex-gas and rev rec, nothing really to speak of in terms of things there.

Moving to SG&A, our SG&A percentage Q3 over Q3 was lower or better by 6 basis points coming in at 9.92% of sales this year. This compared to 9.98% reported last year. Ex-gas inflation and rev rec, it was higher or slightly worst by 5 basis points. Again, to jot down a few numbers here, the two columns, reported and the second column without gas inflation and rev rec -- gas inflation or rev rec. Core operations on a reported basis was better by 7 basis points, so plus 7; ex rev rec, minus 2. Central, minus 1 and minus 2 basis points. Stock compensation, zero and minus 1. Summing up those two columns, again on a reported basis, SG&A was lower or better by plus 6 basis points and ex those other items, worst by 5 basis points.

Now, the key thing here is within the 7 basis points of improvement or rather the minus 2 basis points, ex-gas, rev rec, that's notwithstanding the fact that we're still facing pretty big headwinds from the US wage increases to our hourly employees that went into effect in

June of 2018, as well as additional wage increases implemented in March of 2019. Both of these wage increases negatively impacted SG&A during the quarter, represented about 10 to 12 basis points of the year-over-year variance.

In Q4, the estimated impact will be about minus 5 to 6 basis points, which is the residual impact from June of '18 plus the March 2019 increases and then will tick down to 3 or 4 basis points of detriment we estimate in Q1 of 2020. Central, nothing to speak of there, it was higher by 2 basis points on an ex-gas, rev rec basis. Stock compensation, flat year-over-year and then again minus 1.

Next on the income statement is preopening expense. Preopening expense came in at $14 million this year in Q3, up $6 million from a year ago. We had one additional opening, three openings this year versus two last year. There was also about $2 million of preopening expense in the number related to the chicken plant that we plan to start -- the beginning of production in later this summer.

Additionally, some of this quarter's expense relates to our higher number of openings we have in Q4. In Qs one through three, and the first 36 weeks of this year, we will open a total of 10 new locations, in Q4 we have 11 planned. So there is some remnants of beginning of sort of the preopening there. All told, reported operating income in Q3 was up 5%, coming in at $1.122 billion this year compared to $1.067 billion last year. Below the operating income line, reported interest expense was $2 million lower or better year-over-year, coming in at $35 million versus $37 million. That's just a slight difference in capitalized interest amount.

Interest income and other for the quarter was lower by $5 million year-over-year. Interest income itself was actually higher by $11 million year-over-year. However, various FX items in the amount of minus $16 million negatively impacted the year-over-year comparison. Overall pretax income in Q3 was also up 5%, coming in at $1.123 billion this year versus $1.071 bllion last year.

In terms of income taxes, our reported tax rate in Q3 fiscal '19 was 18.5% compared to 28.8% in Q3 last year. As was mentioned in today's release, this quarter's earnings and our tax rate benefited from a nonrecurring $73 million item. Excluding the $73 million item, our third quarter tax rate would have been 24.9% and we estimate that our effective total Company tax rate for fiscal -- for Q4 of fiscal '19 to be more in the 26.5% to 27% range.

A few other items of note. In terms of expansion, as I mentioned, we've opened through the third quarter to-date a total of -- actually opened 12 units. I'm sorry, opened 13 units, but that includes three relocations, so a net of 10. In Q4, we will open 13 locations, which includes 2 relos, so net of 11, which should put us in terms of net new openings for the fiscal year at 21, the same number that we had in fiscal '18.

About three-quarters of the openings this year in the US and about a quarter internationally. This also includes our anticipation of opening our first Costco in China in Shanghai, tentatively scheduled to open on August 27th, right before the fiscal year ends.

As of Q3-end, total warehouse square footage stood at 112 million square feet. In terms of CapEx, while our new warehouse openings remains in the low 20s, the CapEx spend is in line with prior years. We've got a lot of money being spent on fulfillment, both e-commerce and grocery, expansion and automation, the chicken plant, which is what we mentioned, as well as ongoing expansion and depot and infrastructure, as well as IT modernization.

In terms of stock buybacks in Q3, during the third quarter, we expended $44 million, repurchasing 192,000 shares at an average price of $226.57. To date, we've expended $195 million for 903,000 shares at about $216 per share price.

As a reminder, at the last Board meeting, the Board approved a re-authorization of a stock repurchase program and authorized a new $4 billion program that will remain in fact through April 2023. In terms of e-commerce, overall our e-commerce sales increased, as we mentioned, on a comp basis 19.5%, reported 22%, 19.5% ex-FX and gas. I might point out, by the way, that these numbers do not include the increases that we're seeing with Instacart. Instacart comes into our warehouses and purchases, and that goes into warehouse sales.

The top growth categories in the quarter were electronics, health and beauty aids, furniture, small appliances, automotive and optical, and new brands and items online during the quarter include high end televisions from Sony and Samsung, as well as the latest generation Apple products from AirPods to iMacs and the like. Other things would include things like bareMinerals' beauty cosmetics.

Sales highlights during the quarter included some significant diamond ring purchases, one in the $400,000 range and big ticket items like golf simulators that sold for $14,000 each, which we sold during a five-day period. We also continue to improve our online and in-line cross marketing initiatives. A lot of push notifications for start and end of warehouse promotions, emails featuring hot items and suggestions for Mother's Day and other holidays like Cinco de Mayo.

During the quarter we also completed the roll out of six regional grocery distribution centers located within our existing depots. You will recall that previously we had fulfilled since late 2017 when we began the two-day grocery, we did that through our business centers. As it expands, we pushed it into our depot operations and we'll also have, in those cases, regional assortments.

An update in terms of our buy online and pick it up in store. In the quarter, we began rolling out additional pick up lockers. Over the last several months, we've had 10 locations, but we're in the process of rolling that out to an additional 100 locations over the next four, five months before the September through December holiday season. Continued growth in the Costco app use among our members. We continue experience that with new features recently added like pharmacy orders and pickup notifications, easier shopping ability on member savings events, photo center and various push notifications, and expect several additional new features are planned for July and the upcoming months thereafter.

We continue to focus on getting merchandise to customers faster. Some of that has to do with where we locate the merchandise in these depot and other ancillary operations. As discussed last quarter, we will begin e-commerce operations in Japan later this summer and Australia late summer, early fall.

The next thing I wanted to touch on for a minute is the whole question of tariffs. I'm sure we'll be getting some questions on that. So a few comments. As we indicated a couple of quarters ago on our earnings release, there continue to be a lot of moving parts, although some of the moving parts are getting bigger. And it is still -- but it is still pretty fluent. The actions that we took then and we continue to take where we were able to, not in a big way, we're accelerating shipments before certain tariffs would go into effect or would be increased in the percentage of the tariff. Although there is limited ability to do that, we've worked with suppliers. We've gone to potentially to every supplier on every item as you might expect to see what we can do both reduce costs and figure out how to do that.

In some cases, we've reduced order commitments on certain items. We've looked at alternative country sourcing where possible and feasible, although again there's a limited amount of the ability to do that. And we've taken advantage of lower pricing on certain US items that impacted the other way.

In summary, we will continue to see our customers, competitors react to this. What's interesting is if you -- as you know, this List 3, which is the biggest of the three Lists of potential tariffs items, those were listed back in September of '18 at 10% tariffs and we're willing going to go to 25% at December -- as of December 31st of 2018. That data has continued to move, although it's now moved and it's in fact that 25% for items that I believe are -- that are on -- that are exported after May 10. So we're just starting to see some of those impacts.

As you might expect, it's all over the Board in terms of every item and every vendor is different. In some cases, it's being passed on. In some cases, we're able to work to figure out how to move merchandise. And then the impact of when the price increase does go through, it has a different impact of how it affects sales. We think that we're in a good position in terms of our size and our ability and our relationships with our vendors and we'll keep you posted how it goes. This last piece, again it includes -- it's the biggest List of the three Lists and includes things like furniture, luggage, bikes, vacuums, (inaudible) and more items like that.

That's pretty much it on our side. Lastly, in terms of upcoming releases, we will announce our May sales results for the four weeks ending this Sunday, June 2nd, next Wednesday, June 5th after the market closes. And with that I will open it up for Q&A and turn it back to Jerome. Thank you.

Questions And Answers

Operator

(Operator Instructions) Now, our first question comes from the line of Michael Lasser from UBS. Michael, you're now live.

Q - Michael Lasser {BIO 7266130 <GO>}

Good evening. Thanks a lot for taking my question. Richard, how are you going to comp the $400,000 diamond ring, it's going to be tough next year?

A - Richard Galanti {BIO 1423613 <GO>}

Well, do you have anniversary coming up?

Q - Michael Lasser {BIO 7266130 <GO>}

In a way, I do. I can't afford it. My question relates to the comp. The traffic's been moderating a bit. Should we think about this as just more reversion to the mean or do you think that there's something else going on?

A - Richard Galanti {BIO 1423613 <GO>}

Well, look, every time it reminds me of a few years ago when we saw slight moderation in traffic and it was, oh my god, this is the new normal. And our answer then was, we don't know what the -- we don't know if it is or it isn't. What we know is is we've got a lot of exciting things going on in buying. We certainly -- the different buckets of money we've talked about over the last few years, whether it's the fee income from membership fee increases, the credit card switch, the tax -- the tax reform, all those things don't go away. They in fact grow each year a little bit. And so I think that we feel that we are in a good position to keep driving it.

As it relates to where it goes from here, we'll have to see. We think relatively speaking, our value proposition is strong, if not stronger, than it's ever been out there and we'll have to see where it goes. Now what are some of the headwinds? Recent headwinds included the weather and other things that started back in February. Certainly this new word with the capital T called Tariff, the questions out there that we read about every day and we will see.

Again, we feel -- whatever the impact is, we feel that in the earlier tariffs last year, recognizing many of them were in the 10% range, not the 25% range, we actually felt we picked up a little market share in some cases. We don't know what will happen tomorrow, but we feel we're in a good position from a buying power standpoint and certainly have the ability to drive sales the way we know how to do it with good value.

Q - Michael Lasser {BIO 7266130 <GO>}

My follow-up question is, your core-on-core gross margin expanded rate, that accelerated quite a bit from the last couple of quarters. Is that because of what you are doing proactively or is it just that the market becoming a little less competitive and as a result you're able to earn a little bit more on your sales?

A - Richard Galanti {BIO 1423613 <GO>}

I think it's a little of everything. I think some of it's internal controls. We still manage the basics, managing spoilage, and D&D and negotiating with vendors. It's a lot easier to do that. Our buying power and our strength per item is enormous, given our $150 billion is over 4,000 given items in a given time. Certainly, I get back to some of those other buckets we had available, we're able to use those and we are able -- we have also been able to show that we drive even greater value, the vendor sees a big increase in pickup in unit sales and I think that's worked in our benefit.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay, thank you very much.

Operator

Your next question comes from the line of Edward Kelly from Wells Fargo. Edward, you are now live.

Q - Edward Kelly {BIO 21274619 <GO>}

Yes, hi Richard. I wanted to ask about about margins, just the performance on the core margin and then the core-on-core which obviously was even better. Any additional color on the puts and takes there and then how we should maybe be thinking about that for the remainder of the year particularly as tariffs start to accelerate.

A - Richard Galanti {BIO 1423613 <GO>}

Well, I mean, look, when -- we've always been asked, when prices are going up, when costs we going up, we want to be the last raise them and when prices are going down, we want to be the first to lower them. We're not afraid to use some of those monies to again drive business. I think a lot things worked in our favor this quarter. Just when you to get comfortable with us, we'll do something else, right. But there is, again, we don't really give -- provide direction or guidance of where to go in the future. We feel pretty good right now about our competitive position relative to both in line and online and the value proposition that we bring.

And in fact some of the weakness, whether it's tariff related or whatever it's related, in some cases that we feel that it gives us a leg up as it relates to we can go in there and by large quantities of something and has great value. And these are all anecdotal comments though. Overall, we feel, again, good about our competitive position and the things that we have in the pipeline as it relates to, you know, having good merchants -- great merchandise and great prices.

Q - Edward Kelly {BIO 21274619 <GO>}

And just maybe a follow-up on the tariff side, as we think about List 3 and we think about 25%, you're your philosophy I guess generally, I mean you've always been a bit more of a customer first organization, is there a margin risk associated with that and then as we think about any potential for List 4, how strategically would you think about that?

A - Richard Galanti {BIO 1423613 <GO>}

Well, there is always risk. At some point you can't say, no one (technical difficulty) all these tariffs. We work with vendors. There's been some switching, a small amount of switching to other countries of origin where we can, although we're not the only one in town trying to do that. At the end of the day, prices will go up on things. What's interesting is is it's hard to predict what the impact is. We've seen strength in patio furniture even with certain tariff price increases, although part of that is because there was a little bit of slowdown in patio furniture because of the bad weather in January and February and we get into seasons early. So again, it's hard to analyze each one.

I think what we are most cognizant of is a key price point. If you're something at $9.99, you hate to go to a new calculation that was at $10.49. But if it's 25% on $9.99, you would say, you're not worried about $10.49, you got to figure out where it is above that. And again I think we've done everything we can and we'll see where it goes from here.

And then the real unknown is how long it's going to last. And to the extent it gets into List 4, that's a whole new ballgame as well. That's the rest of everything, if you will, including electronics and apparel and phones and televisions. And so -- and the more discretionary item is we were, again, I think a little positively surprised on the patio side, although we also have to recognize there was some build-up because the weather -- it took a little while for the weather to turn and -- but if you start getting 25% tariffs on that List 4, but -- the List 4 is not here yet and we are hopeful that the ebbs and flows of the relations between our countries improves in that regard.

Q - Edward Kelly {BIO 21274619 <GO>}

Great, thank you.

Operator

Your next question comes from the line Simeon Gutman from Morgan Stanley. Simeon, your line is now open.

Q - Joshua Kamboj {BIO 21155105 <GO>}

Hi, this is Joshua Kamboj on for Simeon. Thank you for taking my question. The expense leverage that you saw in the quarter was encouraging, especially against the wage headwinds that you're facing. Can you maybe go into a little bit more detail about what's driving those specifically and then ignoring the benefit from lapping the wage increase next year, can you continue to drive expense leverage in the same areas for the foreseeable future to offset tariffs?

A - Richard Galanti {BIO 1423613 <GO>}

Look, the biggest -- depending on the level of tariffs, if it's a lot, no. But as we've always said, we're -- the biggest thing is driving sales. If we can drive sales, we are not very good at leveraging expenses with sales or weakening relative to others perhaps, those are things we're not going to do. We're not going to postpone a wage increase and things like that. We work on expenses every day and every week and every month at our budget meetings literally. And I think we, again, there will be a little reduced headwind in each of the next few quarters with the big increases we saw in hourly wages both in June of '17 and now in March -- sorry, in June of '18 and now March of '19 as those -- that 10 to 12 negative goes to 6 or 7 goes to 4 or 5 or whatever I said earlier.

Beyond that, there's also -- I mean there is basis points here and there that go both ways. A lot of the things we're doing like this, the new fulfillment centers, the automation, none of this stuff goes completely smoothly and we don't point out each one of these things, but I'm sure there's some extra hits of 0.5 basis points here and 0.5 basis points there and there's other things that improve. At the end of the day, sales is paramount. The other thing is, I think not over this next year, but over the next several years to the extent that we have a higher increase of openings outside United States, that tends to help the overall percentages on things like healthcare.

Healthcare is 30 basis points to 70 basis points higher in every other country than the US, things like that. And so -- I'm sorry, lower -- healthcare expense as a percent of sales is lower in every other country outside the United States. So there's -- we've been fortunate that our concept works in virtually every other country we've gone to. It takes some times, it takes a few years to get there while we first open in a country, but at the end of the day that will help, but that's not going to help tomorrow, that's over the next five and 10 years.

Q - Joshua Kamboj {BIO 21155105 <GO>}

Thank you. Just of the quick follow up, following up on some of the other questions a little bit more directly. Do you think over the next few quarters your merch margin can continue to expand, that's the core-on-core one, as tariffs have a greater impact on your business?

A - Richard Galanti {BIO 1423613 <GO>}

Well, first of all, we don't guide. That's what I should say stop, but look, tariffs, to the extent that we want to be the last to raise prices, it doesn't mean we're going to wait and not do it at all. We got to be pragmatic about it, but net-net those, that would be be drag, a little bit of a drag. Now, hopefully it's a drag from a plus 20, not a minus 5.

Q - Joshua Kamboj {BIO 21155105 <GO>}

Appreciate it. Thank you.

Operator

Your next question comes from the line of Scot Ciccarelli from RBC Markets. Scot, you're now live.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good afternoon, guys. Scot Ciccarelli. I was curious if you guys have considered providing a click and collect kind of process for your grocery offering given this success that Walmart's had with their grocery pick up?

A - Richard Galanti {BIO 1423613 <GO>}

Not at this juncture, I mean the click and collect that we're doing is simply is more for small size, big ticket items like electronics and jewelry and handbags. We continue to look at it, we continue to scratch our head about it. We recognize that they and some others are putting in a lot of financial commitment to doing this. I think what you're going to find is like everything else in life at Costco, over time we figure out how to do it our way that makes sense for us that still works.

One of the reasons that whether it's Instacart or a smaller scale shipped in the Southeast, which is growing its geographic footprint as well as Google, all those things are ways to do that without us having to get into that business in a big way and that's on 2-day. And recognizing if somebody wants something in an hour, they're probably not going to get it from us. But what we see is, as we're -- the other thing is we still want to drive into the warehouse. And so far we see in small bite sizes here some of the things we've done, the net of having that 1-day grocery with third-parties or 2-day dry grocery through us, it has been slightly additive. So it's not -- while it cannibalizes the number of visits to a warehouse a little, the sum of the two still is an increase in sales. These are small data points in over a short period of time. So we have to see. But we'll figure out how to keep doing it our way and hopefully that will work.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. So, fairly nothing in the near future. Okay, thanks guys.

Operator

Your next question comes from the line of Chuck Grom from Gordon Haskett. Chuck, you are now live.

Q - Chuck Grom {BIO 3937478 <GO>}

Good afternoon. Thanks. Richard, just in light of the trade war rhetoric and market volatility and some of the soft concerns, I'm just wondering if you've seen any change in the consumer behavior, particularly in some of your more important markets such as California. PBH was out saying some things last night. Curious if you're seeing anything on your consumer?

A - Richard Galanti {BIO 1423613 <GO>}

No, we really haven't.

Q - Chuck Grom {BIO 3937478 <GO>}

No, okay, great. And then just taking a step back to follow-up on Ed's question about operating margins, they are much stronger than a decade ago and frankly not many in retail can say that. Just curious when you look ahead, when you think of bigger picture about some of the puts and takes, what do you think about operating margin dollar growth in the future?

A - Richard Galanti {BIO 1423613 <GO>}

Yes, more; more. The slide that has been shown at our International Managers Meeting every year for that three or four-day event from the beginning of time and through (inaudible) over the last 10 years, we're a top-line company. And as long as we can keep driving sales, all those other things fall into place. The fact that we have been successful longer than I thought of continuing to get more people to convert to executive membership, the benefit that we have with a great value on a credit card, all those things drive loyalty and will drive sales and everything else will take care of itself. And we feel pretty comfortable right now with the -- recognizing the value was not just price, but value -- the price is still the biggest piece of value on what we do.

Operator

Your next question comes from the line of Christopher Mandeville from Jefferies. Christopher, you're now live.

Q - Christopher Mandeville {BIO 19724977 <GO>}

Hey, good evening. Could I just ask in terms of competition on the consumable side. Are you seeing anything notable in terms of change on pricing, whether it be greater aggression or maybe a greater willingness to pass on overall cost inflation? And I guess I'm specifically curious about categories like eggs and pork where we've seen some significant deviations on pricing.

A - Richard Galanti {BIO 1423613 <GO>}

Yeah, I mean pork has been all over the board as I understand. But overall -- the answer to your overall question is not really. If anything, I mean using gasoline is an extreme example. I think the fact that our most gasoline retailers have been willing to make more on gas has enabled us to have a bigger value gap and make a little more. And that's -- so that suited us.

Well, again, I think we're fortunate that many of the price wars out there, the traditional retailers in any given category are impacted a lot more than we are on those things. So that's --- I think we've been fortunate. And our basics, you know, what I'll call the supermarket adds of yesteryear, we've been watching those every week since the beginning of time and continue to do so. And where we've helped ourselves is an areas of private label and areas of organic and specialty items. I mean, you go into even something as basic as the cheeses. We're not just selling the basic cheeses anymore. We're selling premium cheeses. And I think everything we do in packaged food items, we've stepped up the quality and whether it's organic or antibiotic-free or you name it, those things we're able to show a great savings and still maintain decent margin.

Q - Christopher Mandeville {BIO 19724977 <GO>}

Okay. And since you brought up fuel, I guess I'm curious that the comment on being able to capture maybe a little bit more margin all while expanding your gap relative to competition. Is that broad based across the country or is it more so confined to areas like State of California? And then could you just speak to comp growth on gallons in the quarter?

A - Richard Galanti {BIO 1423613 <GO>}

As I understand the only geographic region in the US where that's not the cases parts of the Midwest and an ebbs and flows there. Everywhere else, it's been a pretty healthy for us. I think the gaps -- the value gaps when you look at some of these third-party websites that collect from millions of people across the country and pricing, wish we continue to be shown as the best value out there.

Q - Christopher Mandeville {BIO 19724977 <GO>}

And anything on the comps or gallon growth?

A - Richard Galanti {BIO 1423613 <GO>}

They continue to be in the -- I believe there are still in the high single-digits in gallons. Yeah, they continued this quarter to be in the high single-digits whereas I think US gallon consumption is in the low single-digits.

Q - Christopher Mandeville {BIO 19724977 <GO>}

Great.

A - Richard Galanti {BIO 1423613 <GO>}

So we're driving people into the parking lot.

Operator

Your next question comes from the line of Karen Short from Barclays. Karen, you're now live.

Q - Karen Short {BIO 7215781 <GO>}

I'm wondering your core growth margin. Was there any benefit to core-o-core maybe from timing in terms of accelerating delivery of items that may be passing on some price increases because I mean, it sounds like it could be a little more structural in nature although I know you don't really want to commit to that? And then I had another question.

A - Richard Galanti {BIO 1423613 <GO>}

Not really, because in our nobility we kept the cost down, even as costs went up, we had it sooner we held it off. We held off raising price until we were into a higher cost unit -- products.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then I guess then that would lead us to think that there may be something more structural in terms of what we do to core-on-core? Or are you reluctant to go down that path?

A - Richard Galanti {BIO 1423613 <GO>}

Look, again, I guess I choose to use the word that we try to be pragmatic about it. We didn't look back two quarters ago and say core-on-core was down 5 or 6 basis points year-over-year. And then, last quarter it was up 7 or 8 or whatever we reported, now it's up 20. We didn't strategically plan to do it like that. It's our buying power. I think in some of these weak times, certain categories, apparel as an example, we can go in and buy huge quantities of something where manufacturers volumes have been cut by other merchants and really drive great value and keep a little of it and give even a greater value to the customer. Yeah, the product mix is a little bit -- certainly private label is a little of it.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then if we get -- if List 4 does get implemented, what percent is actually imported from China in totality or what would be the increase in what's important directly from China or do you just have no way of calculating that really?

A - Richard Galanti {BIO 1423613 <GO>}

It is really not an easy way to calculate it. First of all, List 4 is somewhat titled everything else, but who knows what everything else is, once it goes through that few month process of exceptions and people appealing the process. And look, it's more significant in the sense it's some categories that are arguably discretionary in nature. Apparel to some extent, electronics certainly and well, people that off. Again getting back to patio furniture, we didn't see it although we believe part of that is related to just the season starting later this year.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then just last question from me. I think tapping self checkout in some stores. Maybe can you just give an update on how many stores that's been and then any color on what you're thinking with respect to traffic in the stores that that's been rolled out?

A - Richard Galanti {BIO 1423613 <GO>}

Of the 540-ish locations in the US, it's in about 100 in the quarter and we are going to move to 250 in rapid order over the next several months. It works by the way for us, it works best in high volume locations where it's gotten a lot easier particularly if you have a credit card now with -- where you can just contact us and it is very fast and customers are using it, our members are using it. And so it's saving some labor at the front end as important and the highest volume units is getting people through the front end faster, which we recognize when you get -- if our average unit is in the 180 to 190 range, you got a lot of units in the 250 to 350 range, that helps.

Q - Karen Short {BIO 7215781 <GO>}

Great, thanks very much.

Operator

Your next question comes from the line of Gregory Melich from Evercore ISI. Gregory, you're now live.

Q - Gregory Melich

Hi. Thanks. Richard, could you give us a little more on the e-Commerce front, specifically is still more profitable from a margin standpoint than retail globally and how could that changes you have roll-out into Japan and Australia, how should we think about that?

A - Richard Galanti {BIO 1423613 <GO>}

Well, keep in mind, the US devours everybody else. Canada devours everybody else to some extent, proportionate to the size of our Company. Overall it's more profitable recognizing we don't charge back every item. There is a charge that the warehouse gets for accepting merchandise and things like that. But at the end of the day, we think it is slightly more profitable at a lower gross margin and there are certain categories like, I mean the most notable one is white goods. Fours years ago in the US, we did maybe $50 million in limited amount of white goods sales, meaning refrigerators, washers and dryers and the like.

Now we display a few items in store, in three -- go out three fiscal years, which was last year's fiscal '18, we did five something -- 500 plus, a little over $500 million and that should be -- we should be able to double that, grow over $700 million this year. So -- double that in a few years. So that's a category that by necessity, nobody was going to go pick it up by and pick it up in the warehouse anymore. This has enabled us to have -- so there's those kinds of things that have helped as well where we would have lost some of that business I think over time and the warehouse anyway.

Patio furniture or patio furniture during the 12 to 16 weeks in the January through April period, predominantly and regular furniture during the kind of after Memorial Day and before back to schools during the 10 or so weeks in the middle of the summer, that's when we sold that stuff. Now we sold some of that stuff year-around online, most notably patio furniture that we sell year-around in a decent amount in geographies where the sun actually shines more often.

Q - Karen Short {BIO 7215781 <GO>}

Got it. And so is it fair to say that still that e-commerce business is very general merchandise heavy and can you update us on what vendor direct is as a percentage of that business or just how big it is as a percentage of sales?

A - Richard Galanti {BIO 1423613 <GO>}

Well, vendor direct, when we first started years ago it was mostly all vendor direct because it was big -- it was solely big ticket items being shipped, drop shipped. That's a lot smaller percentage today than it's ever been. First of all, in addition, over the last few years where we have gone is to one improve the site greatly itself whether it's search, returns and you name it, but we've added categories to create more velocity and more reasons for you -- some of your thinking about it going across costco.com, whether it's health and beauty aids or food and sundries and things like that.

And so I think you'll see that continue, one of the reasons that we are doing some of these automation fulfillment for small packages, if you will, and that's a natural progression of how we do things. And I was reading article just this morning about the writer was suggesting a small percentage of our members shop online at Costco. It is small relative to others, but it's increased each year and is increasing at a greater level now and we're getting better at it. But again, we still want to use the Internet to get into the store as well and we think we've done a pretty good job of both of those.

Q - Karen Short {BIO 7215781 <GO>}

Great, and just a clarification on the tariffs, it sounds like if just pick a number, let's say 15% a year COGS came from China, List 3 would be less than half of that and List 4 theoretically would be bigger, if you went on everything. Is it fair?

A - Richard Galanti {BIO 1423613 <GO>}

Yes, absolutely.

Q - Karen Short {BIO 7215781 <GO>}

Yes, okay, great. Thanks, Richard. good luck.

A - Richard Galanti {BIO 1423613 <GO>}

Yes.

Operator

Your next question comes from the line of John Heinbockel from Guggenheim Securities. John, you're now live.

Q - John Heinbockel {BIO 1508150 <GO>}

So, Richard, let me start with -- the sequential improvement in core-on-core, I'll beat that horse again, is that fairly broad based, right, the 8 to the 21, and then secondly, I don't think -- you guys don't spend a lot of time thinking about item-by-item elasticity or do you, and have a real good sense where we're the where some of that can be given back productively?

A - Richard Galanti {BIO 1423613 <GO>}

Right. It is broad based and we certainly do not thinking a lot about price elasticity. Other -- well, we think our price elasticity in one direction. If we lower the price, will we sell more. And if you think back, John, the couple of -- two or three years ago when we kind of restructured the MVM which had worked well and grew sequentially over 15 plus years and it was all stale and so we changed out, fewer items at a greater values each and what we found is, on some cases it worked and some cases it didn't. But I don't think we ever think about what if we raise the price and sell 2% less units.

Q - John Heinbockel {BIO 1508150 <GO>}

Yes, I'm thinking more of an on the -- if we cut the price, if we reinvest some of our core-on-core benefit, can we get more share or we are just pushing on a string?

A - Richard Galanti {BIO 1423613 <GO>}

We do that. I think we tried the most extreme example of seeing can we drive more value -- more volume and if we can't, we don't stubbornly push on the string in every case.

Q - John Heinbockel {BIO 1508150 <GO>}

Yes, all right. And then secondly, where do you think we stand gross and net openings for next year? And I know you probably have wanted to get up both of those, right, gross openings, probably in the high 20s and maybe get a bit higher than it's been, and obviously you've opened Shanghai, but what's going on with China, does that give you any pause for additional openings beyond Shanghai or no, you're still looking for real estate?

A - Richard Galanti {BIO 1423613 <GO>}

Well, at this juncture, we like every -- we we have two locations, one we are opening this late summer and one we would, if all things go well, about a year, almost two years from now. So let's say year and a half plus after the first one opens. That's not that different than what we've done in other countries. I think in Australia we opened three over the first four years. I think in Japan we opened five. We actually worked fast, we opened six in five years. In Spain, we opened two over four years. So that's not inconsistent. We'll continue -- when they are there, Craig and the real estate guys and Jim Murphy, the Head of International and the local country managers, they're looking at other sites. But right now we want to get to -- look, China is a little unique in many ways, aside from any issues right now with tariffs, that's not hopefully a long-term issue.

Each item has to be registered separately. We're fortunate in the sense that we have a successful operation in Taiwan, which we were able to bring some key people, but we want to hire from within and like we do in other countries start with a very small core group of people from -- that are expats, but really grow it internally and if it's also -- what we've said is, if a new country is very successful, we're perfectly happy to have a couple of units over the first two or three years, and four or five total units, four, five years after we opened our first, we'll go from there.

Q - John Heinbockel {BIO 1508150 <GO>}

And your thoughts on openings this coming year?

A - Richard Galanti {BIO 1423613 <GO>}

Excuse me?

Q - John Heinbockel {BIO 1508150 <GO>}

This coming year, 2019 or 2000 -- August of 20, early thought on gross and net, where would that go to?

A - Richard Galanti {BIO 1423613 <GO>}

Yes, I think that will actually look about the same as this year.

Q - John Heinbockel {BIO 1508150 <GO>}

All right, like mid 20s gross and low 20s net?

A - Richard Galanti {BIO 1423613 <GO>}

Yes.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay, all right, thank you.

Operator

Your next question comes from the line of Scott Mushkin from Wolfe Research. Scott, you're now live.

Q - Scott Mushkin {BIO 7138867 <GO>}

Hi, guys, thanks for taking my questions. Richard, you talked about driving top line sales and that's the key and the Company in realty takes care of itself. And if you kind of look back over the last five years, there's a huge expansion, you blew a number of centers to add to the fresh. So I think that helped a lot, the credit card helped a lot. When you look out over the next year or two or three, what do you see as (inaudible) substantial, What do you see as kind of similar type of sales drivers potential?

A - Richard Galanti {BIO 1423613 <GO>}

Well, I think we continue to see strength -- first of all, I think fresh foods continues to evolve and grow. Specialty items, within both food and non-food, organic, both fresh and shelf stable. One of the things that's -- again the good news in my view is a lot of these -- there's lots of little things, not one giant thing. We continue to add gas stations and third -- in other countries besides US and Canada. It works. e-commerce, as I mentioned, we'll added it to two more countries this year. All those things add on each other.

One of the things that we historically had not done a lot and again this is not a game changer overnight in terms of our performance is, we've been very good at taking items in the US and bringing them elsewhere. And maybe to a small extent some Canadian items because of the size we're up there. We've been bringing and continue to test items that we find in other countries. There are high-end specialty unique items and we're getting some success with that. It's a small thing right now, but we are very good at figuring out how to do that and taking it to the next step.

So, I think you're going to continue to -- we're merchants and we're the best price. And I think that's more than anything what you'll see with us. I think we're doing a better job on the membership side in terms of converting people to executive. We're still seeing good sign-ups with the credit card and as those rewards get bigger, we believe that number becomes even more loyal. So I think we've continued to see -- the good news is some of the concerns that many of you have had over the years that we haven't moved fast enough in certain areas, whether it's the Internet or e-commerce, there's a lot of low hanging fruit out there and we're benefiting from some of that. So I got to tell you, I go to every budget meeting and you hear the merchants or the merchants through some of the other countries talk about some things we're doing and I think that's exciting.

We're now the size from a value proposition, there are certain bulk high volume Kirkland items in paper goods and the like order where we're now the size where we can produce them in another country at the same quality level and dramatically lower the freight cost. Now this is not across the board on everything, but there's lots of those types of opportunities that we continue to do. There's not a shortage of things to stay busy trying to drive our business around here that we feel pretty good about.

Q - Scott Mushkin {BIO 7138867 <GO>}

Perfect. My follow-up question really goes to the competitive climate and we're seeing that maybe one of your competitors -- biggest competitors has kind of tacked a little bit differently, maybe they we're investing a lot in price year ago and not so much now. Is that part of what's going on with the core-on-core gross margins? Is the competitive climate just a little bit easier?

A - Richard Galanti {BIO 1423613 <GO>}

It's really across the board with traditional retail as well. One of things that I mentioned on the last few quarters calls on the SAM side is on the fresh side, they become and continue to be more competitive than they had been historically. That's the nature of the beast. But I think -- and again we're not competing with just one direct competitor, we're competing with traditional merchandise retailers and supermarkets. And on an overall basis, we haven't seen a dramatic change.

Q - Scott Mushkin {BIO 7138867 <GO>}

So you say the competitive climate is stable, not worsening, not getting better?

A - Richard Galanti {BIO 1423613 <GO>}

I think that's fair.

Q - Scott Mushkin {BIO 7138867 <GO>}

Hi guys, thanks for taking my questions. Appreciate it.

A - Richard Galanti {BIO 1423613 <GO>}

Why don't we take two last questions.

Operator

Your next question comes from the line a Rupesh Parikh from Oppenheimer. Rupesh, you're now live.

Q - Erica Eiler {BIO 20192312 <GO>}

Good afternoon. This is actually Erica Eiler on for Rupesh. Thanks for taking our question. So I was actually hoping to dive a little bit deeper into your online grocery efforts. Can you maybe talk a little bit more about how the Instacart and dry grocery ramps are going so far? And what you're seeing with these offerings? And then any metrics you can provide such as type of baskets you're seeing and how you're viewing the incrementality of the purchase, et cetera would be helpful.

A - Richard Galanti {BIO 1423613 <GO>}

Yeah, look, 2-day -- first of all, with 2-day drive, which we do with UPS, it's now the entire Continental United States. Much of it -- much arrives in one day, but we guarantee 2-day and it is expanding and we are actually getting small number of sign-ups where that member is signing up just to receive online because they're too far away from driving.

On Instacart, they too as you I'm sure know, have dramatically increased their geographic footprint over the last two or three years. I think the thing that's most notable is that the value proposition to somewhat buying either directly from Instacart going to their site or going to our same day grocery site -- sorry 1-day grocery side, which is the Instacart engine engine for fresh, we've dramatically improved the value proposition over the last two years. And I think that's reflective of the fact that they've grown and have their own structure in place. And we believe we can be that anchor type customer -- anchor type tenant to driving value.

And so we have sequentially I think now four times brought down pricing over the last two years of what the ultimate mark upon goods is above what if you walk into a Costco (inaudible). And so we're doing more business. It's growing at big numbers, high double-digit numbers, but it's on a small base.

Q - Erica Eiler {BIO 20192312 <GO>}

Okay, great. Thank you.

Operator

Your last question comes from the line of Simeon Siegel from Nomura. Simeon, your line is now live.

Q - Steve McManus {BIO 18474837 <GO>}

Hey guys. It's Steve McManus on for Simeon, thanks for taking our questions. So, apparel's obviously been a huge call out for you guys. But it looks like this offline comps have been trending a little bit lower over the last couple of months, kind of towards the mid single-digit range. Can you just give us some color on what you're seeing within the category or notable call out there?

A - Richard Galanti {BIO 1423613 <GO>}

Within softlines, it's jewelry, that's been a little soft. Household furniture, although some of that had to do with -- it's been a little soft.

Q - Steve McManus {BIO 18474837 <GO>}

All right. If I could squeeze one more in, on the MFI growth, did you guys kind of what exactly was the fee hike contribution for the quarter?

A - Richard Galanti {BIO 1423613 <GO>}

$10 million.

Q - Steve McManus {BIO 18474837 <GO>}

$10 million. Great, thanks guys.

A - Richard Galanti {BIO 1423613 <GO>}

Thank you very much. Have a good afternoon everyone.

Q - Steve McManus {BIO 18474837 <GO>}

Yeah.

Operator

Thank you. And that concludes Costco's Third Quarter Earnings Conference Call. Thank you for joining. You may now disconnect.