Costco Wholesale
Q1 2025 12 Dec, 2024

Speaker 1
Start

Good afternoon and thank you for standing by. My name is Abby and I will be your conference operator today. At this time, I would like to welcome everyone to the Costco Wholesale Corporation First Quarter Fiscal 2025 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. Thank you. And I would now like to turn the conference over to Gary Millership, Chief Financial Officer. You may begin.

Speaker 2
41s

Good afternoon, everyone, and thank you for joining COSCO's Q1 2025 earnings call. I'd like to start by reminding you 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. Comparable sales and comparable sales excluding impacts from changes in gasoline prices and foreign exchange are intended as supplemental information and are not a substitute for net sales presented in accordance with GAAP. Before we dive into our financial results for the quarter, I'm delighted to say that Ron Vakrus is joining us for today's call. I'll now hand over to Ron for some opening comments. Thank you, Gary, and good afternoon, everyone, and thank you for joining us today.

Speaker 3
1m 54s

As we wrap up the Q1 of fiscal 2025, let me make a few brief comments on some of the highlights since we last spoke in September. In the Q1 of fiscal 2025, we opened 7 new warehouses. This included one relocation and resulted in 6 net new buildings, of which 4 were outside of the U. S. Additionally, after the end of the quarter, on the day before Thanksgiving, we opened our 897th warehouse in Pleasanton, California. That opening had the highest ever opening day sales for a U. S. Warehouse at $2,900,000 that day. We continue to project 29 openings during fiscal year 2025, of which 3 will be relocations and so 26 net new buildings. 10 of those warehouses will be outside of the U. S. Gary will speak to a more detailed review of our results in a few moments, but I wanted to share some fun facts regarding our growth across the business. Our U. S. Bakery division has reached new records of 4,200,000 pies being sold the 3 days prior to Thanksgiving. In our U. S. Food courts on Halloween Day, we set a new record of 274,000 whole pizzas being sold. That was an increase of 21%.

Speaker 3
3m 13s

Our U. S. Pharmacy business has prescription growth exceeding 19% for the Q1, setting new volume records for that business. And lastly, we continue to gain market share with our e commerce Big and Bulky fulfilled by Costco Logistics. Costco Logistics completed nearly 1,000,000 deliveries in Q1 and over 196,000 deliveries last week alone. That was a new record as well. The majority of these deliveries were completed in 4 days from the members ordering their merchandise online. All of these milestones reflect the continued strength of our business across the membership offering. These great results are a reflection of the outstanding work done by our over 330,000 employees around the world. Their commitment to our company and the Costco experience for our members is truly inspiring. I'd like to thank all of our people for their outstanding work this year and especially during our busiest time of the year. As we approach our Annual Shareholders Meeting in January, I also wanted to mention that our annual update to the Costco sustainability commitments was just made available online today. This report provides a comprehensive review of the progress we're making towards our sustainability objectives, and I would encourage all of you to take a look.

Speaker 3
4m 35s

With that, I'll turn it back over to Gary to discuss the results of the quarter, and I'll jump back on during Q and A to field some questions. Thank you.

Speaker 2
4m 45s

Thanks, Ron. In today's press release, we reported operating results for the Q1 of fiscal 2025, the 12 weeks ended November 24. We have once again published a slide deck on our investor site under Events and Presentations with supplemental information to support today's press release. You might find it helpful to have this presentation in front of you as I walk through our results. Net income for the Q1 came in at $1,798,000,000 or $4.04 per diluted share, up from $1,589,000,000 or $3.58 per diluted share in the Q1 last year. This year's results included a tax benefit of $100,000,000 or $0.22 per diluted share related to stock based compensation. And last year's results included a tax benefit of $44,000,000 or $0.10 per diluted share also related to stock based compensation. Excluding these discrete tax items, net income and earnings per diluted share grew 9.9% and 9.8% respectively. Net sales for the Q1 was $60,990,000,000 an increase of 7.5 percent from $56,720,000,000 in the Q1 last year. U. S. Comparable sales were up 5.2% or 7.2% excluding gas deflation. Canada comp sales were up 5.8% or 6.7% adjusted for gas deflation and FX. And other international comp sales were up 4.7% or 7.1% adjusted.

Speaker 2
6m 20s

This all led to total company comp sales of 5.2% or 7.1% adjusted for gas deflation and FX. Finally, e commerce comp sales were up 13% or 13.2% adjusted for FX. In terms of Q1 comp sales metrics, foreign currencies relative to the U. S. Dollar negatively impacted sales by approximately 0.3%, while gas price deflation negatively impacted sales by approximately 1.6%. Traffic or shopping frequency increased 5.1% worldwide and 4.9% in the U. S. Our average transaction or ticket was up 0.1% worldwide and 0.3% in the U. S. This includes the headwinds from gas deflation and FX. Adjusted for those items, ticket would have been up 2% worldwide and up 2.3% in the U. S. Moving down the income statement to membership fee income. We reported membership fee income of $1,166,000,000 an increase of $84,000,000 or 7.8% year over year. Membership fee income growth was also 7.8% excluding FX. Remember that the recent membership fee increase doesn't have much impact yet due to the effects of deferred accounting and represented less than 1% of the fee growth in the quarter. In terms of renewal rates, at Q1 end, our U. S. And Canada renewal rate was 92.8%, down 1 10th of a percent from Q4 end.

Speaker 2
7m 49s

The worldwide rate came in at 90.4%, also down 1 10th of a percent primarily due to the U. S. And Canada. As we mentioned on the last quarterly earnings call, our renewal rates are seeing some impact from higher growth in digital sign ups, which renew at a slightly lower rate than our base as a whole. Underlying renewal rates and membership growth remain strong, but this mix shift is likely to have a continued effect on our published renewal rate for the remainder of 2025. We ended Q1 with 77,400,000 paid household members, up 7.6% versus last year and 138,800,000 cardholders, up 7.2% year over year. At Q1 end, we had 36,400,000 paid executive memberships, up 9.2% versus last year. And executive members now represent 46.8 percent of paid members and 73.1 percent of worldwide sales. Turning to gross margin, our reported rate in the Q1 was higher year over year by 24 basis points, coming in at 11.28% compared to 11.04% last year and up 7 basis points excluding gas deflation. Core margin was higher by 31 basis points and higher by 17 basis points without gas deflation. This was driven by mix and our credit card co brand program.

Speaker 2
9m 14s

In terms of core margins on their own sales, our core on core margins were higher by 3 basis points. Ancillary and other businesses gross margin was lower by 12 basis points and lower by 16 basis points ex gas deflation. This decrease year over year was largely due to gas partially offset by e commerce. 2% reward was lower or better by 5 basis points or 6 basis points without gas deflation. And LIFO was flat for the quarter. We had a $19,000,000 LIFO credit in Q1 this year compared to a $15,000,000 credit in Q1 last year. Moving on to SG and A. Our reported SG and A rate in the Q1 was higher year over year by 14 basis points coming in at 9.59% compared to last year's 9.45%. SG and A was flat adjusted for gas deflation. The operations component of SG and A was higher or worse by 15 basis points and higher 4 basis points excluding gas deflation. Higher employee wages that went into effect in July drove the headwind for the quarter, partially offset by sales leverage and productivity gains. As always, investing in our employees remains a key part of our strategy and we will continue to focus on driving top line sales and improving productivity to mitigate the incremental costs.

Speaker 2
10m 34s

Central was higher or worse by 5 basis points and 3 basis points without gas deflation. Stock compensation was lower or better by 2 basis points and 3 basis points without gas deflation and preopening costs were lower or better by 4 basis points both with and without gas deflation. Below the operating income line, interest expense was $37,000,000 versus $38,000,000 last year and interest income was $96,000,000 versus $154,000,000 last year. As mentioned in our Q4 earnings, interest income faced headwinds in the quarter due to lower cash balances subsequent to our special dividend in January 2024 and lower interest rates. This will continue to negatively impact year over year compared in Q2. FX and other was a $51,000,000 gain in Q1 this year versus a $6,000,000 gain last year. This gain offset much of the headwind we saw in interest income in the quarter and was primarily due to FX. In terms of income taxes, our tax rate in Q1 was 22% compared to 24.5% in Q1 last year. As mentioned earlier, this year's rate benefited from a $100,000,000 discrete item related to our annual RSU vesting. Adjusted for this benefit, the tax rate for the quarter would have been 26.5%.

Speaker 2
11m 55s

Turning now to some key items of note for the quarter. Ron talked earlier about our continued momentum with new warehouse openings and capital expenditure in Q1 was approximately $1,260,000,000 We estimate CapEx for the full year will be approximately $5,000,000,000 Taking a deeper look into core merchandising sales, fresh led the way in Q1 with comparable sales up high single digits. Meat was up double digits and demonstrated strength across the department. We have members who are continuing to purchase high ticket premium cut selections and others who are gravitating more towards lower cost per pound options. As always, our focus remains on delivering exceptional quality and value across every item we sell in fresh. Our non foods category was also up high single digits despite some impact from the calendar shift as our buyers continue to bring in new and exciting items at great values. Golden jewelry, gift cards, home furnishings, sporting goods, health and beauty aids, luggage, kiosk and hardware were all up double digits. This quarter we were able to add several new high quality brands across a broad range of categories including Peloton, Wrangler, Springfree Trampolines and Ruggable. Food and sundries had mid single digit comps with our cooler and frozen food departments leading the way.

Speaker 2
13m 18s

We continue to see strong momentum with new and exciting international food items such as Soneea Pork Soup Dumplings, Sonamuzuri Rice and hot pot beef slice chuck rolls. Kirtland Signature continues to grow at a faster pace than our business as a whole. Our goal is always to be the first to lower prices where we see the opportunities to do so. And just a few examples this quarter include Kirtland Signature Organic Peanut Butter reduced from $11.49 to $9.99 Kirtland Signature Chicken Stock from $9.99 to $8.99 and Kirkland Signature Sauvignon Blanc from $7.49 to $6.99 Our merchants are also driving innovation with Kirkland Signature. Most notably this quarter, we introduced new Kirkland Signature Oxy Powder and Kirkland Signature Food Storage Bags, both offering significant value to the national brand alternatives. Within ancillary businesses, pharmacy had the strongest sales growth. Our focus continues to be on keeping prescription and OTC prices low, while also leveraging technology to make it easier for our members to use our pharmacy. Recent examples include the introduction of new prescription inventory management software to better stay in stock and enabling delivery of prescriptions via Instacart. Our food court and optical departments also performed well in the quarter.

Speaker 2
14m 41s

Gas sales were negative low double digits due to the average price per gallon being down low double digits. Costco Travel is another way we deliver unique membership value and these services continue to resonate well with our members. We offer a wide range of vacation packages, car rentals, cruises, hotels, flights and other travel related services. And in addition to highly attractive rates, many of our offerings include a Costco shop card as extra value for booking with Costco. A couple of fun facts about our travel business. Last year, we sold enough rental cars to fill every U. S. Costco parking spot 8.5 times. We also offer great value to members on cruises and our largest cruise booking last year was a 150 day around the world cruise starting from Fort Lauderdale and making stops in places like the Galapagos and Easter Islands. The total price was $293,000 for 2 in the owner's suite cabin and added values on the booking included a shipboard credit of $13,000 and the Costco shop card worth $25,000 Members who use Costco travel spend approximately twice as much as members that do not use these services. Inflation was once again essentially flat in the quarter across all core merchandise.

Speaker 2
16m 2s

Food and sundries and fresh foods were slightly inflationary and this was offset by deflation in non foods. In the supply chain, while egg supplies have been negatively impacted by avian influenza and the recent East Coast port strikes led to a spike in paper and water product demand, overall product supply has generally been good. The predictability of on time shipping delivery remains below pre COVID levels and items are generally spending more time on the water. Our merchants have adapted well to this change and we are in a great position with inventory for the holidays. As we head into Q2, we continue to monitor for potential port strikes in India, the East Coast and Canada and our merchants are adapting plans as necessary to ensure we remain in stock for our members. Turning to digital and e commerce. We continue to make progress with our technology roadmap and enhancements made to the member experience like the ability to check warehouse inventory via the Costco app are resonating well. Our U. S. App was downloaded 2,900,000 times in the quarter, bringing total downloads to approximately 42,000,000. E commerce traffic, conversion rate and average order value were all up year over year, helping to drive another strong quarter of comparable sales growth.

Speaker 2
17m 19s

While strength in bullion was a meaningful tailwind to e commerce sales, hardware, sporting goods, gift cards and home furnishings all grew double digits year over year. As Ron mentioned earlier, Costco Logistics also had another great quarter driving growth in big and bulky items. And Costco Next, our curated marketplace achieved record sales over the Thanksgiving, Black Friday and Cyber Monday sales period. In closing, let me provide a brief update on retail media. To use a baseball analogy, we are very much in the early innings with retail media, but we continue to believe this represents a significant growth opportunity in the future. This quarter, we completed our 1st targeted media campaign through 3rd party media channels with one of our largest CPG partners. The campaign achieved 2 to 3 times the return on ad spend typically expected, highlighting the value we can create for our members and suppliers. Our retail media team is now working with over 25 suppliers who are eager to participate in our next wave of off-site campaigns. And finally, in terms of upcoming releases, we will announce our December sales results for the 5 weeks ending Sunday, January 5, on Wednesday, January 8 after market close.

Speaker 2
18m 36s

That concludes our prepared remarks and we'll now open the line up for questions.

Speaker 1
18m 42s

Thank you. And we'll now begin the question and answer session. And your first question comes from the line of Simeon Gutman with Morgan Stanley. Your line is open.

Speaker 4
19m 30s

Hi, everyone. I hope you can hear me. My one question with a couple of parts. Actually diagnosing the health of the consumer, can you give us some sense of how you're clearing some of the seasonal inventory, maybe apparel, bigger ticket? And then once in a while, we talk about market share in some discretionary categories. Can you share your perspective on that? Thank you.

Speaker 2
19m 53s

Sure. Thanks, Simeon. Yes, we can hear you well and thanks for the question. Yes, so maybe taking that question in a few parts. As we look at the consumer, I think we're seeing a lot of similar trends that we've talked about on the last few quarters. What we're seeing with our members is that now probably more than any time in recent history that combination of newness of items, quality and value are really important to the member. And we're seeing the member being very choiceful about how they're spending the dollars. All that being said, I think we're finding that as our merchants are doing a great job of finding that newness and quality at great value, we've seen some great strength in our non food categories. And certainly, as you heard me say on the prepared comments, we're seeing really strong performance across many of the categories around things like gold and jewelry, gift cards, home furnishings, sporting goods, health and beauty, hardware, all up double digits during the quarter. So we're pleased with the momentum that we're seeing there and I think it reflects the fact that our members are willing to spend as inflation comes down as long as those sort of 3 key ingredients that I mentioned are there for the member as well.

Speaker 2
20m 55s

I think in terms of overall what we're seeing with the member on food and grocery, I would say that we are seeing what we think is a little bit of a shift from food away from home to food at home and that's certainly reflected in strong meat and produce sales that we've seen in our own business. And we are seeing I think a little bit even more of a trend that we've talked about in prior quarters of bifurcation with the member where we have high quality premium cuts they're selling well, but we're also seeing a gravitation towards those lower price per pound items across categories like poultry, cuts of beef and pork as well. Ron, anything you'd like to add?

Speaker 3
21m 33s

Yes, I guess, Simeon, the other part of your question, seasonal sell through appears to be very strong. It's a unique retail calendar with a shorter period of time after Thanksgiving, but our buyers have been through this before and they've responded properly with that as well. So that feels good. Seems to be a very foundational Christmas though, as you see furniture driving a lot of our e commerce sales, appliances, sporting goods, hardware. And so just people are very basic buying this year, but good trends.

Speaker 2
22m 5s

Yes. And I think, Simeon, I guess I didn't mention specifically, we tend to focus on our member and how can we deliver that great value. The data that we do see would tend to suggest that we're growing our share across most of the categories that I mentioned.

Speaker 1
22m 21s

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

Speaker 5
22m 27s

Hi, Ron and Gary. Happy holidays. Their traffic continues to impress a lot. As we look forward, what are your thoughts and key drivers and mix opportunities as you think about ticket and UPT? Also you highlighted retail media, which is a huge great opportunity. How does that intersect with your important multi vendor mailer? And also as you think about incrementality of that opportunity, that would be great to hear. Thanks. Thank you very much. Yes.

Speaker 2
23m 1s

Thanks, Oliver. I think the first part of your question, you probably heard in some of the comments that we made that we were we have been pleased with the traffic that we've seen and the continued frequency of shop from our members. What was nice to see at the end of last quarter, we did see when you adjust for foreign exchange and gasoline that we started to turn positive on the items per basket. And then this quarter when you adjust for those items, we were up about 2% on the slightly over 2% I think on the U. S. And 2% worldwide. So we have seen some improved momentum on the items per basket and I think that's a lot of great work being done by again our merchants making sure that we've got great product offerings in the warehouse and then our operators really executing those campaigns exceptionally well when the members are in the warehouse as well. From a media perspective, I think we look at it very much as an incremental opportunity. Our goal is to continue to maximize the value we can put into everyday product quality and pricing. And where we're seeing a lot of the interest in retail media is really coming from the marketing agencies, which gives us a lot of confidence that this is an opportunity for us to tap into new marketing dollars where a lot of our national brand suppliers are going to those media agencies to invest those marketing dollars to really make sure they're getting a good return on that ad spend.

Speaker 2
24m 17s

And so where we're seeing a lot of the traction and again, I would emphasize it's very early days with retail media for us is something that we're just really embarking on that off-site journey. But really where most of the interest is coming from is from retail media agencies, which we believe is the way for us to make sure that we're driving incrementality and growth in the model.

Speaker 5
24m 38s

Thank you very much. Very helpful.

Speaker 1
24m 42s

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

Speaker 6
24m 49s

Thanks. Good evening, guys. So can you talk about what drove the core on core margin performance this quarter? You have the MFI now rolling through. How do you think about reinvestment of price either in terms of expected price reductions that you see coming down the supply chain or maybe even going above and beyond that? And just as a side question, can you define what's in the hardware category? Is that consumer electronics? Thank you.

Speaker 2
25m 20s

Sure. Thank you for the question. Yes, in terms of the core on core margin, first of all, which I think was the first part of your question, if you break it down between the sort of 3 main categories that we see within the business, that's foods, fresh and non foods. Foods would have been essentially flat, non foods would have been down slightly and fresh would have been up slightly. So those 3 kind of obviously overall we were just up 3 basis points. So there really wasn't a tremendous amount of change overall, but they would have been the sort of key puts and takes in the overall number.

Speaker 3
25m 50s

And then the description of the hardware category really is just that, it's storage, plumbing, lighting, power tools, batteries, those type of the household goods that you would find at a typical hardware store.

Speaker 6
26m 8s

And then on the price investment side, your thought process there?

Speaker 3
26m 13s

That's something that we've done for the history of the company. We're going to continue to invest in price and some of it may come in holding certain prices as some commodities are starting to increase. But investing in items like Gary described, leading with Kirkland Signature. I mean, we feel that we're going to be asking our members and our vendors to contribute with lower prices. We've got to set that example and start with Kirkland. So we're going to continue to look at those opportunities and invest where we can and keep driving sales.

Speaker 6
26m 45s

Thank you. Have a great holiday season.

Speaker 3
26m 47s

Thank you. You as well.

Speaker 1
26m 51s

And your next question comes from the line of Jiang Ma with Bernstein. Your line is open.

Speaker 7
26m 58s

Thank you for taking my question. I have a 2 part question. One, I think Gary you mentioned the difference in renewal rates from online sign ups and then offline sign ups. Can you help us break it out and understand the difference in online behaviors? And second part on the retail media side, how do you expect Costco Connect the 3rd party marketplace to contribute to the growth of retail media going forward? And will that impact the membership loyalty in any way or regard? Thank you.

Speaker 2
27m 32s

Yes, sure. Thanks for the question. So first of all, on the membership rate, I'd maybe take a step back and just say overall, we're feeling very good about the underlying membership metrics that we're seeing. So renewal rates in general sign up activity and then the membership growth remains very strong. As I mentioned in the prepared remarks, really what we're seeing is that over the last few years, we've seen some shift in more of the members that we're acquiring coming through digital channels. And that's helping with the comment that we made last quarter where we're also seeing a slightly reduction in the average age of members because of that change in shift as well. But what it does mean is that often when we have new members being recruited through that digital channel, they're renewing at a slightly lower rate than the historical base that we have. And you may recall that when we talk about membership renewal rate is effectively an 18 month lag that we see that we report out on that renewal rate. And so as we look forward and see that trend continuing as we build more of that new digital member into the base and it slightly affects the mix, we expect it will have a slight impact on that overall membership renewal rate that we report.

Speaker 2
28m 38s

So we wanted to make sure we gave you visibility into that. When we look at individual sort of cohorts of members, we feel good about the ability for us to be able to continue to drive improvement in renewal rate, but we are going to see that impact through as it becomes a flow through from the continued growth in digital members.

Speaker 3
28m 55s

And then this is Ron. The question on Costco Next. Costco Next is our marketplace. This is an exclusive Costco member only marketplace. It's fully curated by our buyers. So everything that's on that site has been reviewed by our buyers, but is exclusive to Costco members. So we think it's just going to enhance the relationship we have our members and give more options for their shopping needs.

Speaker 7
29m 19s

Got it. Just to clarify, I was wondering if you were going to have more 3P Marketplace vendors using the retail media service and whether that's there's any implications on the member side?

Speaker 3
29m 31s

That and that again is as Gary mentioned earlier, we're in the very early stages and we're going to look at where we feel the benefits will be to our members. So that is to be determined yet.

Speaker 7
29m 42s

Thank you.

Speaker 2
29m 43s

You're welcome.

Speaker 1
29m 46s

And your next question comes from the line of Karen Short with Melius Research. Your line is open.

Speaker 8
29m 53s

Hey, thanks very much. I know this is maybe a little out of left field, but just curious, there's kind of been a trend in retail for some for stock splits generally. And I'm wondering what your philosophy is on that because I know you want your employees to have an opportunity to buy stock below the store manager level. And the second question that's kind of unrelated is just tariffs. Any thoughts on that and thoughts on what that could do to inflation?

Speaker 2
30m 25s

Thanks, Karen. Yes, on the stock split, you're probably aware that Costco has done stock splits in the past. And it's something that we'll continue to evaluate and discuss with our board, but there isn't a plan at this time for a stock split. I think for us the way we think about it is the economic arguments that we're showing the repast are a little bit less clear because retail investors and employees both have the ability now to buy fractional shares, but we do also recognize that there's a benefit of the stock feeling more affordable for our retail investors and employees who were very important constituents for us. So we'll continue to evaluate over time. And then I think the second part of the question was on tariffs?

Speaker 7
31m 4s

Yes.

Speaker 2
31m 5s

Yes. Yes. I think from a tariffs point of view, what I would say is that, first of all, there's a lot of uncertainty around the timing and scope of changes. So it makes it difficult for anyone to predict what the impact will be with confidence. And in general, of course, tariffs raised costs. So that's not something that we see as a positive in general. With that being said, I'll quote my predecessor Richard. He'd say, when it rains, it rains on everybody. And I think for us, we've faced tariffs in the past and we believe that our merchants and buyers are equipped as anybody is to sort of work through and navigate and manage that situation. We have a plan over time where we have done that in the past and typically we'll look where we can to pull forward inventory buying, which actually we've done already because of some of the less predictability around shipping and how much time product spends on the water and also because of the risk of strikes that we've seen in the past as well. We'll of course try and work with our vendors to make sure we're looking for ways where we can to mitigate the cost.

Speaker 2
32m 0s

And we also consider alternative sourcing locations where that's practical as well. I guess the final sort of string in our bow would be is if we didn't see the value in an individual SKU then we could always pivot to a different SKU item for the member if we felt the value just wasn't there and it was more effective for us to move to a different item in the warehouse. I guess in context for us, the sort of the amount of business that's affected, we're about a quarter of our business is non foods and then a subset of that is imported. So remember it's a minority of our overall business and then it's a smaller part of that as well we actually import just for context.

Speaker 8
32m 37s

Great. Thank you very much. Have a great holiday.

Speaker 9
32m 40s

You too. Thanks.

Speaker 1
32m 43s

And your next question comes from the line of Edward Kelly with Wells Fargo. Your line is open.

Speaker 9
32m 49s

Yes. Hi, good morning everyone. I wanted to ask you about CapEx. CapEx is kind of inching up over the last couple of years. But taking a step back and thinking about the evolution of your business, your goals, growing the moat, how are you thinking about the outlook for CapEx? Any meaningful changes ahead? And as part of this, anything different sort of in the pipeline from a project or priority standpoint?

Speaker 2
33m 16s

Yes. Thanks, Ed. I wouldn't say there's really any major change. As you mentioned, we have been gradually increasing capital expenditure, more reflection of the continued growth of the business as we've opened new warehouses, seen some inflation in those costs over the last few years. And we have of course been investing a little bit more in technology as well as we sort of modernize the platforms there and look to build the right capabilities to support growth in the future. But I think philosophically, we focus on job number 1, of course, is to focus on the warehouses and invest in continuing to maintain the quality of athletes and invest in new growth warehouses in that 25 to 30 range, updating our supply chain and depots to support the capability there and both digitally. And then also as I mentioned sort of technology investments. But I wouldn't indicate at this point that there's any major change in trajectory. It's more just continuation of the growth strategy that we've had in executing on that strategy.

Speaker 5
34m 11s

Okay. Thank you.

Speaker 1
34m 15s

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

Speaker 10
34m 22s

Hey, guys. Two quick things. Philosophically, price investments get a lot of publicity. But when you think about reinvesting the MFI increase, price, product quality, right, IT labor, there's a lot of things to invest in. Where do those other things rank relative to price? And then what does the international club pipeline look like? I'm thinking in particular, where you control sites, even though they may be years away, Is that I don't think it's over 100, but how big is that pipeline today?

Speaker 2
35m 0s

Yes. Thanks, John. I'll jump in first and Ron may want to add some color as well. I think overall, we look at the reinvestment of the membership fee holistically. So it's partly where is it that we can lower prices of course, part of it's where can we mitigate the impact of inflation to maintain the value for the member even if costs are increasing. It's if we how can we improve the membership experience including investing in our employees' wages as we've done recently as well. And of course innovation with new products through Kirkland Signature. So I think we tend to look at it holistically and say how do we make sure that when we think about what our members are paying for the membership fee each year that we're delivering more value and showing them that they're getting greater value than they're paying by a meaningful margin for the value of being a member. Ron, anything you want to add on that?

Speaker 3
35m 48s

No, I think that that's accurate. And an expansion around the world, I think you'll continue to see an equal amount of 30 warehouses opening up over the next few years for sure. A good portion of those being out of the U. S, we see some great opportunities in Canada and Mexico have been strong countries for us. We continue to see growth opportunities both in Europe and Asia as well. So some of these projects take a lot longer than other ones will. So they'll come on at different times. But I think the outline of 30 a year seems very realistic and a good portion of those not quite half to be outside of the U. S. Thank you. You're welcome. Thanks, Joe.

Speaker 1
36m 31s

And your next question comes from the line of Rupesh Parikh with Oppenheimer. Your line is open.

Speaker 11
36m 38s

Good afternoon. Thanks for taking my question. So I just wanted to get Gary to go back to your comment to that core margins gas were up 17 basis points and you called out mix and credit card co brand program. Is there any more color you can provide in terms of what's driving that?

Speaker 2
36m 52s

Sure. Yes. Thanks, Rupesh. Overall, as you mentioned, we were pleased with where reported gross margin rate came in. We tend to look at it ex gas deflation, as you know, and that was up 7 basis points and then core on core was up 3%. So I think the overall message is that things were stable when we look at the gross margin rate. There were a number of puts and takes in that that largely offset each other within the overall results. The main headwind as we signaled potentially could be the case was around gas, which was impacted by the fact that we had a major event obviously 12 months ago or so in the Middle East that created volatility and often that can create some strange margin performance and we were cycling that. So that was the large headwind. I wouldn't say overall that we've seen in the long term gas margins be unpredictable. It just tends to be more unpredictable on individual quarter when you have that volatility. So that was the sort of biggest headwind. And then offsetting that in the quarter, we had some benefit again this quarter from e commerce as margins improved there and the rate of improvement in e commerce would have been largely similar to what we saw last quarter.

Speaker 2
37m 58s

So we were pleased with the progress we continue to see there. And then as you mentioned in the call, we had a couple of offsets. We saw some benefit from mix as we look at the business. And then secondly, we saw some benefit from the co brand credit card program, as you mentioned. Essentially, the way the credit card co brand works is that we fund a portion of the rewards that are paid to members and then we receive various incentives and payments from our issuing bank and all that flows into gross margin. And essentially, the net effect of that was favorable for the quarter, which offset along with mix and the e commerce benefits, the gas headwind. So as I mentioned overall, I think there were no major takeaways from the puts and takes, but we're pleased that gross margin was up slightly even though we continue to invest in lower prices and deliver more value for the member.

Speaker 11
38m 45s

Great. Thank you for all the color. Happy holidays.

Speaker 9
38m 48s

You too.

Speaker 1
38m 50s

And your next question comes from the line of Peter Benedict with Baird. Your line is open.

Speaker 12
38m 58s

Hi, guys. Thanks for taking the question. Wonder maybe Ron for you on the runway for growth in the U. S. You said 30 new clubs per year next handful of years here and most of those are going to be in the U. S. You guys are just over 600 right now. I think if you include the other 2 players, we're talking about 1400 plus clubs in the U. S, they're growing as well. How do you think about maybe the capacity for the club industry in the U. S. And maybe for Costco in particular? What are you seeing that gives you confidence in your ability to keep growing at this pace in the U. S?

Speaker 3
39m 35s

I think the one thing I see is continued success of operations like I spoke of Pleasanton, California that we opened the day before Thanksgiving. Right in between 3 high volume Bay Area locations in the East Bay and we opened this warehouse up not long ago and in finding incremental business significant incremental business from our members as we relieve the pressure off of those high volume warehouses, we see the existing member base coming more frequently and the build back is quite nice for us. So we see incrementality of the new warehouse and then we see very, very quick build back on those as well. So not only do we still see some opportunities, Scarborough, Maine, we opened over a year ago, building has had a tremendous 1st year in a smaller market like that that we see. So we see some runway for a few years ahead of us yet where we have a combination of new markets, but we really are focusing on how do we continue to improve that member experience by relieving pressure off of some of these super high volume warehouses and we're finding it to be incremental to the business.

Speaker 5
40m 43s

Thank you very much.

Speaker 1
40m 48s

And your next question comes from the line of Greg Milich with Evercore ISI. Your line is open.

Speaker 13
40m 55s

Thanks. I wanted to circle back on e commerce, the growth there of 13%. Could you update us on what the penetration is now? And also how if you add on Instacart and I guess the Uber Eats start, where we're getting up to on that?

Speaker 2
41m 12s

Yes. Thanks, Greg, for the question. Yes, we were pleased with the growth that we saw in digital. I think it's important to remember as well as we shared in the November sales release that there was some impact of timing of calendar as well. So the 13 percent if you think about I think we shared the team shared that we were like a 15% headwind in our November sales results. And so clearly if you take about a third of that you wouldn't be a 1,000,000 miles out with the impact that it would have had on our sales in the quarter as well. So we were pleased overall with the underlying trend and the metrics that we saw around app downloads and traffic and average order were all up as well, which was encouraging. If you think about the mix of the business, it would be in the sort of from the numbers that we disclosed publicly as being part of our digital business in the sort of 7% to 8% range of our total sales. So as you know, it continues to outpace our overall growth and we expect that trend to continue. You're exactly right that when you recognize how we define it compared to how others define it, we wouldn't include some of those third party sites that are delivering.

Speaker 2
42m 16s

And there's a few other business parts of our business that we don't include in there as well that would fit in under other businesses. When we add those in there and when you sort of strip out gas, which I think most companies do when they compare, we'd be north of 10% in terms of total penetration of e commerce sales.

Speaker 13
42m 33s

Got it. Thanks. And then maybe circling back on private label, could you just update us now on the penetration, especially given some of those great new items you've come out with that you highlighted earlier in the call and what that could eventually be?

Speaker 3
42m 48s

Yes, I think it's up about 30, almost 33% at this point in the U. S. Is where we've now hit. And that's primarily the food and sundry side of things where we see the majority of our private label. But we're just bumping up against 33% and it's growing a little faster than the rest of the business.

Speaker 9
43m 11s

That's great guys. Have a great holiday. You as well. You too. Thank you.

Speaker 1
43m 17s

And your next question comes from the line of Scott Mushkin with R5 Capital. Your line is open.

Speaker 5
43m 25s

Thanks. Hey, guys. Thanks for taking my questions. So I just wanted to kind of maybe ask a higher level question around your business. The traffic growth, which is the lifeblood of a retailer, has been very strong given the size of the company. You talked about the Pleasanton opening. But I was wondering if you could kind of give us an idea of what you think is driving this? Is it the club format generally resonating consumer mindset initiatives? And how do we think it's like 2, 4 years now is it the numbers this time? You're right. We've lost you halfway through the comp questions. I'm sorry.

Speaker 5
44m 13s

I apologize. I don't know why that's happening because you guys are clear as a bell. Just to say, this type of traffic growth is your initiatives, the industry consensus and what your thoughts are about keeping this type of traffic going for years?

Speaker 3
44m 32s

Okay. And I think we got most of your questions that really regards around traffic growth and why we what we see that happening and if we feel that that can continue on. And that's what I'll try to answer and hopefully that was what you're talking about. I think from some of the comments you made, I think it's all of the above. And some of the fun facts I gave out there was just really to point to the growth success we're seeing in several parts of our company, be it the pharmacy, the food court, our fresh foods area. I've got to contribute a big part of that to our buyers and operators and the work that they're doing and keeping relevance to the member needs and being reflective of what we were focusing on some of the lower cost proteins for some of our members, while we're focusing on the Wagyu for the members that would like those goods as well. So I think our people are doing a tremendous job knowing our customer, but it really is all parts of the business are contributing. Their tire business is very strong. Our non food business continues to strengthen.

Speaker 3
45m 29s

E commerce is doing their part. But it just goes back to execution from the teams.

Speaker 1
45m 39s

And your next question comes from the line of Robbie Ohmes with Bank of America. Your line is open.

Speaker 14
45m 47s

Thank you. Thanks for taking my question. It's on the competitive impact. So it may end up sounding like more than one question. But are there any competitive impacts you guys are seeing worth calling out benefits or headwinds. So maybe remind us when a regional player you compete with raises their membership fee, does that help you guys at all retain or retention rates, things like that? And also, I know you've been asked this, but any pressures you're seeing on the fact that you guys don't do scan and go and Sam's seems to be doing really well with it and any other competitive impacts you can call out? Thanks.

Speaker 2
46m 28s

Yes. Thanks for the question, Robbie. I think we're generally our own biggest competitor, honestly. That's generally how we approach the business. Maybe the couple of trends that add some color on that that I would call out would be, we haven't talked for some time about cannibalizing our own business with opening new warehouses. And as Ron mentioned, generally we're seeing significant incrementality. But as we have opened more warehouses, we certainly create some of that. We don't split it out in our numbers. We just flow through our results, but it does impact the number because we are moving some traffic from existing warehouses when we open a new one. I think from a competitive point of view, I guess the biggest tailwind I would call out and Ron mentioned it briefly in prepared comments around our business is that obviously we're seeing quite a lot of disruption in the retail pharmacy business right now. And I think with the work our teams are doing to deliver great value for the member and continuing to improve the experience and make it easier to engage with our pharmacists. As I mentioned in my prepared comments, we're seeing significant growth in that business today.

Speaker 2
47m 29s

I think that's partly the work that we're doing and partly I think there is some disruption in the industry currently as well.

Speaker 14
47m 37s

And just any comments on Scan and Go? Maybe remind us why that might not be on your agenda?

Speaker 3
47m 43s

I mean, I think we've got our job is, as Gary said, to take care of the members and make sure they move through. Do we hear about Scan and Go? Yes, we do. Self checkout has been a great option for our members and we focus on that. Our job really is that we will continue to keep an eye on technology and how we can improve that front end experience that is the one pinch point. That was the focus of our door scanners as we took a lot of pressure off of the cashiers and moving lines through and saw some nice productivity enhancements when we did that. But at this point, it's not something we're hearing quite often. We do hear it randomly, but we're going to keep an eye out there on technology and make sure that we're doing our part to keep the experience as strong as we can for our members.

Speaker 14
48m 24s

Great. Thank you.

Speaker 3
48m 26s

You're very welcome.

Speaker 1
48m 29s

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

Speaker 9
48m 36s

Good evening. Thank you so much for taking my question. Given the recent sales contribution from categories like precious metals and gift cards, have you, A, expanded the aperture of what Costco is now willing to sell or what the member is willing to buy from Costco? And B, have you changed your philosophy on the margin where you are expecting more profitability from traditional product vendors to offset the negative margin impact from selling these items that don't drive a lot of profit? Thank you very much.

Speaker 3
49m 16s

I think as far as new categories, you go back to caskets that we started many years ago that we would never thought would have been a business for us and we were able to find a way to deliver great member value and great quality. And that was such as the addition to gasoline we had many years ago in the company as well is that can we find something that meets the needs of our members and ensure we can deliver the right quality and the great price. So I think the tickets in precious metals was again great work by our buying teams and finding new areas that we can deliver great quality and great value to our members. And I see them working hard on the next categories that are going to be coming for us. But that's part of the treasure hunt at Costco is always keeping nimble and continue to change those categories that we can find new areas to improve the lives of our members.

Speaker 2
50m 4s

Yes. Maybe Ron just to add on that Michael to your question. I think we'd give a bit more credit in addition to Ron's point about it's a great work by our merchants creating new and exciting items. We give a bit more credit, I think, to the impact they have on the business, not necessarily because we see significant margin as you mentioned from them, but they're driving traffic through our website and we do get a high proportion of cross selling when members are buying things like precious metals. So it's driving our ability to grow our digital business overall. And I think we see it as something that also just creates a lot of awareness about our e commerce business as well. So as you know, we don't advertise, but it's identifying these exciting items that help drive traffic and awareness of what Costco offers. So and I think some of that is a factor in what helps with the continued growth in e commerce, not just from a top line perspective, but also the margin improvement that we talked about on the call. So I think we would look at it a little bit more broadly for sure.

Speaker 9
50m 59s

But just to clarify that second point, are you having to offset the margin impact from selling these traffic driving items that don't carry a lot of margin by requiring even better margins on the rest of the assortment?

Speaker 2
51m 19s

No. What we're seeing is we're driving a mix improvement overall because of the traffic that it's driving and the engagement with the website. And remember, of course, as well that there's very low SG and A costs associated with that product. So it also helps create leverage in the e commerce model as well.

Speaker 3
51m 35s

So the answer is really no. We're not making more margin on those other items to offset that. We're just driving down our SG and A, so we don't require more margin.

Speaker 9
51m 46s

Thank you very much and have a good holiday.

Speaker 3
51m 48s

You as well. Thank you.

Speaker 1
51m 52s

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

Speaker 5
51m 59s

Hey, thanks very much. Ron, can you talk about Costco's right to earn more wallet share with your more affluent higher income shopper, particularly on the discretionary side of the business? And then Gary, just on the margin bridge, can you just explain why the 2% rebate was favorable 5 basis points historically? It's almost always negative or neutral. Thank you.

Speaker 3
52m 26s

Sure thing. Chuck, your question was why are we gaining more market share with our affluent customers? Is that what your question was?

Speaker 10
52m 32s

No. My question is do you think you've earned the right to earn more wallet share with that higher income shopper?

Speaker 3
52m 40s

Absolutely. I think we do. I think as we continue to find the brands, I mean and deliver also with great quality Kirkland Signature, we will continue to see that growth in that customer. We resonate that is our member and that's who we cater our mixes to. And I think that we see great runway for us in the future.

Speaker 2
53m 0s

And then Chuck on the second part of your question. So with the 2% rewards, think of it as that throughout the year, we're accruing what we believe is the right amount of redemption for the 2% rewards. And generally speaking, we're going to be conservative around that because we want to make sure we're fully accrued. And then when we get into the Q1 each year, we're sort of truing up, if you like, what the actual spend was. So I'd almost think of the adjustment this quarter sort of offsetting the increases that we saw in the back half of last year. And so you have to net those out to say underlying there is a gradual increase in the 2% spend, but it kind of nets off between quarter by quarter.

Speaker 5
53m 37s

Okay. So it was essentially a true up then? Right. Okay, great. Awesome. Thank you.

Speaker 1
53m 46s

And your next question comes from the line of Kelly Bania with BMO Capital Markets. Your line is open.

Speaker 15
53m 55s

Hi, thanks for taking our questions, Ron and Gary. I was wondering if you could just talk a little bit about your partnerships with Instacart and Uber, now that you've had Uber for quite some time. What you've learned? What is the pace of growth and how that's adding to comps? And just general awareness among your membership base of the service there, particularly as you add new services, like you mentioned, the pharmacy, I guess, coming in and what something like that could do to the growth there?

Speaker 3
54m 29s

Yes, I guess I will start with that. Very strong partnerships with both organizations. We have we've closely looked at what the behaviors of the members were and found great incrementality to our members shop frequency goes way up. And it changes the shopping habits. I think they'll use us more for fill in between their big Costco brick and mortar shop to go into an Instacart or an Uber and shop those directions. So I think that we're finding that it's the most cost effective way to do some small non food item deliveries as well, where we would have otherwise shipped those via UPS or a carrier from a distribution center. We can now have those to a member within a few hours. So if you're looking for a blender that will fit in the back of a Prius, we can get that to you in a couple of hours at a very low cost. So it's improving our e commerce delivery speed and time to the member and convenience is there as well. So we're very happy with the partnership. Our head merchant works very closely with both of those organizations and we think it's a great service for their members.

Speaker 2
55m 37s

And I guess the only thing to add, Kelly, as you the first part of your question, it continues to grow very strongly. So at least in line with the pace that we see in our digital business overall.

Speaker 3
55m 45s

Yes, slightly higher than our e commerce business growth.

Speaker 1
55m 52s

And your next question comes from the line of Chuck Cerankosky with Northcoast Research. Your line is open.

Speaker 12
56m 0s

Good afternoon, everyone. Could you talk a little bit about labor relations and the current negotiations with the Teamsters, please?

Speaker 3
56m 10s

I guess, Chuck, what I will say about that is that Costco, we will always take care of our employees as we always have done. That means that we're going to focus on a fair and a timely process for getting to an agreement with the Teamsters. We have a 40 year track record of dealing fairly with the Teamsters Union and really nothing has changed about that. So this is these are Costco employees. They're of great importance to us and we're going to do everything as we can to take care of those employees as we do all of our employees.

Speaker 12
56m 46s

Great. Thank you.

Speaker 1
56m 50s

And your next question comes from the line of Cory Tarlow with Jefferies. Your line is open.

Speaker 16
56m 57s

Hi, good afternoon. Thanks for taking my question. I was wondering if you could talk a little bit about the international performance that you saw comps decelerated on a multiyear stack versus Q4. So just curious by region if there's anything to call out that changed versus the prior quarters? Thank you.

Speaker 2
57m 18s

Yes. Thanks for the question, Cory. I don't think there's anything we'd be particularly calling out. I mean, there's certainly some nuances sometimes between some of the international markets of when certain holidays fall and they would have had, I'll give you an example which I wasn't familiar with before joining the company and having recent conversations that in Taiwan there's a big impact from the holiday season in the same way there is here around Black Friday. And so there are nuances like that that we see in individual markets that sometimes can affect the calendar. But overall, we've been pleased with the momentum that we've seen in the international businesses and we continue to see strong growth relative to both our own internal expectations and then also as we look at the growth in those markets, how we continue to grow our market share. So nothing I would call out as being unusual there.

Speaker 5
58m 8s

Thank you.

Speaker 1
58m 12s

And we have time for one more question. Your final question comes from Laura Champine with Loop Capital. Your line is open.

Speaker 7
58m 21s

Thanks for taking my question. It's a follow-up on your digital business, which obviously is growing well. But how would senior management diagnose or grade your online presence from a look, feel and function perspective relative to your competition? And related to that, this growth in members who are joining online, is that something you're driving? Or is that just an output of the attractiveness of your online offer?

Speaker 2
58m 53s

Yes, thanks for the question. I think again, I'll say we're probably our own toughest critic. I think when we look at our business overall and we look at the growth over the last 10 years, we've actually grown at a faster pace than the e commerce sort of business in the U. S. Has grown in general. So in one respect, we're very pleased with the momentum and the growth that we've seen and continuing to see that higher engagement. But we're never satisfied. We believe there's more work we can do to keep improving the member experience. We made recent changes with things like search functionality and making inventory available through the mobile app. And those changes are certainly members are seeing the benefit of that and commenting positively on the changes that we're seeing. But we know that we're on a technology journey. We've sort of been building the foundations of that journey over the last few years. And the goal is to keep getting better and to keep enhancing the member experience. So I'd say we still believe there's more work to do and we believe by doing that work we can continue growing our digital business even more effectively.

Speaker 3
59m 50s

And I would add to that. We realize that we do have some opportunity. We definitely see that we can continue to improve. Gary is exactly right. We're doing the back of the house work at this point, speed, stability, making sure that all the foundational work is done so we can build on that. And then I think in short order, people will start seeing the front side of things that will come in. But I think Costco Logistics is a great example of the progress we've made. We are now able to pre deploy things around the U. S. And have deliveries made in 4 days, which couple of years ago would have taken us 2 weeks. So we're seeing the distribution centers coming online. We're starting to see the app usage go way up. Functionality is being added to that as well. So it's a journey. We're going to start seeing some more forward facing improvements in the next 12 months that we as we sort of start putting our logistics sides behind us and we get those things taken care of. And as far as the e commerce engagement with membership sign ups, probably the biggest difference is that we have less executive members sign up online, which do renew at a higher basis.

Speaker 3
1h 0m

And so and I think that that big part the big part of that is that they don't have an employee to talk to when they're making that transaction and they don't understand all the benefits of the executive membership. So we're able to capture those later on in the past and but that's the first thing we see there is that at least we start engaging with the member and then we will work on showing them the benefits of the executive membership down the road.

Speaker 7
1h 1m

Got it. Thank you.

Speaker 1
1h 1m

And ladies and gentlemen, this concludes today's conference call and we thank you for your participation. You may now disconnect.