Q1 2021 Earnings Call

Company Participants

- Richard A. Galanti, Executive Vice President, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Chris Horvers, Analyst
- Chuck Grom, Analyst
- Edward Kelly, Analyst
- Gregory Melich, Analyst
- Karen Short, Analyst
- Kelly Bania, Analyst
- Michael Lasser, Analyst
- Mike Baker, Analyst
- Oliver Chen, Analyst
- Robert Moskow, Analyst
- Robert Scot Ciccarelli, Analyst
- Rupesh Parikh, Analyst
- Simeon Gutman, Analyst
- Unidentified Participant

Presentation

Operator

Thank you for standing by, and welcome to the Q1 Earnings Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question-and-answer session. (Operator Instructions) Thank you.

I would now like to hand the conference over to your speaker today, Mr. Richard Galanti. Please go ahead.

Richard A. Galanti {BIO 1423613 <GO>}

Thank you, Cindy, 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. 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 first quarter of fiscal -- our fiscal year 2021, the 12 weeks ended November 22nd. Reported net income for the quarter came in at $1.166 billion, or $2.62 per share, compared to $844 million, or $1.90 per diluted share last year. This year's first quarter included tax benefits of $145 million, or $0.33 per share, $0.16 of which was due to the deductibility of the $10 per share special cash dividend, to the extent received by the Company's 401(k) plan participants; and $0.17 related to stock-based compensation. Last year's first quarter included a $77 million, or $0.17 per share tax benefit related to stock-based compensation as well. This year's results also included the costs related to our COVID-19 premium wages of $212 million pretax, or $0.35 per diluted share.

Net sales for the quarter increased 16.9%, to $42.35 billion, up from $36.24 billion last year in Q1. In terms of our first quarter comp sales metrics, on a reported basis for the US, we reported a 14.6% figure, excluding gas deflation and FX, impacts the 14.6% for the 12 weeks would have been 17.0% increase. Canada for the 12 weeks reported 16.2%, ex-gas in FX 16.8%. Other international reported 18.7%, ex-gas and FX 17.7%. So also for the total company, we reported 15.4% comp sales increase, excluding gas deflation and FX in the 15.4% would be 17.1%. E-commerce, on a reported basis for the 12 weeks was 86.4% and excluding FX 86.2%.

In terms of Q1 comp sales metrics, traffic or shopping frequency increased 5.5% worldwide and plus 7.6% in the US. Our average transaction size was up for the company, 9.4% in the quarter year-over-year and up 6.5% of the US. These include the negative impacts from gas deflation in the positive impact from FX. Foreign currencies relative to the US dollar positively impacted sales by about 30 basis points and gasoline price deflation negatively impacted sales by approximately 200 basis points. Going down the income statement, membership fee income came in at $860.9 million, up $57 million, or 7.1% ex-FX would have been up $54 million, or 6.7%. During the quarter, we opened eight new units.

In terms of renewal rates, our US and Canada renewal rate as of the end of Q1 '21 was 90.9%, that compares to a quarter ago of 91.0%, and worldwide it was 88.4%, which was the same as it was a quarter ago. And the US and Canada rate of 90.9%, compared to the 91.0%, this 0.1% decline was primarily result of what we believe to be deferred renewals in Canada, during the pandemic. For example, traffic of frequency in our Canada warehouses in Q1 came in at minus 1.3%, compared to a plus 7.6% for the year in the United States. By the way, the US renewal rate was the same in both quarters end.

In terms of number of members at Q1,end, total paid households at Q1 end was $59.1 million, up from 12 weeks earlier Q4 end of $58.1, and total cardholders

At Q1 end was $107.1 million compared to 12 weeks earlier $105.5 million. Also at first quarter end, paid executive memberships totaled $23.3 million, an increase of 642,000 during the fiscal first quarter. On to the gross margin line, our reported gross margin in the first quarter was higher year-over-year by 50 basis points coming in at 11.55% of sales, compared to 11.05% a year ago, excluding gas deflation the 50 basis point increase would be 30 basis point.

If you jot down two columns of numbers here to shed a little light on the components of gross margin, on a reported basis in Q1 '21, the core merchandise margin year-over-year was up on a reported basis, 83 basis points, plus 83; second column without gas deflation would have been plus 66 basis points. Ancillary businesses minus 15 basis points reported and minus 20, ex-gas deflation, 2% reward minus 6 basis points and minus 4%, other minus 12% and minus 12%. And if you add up the two columns on a reported basis, again, gross margin is reported as a percent of sales. Year-over-year and the quarter was up 50-basis points on a reported basis and ex-gas deflation, up 30 basis points.

Now the core merchandise component of gross margin shows was higher by 83 and up 66, ex-gas deflation. Similar to last quarter, we had a sales shift from ancillary to core. This resulted in a higher contribution of our total gross margin dollars coming from the core operations versus last year. Looking at core merchandise categories in relation only to their own sales on core if you will, margins year-over-year in the quarter were higher by 65 [ph] basis points. Fresh foods was again the biggest driver here. With strong sales in fresh, we benefited from efficiency gains and labor productivity and significantly lower products spoilage. Food and sundries, softlines and hardlines they are the three main core components, all had higher margins year-over-year in the quarter as well, but fresh foods was the driver.

Ancillary and other businesses gross margins, as I showed you here was lower on a reported basis by 15 basis points and minus 20 ex-gas deflation. Most of the impact coming from travel and to a lesser extent from gas optical and hearing aids and food courts. Costco Logistics, which is the name for the acquisition of Innovel, that we did several months ago, impacted ancillary margins by minus 6 basis points, slight relative improvement from the prior quarter year-over-year. 2% Reward, nothing surprising there. And the other, the minus 12 basis points, all of this was attributable to the costs of the COVID-19 of $53 million of the $212 million total -- the total amount previously mentioned. These are the direct costs for incremental wages allocated to our manufacturing production and fulfillment operations. All told even with the $53 million of COVID costs hitting the margin. Q4 year-over-year gross margin on a reported basis, ex-gas still up 30 basis points year-over-year.

Moving to SG&A, our reported SG&A in the first quarter as a percent of sales was lower or better year-over-year by 15 basis points coming in at a 10.15% of sales compared to a year earlier, first quarter of 10.30%, and ex-gas deflation, the 15 basis improvement would be 32 basis points of improvement. Again jotting down two columns of numbers, reported and without gas deflation, core operations in Q1 on a reported basis was lower or better by 49 basis points, so a plus 49; ex-gas deflation of plus 62, central plus one and plus three basis points, stock compensation plus three basis points and plus four basis points, other minus 38 basis points and minus 37 basis points, and summing of those two columns up total reported SG&A year-over-year was better plus 15 basis points, and ex-gas deflation plus 32 basis points.

Now SG&A at the core, again it shows ex-deflation improvement of 62 [ph] basis points. This excludes the COVID costs, which I'll talk about in a minute. There was significant -- they were just basic significant leverage with strong core merchandise sales increases. In terms of other, the minus 38 basis point or minus 37 basis point number ex deflation, gas deflation. These were our incremental costs of the COVID-19, or $159 million of the $212 million total number that we had mentioned earlier. The premium wages have been extended through January 3rd at this time. Again even including these $159 million of COVID-related premium pay expenses, SG&A year-over-year improved nicely.

Next on the income statement is pre-opening expense, $22 million this year in the first quarter, compared to 14 million a year earlier. We had 10 openings, eight net of two relocations during the quarter and four openings gross three net of one relocation, a year earlier. Last year's $14 million number did include a couple of million dollars related to pre-opening on our new poultry -- on our poultry complex, which was opened and went into the business, right before the beginning of Q1. All told, reported operating income for Q1 '21 increased 35%, coming in at $1.43 billion this year compared to $1.061 billion last year, even at a higher percent increase, of course it would have been higher, now we had those the premium pay.

Below the operating income line, interest expense was $39 million this year versus $38 last year. Interest income and other for the quarter was lower by $6 million year-over-year. Interest income itself within interest income and other was lower by $22 million year-over-year, due in large part to lower interest rates, offset by FX and other which was up -- which was higher or better by $16 million year-over-year. So overall, reported pre-tax income in Q1 '21 was up 34% coming in at $1.42 billion this year compared to $1.058 billion a year earlier.

In terms of income taxes, our tax rate in the first quarter of fiscal '21 was 16.8% compared to 19.1% in Q1 last year. Both year's tax rates benefited from the tax treatment of stock-based compensation as mentioned earlier. This year's tax rate in the first quarter also benefited from the tax deductibility of the special dividend payable to Company's 401(k) participants as discussed that portion payable to 401(k) participants as discussed earlier in the call. This year's full -- this full year's, fiscal year's effective tax rate, excluding these discrete items is currently projected to be between 26% and 26.5%.

In terms of warehouse expansion, as I mentioned in the first quarter of this fiscal year, we opened eight net new units. Our plan for the year is somewhere in the 20 to 22 range, none in the second quarter in six or so, five or six in Q3 and seven or eight in Q4. As of Q1 end, total warehouse square footage stood at 117 million square feet.

In terms of capital expenditures, in the first quarter of '21, we spent approximately $893 million. Our full year CapEx spend for fiscal '21 is still estimated to be in the $3 billion to $3.2 billion range.

In terms of e-commerce, overall, our e-commerce sales in Q1 FX increased at 86.2% year-over-year. A few of the stronger departments food and sundries, housewares, pharmacy, OTC and health and beauty aids, small electrics and TVs and other electronics. Total online grocery grew at a very strong rate in Q1, nearly 300%. The comp numbers that I mentioned 86.2% for year follow our usual convention which excludes these third-party same-day grocery program as they come in themselves and shop at our warehouses and then deliver to our members. If we include the third-party same-day in our e-commerce comps, the 86.2% result would have been just over 100%.

Innovel, now re-branded as Costco Logistics, continues to grow and we continue to push more big and bulky items to the site. We've added -- in the past quarter, we added an Instacart scheduler this quarter, where members can select specific delivery dates for most big and bulky items and made improvements to our call center with specifically trained agents as well, that continues to grow nicely. And lastly, a couple of fund sports items just loaded two days ago. We have a Babe Ruth Autographed Baseball for $64,000 and a Ty Cobb Autographed Louisville Slugger Bat for $160,000. We've also recently sold a number of memberships for wheels up a private jet service operator.

I turn it -- now turning to COVID and some of the issues and impacts surrounding it. From a sales perspective similar to our strong sales results this past summer in our fiscal fourth quarter, we have continued to enjoy strong sales results during the first quarter of fiscal 2021. We continue to generate strong sales in food and sundries and health and beauty aids and fresh foods and the like. And we've also benefited from improved sales and products and items for the home. As people are spending less on air and travel and hotel and dining out, they seem to have redirected at least some of those dollars to categories like electronics, furniture and mattresses, exercise equipment, housewares, cookware, domestics, et cetera. And as mentioned earlier, sales in most of our ancillary businesses were lower year-over-year in the quarter, travel gas, hearing aids and food courts.

From a supply chain perspective, 40,000 food [ph] view, if you will. Most factories are up in running our suppliers, and in many cases production capacity has been increased. However, even higher increases in demand of some products are still creating some supply issues. There are instances of 50% or 100% or even more sales increases of an item. And if we could procure more we'd have even higher sales. Examples would include things like exercise equipment, certain major appliances, certain electronics items, as well as certain housewares and small electric items.

On the transportation front, there have been some container shortages at origin, as well as some congestion and destination ports here in the States. The latter typically two days to four days, but a little longer in some cases. We're managing through it, and expect relief not until March or so of 2021. As well the past few weeks there have been some challenges that you may have read about in the industry, in terms of delayed delivery times of items just given the number of items being shipped now through third-party carriers. While this may reduce, some sales of members are not confident in time, we have late delivery. We like others, I'm sure, I've done a couple of things. We've adjusted stated back to delivery times on our side to remind their people to shop early. And in our case, we took several hundred non-food items -- non-food online items that are also in line and then providing same-day delivery through Instacart, including other items like airpods, instapods, laptops and many over-the-counter and health and beauty aid items, as well as some other home essentials.

In terms of food and sundries, continue limits on some paper goods, demand and sales went up as COVID began spiking again. Toughest areas, natural gloves, surface cleaning wipes and sanitizing sprays. Also in some cases, some paper goods. Overall, dairy items are in good shape as well as proteins and produce the fresh side.

In terms of Halloween merchandise planning and results, Halloween, we went into it a little more conservative in terms of costumes and Halloween specific candy items. W came out of Halloween with pretty clean inventory levels. Christmas, as I think you mentioned on the last earnings call, responding to a question. We went a little more basic in terms of needs and uses for the house. So very strong. We run into it with fundamental items for the home like housewares, TV's, electronics. Even added items like barbecues and pressure washers and furniture items. A little less, we'd cut back a little bit on seasonal items like Halloween decorations and gift wrap and some of the candy and food baskets, and some instances as we've already sold through those inventories.

Our warehouses overall have remained open and are mostly back to regular hours with an additional hour on any mornings for seniors and persons with disabilities. Warehouses are still following social-distancing and sanitation guidelines. And in some jurisdictions, we have to limit occupancy. Since May 4th, as you may recall, we've required members and employees to the warehouses to wear masks. And since November 16th, we required face shields for those unable to wear masks. Some of these initiatives of course will extend well into Q2 of this fiscal year. Finally, in terms of upcoming press releases, we will announce our December sales results for the five-weeks ending Sunday, January 3rd, and Wednesday, January 6th, after market closes.

With that, I will open it up to questions-and-answers. And I'll turn it back to Cindy. Cindy?

Questions And Answers

Operator

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

Q - Simeon Gutman {BIO 7528320 <GO>}

Hey everyone. Good afternoon. Richard, I wanted to ask following on you talked about some of the merchandizing plans around Halloween and Christmas. You are going to begin to lap some pretty massive surges in growth when you get into 2021. I know you don't guide, but you are probably planning inventory purchases. So I wanted to ask how you sort of manage with a pretty wide range of outcomes? And I don't know if you have any guidepost thinking about some of the gains you are making in fresh food as far as the spoilage and the markdowns that don't seem to be happening. So how do you think -- how do you plan for lapping some of those as well?

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

Well, I mean, there is a few different things and time periods that will be and questioned. If we recall, there was a big surge in frequency and sales results. The last week in February, and the first two or three weeks of March, when people were coming in and hoarding in our view, and of course, we were running out of everything basics from water to paper goods, to cleaning supplies and things like that. And in some cases, and then beyond that into April, May, there were some issues as there were some COVID spiking at many fresh plants -- protein plants meat and poultry and alike. And so, it's hard to project completely. I think I started of late, we have tried to build a little extra inventory where we can and some of the key things that aren't going to go out of style like paper goods and cleaning supplies. Although then you get to next rush of spiking and whenever extra inventory you had it goes away pretty quickly.

Look, we'll continue to work around it. We work -- and in some cases, it's a little easier in a sense that we have fewer suppliers to deal with or fewer items to deal with. Arguably, in other cases, given our huge volumes that creates its own challenges sometimes. I think the bigger challenge is going to be post May last year and this past year, when we saw kind of sales strength not just in those key essential categories like fresh foods and foods and sundries, and paper goods and health and beauty aids, but also on the non-food side, items for the home if you will and those types of basic items. And again, people spending some of those dollars. Look, some things will improve and some things may be degraded a little bit. Some things that are degraded may take a while and not everything is going to happen unlike what was not going up one day and everything is going to get better from a food standpoint in terms of restaurants being opened. And so, I think, we are in it together and we feel pretty good that we've got a good format to serve our members well and we'll go from there.

Q - Simeon Gutman {BIO 7528320 <GO>}

And as far as, I don't know, events, I know, road shows, I don't know how prevalent they've been. Your mailers, are there things that you can change the cadence of either to get more aggressive? Grocery, you've taken a huge amount of share this year. Is that an area you are going to lean into stronger? Just curious how are thinking about the merchants are prepping for the upcoming year?

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

Well, as it relates to promotional forms that we do like the mailers or even online type of mailers, these are some of those have been changed because some of the big ticket non-food -- not big ticket, I am sorry. Some of the big size items that are always in there like paper goods, like cleaning supplies, in some cases we've had to eliminate some of those items from the mailer. We put other items in. In some cases, it's done fine and in some cases, it's a little bit less of a sales increase. But that's not just going forward, that's been in the last few months as well that we've changed those things. I think we've been pretty good at pivoting and adding new items. I think the examples of -- for Christmas, while we may have -- maybe and went a little too deep into cutting back, not they were big cuts, but we are running out of some of those decorative things we could do earlier and we would have like to. We also though found success in lots of essential, basic fundamental items. I don't think -- I mean, the first Christmas, we probably brought in barbeque grills and pressure washers to market. And they are doing well, because people are buying gifts for the home.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thank you.

Operator

And your next question comes from the line of Mr. Mike Baker of D.A. Davidson. Your line is now open.

Q - Mike Baker {BIO 4323774 <GO>}

Hi, thanks. I was a little curious on the holiday trends. Just two questions really, one by trying to advertising get customers to spread out their sales and comment a little bit early. Do you think there is any pull forward of holiday sales into November from December? And then the second part of the holiday question, I think you said that you're out of stock quickly some of the seasonal items. Do you think you could have made a little bit more aggressive on the seasonal stuff, how much do you think your sales could have been up, if you had done that?

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

Yes. Well, first of all, talking to the buyers, they definitely feel that some of the merchandize and sales were pulled forward into November, not only from December, but even the week of November and there has been articles out there about Thanksgiving and overall, not Costco-specific, but just in general about what's going on online and what have you. And so, certainly some of that kind of got push forward. In terms of some things, I mean there are examples where instead of buying 10% more this year of a given item, we bought 10% or 20% less. So, we still bought a lot. We just not like we cut our order back by half. But in retrospect, we probably could have sold a little bit more. I don't have a dollar number. It's probably not that meaningful. For every negative there is another positive. Needless to our say, our comps overall have been very strong.

Q - Mike Baker {BIO 4323774 <GO>}

Yes. That's fair. And if I could add -- ask one more, I guess, unrelated question. The MFI, the 7.1% increase, that's better than it has been. A nice acceleration there. Any color as to where that acceleration came from more in the 4%, 5% range got last few quarters?

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

Well, I think, in terms of shopping frequency?

Q - Mike Baker {BIO 4323774 <GO>}

No, membership fee income.

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

No.

Q - Mike Baker {BIO 4323774 <GO>}

Correct.

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

Oh, I am sorry. Okay. I didn't hear the first part of the question. Well, I think we opened a few more units than we did a year earlier. Without looking that deeply, that's probably most of it.

Q - Mike Baker {BIO 4323774 <GO>}

Okay. Fair enough. I appreciate the color.

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

Thank you.

Operator

And your next question comes from Chuck Grom of Gordon Haskett. Your line is now open.

Q - Chuck Grom {BIO 3937478 <GO>}

Hey, thanks. Hey, good afternoon, Richard. In your online offering, can you remind us where it stands in terms of total mix of business and also level of profitability relative to the store? And looking ahead, what categories you may start going into more?

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

Well, I'll tell you, it's sort of in-store of course, and warehouse, we've got about 3800 active items. Online, we typically got somewhere in the high single digit thousands, I mean, call it, 9,000 plus. I am sorry, and in terms of sales, it's about 7% of sales. Now we don't include in that number as I mentioned like the third party sales like the Instacart Same Day Fresh, because their employee or a contracted employee is coming into Costco shopping just like any other customer coming to shop. So that you could add a little bit more to that. But in terms of what we call online, it's about 7%. I think it was 6% in fiscal 20 for the entirety, and of course, it was half way through the year when you saw ecom percentages increases jump dramatically with the advent of COVID.

Q - Chuck Grom {BIO 3937478 <GO>}

And then, talk about core profitability.

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

Overall, ecommerce a little less profitable. You've got category-wise, it's profitable. You've got -- category-wise, you've got merchandize categories that don't include some of the highest gross margin components of our business like fresh, like apparel in a big way in terms of the penetration. You've got electronics which is a lower than average margin business both in-store and online and so much bigger percentage of penetration online, so they are examples. Certainly, the profitability of ecommerce has been helped with the types of comp sales increases we've had over the past year. But also over this past year, there is some of the cost inefficiencies of growing it so fast. We -- in terms of fulfillment, as we are continually adding locations where to shift out of and getting closer to the customer as this overall size of the business has grown a lot.

And as I mentioned earlier, the investment in Innovel, recall, we are calling Costco Logistics, that was a -- as we expected a hit year-over-year to the margin simply because it's being ramped up and upgrading it.

Q - Chuck Grom {BIO 3937478 <GO>}

Gotcha. And then, just a follow-up on next question and I pardon my near-term orientation of it. But when you look at the comp in November and the fall-off at the end of the month, albeit, it's still strong, just when you look back if there is any learnings on to why you think sales fell off. And then curious if the revenue trends have started to bounce back.

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

I think it's -- I mean, our best guess is, it's complete pull-forward. I mean, the fact is, is people marketing bigger ticket items and some of those types of holiday items earlier in November.

A - Unidentified Speaker

Last Friday, it was promotions and for the whole month.

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

Yes, Bob, here mentioned that, Black Friday promotions this year. More of those things we promoted earlier in the month. And not an assessment everybody else out there too.

Q - Chuck Grom {BIO 3937478 <GO>}

Got you. All right. Thanks a lot.

Operator

And your next question comes from Mr. Michael Lasser of UBS.

Q - Michael Lasser {BIO 7266130 <GO>}

Good evening. Thanks a lot for taking my question. Nice holiday gifts and some people on this call might be considering getting for loved ones this season. When you look at your sales, compared to the rest of the consumables retail entity, most others are seeing a deceleration in their comps, whereas Costco is seeing an acceleration in its comps. Why do you think that is? Is it's simply because customers -- members are coming into buy their discretionary goods and moving up their baskets which is the consumable items?

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

We definitely think that, look, being essential in recognizing the people clearly are coming in to buy food and cleaning items and health and beauty aids and alike. That gets you in the door. And certainly in our view, given that money is being spent on other things in normal years perhaps is being spent more for things for the home. We have that as well and I think that has helped us in that regard.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay. So, it really comes down to mix and the Costco results to helping that to really consider.

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

I buy it. I'd like to think part of it is people feel hopefully, at least relatively safe coming into a big wide open box environment where we've done and we think a pretty good job of social distancing and other safety protocols.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay. And the gross margin increases it seems like it's a function of just the strong sales allowing Costco to be able to sell through better than it might. Why is it been able to? Is that right that we should it should have posted --

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

Yes. I think most of it is strong sales which shows its brightest colors with fresh food where you've got two cross components that have improved dramatically, spoilage and labor productivity. So, that has certainly helped.

Q - Michael Lasser {BIO 7266130 <GO>}

One other thought on it, like it seems -- sorry.

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

Oh, less promotion. The other, Michael is, I think you've all read about this from an industry perspective. There has been less promotional activities out there. While we were still getting great values on things, when you look at TVs in general, well, prices have come down across the board just because they always do over time. And these seem to be getting better, bigger and less expensive. There is not the kind of promotional money being thrown at it by the manufacturers because they haven't had to. And so, I think that too has had some impact.

Q - Michael Lasser {BIO 7266130 <GO>}

That's helpful. I hope you have a great holiday. Thank you.

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

You as well.

Operator

And your next question comes from the line of Mr. Scott from RBC Capital Markets.

Q - Robert Scot Ciccarelli {BIO 3287989 <GO>}

No, the attempt there. Hi guys. Scot Ciccarelli. So, I believe some of the products you guys sell via your website or ecommerce are for members only, but not all of them, or it doesn't look like that from a -- perspective. So, assuming it's not just a -- difference, how much of your ecommerce sales are coming from members?

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

Virtually all. I believe part of the challenges is on some items as we work with our suppliers and ourselves as well. We want you to be able to have sign in to see the prices.

Q - Robert Scot Ciccarelli {BIO 3287989 <GO>}

I got it. Okay. And then, Richard, what's the update today regarding how much of your ecommerce sales are being drop shipped from vendors versus kind of delivered through Costco?

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

About 50-50. A little less than 50 is being drop shipped.

Q - Robert Scot Ciccarelli {BIO 3287989 <GO>}

Got it. All right. Appreciate it. Happy holidays.

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

Same to you.

Operator

And next question from Karen Short with Barclays. Your line is open.

Q - Karen Short {BIO 7215781 <GO>}

Hey. Thanks very much. A couple questions I wanted to ask. So, first just on COVID and wages. So, the 212 you called out obviously gave us a breakout on the impact on cost of goods versus SG&A. But that was a little higher than the number, I think the $14 per week that you've guided. So, wondering if that's -- what the delta would have been, because that would have gotten us to about $168 million. And then, wondering if you can give a little color on what the -- like other cleaning component might be would have been in this quarter and then how to think about it in to next quarter, because presumably, does -- like I asked last quarter, that January 3rd date is probably not the undate I would assume.

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

Well, we'll find out. Needless to say I can't comment on that, but a big chunk of the difference of 14 I may have round -- honestly down to 14 and now it's rounding up to whatever. But at the end of the day, there is more hours is the biggest delta. More cumulative hours.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then the cleaning component?

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

That's relatively as well.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then, I am wondering if you could give a little color on the expansion of the Instacart relationship. You obviously listed a couple of SKUs that you've added on to that with respect to the third-party. Can you give a color on what the markup is on non-shoot items versus shoot and then give a breakdown on what that would be for members versus non-members on the markup?

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

Well, I can't be that specific. We continue over the last three or four years, we've continued to work to lower the effective average markup across the board on items. There is some discretion on some to be lower than them and some to be higher but there is an average, which includes both their markup, plus whatever other fees that person is spending here, whether it's a per delivery fee or per monthly fee or per monthly fee to Instacart. As given some of the unique issues during the end of the year with the high demand for shipping, and the capacity issues out there with the third-party shippers we -- given that Instacart is always coming in, we've added some items to the tray. In some cases, there is a maximum markup on those that is -- in many cases, smaller than that -- quite a bit smaller than that on that mid to high teen number percentage-wise.

Q - Karen Short {BIO 7215781 <GO>}

Okay. And then just last question. In terms of MFI, obviously, the -- I think, January of 2021 would be the new timeline in terms of the tax deductibility in California. Is there any thoughts in terms of the timeline, in terms of how you would think about. And then, your membership fee increase, because I think in the past you've historically done that when you've actually seen counter intuitively traffic slowing and it seems like you may be looking at slower traffic to space on tough compares as we get into parts of next year. So, that's great color on them.

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

Well, I mean, historically as you know for 35 years, we've effectively raised the basic fee $5 every roughly five years and I say roughly it could be 5, 5.5 years. And the executive membership has been raised to originally started at 100 and now it's 110 then 120. The last time we did the increase was I believe was in June-ish of 2016. So five years -- it's June 2016. But it was June of one of the years either 2016 or 2017, but it will be five years from then that we might look. You mentioned that, we've done it when things are -- sales have been stronger and when sales have been weaker, when the economies get to hit or whatever else. We look at it and somewhat it dependently at that. We look at it and we feel heavily improved the value of the membership by more than that five or respective $5 or $10. And I am not suggesting we might wait or not, but time will tell.

Historically, we've always thought very good about when we've done it and certainly the value proposition has been enhanced much -- at a much greater multiple than the $5 or $10.

Q - Karen Short {BIO 7215781 <GO>}

Thanks. Have a great holiday.

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

Thank you, Short.

Operator

Your next question is from Oliver Chen of Cowen.

Q - Oliver Chen {BIO 15320650 <GO>}

Hi. Thank you very much. Hi, Richard. Regarding what's ahead with vaccinations, do you see a role that your pharmacy will play in that and also in this dynamic environment, how are you thinking about managing inventory versus sales as we look forward to hopefully a pathway to vaccination, et cetera. Thank you.

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

I believe there -- we and the country are in the first phase of the vaccination process. We are not participating in that. But I believe Phase 2 which will be just a short period down the road. Our pharmacies will also be part of the many pharmacies throughout the country that are going to be providing the service of vaccinations for them. We are in Phase 1 in the State of Alaska only currently. But I think throughout our country we plan to be in Phase 2 which will be the big push after this first initial round. And in terms of managing inventories, while space is not infinite, certainly the cost of carrying extra inventory isn't very expensive right now, given very low interest rates. But at the end of the day, as I mentioned, it's little earlier, we -- I think we plan positively in terms of how our sales have been and to the extent of the example of those seasonal items, we keep down a little bit. But not a lot. And I think we'll continue to do that kind of planning. A lot of times on items that are short, but there is certainly no risk of having the only risk of having is some extra paper towels for a few weeks is the risk of having them. There is not any obsolescence or markdown risk on it. We always tried in times when there is more of that available, we'll build up a few extra weeks of supply. But overall, I don't see a big change in our inventory turns or payable cycles.

Q - Oliver Chen {BIO 15320650 <GO>}

Okay. And e-commerce?

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

I can say that more by comp sales than anything. When we were enjoying a pre-COVID a 6% to 8% comp sales number, inventories as a percent of -- payables as a percent of inventories was whatever the number was. When we saw the big increase in comps, you saw the payables as a percent of inventories going up.

Q - Oliver Chen {BIO 15320650 <GO>}

Got it. That's very helpful. And on the topic of ecommerce, as we think about longer term growth rates as well as new customer acquisition that you are seeing an engagement online, what are some of the major catalysts for innovation going forward that you will implement or that you are looking to implement? And then, how do you think growth rates may evolve as hopefully reopening occur eventually?

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

Well, look, we even today want things to get back to normal from a business standpoint and also most importantly from a personal standpoint. And over the next couple of years, god willing, starting with this process of vaccinations and vaccines and hopefully a big chunk of this progress through by the beginning or during the summer people will get out more and will be going back to restaurants and alike and will that have an impact on our food sales? Of course, it will. So, some of this positive will be sticky. Some of the new members will be sticky and we'll go from there. I think that, there are lots of attributes to value and customer loyalty, certainly, the best prices on great quality merchandize that the member trusts in our view is the biggest attribute. And that's where we start from. We -- ecommerce is certainly -- and the acquisition of Innovel in terms of big ticket items and having a great service and a great value for those items we think helps us. But ultimately, we still want our members to come into the warehouse. When they come in, they see the items and they are more likely to buy some of those items and certainly, driving them with great value and great quality is what we are all about.

Q - Oliver Chen {BIO 15320650 <GO>}

That's helpful. And last, on that logistics, Costco Logistics part, what should we know about as we model that going forward in terms of the margin headwinds and the dimensions around the size of that business relative to total? Thanks.

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

Well, the only two data points we've given you is in Q4, year-over-year it was about, I think an eight basis point margin hit and in Q1 which we just reported for this new fiscal year was a six basis point margin hit. As guessing games go, assume that there will be constant improvement in that over the next several quarters. So that it won't be a negative. That doesn't include any benefit we get from increased sales of those items and the margin associated with that. But when we bought this we knew that they would be dilutive from an earnings standpoint for the -- certainly in the first year and perhaps into the second year hopefully on a decreasing basis and certainly in the first two quarters it would indicate a little of that. But at the end of the day, we think it -- those companies that have had their own infrastructure to be able to do last mile delivery and installations, it's a positive certainly the home improvement companies have done that and the retailers and it worked out for us and we are excited about what we can do with it.

Q - Oliver Chen {BIO 15320650 <GO>}

Thank you very much. Happy holidays. Best regards.

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

Same to you.

Operator

Your next question from Edward Kelly of Wells Fargo. Your line is now open.

Q - Edward Kelly {BIO 21274619 <GO>}

Yes. Hi, Richard. Good afternoon. You mentioned freight. I was hoping you could provide just a little more color on the headwind and then you talked about an improvement maybe coming in March. Any more color behind that?

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

Not really. Before each call, I'll sit down with the Head of Merchandizing and some of the other senior people in merchandizing and just get the color on their departments and what's going on. And it was a by the way comment that, with things coming from Asia as an example, or in general, there is container shortages. And so, we may take a few extra days to get things on to ship. Or the ship may its sailing not full in some cases. The same thing is on some of the big ports in the United States like on the West Coast particularly. They've mentioned two to four days of delay. Again, two day for us is not a lot but when you are moving inventory fast, you want to have it -- once it's -- you've ordered it, you want to it go to put on the ship and get here in on to our floor. So, it's not a big deal and the comment was, I said what will improve and said probably not until February, March. So, I just -- that's what I threw out. Not any more impacts from that.

Q - Edward Kelly {BIO 21274619 <GO>}

Okay. And then, I just had a question on ecom and just digital strategy generally. Any updated thoughts on buy online pick up at store. I mean, you had essentially kind of become a standard offering across the industry and we probably see accelerated a lot of digital adoption. Just curious as to whether you are rethinking that at all.

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

We are not rethinking it. We continue to look at it and scratch our heads a little bit. But at this juncture we don't have any current plan to do so.

Q - Edward Kelly {BIO 21274619 <GO>}

Okay. And then just lastly for you, fuel, I think gross profit per gallon this quarter was probably up quite a bit. I mean, look at the OPEC's data it looks like maybe double. Is that about right and then what the gallon sold do this quarter?

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

We don't -- the gallons sold were down -- not down as much as they have been and it's troughed a few months ago and you are right, on margins, that not a double. I can't give you any quantitative number there. But in terms of margins were up year-over-year as a percent and gallons were down year-over-year.

Q - Edward Kelly {BIO 21274619 <GO>}

Okay, thank you

Operator

And your next question from Chris Horvers of JP Morgan.

Q - Chris Horvers {BIO 7499419 <GO>}

Thanks good evening. So, wanted to follow-up on the holiday pull-forward question. I was curious the merchants are thinking about how the season progresses, particularly as we get close to Christmas, some retailers think that given the earlier cut-off time to get the guess in time for Christmas that there could be a big brick and mortar surge. I think other retailers are saying that no what you seen all started like with prime day and it's just been a pull-forward. So don't expect anything out of the -- anything unusual close to Christmas too. So, curious what your merchants are thinking.

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

Well, merchants are feeling pretty -- I would say, aggressive with this. They feel that, again, some of it was pull-forward. But there is still -- and again, running out of some gift wrapping paper two weeks before you wanted to is not the end of the world. But every sale is a sale that we want. And the same token bringing in fundamental items that if you end up having a few extra SKUs or few extra quantity of certain SKUs the day after Christmas is not going to kill you because it's not stuff that's seasonal that has to be marked down in a big way. So, I think that, we can lean it to it recognizing that our sales overall particularly brick and mortar have done well. That we are basing our assumptions on what we are going to do I think over the next two weeks, positive relative to this. Recognizing there could be some pull-forward and it will be some because of the dates got a little longer on shipping. But at the end of the day, we see that -- we are always with you. That should help the in-store experience and we'll see.

Q - Chris Horvers {BIO 7499419 <GO>}

Got it. And then, in terms of the -- you called out travel and gross margin as a big impact there. Is there something around the counting of that? You haven't called out prior, maybe it was just because it's irrelative to other things and the ancillary business. But is there an accounting thing. Is there seasonality to that and would we expect that to sort of get worse for some reason?

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

What we can -- like you to do is just like in a 10-K, you got to put the -- you got to rank them in order of dollars. So, in the case of travel, first of all it's a very high gross margin business. To the extent that we are simply acting as a broker like our car rentals, there is sales and no coast of sales equals gross margin or very little cost of sales. Only when we curate an item and take ownership of it, you will like hundred crew ship weeks or whatever I am making this example up, where you sell $100,000 or something and make a few thousand dollars or $5,000 of margin. That's a 5%. But you have big chunks of that business that are 80 plus percent margin. So, it's a business that started to show a little bit of life as we ended December. But with the spiking of COVID in the last several weeks that has dissipated quite a bit. And even some of the life that occurred in the summer were bookings out as for Christmas some of those are being cancelled as you would expect them to be. So, it's that -- it's the rank order of them which one hit harder a little bit.

Q - Chris Horvers {BIO 7499419 <GO>}

Got it. And then, the last question is, on price gaps relative to peers and club and grocery, how are you -- what -- have they widened? Where do you see them now? I think if you go back to this 2009 timeframe, where sort of lap peak food at home inflation and you lap some food at home wallet gains. You seem to get more aggressive on price. So, just want to get your thoughts on where you see the price gaps now and how you are thinking about that into 2021?

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

Well, I mean, we look at our comp shops compared to warehouse, clubs as well as comps specifically on certain items and at their traditional retail formats, we feel very good about our competitive mote if you will. And we don't think that's an issue at all for us right now. But we are the ones that keep pushing and pushing the limits further.

Q - Chris Horvers {BIO 7499419 <GO>}

Got it. Have a great season, guys. Thanks.

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

Thank you.

Operator

And next question from Robert Moskow of Credit Suisse.

Q - Robert Moskow {BIO 6299775 <GO>}

Thanks for the question. Richard, you mentioned that manufacturers, I guess, goods -- they are not promoting as much, not giving as many discount as usual because they don't have to. Any point you think that could slip the other way? And if so, what would drive it? Is it the body of supply or maybe a more intense competitive environment?

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

Gosh. When I find out, I'll let you know. I mean, what's happened of course with everything in the strength -- both the strength in electronic items, TVs, air pods and everything else of between and laptops and the demand for those things is enormous and in some cases, some shortages of supplies in general even if capacity has gone up it's going to overlap more. So, and it's hard to say.

Q - Robert Moskow {BIO 6299775 <GO>}

Okay. I was thinking more on the lines of package crude, we've heard some categories putting promotions back in. Do you have any insight into that?

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

Okay. I don't. I'm sorry.

Q - Robert Moskow {BIO 6299775 <GO>}

Okay. All right. Thank you

Operator

And next question from Greg Melich of Evercore ISI.

Q - Gregory Melich

Hi. Hey, it's Greg Melich. I think that was me. Hello, there's really two questions. One was there any grocery inflation showing up and we see CPI for gross picking up and with less promotion? What are you guys seeing there?

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

Very, very, very little.

Q - Gregory Melich

Sort of something, but it's nothing like 4% or 5%, some of those other numbers we see out there.

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

Oh, it's not even 8%. Very, very, very little. Three verys. Triple verys.

Q - Gregory Melich

On cash, so that the special dividend, congratulations, and keep the special and getting it done. We should be back a little under $10 billion of cash. What's the right number that you want to run the business with, either still during COVID, or even on the other side of it?

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

Well, keep in mind, there is a chunk of it, that is, we had debit and credit card receivables that could be $1 billion or $1.5 billion. There is upwards of just under $1 billion that is related to insurance captives and the like. There is a $2 billion to $3 billion that overseas in different countries, which for whatever reasons. And the last one you want to bring back because of whatever withholding your other taxes related to it. So at the end of the day, someone asked the question after we announced a $10 dividend. We could have done more. The answer is, we could have, but why rush? I mean right now we still don't know what's going to happen with COVID and what may happen next year in the economy. And so we'll probably have a little more cash than normal, than pre-COVID, if you will, but that's okay, too.

Q - Gregory Melich

And then last, could you just -- what our average range -- rates today, just sort of level set where the -- and we know COVID up. Thanks for that, helping us there, but where are we now before all that?

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

You mean, the average US hourly wage?

Q - Gregory Melich

Yes.

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

I think we're in the -- well, ex the $2, where -- we're either right above or just approaching $24 average in the US.

Q - Gregory Melich

Excellent. $24 in the US And so, the -- and the changes for the base rates going up, that was -- you did that, that was completed when?

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

In March, I believe, last year. Last March, beginning of March. March of 2019. I believe those near the beginning of March, whatever that Monday start for that, weekly pay period was, or biweekly pay period. And that was $2 across the board.

Q - Gregory Melich

Right. And the COVID stuff up on it?

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

Excuse me.

Q - Gregory Melich

The COVID, it was on top of the actual wage rate?

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

Yes.

Q - Gregory Melich

All right. Got it. Great. Well, good luck. Have a great holiday.

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

Thanks. You too.

Operator

And next question from Rupesh Parikh of Oppenheimer. Your line is now open.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Good evening. Thanks for taking my question. So, I wanted to ask about just some of the countries where you have lower COVID infections, China, Australia seems to be normalizing now. How is purchasing behavior in those markets return back to -- whether maybe pre-pandemic. I am guessing, Australia is probably a better read than China?

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

They both have stronger comps.

Q - Rupesh Parikh {BIO 15915617 <GO>}

From a carry forward perspective, have you seen the carry forward shift to I guess, maybe where they were pre-pandemic if you look at the mix?

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

Well. I don't have that detail in front of me unfortunately. And when I look at comps by country, in local currencies, we are - in most countries we are back to normal, if not a little better.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Okay. Okay, great. And then, just in the US just given we seen spikes in infections and California has had more restrictions recently put in place. I was curious if you can just comment on anything you are seeing more recently in terms of the changes in consumer behavior or traffic to your stores?

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

The only thing that I've noted is, is that when it first started a few weeks ago, or when -- the California, everyone there was waiting for - in California, everybody was waiting to hear what the new restrictions was going to be in terms of lockdowns. There was a spike in shopping and people were coming in. So, we had particular strength over a couple of week period when more spiking was accruing.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Okay, great. Thank you. Have a great holiday.

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

Thank you. You too. And your next question -- We'll take two more questions, Cindy.

Operator

Okay. Your next question from Kelly Bania of BMO Capital.

Q - Kelly Bania {BIO 16685675 <GO>}

Great. Thanks for fitting me in here. Richard, just wanted to back to the buy online and pickup at store question. I know you've said for several quarters, now you continue to scratch your head, but it does seem like a lever that maybe you could pull one day that's already been pulled by pretty much everybody else in retail. But I guess, just given the massive growth that you've seen with Instacart and your third-party partners there, this does clearly seem to be a segment of your membership base that's willing to pay a premium or that markup for that service. So, I am just curious if you thought about even a markup type structure for pickup or even like a higher price point membership for a pickup type service?

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

Well, as it relates to general conversations about it, those are topics that are discussed. One of the challenges right now is there is a lot of the buy online and pickup in store traditional retail promotions are at the same prices which you can come in and buy it for. So, somebody is paying for the picking it up and storean waiting for you to pick it up. I think that will shake you out to over time as people -- as somebody has to pay for either the company or the customer. I am not trying to be -- we are looking at all those things, but we haven't made any decisions to go forth with it.

Q - Kelly Bania {BIO 16685675 <GO>}

Okay. And just maybe quick follow-up, you mentioned the 7% ecom penetration from a sales perspective, but just curious if you could share just the percent of your maybe membership households that are engaged with Costco from a digital ecommerce perspective?

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

We don't give out that information yet.

Q - Kelly Bania {BIO 16685675 <GO>}

Okay, thanks.

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

As you might expect, it's growing to improve. Yeah.

Q - Kelly Bania {BIO 16685675 <GO>}

Of course.

Operator

And your last question from (inaudible) of Jefferies.

Q - Unidentified Participant

Thanks. Good afternoon, everyone. And thanks for squeezing me in. I just want to follow-up on Rupesh's earlier question, but ask it a slightly different way which is looking at your cohort of new members that have joined really kind of the third quarter of last year, any performance distinctions or category mix distinctions that might give you encouragement that those members might be a bit more sticky going forward or might be a bit longer lifetime value customers into the future? Thank you.

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

We don't have a lot of that information yet. What we -- recognizing that some of them sign up because of COVID and because we can deliver through Instacart food fresh and or we cans serve them online. But there is not a lot to go on yet.

Q - Unidentified Participant

Okay, thank you.

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

Well, thank you everyone. Hopefully, you have a happy and healthy holiday season onto a better 2021. Have a good day.