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Q2 2023 Earnings Call

Company Participants

- Josh Dahmen, Financial Planning and Investor Relations AVP
- Richard A. Galanti, Executive Vice President and Chief Financial Officer

Other Participants

- Analyst
- Brandon Cheatham
- Christopher Horvers
- Chuck Grom
- Greg Melich
- John Heinbockel
- Karen Short
- Kelly Bania
- Michael Lasser
- Scot Ciccarelli
- Scott Mushkin
- Simeon Gutman

Presentation

Operator

Good day. My name is Emma, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Costco Wholesale Second Quarter Fiscal Year 2023 Earnings Conference Call. All the 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.

Richard Galanti, CFO, you may begin your conference.

Richard A. Galanti {BIO 1423613 <GO>}

Thank you, Emma, and good afternoon to everyone. I will 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.

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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 being 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 second quarter of fiscal '23. The 12 weeks ended this past February 12, as well as February retail sales for the four weeks, ended this past Sunday, February 26. Reported net income for the quarter came in at $1.466 billion or $3.30 per share, compared to $1.299 billion or $2.92 a share, per diluted share last year, an increase of 13%.

In terms of sales, net sales for the second quarter increased 6.5% to $54.24 billion compared to $50.94 billion reported a year ago in the second quarter. Our comparable sales for the second quarter were as follows: in the U.S., 5.7% for the 12-week period, excluding gas inflation 5.8%; Canada, 3.5% reported, and 9.6% excluding gas inflation and FX; other international, 3.8% reported and 9.5% ex-gas inflation and FX; for total company of 5.2% reported and 6.8% excluding gas inflation and FX. E-commerce was a 9.6 minus -- minus 9.6% for the 12 weeks reported, and minus 8.7% excluding FX.

In terms of second-quarter comp sales metrics, traffic or shopping frequency increased 5% worldwide and 3.7% in the United States. Our average transaction or ticket was up 0.2% worldwide, and up 1.9% in the U.S. during Q2. Foreign currencies relative to the dollar, negatively impacted sales by approximately 1.8%, and gasoline price inflation positively impacted sales, very slightly, by approximately 0.2%.

I'll review our February sales results later in the call.

Next on the income statement is membership fee income. Reported in the second quarter $1.027 billion of membership fee income or 1.89%. That's for this year's second quarter compared to $967 million a year earlier, so a $60 million increase in dollars or up 6.2%. Excluding the headwinds and FX, the $60 million increase would have been higher by $20 million additional. So, on an FX-adjusted basis, membership fee income was up just over 8 percentage points.

In terms of renewal rates, at second-quarter end, our U.S. and Canada renewal rates -- our U.S. and Canada renewal rate was 92.6%, up 0.1% from Q1 end. And worldwide rate came in at 90.5%, also up 0.1% from the prior quarter, both represent all-time highs. Membership growth has remained strong. We ended the second quarter with 68.1 million paid household members, and 123.0 million cardholders, both up more than 7% versus a year earlier.

In terms of -- at Q2 end, we had 30.6 million paid executive memberships. This is an increase during the 12-week quarter of 630,000 members since Q1 end. The executive members now represent 45% of paid members and about 73% of worldwide sales.

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Moving down the income statement, next is our gross margin. On a reported basis, gross margin was higher year-over-year by 8 basis points coming in at 10.72% as a percent of sales, as compared to a year earlier second quarter at 10.64%. Now, the 8 basis points up, and then excluding gas inflation, it would have been up 9 basis points.

As I always ask you to draw a little chart with two columns, reported and excluding gas inflation and then, we'll go down the line items. Core merchandise was minus 6 basis points reported and also minus 6 ex-inflation -- gas inflation. Ancillary businesses were plus 2 basis points and plus 3 basis points year-over-year; 2% reward, minus 2 basis points and minus 2 basis points. LIFO, since we had a charge last year, nothing this fiscal quarter, it was plus 14 basis points and plus 14 basis points, for a total, again reported 8 basis points up year-over-year and ex-gas inflation, up 9 basis points.

Starting with the core, our core merchandise gross margin again was lower by 6 basis points year-over-year. In terms of core margin on their own sales, our core-on-core margin, if you will, it was lower year-over-year by 26 basis points. Most major departments, in general, were down with fresh foods being down a little more than others. We're continuing to hold or drop prices where we can to drive traffic and improve our competitive advantage. Overall, core sales benefited from sales shifting from ancillary and other businesses to core.

Ancillary and other businesses gross margins, again, were higher by 2 basis points and 3 basis points ex-gas in the quarter. Gas business centers and travel were better year-over-year, offset in part by e-com and pharmacy. 2% reward lower by 2 basis points, that's reflective of the higher sales penetration coming from our executive members. LIFO, as I mentioned, was a year-over-year variance of plus 14 basis points. We had no LIFO charge this fiscal quarter compared to a $71 million charge in Q2 last year.

Moving on to expenses, SG&A. Our reported SG&A for the second quarter was higher year-over-year by 13 basis points. This year, it was 9.11% compared to 8.98% in the second quarter of last fiscal year. Jotting down some numbers for the two columns, first column being reported and second ex-gas inflation.

Operations was down -- higher -- I said minus 2 basis points, higher by 2 basis points. So, minus 2 basis points and minus 2 basis points. Central, minus 9 basis points and minus 9 basis points, so higher year-over-year in central by 9 basis points. Stock compensation, minus 2 basis points and minus 2 basis points. And then all told, that would be 13 basis points higher both on a reported basis and ex-gas inflation.

The core operations component of SG&A, again, higher by 2 basis points, and also higher by 2 basis points ex-gas inflation. This includes the wage and benefits increases implemented last March -- last March in last year's third fiscal quarter, and an additional top-of-scale wage increase that went into effect July 4th, which was in our fourth quarter of last year.

Central, as I mentioned, was higher by 9 basis points year-over-year. About half of this increase is a charge related to a tax audit, covering several prior years. Stock comp, pretty

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much as expected, just a couple of basis points. Below the operating income line, interest expense was $34 million this year, $2 million lower than the $36 million figure in Q2 of last year.

Interest income and other for the quarter was higher by $89 million year-over-year. This was driven by an increase in interest income due to both higher interest rates being earned and on higher cash balances. The increase in interest income was slightly offset by unfavorable FX.

In terms of income taxes, our tax rate in the second quarter was 26.1%, down slightly from the 26.7% figure in Q2 last year. The effective rate for the year, excluding discrete items, is currently -- continues to be projected in the 26% to 27% range. Overall, net income was up about 13%.

In terms of a few other items of note, warehouse expansion. In the second quarter, we opened three net new warehouses, two in the U.S. and one in Australia. Additionally, next week, we'll open our third warehouse in China, with our fourth and fifth China openings -- new openings scheduled to open in the fourth quarter of this fiscal year. So, a total of three this fiscal year in China.

In fiscal '23, we expect to open a total of 27 warehouses, including three relocations. So, a net increase of 24 new warehouses. These 24 planned new openings are made up of 14 in the U.S. and 10 in other international. The 10 in other international includes the three in China, along with our first Costcos in each of New Zealand and Sweden, both of which were opened during the fiscal first quarter.

Regarding capital expenditures, our second quarter fiscal '23 capital spend was approximately $900 million. Our estimate for the year remains in a range of $3.8 billion to $4.2 billion based on timing.

In terms of e-commerce, as I mentioned, e-commerce sales in Q2 ex-FX decreased 8.7%. This weakness was driven mostly by our online mix of sales. Big ticket discretionary departments like majors, home furnishings, small electrics, jewelry, hardware, these were down 15% in the quarter and make up 58% of our e-com sales. These same departments, by the way, were down 11% in warehouse but only make up 8% of total warehouse in-line sales.

Now, a few comments regarding inflation. It continues to seem to improve somewhat. Recall back in the fourth fiscal quarter, which ended last August, our estimated year-over-year price inflation was 8% for that prior fiscal year. During Q1, the estimate on a year-over-year basis was about -- came down to 6% to 7%. In Q2, we estimate that the equivalent year-over-year inflation number has come down to 5% to 6% range, and even a little lower than that towards the end of the quarter according to the buyers.

We continue to see some improvements in many items. Commodity prices are starting to fall not back to pre-COVID levels and some examples, but continue to provide some relief with things like chicken, bacon, butter, steel, resin, nuts.

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Switching over to our inventory levels. Again, both in Q3 and Q4 fiscal year-end a year ago -- in fiscal '22, on a year-over-year basis, our inventories were up 26% year-over-year. And then, in our first quarter of this year, they were up 10%. So, a good improvement there.

As of this quarter end, our inventory year-over-year at -- as of the end of Q2 was down 2% year-over-year. Regarding the 2% drop, we were a bit over-inventoried last year as a result of supply chain challenges causing the inventory to be backed up at the ports. And talking to the buyers a year ago, the estimate of just timing of getting things across the ocean was 70 plus days. Today, it's back down to 30-ish days. And so, supply chain improvement across the board and rates, of course, coming down.

Now, turning now to our February sales, the four weeks ended this past Sunday, February 26th. As reported in our release, net sales for the month were $17.06 billion, an increase of 4.7% from $16.29 billion a year earlier in the month of February. Recall from January's sales results that the Lunar New Year, Chinese New Year occurred on January 22nd of this year, 10 days earlier this year. The shift positively impacted February's other international by about 2%, and total company by about 0.25%. Additionally, February's results for both the U.S. and total company were negatively impacted by approximately 1% we estimate, as a result of substantially worse weather this year-over-year. I believe most of that was on the traffic side rather than the ticket side.

Same-store sales, again in the release, the U.S. as reported 3.4%, ex-gas 3.5%; Canada reported 1.2%, ex-gas and FX 7.3%; other international, 6.5% reported, ex-gas and FX, plus 11.5%; total company, 3.5% reported, which ex-gas and FX was 5.0%. In terms of e-com, minus 11.2% reported compared to a minus 10.3% without gas -- without FX. That's actually an improvement from our January e-com results.

Our comp traffic or frequency in February was up 4.9% worldwide and 3.1% in the U.S. Foreign currencies year-over-year relative to the dollar negatively impacted total and comparable sales as follows: Canada being impacted by 5.5 percentage points; other international by approximately 5.7 percentage points; and total company by approximately 1.5 percentage points. Gasoline prices were essentially flat year-over-year ever so slightly inflationary, but essentially flat. Worldwide, the average transaction for February was down 1.3%, including the negative impact from FX that I just mentioned.

In terms of regional and merchandising categories, general highlights for February that we normally do on the monthly sales call. The U.S. regions with the strongest comp sales were the Midwest, the Northeast, and the Southeast. In terms of other international in local currencies, we saw the strongest results in Spain, UK, and Mexico. Year-over-year inflation for food and sundries and fresh foods while still elevated were at their lowest levels in nearly a year with food and sundries inflation dropping to the high single-digits, and fresh foods to the low-to-mid single-digits.

Moving to merchandise highlights, the following comparable sales results by category for the month exclude the negative -- which excludes the negative impact from foreign exchange. Food and sundries were positive low double digits. Cooler, food and sundries

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were the strongest. Fresh foods were up mid-single digits. Better-performing departments included bakery and meat.

Non-foods were negative mid-single digits. The better-performing departments included tires, health and beauty aids, and apparel, as well as majors, jewelry, and housewares -- I'm sorry, and apparel. Major, which -- electronics and big-ticket electronics items; jewelry, housewares, domestics, and small appliances and hardware were the worst performers, consistent with Q2 overall. Ancillary businesses sales were up mid-single digits with food court, hearing-aid and pharmacy were the top performers there.

Finally, in terms of upcoming earnings and sales releases, we will announce our March sales results for the five weeks ending Sunday, April 2nd, on the following Wednesday, April 5th, after market close.

And with that, I'm happy to turn it back over to Emma for questions and answers. Thank you.

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions) Your first question today comes from the line of Simeon Gutman with Morgan Stanley. Your line is now open.

Q - Simeon Gutman {BIO 7528320 <GO>}

Hey, Richard, how you doing?

A - Richard A. Galanti {BIO 1423613 <GO>}

Good.

Q - Simeon Gutman {BIO 7528320 <GO>}

So can we start, I guess, sizing up the consumer. I want to see how you view February in, I guess, the continuum of months. And then part of it, I think you said the down mid-teens with some of those e-commerce categories, thanks for that information. Is that stable? Is that worse? What's -- how do you kind of diagnose the whole consumer in the business?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, I think, as we talked about even the last 12 weeks ago in the quarterly numbers, we've seen some weakness in what I'll call, big-ticket discretionary items. It's -- I think, I'm not an economist but I think it's a combination of the economy and concerns out there as well as particularly strong numbers that we enjoyed not only a year ago, but a year prior to

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that with COVID that we, of course, benefited in big ways with those big ticket items. So all those things, I think, reflect that in those numbers.

We're seeing -- there's just a couple of weeks in a couple of regions, where we started to set out some seasonal things for spring and summer. So far so good but it's literally small data points in small parts of the country where the weather has been a little better, which is not a lot of places. But anecdotally, some comments were made on things like even some water sports items and camping equipment. But it's -- this is a small data set. So we'll cross our fingers and hope to see, but overall, units are generally fine. I mean, there's some things still with like on the computer side, there's weakness overall, not just with us.

We're still seeing, I think, I mentioned this in the -- on the first quarter call, we're seeing decent sales in units of televisions, all the average selling price points have come down. I think it's just in the next couple of weeks where the new TVs for the upcoming season are coming out. But other than, that yes, what we look at, of course, is our average transactions, our shopping frequency is up, our new sign-ups are continuing to be strong, up 7% in terms of new sign-ups on less than 3% new openings. So those things bode well, but people certainly are spending their dollars where they feel they should be spending them. And so, we'll see where it goes from here.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay. Follow-up on EBIT growth. I know you don't guide but this business has averaged, I think, about high-single or maybe around 10% over time. This year it's a little below average because of some of the lapping. And you are lapping some great fuel, gross profits, curious of the puts and the takes. So whatever number that you expect the EBIT dollars of this business to grow, are you confident in the levers that you have to get there?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, look, we feel good about what we're doing in driving business in the right way and growing our business. We're -- as you and others have heard forever, we're a top line company. While I can't give guidance, certainly we've seen -- we and everybody who has cash benefit from earning more money to their interest -- on their cash right now.

As we saw in this quarter, there was a $70 million improvement in year-over-year comparison of gross margin, simply because of LIFO. To the extent that -- we can't predict what's going to happen, at least the trends yesterday were that we're starting to see some improvement in inflation. To the extent that continues, we're comparing to LIFO charges in excess of $100 million and $200 million in each of Q3 and Q4. So that's something that we look at as well.

Gas is volatile, no pun intended. And it's been quite profitable in some quarters more than others. But we think that we've got the different levers to -- and puts and takes, if you will, to do that. But ultimately, it's about driving sales and certainly, we know we're getting the customer in, we're getting more of them in and they're again renewing at the highest rate ever. So that -- we'll go through this as good if not better than others.

Q - Simeon Gutman {BIO 7528320 <GO>}

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Thanks, Richard.

Operator

Your next question comes from the line of Michael Lasser with UBS. Your line is now open.

Q - Michael Lasser {BIO 7266130 <GO>}

Good evening. Thanks a lot for taking my question. So Richard, last time there was an economic downturn in the United States and globally, Costco performed pretty well, was able to comp positive during that time. This time around it's a much bigger business and it might exhibit more economic sensitivity. So a, is that how you are thinking about it? And b, what actions would Costco take to preserve its profitability in the event that it saw negative comps in the coming quarters.

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, we are going to do things to drive market share first and foremost. We are certainly cognizant of the bottom line. And I think, this is a good example of that -- this quarter is a good example of that. But at the same token, we're going to do what we need to do to drive sales because long-term, when we get our customer in and they buy stuff, they're going to come back and buy more stuff. And we've always done a good job of that. And even in the last -- again, this one's a little different, this economic downturn, with the rising interest rates and the headlines of recession and high interest rates.

But that being said, we're -- I think, we're fortunate in the sense that we've got a multitude -- various types of businesses within our business from big-ticket discretionary items to food and sundries and health and beauty aids, and fresh foods, which is really driving the cart right now, more so than it has in the past. So we'll continue to do what we do. And I remember years ago, someone asked about if sales were slowing down, what would we do? And we said, we'd drive more sales by being even hotter on prices. But generally, that's worked for us and I see that equation continuing.

Q - Michael Lasser {BIO 7266130 <GO>}

And follow-up question is to your point, your -- the inflationary number that you cited are lower than what others are experiencing. So presumably, your price gaps are widening, which makes sense and you are delivering more value for your member at a time where they arguably need it. And with that being said, how does the fact that you are delivering more value to your consumer and they may be somewhat pressured play into your mindset around whether or not you would raise your fees? I believe this spring would be the five-year anniversary of the last time you raised your fees and you typically do it around this time.

A - Richard A. Galanti {BIO 1423613 <GO>}

Yes, actually June would be our sixth anniversary.

Q - Michael Lasser {BIO 7266130 <GO>}

Yes, sorry.

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A - Richard A. Galanti {BIO 1423613 <GO>}

But and as I mentioned in previous calls -- no worries. I mentioned in the previous calls, looking at the last, I think, three, they is about now averaged around five years and seven months, which is about now, or last month. And what we said over the last few semesters -- over last few quarters was -- I have a college kid, for the last few quarters is that it's -- in our view, it's a question of if -- of when not if. And so, we'll let you know. But keep in mind, that's one way that we become even more competitive. We take those monies and directly become more -- even more competitive.

I might add though when we do -- our locations do weekly comp shops of 100 to 150 key items, all directly competitive items. And then a variety of other -- against our direct competitors. And other limited comp shops against other forms of traditional retail where the gap of competitiveness is much greater. But at the end of the day, our relative level of competitiveness in our view is as strong as it's ever been. And we do that weekly in the locations, and every four weeks at our every four-week, monthly two-day budget meeting, each of the regional operations' senior executives get up and show those numbers. And you can be rest assured we're going to continue to do that.

Q - Michael Lasser {BIO 7266130 <GO>}

Understood. Thank you very much and good luck and go Trojans.

A - Richard A. Galanti {BIO 1423613 <GO>}

There you go.

Operator

Your next question comes from the line of Christopher Horvers with JPMorgan. Your line is now open.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks. Good evening. So, following up on the first question, I guess, relative to the last time that you spoke to us, do you think the consumers deteriorated at all? Anything that you're seeing on the -- what they're buying, how price sensitive private label income demographic? What are your observations around the rate of change for the consumer?

A - Richard A. Galanti {BIO 1423613 <GO>}

Not terribly different than a quarter ago, or probably in David's January sales recording. So again, it all centers around big-ticket discretionary, and we look at that and we look at how it compared to a year-ago, and two years ago. We had so much strength there, not only with COVID and people buying big-ticket stuff and now the economy and the interest rates. So, that's to be expected.

Again, we kind of go phew, our strength in food and sundries and fresh foods, and health and beauty and things like that have helped to counter some of that. One interesting comment that I think I haven't made in the past, we've been asked that during this concern about inflation and people trading down, have we seen any delta in the sales penetration of our own Kirkland Signature items. And of course, my first comment is, that's a trade up or a trade equal, not a trade down. But at the end of the day, we have seen actually in the last few months, a bigger delta than normal. I'd say over the last 10 years, we see a half or a little less than a half a percent a year of increased penetration. In the last for this quarter -- for this quarter, year-over-year, we've seen about a 1.5 percentage, a little over 1.5 percentage point increase in sales penetration on the food side, foods being anything packaged or dry or wet, you name it. And so that we have seen a little bit of an increase in that and I guess that's consistent with the concession that most people are looking to save money. And of course, if it's our brand, that's brand. That creates loyalty.

Q - Christopher Horvers {BIO 7499419 <GO>}

Yes. And then, on the pricing/LIFO point, last quarter you talked about like we could have a LIFO benefit and that could be a source of funds in terms of investing in price. So a two-part question. If prices stayed here today, would we essentially get back the LIFO headwinds that you had a year ago, as we think about, going forward? And then the second question is you mentioned your price gaps are as good as they've ever been, but at the same time, there are some changes in consumer. So should we think about that LIFO as a source of funds to further invest in price?

A - Richard A. Galanti {BIO 1423613 <GO>}

I was looking at it more not as a source of funds, but more as a -- look, to the extent that -- and this is just using this as an example. If there was no LIFO charge plus or minus in Q3 and Q4 on a year-over-year comparison, you have on a pre-tax basis $130 million positive delta and a $223 million positive delta. Those are nice numbers to have a positive delta. So from a standpoint of looking at the earlier question about are we cognizant of earnings growth, if you will, or reported earnings per share, part of that plays into that, that gives us a little bit of cushion there, as does gasoline from time to time, as does first and foremost stronger sales. So all those things play into that. But, I think generally speaking, we're still going to do what's right in our view to drive sales, that's what we want to do first and foremost. And to the extent that that example occur in Q3 and Q4, that gives us a little room to do that without even thinking about it.

Q - Christopher Horvers {BIO 7499419 <GO>}

And then just from the accounting perspective, do we -- should we automatically get that back if prices stay at these levels on the lap?

A - Josh Dahmen {BIO 20457944 <GO>}

If the lap stays at zero.

A - Richard A. Galanti {BIO 1423613 <GO>}

If the lapping stays at zero, yes, there would be no new charge. So it would be comparing to a charge last year. To the extent -- yes, to the extent, yes, prices were to go down relative to a year ago, you'd actually have a LIFO credit which would be even a bigger year-over-year delta.

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Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Thanks very much.

Operator

Your next question comes from the line of Chuck Grom with Gordon Haskett. Your line is now open.

Q - Chuck Grom {BIO 3937478 <GO>}

Hey. How you doing, Richard? Just curious if you could talk about the gas business from a competitive standpoint and how that's changed bigger picture over the years and then more recently, how gas gallons have trended?

A - Richard A. Galanti {BIO 1423613 <GO>}

Yes. Look, we -- gas has been a relative blessing as well. It's a profitable business, it is volatilely profitable; sometimes it's more than -- and sometimes it's less, but overall, it's a profitable business. It's given us an additional competitive advantage of getting people in the door, if you will. I think it was this last summer into early fall where I've given some numbers where our gallon sales increases in the U.S. were up in the mid to high-teens compared to darn near flat for the U.S. population as a whole. I had asked yesterday on that and I think that 15-plus-percent delta of us versus the U.S. population is still about 10 percentage points. And so, we are still seeing -- taking market share, if you will, getting people in the parking lot.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. Thank you.

A - Richard A. Galanti {BIO 1423613 <GO>}

And in terms of value, when we look at a value compared to average value across our locations where we do comp shops, in some cases every day in many locations. This year-to-date, I'm looking at single-digit number. We feel that are -- we saved a member $0.37, that's an improvement. Over the last five years, it's gone from the mid-20s to the mid-30s.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay, that's a helpful context. And then just on the inflation just as prices have started to come down, curious -- and as you've invested in price too, curious what you've seen from a demand perspective, and how you're measuring the success of some of those price actions that you appear to be taking?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, it's an art, not a science. Yes, we do some -- we'll look at high velocity items where we can make a big difference fast on some items. On some things, I mean, this is just anecdotal because it was from our budget meeting, with shipping costs coming dramatically down on 25 and 50 pound bags of jasmine rice. We've seen a big uptick in

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sales, because that's an item that really skyrocketed because it's a per pound based on the size of the bag, it was a heavy freight cost. And so as that comes down, we see that going.

We're -- I think we're doing more with our suppliers, working -- changing things around with the MVM. Part of that's based on allocation issues of what we have. But overall, no, we're a firm believer if you improve the value by lowering the price, you're going to drive more sales.

Q - Chuck Grom {BIO 3937478 <GO>}

Great. Thank you.

Operator

Your next question comes from the line of Scot Ciccarelli with Truist Securities. Your line is now open.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good afternoon, guys. Hi, Richard. So you guys like many others, have seen a shift away from a bunch of discretionary categories, probably stronger sales strength in the consumable category, but gross margins are actually pretty stable. So I guess the question is, should we start to expect more gross margin pressure on a go-forward basis if we were to kind of see that mix shift continue to lean towards kind of food and consumables?

A - Richard A. Galanti {BIO 1423613 <GO>}

Frankly, the delta between those various categories are not as extreme as they used to be. And in fact, in things like fresh foods and food and sundries, some of the weaker categories are -- not weaker, but lower margin categories are things like big-ticket discretionary items. We make a smaller percentage, more dollars per unit, of course, but a small percentage on big-ticket electronics. And so that impacts more the gross margin dollars than the percentages there. If anything, if you go do a little homework on what the cost of processing and selling a rotisserie chicken, our $4.99 price is what we -- which maintained is an investment in low prices to drive membership, to drive a sales in a big way. So there's some things that we do, notwithstanding huge inflation over -- and even though some of the costs have come down a little bit relatively speaking, we want those wow items in there as well.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. Thank you. And then one follow-up here. You guys have obviously done a couple of one-time dividends over the years, but that was always in a really low interest rate environment. And as you guys just reported, with your net interest income, you can actually generate some real returns on your cash now. So does -- I guess the question is does the higher risk-free interest rate environment actually discourage you from returning that capital through future dividends?

A - Richard A. Galanti {BIO 1423613 <GO>}

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Well, it's helps a little right now, so that's a good news. I don't think it changes our view that this -- the special dividend which we've done for over the last 10.5 years, I think, it's still an arrow in our quiver. And at some point, it's something you might see again, but I'm not trying to be cute, it's kind of like the membership question, you'll -- we'll let you know when we do it.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. Thanks, guys. Have a good evening.

Operator

Your next question comes from the line of Karen Short with Credit Suisse. Your line is now open.

Q - Karen Short {BIO 7215781 <GO>}

Hey. Thanks very much, good to talk to you. So Richard, I just had a question on -- you made a comment that you're particularly cognizant of the bottom line, I think, was your exact commentary. So I'm wondering if you can triangulate that with what you think, net or pre-tax margin numbers should look like on a go-forward basis, but also triangulate that with the fact that you also commented that you're looking to invest in price to gain share in various categories.

A - Richard A. Galanti {BIO 1423613 <GO>}

Sure, well, I think on the latter comment, we're looking to use price to gain share. We're continuing to do that, it's not like we're going to go do more or less, that's what we do for a living. What I was trying to say in the comment is that we are particularly cognizant of the bottom line, we are a public for-profit company, and shareholders want to know what we're doing.

We have -- there have been times for those of you that have followed us for many years, when we might take a bigger hit on some expense in a given quarter. I think, in fact, many years ago it was the rotisserie chicken example that we frankly I think have more levers today to adjust things which helps us. But we're not going to -- we're not going to get away from that, those two things, driving the top line and being cognizant that we're also a public company trying to earn money for our shareholders. But we're going to prioritize driving sales because that will benefit all the other things on the income statement.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then just on inventory, just obviously inventory down meaningfully, but any thoughts on how to think about inventory going forward relative to sales, given that it was down 2.5%? And I'm not sure how much of that was gas or fuel related. So maybe if you could parse out that relative to the ex-fuel commentary.

A - Richard A. Galanti {BIO 1423613 <GO>}

By the way, gasoline inventory is very small relative to everything else. It turns darn there daily. So -- but a lot of the improvement or reduction in inventory year-over-year was all

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the stuff backed up with the supply chain challenges and the port challenges a year-ago. So, we feel we're in good inventory shape, the flow is much better and there's always going to be anecdotal examples of stuff that we have a little too much of something, or a little too less. But we feel pretty good right now about our inventory levels, even by category.

Yes, there's a few categories a little over a few categories under, but nothing like when we were 26% up and you had a lot of what I'll call in transit stuff literally on those pictures that you saw on the news of the ports and the ships. And so that's improved a lot.

Q - Karen Short {BIO 7215781 <GO>}

Okay, thanks so much.

Operator

Your next question comes from the line of Oliver Chen with TD Cowen. Your line is now open.

Q - Analyst

Hi, Tom on for Oliver. On digital, can you guys add some color as to how comps are expected to trend in the near-term, just given the easing compares in the back half of the year? And additionally, what opportunities lie ahead in terms of digital business from an engagement point of view.

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, we don't project where we're going. But I was glad at least that February was -- while negative, was a little better than January. We've got additional marketing activities that we've got going on there. We did hire just five months ago a new Head of Digital that is in the process of doing a lot of things, so there will be more to report over the next several quarters.

But -- and there's, in my view there's a lot of opportunities and low-hanging fruit to do that. The biggest thing the challenge that we've had just looking at our current numbers was that we've been so successful over the last two years, not only did COVID drive huge business on things for home -- big ticket things for home, be it furniture, electronics, televisions, you name it, computers and also the acquisition a couple of years ago or three years ago of what's now called Costco Logistics, those two things drove that business in such a big way. That -- we recognize that's part of it. But we're not hanging our hand on that, we want to grow the sales.

Q - Analyst

Great. And then a follow-up on the executive memberships. With the higher penetration there, could you just talk about how those members behave relatively, and additionally the effects on the business from that higher penetration.

A - Richard A. Galanti {BIO 1423613 <GO>}

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Well, they're more loyal, they spend more and they come more frequently. It's only good stuff. So, look, at the end of the day, if we can get somebody to commit -- in the U.S. as an example, spend $120 instead of $60 at the current rates, with that, they get a 2% reward with some other benefits on certain consequential transactions. That definitely drives loyalty and drives frequency.

And so the executive member spends more and shops more. And then if we get them also to get the co-branded Citi Visa card, it's even better than that. So all those things work, in our view, in a positive direction. And so we like the fact that the executive membership penetration helped by its -- we've said in the last couple of years, we brought it into a few other smaller countries. You need a core base of 15 or so locations to do it. And so we've provided it in other locations as well. But we're still seeing increased penetration in the U.S. of that. We do a better job by the way, when somebody new comes in to sign up, getting them to sign up. We do a better job of explaining the benefits of an executive membership than we did years ago as well.

Q - Analyst

Great. Thank you.

Operator

Your next question comes from the line of Kelly Bania with BMO. Your line is now open.

Q - Kelly Bania {BIO 16685675 <GO>}

Hi Richard. Thanks for taking our questions. I'm going to venture to ask a margin question here. The core-on-core has been down for about eight quarters in a row I believe. I was just wondering if you could help us understand the thought process in managing the core margin in that way? And I guess particularly given your comment that some of the low margin categories like big-ticket are under a little bit more pressure. So, maybe even a little bit more surprising. Is it just the way that other mix is shaking out? Is this intentionally, are you reinvesting any of the maybe gas windfalls that we've had over the past several quarters, are you investing that back into the store? Maybe just help us understand the thought process in this core-on-core decline here.

A - Richard A. Galanti {BIO 1423613 <GO>}

Yeah, I think the biggest component of that -- answer to that question is, our fresh margins have been the biggest piece of that coming down. And looking at it, our fresh margin in Q2, compared to Q2 three years ago, pre COVID, we're still up about 50-60 basis points. Now, we were up a lot more than that because of all the things that COVID did. It drove tremendous sales growth in those areas, which created less spoilage, which is a proponent of cost of sales in fresh foods, and labor productivity in places like the bakery and the meat department. And so it was, if you will, outsized improvement, we're still better than we were pre-COVID. And so I think -- and we've maintained the sales, when we had outside sales and these are not real numbers, I don't have them in front of me, but let's make them up and say that fresh pre-COVID was going up 8% or 10% a year, 8% a year or whatever it was and then we enjoyed a couple of years of 20 plus percent, I believe.

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And now we're still doing fine with sales growth, not up to 8% or 10%, but nonetheless -- but it's still a positive and so we've kept all those outsized gains, but we've also, of late, not just in the last month or two, but over the last several months have invested in pricing and certainly fresh helps drive that. And I gave the example of the rotisserie chicken, but that goes through lots of areas of fresh foods where that's the key -- one of the key categories that people come into shop for.

Q - Kelly Bania {BIO 16685675 <GO>}

And are you thinking of managing that in a way to get back to kind of pre-COVID levels or would you let that run a little above for some period of time?

A - Richard A. Galanti {BIO 1423613 <GO>}

I don't think we're smart enough to know how to manage all these things. There's so many different components of what is the gross margin from the different core departments to the ancillary businesses, to gas, to LIFO now. So it's -- it really is fluid and we -- managing it is -- we do manage it, but it's managing it in an organized chaotic way sometimes too as things change every day. I think we do a great job of doing it, yes.

Q - Kelly Bania {BIO 16685675 <GO>}

Okay. Maybe just -- no, agreed, agreed. I guess following up on the LIFO as it relates to the margin, you gave out some of the numbers in terms of the dollars in the last couple of quarters. In order of magnitude, would those kind of offset some of the gas margin tailwinds? Is that the way to think about it, or would the GAAP margin tailwinds be bigger, smaller than those LIFO charges?

A - Richard A. Galanti {BIO 1423613 <GO>}

Sometimes in a given month even, it can be bigger or smaller, honestly. I mean, it does fluctuate quite a -- gas fluctuates quite a bit. But good try on asking.

Q - Kelly Bania {BIO 16685675 <GO>}

Yes. Thank you.

Operator

Your next question comes from the line of Greg Melich with Evercore. Your line is now open.

Q - Greg Melich {BIO 1507344 <GO>}

Hi. Thanks. A couple of questions. One, hate to go back to the membership fee, but it just seems right. Does the $120 executive price point, now that that's, what, 43% of members and 70-some percent of sales, does the fact that that's where the bulk of the sales are coming from change the thought process, in terms of how you might do the timing of the membership?

A - Richard A. Galanti {BIO 1423613 <GO>}

No. Not at all.

Q - Greg Melich {BIO 1507344 <GO>}

No, not at all. Great. And then second is on items in basket, trying to figure out how as comps slow, and I imagine you're still getting that wage inflation, SG&A doesn't delever more. Is it -- why is that? If traffic is still growing, and we have inflation, is it just because items per basket are down or how do we think about managing the SG&A dollar growth in this, not deflationary, but disinflationary environment?

A - Richard A. Galanti {BIO 1423613 <GO>}

Yeah, units are still up and inflation, frankly, price inflation offsets it a little bit, helps offset it a little bit. And I think the focus on trying to keep figuring out how to do things more efficiently. One of the things that again that we do religiously every four weeks at the budget meeting is the operators are talking about certain focus items, whether it's improving overtime hours or things we've done to automate something physically improve the flow of goods in a warehouse.

We've done a pretty good job of that and we've done that notwithstanding two off-season wage increases this year -- three off-season wage increases, if you go back, I think 15 months, over the last 15 months. So, our leverage there, or very slight deleverage is pretty impressive, given that labor benefits is our single biggest expense category. So it's productivity. And I think we've continued to do a good job of that.

Q - Greg Melich {BIO 1507344 <GO>}

And just so I'm getting the math right on the comp, if the comp is running 6, and inflation is running 6, then -- but traffic's up 3, then items in basket would be down 3?

A - Josh Dahmen {BIO 20457944 <GO>}

Items are up, but it's higher -- it's the mix because ---

A - Richard A. Galanti {BIO 1423613 <GO>}

My guys are helping me here. It's mix. Yes, mix.

Q - Greg Melich {BIO 1507344 <GO>}

It's a 100% ASP, got it. Alright. That's great. Thanks and good luck.

Operator

Your next question comes from the line of John Heinbockel with Guggenheim. Your line is now open.

Q - John Heinbockel {BIO 1508150 <GO>}

Hey, Richard I want to start with -- I know you guys have begun doing a lot more data analytic work, and you talked about maybe investing in price. Have you done much work

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on price elasticity by category or item? And you think in the context of non-food is where there's softness, right, it's not consumables, what can you do mid-course direction -- mid-course correction there, right, on non-food? Is there elasticity where you can drive some share early in season by making targeted investments in those categories?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, I think, there are and we do. We don't analyze frankly the price elasticity on a historical basis other than we know what works in the past and we keep doing it more. It's pretty straightforward. But we're not doing A/B tests or tests and -- let's take this price delta in this region, down X or up only Y in a different region, in a different month to see which one works better. We're pretty singular-focused on, if we lower the price, we'll do more sales.

Q - John Heinbockel {BIO 1508150 <GO>}

All right. Then to follow-up on that, right, so, again, you think about non-food, what are the buyers -- you said there are times maybe non-food is going to be a little weaker and it's not all non-food, right, it's certain categories. Have you dialed back inventory? Do you want to get product in -- you get it in early any way, not sure if you can get it in earlier. What do you do if anything, I guess, inventory would be the biggest thing?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, first and foremost, is being in stock and to the extent that we bring in a few things early. I think the anecdotal comment I have mentioned about water sports and camping, we brought that a little earlier, because we had some room and needless to say, there's parts of the country where there's no sense bringing in some of that stuff early given the weather right now. But at the end of the day, I think we've always done a pretty good job of that as well.

The big thing is working with our suppliers, using electronics as an example. These are anecdotal stories, but during -- while sales were very strong for two years during COVID and supply chain challenges were still there, there was virtually no promotional things. There's now more promotional. We have to -- our buyers are out there making sure that we're getting every promotional penny that's out there and being on top of that with our suppliers. That's part of what we do, but that's been more of a focus. Yes, we focus on the categories that are growing. Examples would be like hardware and apparel, which are very strong for us right now.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay. Thank you guys.

A - Richard A. Galanti {BIO 1423613 <GO>}

Yes, part of our apparel strength is getting more well-known stuff in.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay. Thank you.

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Operator

Your next question comes from the line of Paul Lejuez with Citi. Your line is now open.

Q - Brandon Cheatham

Hey, everyone. This is Brandon Cheatham on for Paul. Thanks for taking our question. Hey, Richard. I want to go back to your comments on wider price gaps. It sounds like you're managing the business just kind of how you always have, but your price gaps are wider than they ever have been. So, I'm just wondering like how has your competitors' behavior changed? Are there certain categories that they are not responding to or are they responding slower than they have in the past?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, I think, I said they are as wide as they have ever been. I don't know if they have gotten wider. But we feel very good about where they are. And this is against direct competitors or other large boxes on certain categories, recognizing when it's a traditional retailer, there is a much bigger price gap to start with.

And remind you also, when we're looking at -- despite the fact that we and another warehouse club essentially sell the same types of items, we want to make sure that on the exact like branded items, we're better priced. So, on those 100-150, that's where we look at that, they're the most competitive and whether it's Coke and Pepsi, or Advil, or Tide detergent or key items that everybody knows the price of or is that same item. There are plenty of items that are differing in quantity, quality size color, you name it, where we feel that in some cases we have a better value, but that's up to the customer to behold that.

And so we just keep doing what we're doing. We're focusing on those competitive items and constantly figuring out how to drive more value in any item we do. How do we -- especially private label, but how do we upsize the pack, while improving the price per unit within the pack. Even when there was big inflation, how did we -- if there was a 10% increase in inflationary cost increase in something, how do we get the vendor to eat a little of it, will eat a little of it? Needless to say, still the majority of that increase is going to be in the price. But how do we also beyond that logistically -- not logistically, but from a manufacturing standpoint and a packaging standpoint, how do we lower the price by a few extra percentage points by figuring out how to get X percent more sell units on a pallet by changing the configuration of the pack size. I think, we have -- we focus more on that than anybody I know because we're taking our $230 billion or $240 billion in sales and dividing it by 3,800 items. So we have many items that are $50 million, $100 million, $300 million, $500 million items and when we can do that, we think that we do a good job of that.

Q - Brandon Cheatham

So that's to say, I mean, you think that you've got maybe a little bit of a cost advantage over your competitors. So they're not able to quite match you, when you make moves like this?

A - Richard A. Galanti {BIO 1423613 <GO>}

I'm sorry, what was that?

Q - Brandon Cheatham

That you have a cost advantage, a little bit of a cost advantage compared to your creditors, so, they -- when you take prices down, they can't quite match you. And so that's why you're able to get your price gaps as wide as they have been?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, I think it's our model versus other models. Look, there's -- we have -- we respect and have very formidable competitors, whether it's other warehouse clubs, or big-box discounters or supermarkets and we're all doing what we can do to maximize our own respective model.

So, I think, we -- certainly when we make some price changes to things we see our competitors act to them in some cases and not in others. I think the fact that we have fewer items and we're out there every week. I know that our merchants when they see those comp shops, if there's -- I'm making this up, if there's a 100 items and we're the same on 50 and lower on 45 and higher on 5, those 5 better be changed this week. And - we do -- so I know we're on top of it. I can't speak to our competitors, but I assume they are also. But we have a model that allows us -- the cost structure allows us to mark up our goods on average in the low teens compared to traditional retailers in the mid-20s to 100. So, there's -- we have a little room there.

Q - Brandon Cheatham

Got it. And I wanted to ask about -- Sam's Club recently announced that they'd change course and start opening doors. I'm wondering does that impact you all at all, on your opening plans? Would you go locate in the place even if you knew they would be opening nearby or would that preclude you from the area?

A - Richard A. Galanti {BIO 1423613 <GO>}

No, we're going to open where we want to open. Certainly, look, whether it's an existing open location or something that we're aware of based on what's going on in the real estate activity out there, which we all know what everybody's doing, in advance in a way. And so, does it impact us? It may impact us in some examples of whether it's Sam's or somebody else to push this one more soon.

And, look, I was going to say when you asked about them announcing they are going to open more doors, I think they said they're going to announce -- open about 30 over the next 5 or so years -- 5 or 6 years. They apparently didn't get the memo that they should close some more, but I'm just kidding. Look, we respect them as a competitor and we don't see that changing what we do. And there's plenty -- I think it bodes well, though, that there's plenty of capacity still in this country, of course, in other countries even more so.

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Q - Brandon Cheatham

Got it. Appreciate it and good luck.

A - Richard A. Galanti {BIO 1423613 <GO>}

Thanks. We'll take one more question.

Operator

Your last question today comes from the line of Scott Mushkin with R5 Capital. Your lines are now open.

Q - Scott Mushkin {BIO 7138867 <GO>}

Hey guys. Thanks for taking my question. I have tons, but I guess the first thing I wanted to ask a little bit, you gave the regional sales kind of which regions were better. I mean, obviously, there's been a lot of layoffs in tech. Are you seeing any? And you have a huge business out in California, are you seeing that business underperform relative to just over a couple of month period? That's my first one.

A - Richard A. Galanti {BIO 1423613 <GO>}

Not really. My guys here are looking at the numbers and they're saying not really. And what was the gas?

A - Josh Dahmen {BIO 20457944 <GO>}

(inaudible) gas.

A - Richard A. Galanti {BIO 1423613 <GO>}

Oh. One of the things that Josh mentioned is, well, we have 400 locations. 400-plus of our 550-ish locations in U.S. have gas, that's even a bigger percentage in California and higher volume gas units. And with gas pricing -- gas inflation coming down dramatically year-over-year. That's partly why they're not in the best performers. If you took that out, there's not a whole big difference out there.

Q - Scott Mushkin {BIO 7138867 <GO>}

And then just curious, and maybe this is a silly question. What happens with that gas business, especially in California with the push to EVs?

A - Richard A. Galanti {BIO 1423613 <GO>}

Yes, it's a long road ahead. At some point, we only have 11 carwashes, so we'll have plenty of room for carwashes for 30 years from now. But at the end of the day, we think it's a very long road, it's not happening in the next few years. And the fact that we're still taking such market share relative to U.S. gas, gallons in general is a positive. So, it's a question, but not -- it can defer for 5 or 10 years frankly.

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Q - Scott Mushkin {BIO 7138867 <GO>}

Yes, tell this [ph] to the California. Hey, my last question. I know this call has gone long, just wondering about a little bit long term, the initiatives. You had a big push into fresh several years ago. It's obviously worked out really well. We had the credit card. We had the big push into big-ticket. Is there anything on the horizon like that, that will change the business a little bit and maybe grow it a little faster?

A - Richard A. Galanti {BIO 1423613 <GO>}

Well. International in general, there is plenty of opportunities. If you look at some of the foreign countries, as a percent of sales, they are more profitable than the U.S. So, those things -- that creates more opportunity. I think on the -- I don't see anything big right now coming on vertical integration, might we do another poultry activity at some point. But that's still a few years down the road to even consider.

We did a meat -- a second meat plant outside of Chicago for the Midwest and East Coast just a couple of years ago. We're expanding our bakery commissary. So there's nothing another couple of hundred million dollar plus projects going on like that. I think another area that I think bodes well for us, in terms of competitiveness and getting our -- continuing to work on getting prices down is working with suppliers, certain things that we currently ship from the U.S. elsewhere or air freight, in the case of produce elsewhere. There's plenty of activity going on what I'll call the hot house side, could you grow more vegetables? But that's all good in concept, but it takes time to figure out, and there's plenty of people trying to figure it out there. And so we're waiting for that.

The other thing, I think I gave an example a few years ago, something as simple as cashews. Historically, they're all grown and washed and prepped for roasting in Eastern Africa, shipped to America for roasting, quality roasting, packaging and then shipped out to the 13 or 14 countries. Today, those that are ultimately sold in Korea, Taiwan, Japan, Australia, and China are now shipped to Vietnam to a quality, roaster supplier of ours, they grew over time with us. And we dramatically lowered the cost on that portion of a huge amount of dollars. And then using that to do what we normally do, take 80% or 90% of that savings, and lower the price even further in those countries.

And there's plenty of opportunities that I know we're now talking with big suppliers of these hundred and multi-hundred million dollar items that we buy, whether it's paper goods, plastic items, things like that which of these items could be produced overseas, particularly on the Asia side, rather than having to brew some here and ship them there, there's a lower cost of production and as long as we can maintain that quality. And so I think there's plenty of -- there's going to be lots of little opportunities that become in total a good opportunity for us.

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Q - Scott Mushkin {BIO 7138867 <GO>}

Hey, that's great color. Appreciate it.

A - Richard A. Galanti {BIO 1423613 <GO>}

Well, thank you everyone. We're around. I'm sure we'll be talking to a few of you today and tomorrow and early next week. Have a good afternoon or evening.

Operator

This concludes today's call. Thank you for attending. You may now disconnect.

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