Costco Wholesale
Q3 2025 29 May, 2025

Speaker 3
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Ladies and gentlemen, thank you for standing by. My name is Abby, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Costco Wholesale Corporation third quarter 2025 conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. If you would like to ask a question during that time, simply press star followed by the number one on your telephone keypad. If you would like to withdraw your question, press star one a second time. Thank you. I would now like to turn the conference over to Gary Millerchip, Chief Financial Officer. You may begin.

Speaker 1
40s

Good afternoon, everyone, and thank you for joining Costco's third quarter 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 intended as substitutes for net sales presented in accordance with GAAP. Before we dive into our financial results, I'm delighted to say that Ron Vachris is joining us again for today's call. I'll now hand over to Ron for some opening comments.

Speaker 2
1m 50s

Thank you, Gary, and good afternoon, everyone, and thank you for joining us today. As we wrap up the third quarter of fiscal 2025, let me make a few brief comments on some of the highlights. Since our last earnings call, we've opened nine warehouses, including relocation in Melbourne, Australia, our 37th warehouse in Japan, and seven net new U.S. locations. We plan to open another 10 warehouses during the fourth fiscal quarter, which will include our second warehouse in Sweden, our 20th warehouse in Korea, and our 110th warehouse in Canada. For this fiscal year, we expect to open 27 new warehouses, including three relocations, for a total of 24 net new buildings. This will bring our total warehouse count to 914 worldwide. Our merchandising and operations team did a fantastic job in the quarter, delivering some strong financial results while also maintaining our competitive price position despite a challenging macroeconomic backdrop. Capitalizing on the focus and scale we are able to achieve through our limited SKU count and global footprint, we continue to increase the overall value of our membership, including extended gas station opening hours and lowering prices on some key items such as eggs, butter, and olive oil.

Speaker 2
3m 9s

The combination of expanded gas station hours, new gas station openings, and lower prices at the pump have led us to having two of our all-time highest gallon weeks in the U.S. during the last month. In times of consumer uncertainty, our Kirkland Signature brand is uniquely positioned to provide our members with great quality and great values. During the third quarter, sales of Kirkland Signature items again outpaced our overall sales growth, with our KS sales penetration up approximately 50 basis points year over year. We continue to move more Kirkland Signature product sourcing into the countries or regions where the items are sold, and this is helping us to lower costs and mitigate some of the potential impacts of tariffs. We are remaining agile as the situation with tariffs evolves, while also supporting the commitments we have made with our long-term suppliers. As an example of this, during the third quarter, we rerouted many goods sourced from countries with large tariff exposure to our non-U.S. markets. In the U.S., we pulled forward some items that we had planned for the summer and sourced additional locally produced goods to reduce tariff impacts and ensure that we were in stock. Actions such as these are allowing us to continue to provide great values for our members while also delivering value to our shareholders.

Speaker 2
4m 31s

Digital and technology are important parts of our future growth, and we're investing to improve the member experience. A recent example in e-commerce is the launch of Buy Now Pay Later offering through our partnership with Affirm. This new program allows our members greater access to the Costco values on big-ticket items such as appliances, furniture, consumer electronics, and much more at exclusive rates for the Costco members. While still early days, we've been pleased with the initial sales results. In our warehouses, we continue to work on opportunities to further improve the member experience. Please be on the lookout for several new technology pilots we are focusing on to help our members check out through our front end at a faster pace. As we look ahead to the remainder of the fiscal year, while the impacts of tariffs and the outlook for the economy in general remain unknown, we are confident in the ability of our operators and merchants to rise to the challenges and continue to offer great service and find consistent values for our members. Our results in recent quarters have reinforced for us that in uncertain times, our values resonate with members as strongly as ever.

Speaker 2
5m 45s

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

Speaker 1
5m 52s

Thanks, Ron. In today's press release, we reported operating results for the third quarter of fiscal 2025. The 12 weeks ended on May the 11th. 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 third quarter came in at $1.9 billion, or $4.28 per diluted share, up more than 13% from $1.68 billion, or $3.78 per diluted share in the third quarter last year. These results were driven by strong sales and margin performance, despite the headwind of a $130 million LIFO charge in the quarter and operating income being negatively impacted by a catch-up accrual of $40 million for the increase in employee vacation days included in our March 2025 employee agreement. As in Q2, foreign exchange rates also negatively impacted the translation of international net income to U.S. dollars. In Q3, the impact was $35 million, or $0.08 per diluted share. Net sales for the third quarter were $61.96 billion, an increase of 8% from $57.39 billion in the third quarter last year.

Speaker 1
7m 18s

U.S. comparable sales were up 6.6%, or 7.9% excluding gas deflation. Canada comp sales were up 2.9%, or 7.8% adjusted for gas deflation and FX. Other international comp sales were up 3.2%, or 8.5% adjusted, and this all led to total company comp sales of 5.7%, or 8% adjusted. Finally, e-commerce comp sales were up 14.8%, or 15.7% adjusted for FX. In terms of Q3 comp sales metrics, foreign currencies relative to the U.S. dollar negatively impacted sales by approximately 1.2%, while gas price deflation negatively impacted sales by approximately 1.1%. Traffic or shopping frequency increased 5.2% worldwide and 5.5% in the U.S. Our average transaction or ticket was up 0.4% worldwide and up 1.1% in the U.S. This includes the headwinds from gas deflation and FX. Adjusted for those items, tickets would have been up 2.7% worldwide and 2.3% in the U.S. Moving down the income statement to membership fee income, we reported membership fee income of $1.24 billion, an increase of $117 million, or 10.4% year over year. Membership fee income growth was 11.4% excluding FX, and the recent membership fee increase represented approximately 4.6% of fee income in the quarter. In terms of renewal rates at Q3 end, our U.S. and Canada renewal rate was 92.7%, and the worldwide rate came in at 90.2%.

Speaker 1
9m 7s

As cohorts of new members from digital acquisition campaigns and warehouse openings in Asia move in and out of the calculation, there will continue to be some volatility in this number quarter to quarter. The decreases in the renewal rates in Q3 versus Q2 were primarily attributable to sign-ups from a Groupon promotion in the fall of 2023 entering the renewal rate calculation for the first time this quarter. Higher penetration of online sign-ups entering the renewal rate calculation also contributes to the lower renewal rate. These new digital memberships are a net positive as they grow the overall membership base and are generally younger members, but they also renew at a slightly lower rate. We ended Q3 with 79.6 million paid household members, up 6.8% versus last year, and 142.8 million cardholders, up 6.6% year over year. At Q3 end, we had 37.6 million paid executive memberships, up 9% versus last year. Executive members represented 47.3% of paid members and 73.1% of worldwide sales. Turning now to gross margin, our reported rate in the third quarter was higher year over year by 41 basis points, coming in at 11.25% compared to 10.84% last year and up 29 basis points excluding gas deflation.

Speaker 1
10m 35s

Core was higher by 36 basis points and higher by 27 basis points without gas deflation. In terms of core margins on their own sales, our core-on-core margins were higher by 36 basis points. A significant part of the increase was driven by our fresh departments, where strong sales leverage benefited our payroll costs and spoilage results. Additionally, the decrease in some key commodity and ingredient costs, such as dairy, butter, eggs, and olive oil, were a tailwind in fresh and food and sundries. In general, we feel margin pressure during times of inflation on these types of ingredients as we keep prices low for our members, and the opposite is often true when prices fall, as we feel the margin relief faster while also being able to lower prices more quickly than our competitors. An example of this during the quarter is our croissant program, where we held prices lower when butter costs were elevated and are now seeing margin relief as those costs have come down. Food and sundries margin also increased during the quarter. In this case, we were able to lower egg prices by approximately 10% and butter by $1 per sell unit, or approximately 7%, while also returning margins to more normal levels.

Speaker 1
11m 52s

Lastly, in core-on-core, non-food margins were up slightly worldwide but down slightly in the U.S. Ancillary and other businesses' gross margin was higher by 30 basis points and 27 basis points without gas deflation. Improved margins in gas and e-commerce were the main drivers of the increase. LIFO negatively impacted the gross margin rate by 23 basis points, both with and without gas deflation. We had a $130 million LIFO charge in Q3 this year compared to an $11 million credit in Q3 last year. I'll share more color on LIFO and inflation a little later in the call. Other was lower by two basis points, both with and without gas deflation. This relates to the catch-up accrual for the increased employee vacation days included in our March 2025 employee agreement. This change impacts gross margin for the employees who work in our supply chain and/or manufacturing departments. Moving now to SG&A. Our reported SG&A rate in the third quarter was higher or worse year over year by 20 basis points, coming in at 9.16% compared to last year's 8.96%. SG&A was higher or worse by 11 basis points adjusted for gas deflation. The operations component of SG&A was higher or worse 13 basis points and 5 basis points without gas deflation.

Speaker 1
13m 18s

This increase was due to our investment in employee wages, partially offset by sales leverage and productivity improvements. The incremental year-over-year impact from this year's March employee agreement was mid-single-digit basis points, on top of the low double-digit basis point impact from our July 2024 wage increase. We will lap the July increase 10 weeks into the 16-week fiscal fourth quarter. Central was higher or worse two basis points and one basis point without gas deflation. Stock compensation was lower or better by one basis point, both with and without gas deflation. Pre-opening was higher or worse by one basis point, both with and without gas deflation, driven by more new warehouse openings in the quarter this year. Other was higher or worse by five basis points, both with and without gas deflation, reflecting the catch-up accrual for higher vacation days in our 2025 employee agreement. Below the operating income line, net interest in Other was $50 million this year versus $87 million last year. The difference year over year was largely attributable to foreign exchange. In terms of our income taxes, our tax rate in Q3 was 26.2% compared to 26.4% in Q3 last year. Turning now to some key items of note in the quarter.

Speaker 1
14m 40s

Capital expenditure in Q3 was approximately $1.13 billion, and we estimate CapEx for the full year will be a little over $5 billion. Taking a deeper look into core merchandising sales, fresh category comparable sales were up high single digits. This was led by double-digit growth in meat, with produce also performing very well in the quarter. Non-foods also had comp sales in the high single digits. Our buyers continue to do an excellent job finding new and exciting items at great values, which are resonating well with our members even as they remain very choiceful in their spending on discretionary items. In the quarter, gold and jewelry, majors, toys, housewares, and home furnishings were all up double digits. While we continue to grow share in most non-food departments, we are seeing some deceleration in year-over-year growth as we start to lap tougher compares in bullion and gift card sales from a year ago. Food and sundries had mid to high single-digit comps, with cola and frozen food showing the strongest results. In addition to lowering prices on butter and eggs, a few other examples where we were able to lower prices in the quarter to provide greater value to our members included two-liter Kirkland Signature organic extra virgin olive oil from $24.99 to $18.39, Kirkland Signature chocolate macadamia clusters from $17.99 to $14.69, and Kirkland Signature organic mixed nut butter from $8.69 to $7.59.

Speaker 1
16m 16s

As Ron mentioned earlier, we are continuing to move more items to locally sourced production, which is allowing us to lower prices in those markets. A notable example in the quarter was our Kirkland Signature ultra-clean laundry products. These SKUs are now sourced in Asia for our APAC warehouses, allowing us to significantly lower transportation costs and reduce member prices in the region by approximately 40%. In the U.S., we are sourcing more American-made goods where available, including items such as mattresses, pillows, and plastic resin goods. New KS offerings are another way we are delivering more value to members. These items typically offer members 15%-20% value compared to the national brand alternative with equal or better quality. In Q3, we launched over 40 new KS items, ranging from mini muffin bites to smoked pork ribs and various new apparel items. Within ancillary businesses, pharmacy and optical departments led the way. We are able to bring significant value to our members in Optical through the combination of our labs, which manufacture our own high-quality lenses, coupled with great prices on a wide range of frames, including luxury brands. Gas comps were negative low double digits during the quarter, driven by a lower average price per gallon.

Speaker 1
17m 37s

I'll now share some additional color on inflation and tariffs. Fresh and food and sundries inflation remained relatively similar to last quarter. In non-foods, we saw low single-digit inflation return for the first time in a number of quarters. This was driven primarily by imported items. As a reminder, about a third of our sales in the U.S. are imported, and about two-thirds of those sales are in non-foods. Items imported from China represent about 8% of total U.S. sales. The inflation experience in non-foods was the primary driver of the $130 million LIFO charge for the quarter, which is calculated comparing the net landed cost of inventory at the beginning of the fiscal year with the net landed cost of inventory on hand at the end of the current quarter. Based on our LIFO accounting methodology, if the current rate of inflation is maintained until our fiscal year end, we would have an additional $40-$50 million LIFO charge in the fourth quarter. Any change in the level of inflation in the fourth quarter could increase or decrease the size of that charge. As we navigate an evolving environment with tariffs, we are working closely with our suppliers to find ways to mitigate the impact on cost, including moving production and sourcing to other countries where it makes sense to do so.

Speaker 1
18m 57s

As Ron mentioned earlier, we are leveraging our scale and global operations to help inform this approach. At Costco, we remain committed to providing quality items at the lowest possible prices, and raising prices is always seen as a last resort. The evolving landscape with tariffs is adding complexity and challenges for how we operate our business, but we believe our expertise in buying and limited SKU count model give us greater agility to navigate the environment and ultimately increase our member values compared to the market. The global supply chain remains relatively stable, although, as previously shared, shipping delivery dates are generally less predictable than they were pre-COVID. While the spot rate for shipping containers has increased recently in response to a short-term increase in demand during the window that reciprocal tariffs have been paused, our shipping is generally covered by contracts, and so we have not seen any material impact. Turning now to digital and e-commerce, we continue to make progress with technology. As shared on last quarter's call, one of our key focus areas is building capabilities to deliver more personal, relevant experiences for our members, helping them save time and money. In the third quarter, successes included a targeted Mother's Day campaign to members who had purchased traditional Mother's Day gifts last year and the launch of a personalized product recommendation hub for members, showcasing items based on previous browsing history, new items they might find relevant, and best-selling items in their geographical area.

Speaker 1
20m 32s

Gold and jewelry, toys, health and beauty, majors, housewares, small electrics, and apparel all grew double digits year over year. We continue to grow share in big and bulky items sold online, powered by our investment in Costco Logistics. The combination of great values and the delivery experience that includes installation and haulaway of old items is resonating extremely well with our members and resulted in a 31% increase in items delivered in the quarter. Costco Next, our curated marketplace, also continues to show healthy year-over-year growth. In Q3 fiscal year 2025, our sales on Costco Next equaled our total sales for all of fiscal year 2022, and we are excited about the pipeline of new vendors in development for future rollout. Finally, in terms of upcoming releases, we will announce our May sales results for the four weeks ended Sunday, June the 1st, on Wednesday, June the 4th, after market close. That concludes our prepared remarks, and we will now open the line up for questions. Thank you. We will now begin the question and answer session. If you have dialed in and would like to ask a question, please press star one on your telephone keypad to raise your hand and join the queue.

Speaker 1
21m 51s

If you would like to withdraw your question, simply press star one a second time. If you are called upon to ask your question and are listening via speakerphone on your device, please pick up your handset and ensure that your phone is not on mute when asking your question. To be able to take as many questions as possible, we ask that you please limit yourself to one question. Again, it is star one to join the queue. Our first question comes from the line of Simeon Gutman with Morgan Stanley. Your line is open. Hey, everyone. I wanted to ask Ron, since he's in the room. Costco has continually invested in price, and the nice thing is that you do not really have to catch up over time. Curious what you are telling the merchants right now, given this moment in time. Do you put the pedal to the metal in anything different about the posture? Are you seeing in places where price you are holding relative to the market, are you seeing tonnage and unit volume actually change meaningfully? Thanks. Very good question, Simeon. It's quite complicated, as Gary said now, as we're dealing with the moving tariff scenes as things continue to change each day.

Speaker 1
23m 6s

We have been very fortunate with some of the key commodities coming down, and then our buyers are immediately the first ones down on those goods. We take every advantage of every opportunity that we can lower prices. We have seen our competitive landscape improve slightly at the latter part of the quarter, which is very good for us. It means that we're doing the right thing, but we're going to continue to invest in price. It's what we do. It's how we grow our business, and we're going to continue to try and mitigate as much of this impact on tariffs as we can for our members. As we've always done, it's full force ahead on lowering prices where we can. Okay. Thank you so much. Our next question comes from the line of Christopher Horvers with JP Morgan. Your line is open. Thanks. Good evening, guys. Quick follow-up on that last question and then an add-on. Ron, when you mentioned that it improved in the latter half part of the quarter, is that because your peers are raising prices? How are price gaps changing given the inflation that's going on out there? Secondly, as you think about the March-April period, you did extremely well in the non-foods category.

Speaker 1
24m 24s

Clearly, a lot of that is share. To what extent could you quantify pull forward in some of these tariffed items that you saw in the end of March, beginning of April? Thanks very much. You're welcome. I think that the delta improvement has really been a very hard focus on movement and trying to work with our suppliers and lowering price wherever we can. I truly believe that we are the first one down whenever we have those opportunities, and that does create that improved delta for us. We are watching pricing daily, if not hourly, on every key commodity. You have commodities like butter and eggs come down. There is quite a halo effect to many different items. Our buyers are on top of that, talking to all the suppliers that would benefit from those reductions in cost and trying to really move those products into lower cost as soon as we can. I cannot speak for the others, but I can speak for us. It is about lowering the prices as soon as we can and taking advantage of those opportunities. As far as non-foods, yeah, we did. As we saw things starting to build on this tariff front, our buyers were very proactive, and they pulled a lot forward.

Speaker 1
25m 31s

A lot of our summer goods, most of our patio program, our sporting goods program, got in early this year, got it in ahead of the tariff impacts. That allowed us to hold prices or come just slightly up on prices when we needed to be. That has really helped. Some key categories that we have had good, healthy inventory on, such as furniture. Appliances are not so much impacted, which has been a big driver for us, and non-foods as well. It was strategic movement of goods. Like I spoke about, things that were hit with a higher tariff, we partnered with our other regions around the world where non-U.S. tariff impacts. Anything in terms of how much demand maybe pulled forward? I think that we saw slight impact on it. To quantify it, it was very tough to do. It was very tough to quantify that we saw any certain percent of a pull forward of the fear of tariffs. Got it. Thanks very much. You're welcome. Our next question comes from the line of Michael Lasser with UBS. Your line is open. Good evening. Thank you so much for taking my question. Gary, it seemed like you were sending a reminder that you will soon lap this outsized growth from precious metals and gift cards.

Speaker 1
26m 51s

To what extent should we recalibrate our expectations as Costco laps some of those outsized gains? If you can quantify that, that would be super helpful. At what point does Costco just reach a limitation to its rate of growth in the U.S.? The company's got to be mindful of depleting the overall membership experience as these clubs get so busy, and it's difficult to find parking. It's difficult to navigate through the store. It takes a little longer to get in and out. What percentage of your clubs in the U.S. would you say are currently at that level or approaching that level? Thank you very much. Hi, Michael. Yeah, thanks for the questions. Just to cover the first part, I think Ron will jump in on the second part of the question. Yeah, we were sharing on the call. You may recall we'd been sharing on previous quarters that we were up double digits in non-foods, and we were high single digits this quarter. Part of the commentary that I shared was to remind you that some of that would be a reflection of the fact that we are cycling bullion starting to flow through on a year-over-year basis, particularly online.

Speaker 1
28m 3s

Also, gift cards. We had a particularly strong program of gift cards last year. As we cycle those, you saw still very strong non-food sales and strong market share gains, but the number would have decelerated into that high single-digit range. I think it's kind of difficult to predict, obviously, where the consumer behavior goes in the future because of some of the things that Ron mentioned around the uncertainty. Also, when you look at our individual month-to-month data, we obviously are sharing very transparently every month what our sales results are. There are going to be periods where, like we shared earlier in April, where there's probably, if you look at individual item categories like consumer electronics and even in paper products, it looked like a higher level of sales in April because of that. You probably see a little bit of relief in some of those areas flowing through in the next couple of months. I wouldn't really say we have anything other than confidence in what our buyers are doing in finding great quality items at great value and newness in terms of new and exciting items for the member. Everything we're still seeing right now would be that sort of the state of the consumer is that they're very focused on those three things, but where you can meet those three things really well with value and quality and newness, our members are still spending and buying non-foods items.

Speaker 1
29m 18s

We think that the teams are doing a great job, and we continue to see opportunity to grow in that space. On the operations side, it is a strategic priority for all of us in the company right now to continue to how we improve the member experience in our high-volume warehouses. As we speak about the fourth quarter openings, about 80% of those warehouses we're opening are going to cannibalize high-volume locations for us. That's going to take some relief off. We strategically look at new markets for openings, but with a real importance on strategically cannibalizing those warehouses where we can make that improvement of member experience in there as well. The recent expansion of gasoline hours was a great indicator that the throughput for our members improved nicely, and we saw that immediately in gallon increases. On the technology front, we've realized with some of these pilots, as we are working through these different systems to speed up the front-end experience and get that moving flowing quickly, the backside of that is it turns over parking spaces quicker. When you turn over parking spaces quicker, it makes the whole experience better. We are very mindful of the high-volume warehouses we have, and we're strategically working on many different fronts to how do we continue to grow the volume in those existing buildings and continue to infill and look for new markets in the U.S. as we do in all the regions around the world.

Speaker 1
30m 42s

I guess maybe just one thing to add to Ron's comment, Michael, as well. I think you see in our 10K each year, we show the year-by-year sort of vintage of our warehouses. And I think the ones that Ron's particularly talking about are where we have that over $400 million of sales, which is, I think, what, 40 or so warehouses where we're in that sort of category. They are the highest priority there. I think as we do that, there's still tremendous growth in the less mature warehouses, and we see year-over-year continued growth. I think that gives us a lot of confidence that while we make those enhancements that Ron mentioned, we still have significant opportunity with the vast majority of our warehouses to continue to grow and for them to look and to mature like our higher sales warehouses today. Thank you very much, and good luck. Thank you. Our next question comes from the line of Scott Chickarelli with Truist. Your line is open. Good afternoon, guys. Appreciate the time. I think you guys have increased your EBIT margin on a year-over-year basis now by eight or maybe nine quarters in a row, however slight, even though we've had a pretty funky macro environment, tariffs obviously being the latest piece of that.

Speaker 1
31m 50s

Is there any reason we would see that trend change over the next few quarters? Because it does seem like it's a bit of a conscious decision, not just randomness. Thanks. Hi, Scott. Yeah, thanks for the question. I would say overall, I know I mentioned this last quarter as well when we talked about the gross margin rate, that we really are probably less focused than you might think on the individual quarters. We're more really focused on how we manage the business for the long term. You are going to see, I think, individual fluctuations quarter by quarter as we make decisions to invest in the business at certain times to grow the company. Certainly at other times, like we saw in this quarter, of course, with gross margin rate in particular, we saw some real benefits in fresh productivity and lower spoilage and also some of the benefits of deflation in certain commodities. I think it's fair to look at our model over the longer term. I wouldn't particularly pick a number of quarters, but I think over the longer term, looking at generally how we've been able to grow the business and grow profitability. I think our philosophy overall is, as I know you've heard probably my predecessor, Richard, say this many times, is that our goal is to continue finding ways to drive value for our members, lowering our prices consistently and doing that through our global buying, doing that for in-country production, Kirkland Signature growth, as Ron mentioned earlier, and even some of the newer opportunities like e-commerce growth and getting more profitable in e-commerce and building the retail media business.

Speaker 1
33m 14s

In all cases, our philosophy is how do we take 90% of that value and give it back to the member to drive top line? We do think over time we can still be increasing our margin a little bit as part of that plan. That is our overall philosophy. We would not particularly guide to, we do not guide at all, as you know. We would not guide to thinking about an individual quarterly cadence, but that is more philosophically how we think about growing the company. Understood. Thank you for the time. Our next question comes from the line of Zihan Ma with Bernstein. Your line is open. Great. Thank you for taking my question. Gary, I wanted to follow up on your LIFO comment. Clearly, a lot of your peers use rim inventory accounting, which is likely going to drive margins maybe in the opposite direction in the next quarter or two. For your LIFO estimates about the other kind of $40, $50 million of LIFO charge in Q4, am I reading that correctly? You're suggesting a moderation in the LIFO impact in Q4 and in the coming quarters. How should we compare that to in the 2022 period where you had more of a full 12-month impact of LIFO headwind?

Speaker 1
34m 27s

How does today's environment differ from then? Thank you. Sure. I'll maybe break the question into a couple of parts because I think it's probably helpful just to explain how I hate to get sort of too technical on the accounting side, but just at least give a brief explanation of how we follow rules in calculating our LIFO charge. Essentially, and you may recall, the first two quarters of this year, we were seeing slight deflation in non-foods. We actually had a credit to our LIFO charge for the first two quarters, largely because foods and sundries and fresh were generally sort of fairly stable and sort of low inflation, which continues to be true, and non-foods being deflationary. In the third quarter, we saw non-foods start to become slightly inflationary. Because of the way our LIFO calculation works, we're essentially estimating for the full year what the LIFO charge will be. We're saying, what will our inventory net landing cost of an item times the number of items that we have in inventory at the end of the year? How will that cost compare to the cost at the start of the year? What we do is we sort of calculate what we estimate that will be for the end of the year, and then we take the proportionate amount for the number of quarters.

Speaker 1
35m 37s

If you think about the third quarter, we saw higher inflation. As we were calculating out, our point estimate for the end of the year based on that calculation is about $145 million, call it, for the full year based on the current inflation rate that we're seeing. We had to take three quarters or not quite three quarters, 9/13, so 9 periods out of 13 periods in the year-to-date catch-up in the quarter alone. The $130 million charge is not a charge for the quarter. It is really a true-up for the whole of the year for our estimate of inflation. Because we will have four-thirteenths of that charge in the fourth quarter if inflation stays the same, that is where the $40 million-$50 million incremental charge comes in in the fourth quarter. Really, all of that is getting us to the same data that we are looking at today, which is saying we believe there is inflation in our system because of the higher cost in non-foods. The inflation rate has turned slightly positive on non-foods. We are estimating based on current inflation rates that we see the charge for the year will be $145 million. We have had to catch that up in the first three quarters.

Speaker 1
36m 40s

It is a $130 million charge in the first three quarters that we show in Q3, and then there will be an incremental $40 million-$50 million charge in Q4. That $40-$50 million estimate is really just based on what our current inflation rate is. If that inflation rate stays the same, if the tariff situation does not really change materially, that is our best estimate of what that outcome would be for the year. If we were to see higher tariffs, which led to higher cost of goods, or lower tariffs and lower cost of goods, that could move that number up or down, and we would have to true it up for the whole year in the fourth quarter because it is an estimate of the inventory value at the end of the year. I'm sorry if that was a bit long-winded, but I was trying to make sure I'm giving you kind of how the math works because it could feel a bit misleading that we're saying there was $130 million of inflation during the quarter, but it's really a true-up for the first three quarters of the year. I would say, in general, that still means that inflation is below where it would have been back in the post-COVID period.

Speaker 1
37m 41s

Our inventory levels are anywhere between $12 billion-$13 billion. If you think of a charge of $145 million of LIFO charge, that's really only 1-1.5% of inflation overall within our LIFO calculation. It's still relatively low overall inflation, but it certainly is a change in trajectory from what we were seeing in the first two quarters. That's very helpful. Thank you. Just a quick follow-up. Does that of that bleed into the first half of next year as well? It really depends on what happens with inflation going forward. We'd take the new level of inflation at the end of the fiscal year, and then our LIFO forecast for 2026 would be based on whether we think the amount of inventory and the net landing cost of the product will increase in that year. It really depends on it. There wouldn't be a carryover from current inflation into 2026, but if inflation was to rise again, that could create a higher LIFO charge in 2026 or a lower LIFO charge if tariffs were reduced. Right. Very helpful. Thank you. Just to clarify, the LIFO charge, the $12 billion-$13 billion is for U.S. inventory because we're still on the retail method for most of our international countries.

Speaker 1
38m 58s

It is really based on our U.S. business that the LIFO charges incur. Right. Thank you. Our next question comes from the line of Greg Melich with Evercore ISI. Your line is open. Hi, thanks. Just one quick clarification and then follow-up on digital. On the inflation in grocery last quarter, you said it was slightly positive. Was that around 0.1%? Is that the sort of range we are talking about? Yes, it would be in that range. Maybe just slightly higher than that, Greg, but you are in the right ballpark. Low single digits for sure. Again, very similar to last quarter. In grocery, it is a bit like it has been for the year to date. There are some items that are inflationary within grocery. While egg prices have come down, as we mentioned earlier on, within the year, they're still inflationary compared to what we would have seen in eggs last year. Things like pulp are still inflationary as well within grocery. Then you've got butter and flour cheese and some of the dairy items that have turned deflationary. There's quite a bit of moving parts in there, but it really hasn't changed that materially since the earlier part of the year overall.

Speaker 1
40m 10s

What I'd love to do is a little deeper on digital, just given the double mid-teens growth. Could you just level set us now on what percentage of the business is digital? Particularly that Costco Logistics, up 31%. What percentage of e-commerce is now done through Costco Logistics? Yeah. On the first part of the question, it depends on the definition you use. If you just do the sort of math on our business and how we define digital, which, as a reminder, does not include the delivery solutions that we offer through Instacart. It does not include our travel business where most of it would be online. There are a number of elements that I think others might include in their sort of e-commerce business that we would not. On the straight math on how we define it, it would be about 8% of our business. If we included some of the components that others would include, it probably takes it to slightly north of 10%. If you take gas out of our total sales, which I know obviously there is not an e-commerce element to gas, it is around the 12% of total sales that we generate today, Greg. In terms of Costco Logistics, this is Ron.

Speaker 1
41m 27s

It's about 20-25% of our total deliveries for Costco Logistics, but it is about 80-85% of our big and bulky. We don't run our buyers make decisions of what to put through that network and what not to put through it. They look for the best cost delivery source. We know that big and bulky, patio, furniture, televisions, safes, those kind of things, all but the super specialty stuff, we run through Costco Logistics. A big chunk of that business is going through the network of big and bulky. Is there any members that haven't used your digital yet in some way, shape, or form? Or is it still only half the people that really use it? Yeah. It's over half that have downloaded the app for sure, but there's still plenty of opportunity for growth in our mind. We still see it as an area where we'd expect to outpace our overall growth. As we continue to improve the member experience with enhancements every quarter, Greg, around whether it's the inventory available on the app or improving the search functionality, improving the way in which we communicate with members, as I talked about earlier on the call, we believe all of those things are going to drive more digital engagement.

Speaker 1
42m 38s

We think tied to even some of the comments that Ron was making about speed of checkout, where members use the digital wallet and have their payment card integrated within the wallet, it significantly increases the speed of checkout through the check lane in the warehouse as well. We still think there's plenty of opportunity to keep driving higher penetration of digital engagement with our members. We think it's got a runway to continue to grow in the future. Great quarter, and thanks for the details. Sure. Thank you. Thank you. Our next question comes from the line of Chuck Graham with Gordon Haskett. Your line is open. Thanks. Good afternoon. Ron, you called out some technology efforts at the front end as an opportunity. Could we double-click on that a little bit? With regards to the extended hours of operation at the gas stations themselves, have you thought about testing that within the clubs? Thanks. Sure. The first question, yeah, as Gary said, we found that digital really enhances the speed of checkout. We are really working hard on the digital membership card usage as well. We've also engaged in some Scan&Go done by Costco kind of tests that we're doing out there that have been extremely successful of moving people through the lines and expediting the transactions.

Speaker 1
43m 54s

We've seen some very, very early results have been very positive and great adoption from our members seeing that as well. We're just looking at the whole overall. Our operations team is really focused on the front ends, and we know there's many benefits to that part of the Costco experience of moving people through much better. It really is using the digital enhancements that we have available today, and we think we'll see some good things going through there. Yeah, we continue to look at the hours of the operation as well. Gas has been very creative to scale in growth in our sales in the gas business. We continue to look at the operation side of things as well, the warehouse hours. Great. Thank you. Our next question comes from the line of John Heinbockel with Guggenheim Securities. Your line is open. Hey. Quick one for Gary, one for Ron. I know you got a depot opening in Florida soon. Can you remind us on the supply chain side, distribution, transportation? What's the opportunity there to continue to lower cost from where we are now? Ron, have you made any changes with regard to tariffs on how you think about receipts, demand planning over the next, I don't know, six months, and how you flow that in?

Speaker 1
45m 16s

It's harder maybe for you to chase inventory, but how do you attack that, if at all? Thanks, John. On the depots, I think that it's certainly interesting being relatively new to the company to see really how efficiently we operate our depot network. As I think you may be familiar with, we generally are not really holding inventory in any of the depots. We're moving product straight through. I think it ties a little bit to your point of, as we grow in scale, how do we make sure we optimize the network to be even more efficient just because of the scale of operations that we have now? We know that when we look at our most productive warehouses and highest volume areas, we see incremental leverage that's created in our overall financial model. I do not think there would be anything we would call out as being a change in strategy, but certainly continuing to invest capital in places where it makes sense to optimize the network for depots, we think can help continue to improve our efficiency. I think the second part of it would probably be more in e-commerce as we are growing that business. We have built out the Costco Logistics network and invested in, especially on the west side of the country, I would say.

Speaker 1
46m 20s

When we acquired Innovel, there was a strong presence in the east, less presence in the west. We built out that network. I think it is part of how we keep showing improvement quarter over quarter in the other gross margin line where e-commerce continues to improve. Part of that is really leveraging those investments to drive more scale and more efficiency in our e-commerce operations. That's probably the bigger area where you see it now results quarter to quarter. The question on strategic planning of future buying, yes, our buyers are extensively going through short-term, mid-term, and long-term strategies as far as buying goes. As you know, the continuous changing environment out there has presented a lot of opportunities for that group to stay on top of this. We're having to make some decisions based on the current information that we know today. As you can imagine, with our volume and the size of our company, our commitments are six-eight months out for supply with a lot of our suppliers. In doing that, we're empowering our buyers to make decisions now based on the importance of the item. Is it something that we can replace with something domestically here, or is it something that we need to go ahead and move on quickly and bring in prior to any future tariff increases?

Speaker 1
47m 35s

They have a strategic plan out there. They're looking at different areas. We went through a lot of this exercise during the COVID days when you could not get goods out of China for a different reason. It is the shipping backups that we had there. I think our buying, and I know our buying team, executed great results during those periods of being very nimble and going out and finding new places that bring value and quality to our members. We are going to remain nimble. We are going to make good decisions. The nice part is we do have some non-U.S. business that we can work closely with. If we do get caught with something at a higher tariff rate that we do not feel would be something good for our members here in the U.S., we can work with the other regions to move goods out there as well. Thank you. You are welcome. Our next question comes from the line of Rupesh Parikh with Oppenheimer. Your line is open. Good afternoon. Thanks for taking my question. Two quick ones for me. Just going back to the core and core margin improvement, Gary, do you expect some of the positive drivers you saw during the quarter to continue near-term?

Speaker 1
48m 36s

Second, just on tariffs, just given maybe there are some hopes out there that some of these tariffs will be rolled back. If we do see that, would you expect your vendors to reduce some of the tariff-induced price increases? Yeah. Thanks, Rupesh. On the core gross margin, I would say some of those were fairly unique to the quarter in the sense that the adjustment that we saw around some of the deflation in some of the ingredients that I talked around, around butter and eggs and dairy. I think, as you know, we continue to look for ways to invest in the member to drive top-line growth in our sales. I think, again, versus sort of maybe talking about what might happen in the next few quarters, I think of it really sort of reflecting what I shared earlier in the call, where how can we continue to invest those dollars to drive more value for the member, drive top-line growth in the company? I do think that we've been able to be somewhat nimble in that if there are continued impacts on inflation in non-foods, obviously we could see some impact there where we're giving back to the member essentially to try and hold on some of the increases there and the benefit that we've had on things like fresh in particular, where you look at the productivity improvements and spoilage improvements.

Speaker 1
49m 47s

Obviously, those are the things that can potentially fund our investments in other areas to ensure that we're delivering more value for the member. I think we'd look at it more on the longer term versus the short-term benefits, but we'll continue to look for ways to invest to drive top-line growth in the business. I think from a tariff rollback, it's kind of really difficult to predict. Obviously, we're operating in really a dynamic environment, and we're staying agile. I think all of our suppliers are staying agile. Really, the focus is on how do we react to the moment and make sure that we're there for our members in managing prices of the products and continuing to find the most relevant items for the member. It's a little bit difficult to predict what might happen around the corner. I think, as Ron mentioned earlier, we believe we're, because of our limited SKU counts and the expertise of our buyers and that long-term commitment to our suppliers that we have, we believe there's opportunity for us to continue to widen our value versus the market as we adapt to the changing environment. Great. Thank you. Our next question comes from the line of Kelly Bania with BMO Capital Markets.

Speaker 1
50m 55s

Your line is open. Hi. Good evening. Thanks for taking our questions. Just wanted to try and see if we could understand your stance on inventory planning here. You made the comment that raising prices is a last resort, which is clearly consistent with Costco's pricing philosophy. As we look out into the back half of this year, can you give us a sense of how much price that might not be able to mitigate that might end up having to be passed on and how that could impact your units, particularly on the discretionary side of the business, how you might be planning those? I guess also with respect to inventory, are you seeing an environment that is supporting an elevated level of opportunistic buys in this dynamic environment? Sure. Thanks, Kelly. I think, as I mentioned a moment ago, it's just such a dynamic environment right now that really the focus that we've had in our buying teams is really staying agile to manage the situation. I think I mentioned on the prepared comments, a lot of the focus the team has right now is as we look at the impact of tariffs, where are the places we can work with our suppliers to find ways to be offsetting some of the impact of those?

Speaker 1
52m 18s

Where are places where we could potentially be sourcing with them from different countries, if that's practical, to minimize the impact? In some cases, we're also looking at, I think, a benefit of being a limited SKU count model is we can look at rotating into different items and finding different assortment that makes more sense for the member. I think to answer your question, it's probably difficult to say in general terms because it really depends on the individual items and looking at how do we make sure we're delivering the best value for the member and delivering the right items that will really resonate with them and drive the volume that will allow us to keep those prices very low and really kind of doing it item by item. I'll give you a couple of examples that might be helpful. As we looked at what happened with fresh, for example, during the last quarter, we saw inflation as a result of tariffs because we import certain fresh items from Central and South America. On pineapples and bananas, for example, because they're key staple items for the member, and we felt it was important to really eliminate the impact there for the member by working with our suppliers and by us finding efficiencies and accepting that there may be a margin impact, we essentially held the price on those to make sure that we're protecting the member.

Speaker 1
53m 39s

When we looked at we also sourced flowers from Central and South America. We looked at that item and decided that while we were able to offset some of the tariffs through similar activity, that we did increase some price there because we felt that that was something that the member would be able to absorb, and it was more of a discretionary item there. If I look at the non-food examples, we're starting to look now because of the potential impact of tariffs is where are there places where there are items that are produced in the U.S. where we might have opportunities to lean in more to some of those items and deliver great value? It might be live goods, mattresses and pillows I mentioned, I think, in the prepared comments on the call, even U.S. outdoor furniture. Some of these areas where we think there could be opportunities to really deliver value for the member when there are maybe some places where that value might not be there because of the impact of tariffs. Health and beauty would be another good example, I think, in nutritional items that have grown really strongly for us, and we see strong continued appetite for those items from members.

Speaker 1
54m 39s

Looking to really see where there are opportunities to buy great items at great quality and value for our members there as well. Thank you. I was curious if I could just follow up with a question on the Affirm partnership and the thought process there. Clearly, Costco has maybe a more defined set of payment options for members than typical retailers. Just curious if you tested this and what you expect to get out of this. Is it just more support for kind of the big and bulky purchases? Just any thoughts there? Yeah. It's very much as you described, Kelly. Actually, we saw partly because Affirm has a white label product, if you like, where it's offering service to members, that there were some Costco members that were already using Affirm as a solution for part of purchasing certain products at Costco while not coming through our ecosystem and not getting the full value from Costco with the exclusive pricing that we can offer to members on the Affirm product when it's through our website and through our digital solutions. As we looked at the growth that we're seeing, which has been very strong in many of those big and bulky and large purchase items, we recognize there are some members that want to be able to structure those payments over a period of time.

Speaker 1
55m 59s

We believe it's an opportunity for us to be able to deliver more value for the member by having exclusive pricing there while also giving them more options in the way in which they can buy the product. Thank you. Our next question comes from the line of Kate McShane with Goldman Sachs. Your line is open. Hi. Good afternoon. Thanks for taking our question. The numbers really do speak for themselves when it comes to membership growth. We wondered if there was anything to note, just given that it's been several months since the price increase, in terms of any kind of member response. Internationally, have you seen any kind of impact from Costco being a U.S. brand? Yeah. Thanks, Kate. Overall, on membership, I'd say we're very pleased with the metrics. We tend to look at it across renewal rates, continued sign-up activity overall, and then is the membership count and the income growing. When we look at those three metrics, we're pleased with the overall direction that we're seeing in all of those metrics. It's a little bit early in the renewal calculation still to have a really good feel for any impact from the membership fee increase.

Speaker 1
57m 14s

We'd just be starting to see some of that enter the number now, but nothing that we'd flag as material in the numbers that we're seeing in renewal rate. I think, as we shared before, we really haven't heard a lot of member feedback. I think the fact we waited seven years to increase the fee when we typically would do it in five. There was a level of understanding it may be coming and also holding on many prices around the hot dog and the rotisserie chicken at times when inflation was higher as well. Nothing in general I would call out there. Overall, in terms of the international business, to your question, I would say that our members are very vocal in sharing feedback. I think we certainly hear some feedback from members that they wish the relationship was better today between the countries. In terms of sales growth, as you saw in our published numbers, we continue to have really strong sales growth in Canada and internationally. In fact, I was just looking this morning, all of our international countries had positive comp growth during the quarter as well. There is really nothing that we call out other than I think there is definitely a recognition that there is tension at the moment between the relationships.

Speaker 1
58m 24s

Thank you. Our final question comes from the line of Peter Benedict with Baird. Your line is open. Hi, guys. Thanks for sneaking me in. I guess a question on the renewal rates. I know you flagged that they would be coming in a little bit because of the nature of the past sign-ups. How long do you think this persists? When do you think it may stabilize? Any theories as to why these digital members renew at a lower rate? Do you have any strategies to address that? Is it just the nature of the member or the new customers that are signing up? Just curious your thoughts on that. Thank you. Yeah. Thanks, Peter. I'd say overall, we expect it's likely to continue for a while. You may recall last quarter, it bumped up by 20 basis points. This quarter, it bumped down by 30 basis points. You kind of have this lag of periods of time where we've got these digital promotions that we're doing that are coming into the calculation. There are some members that are taking advantage of a unique promotion there. There are also an average younger age of member in that group as well.

Speaker 1
59m 37s

We tend to see they renew at a slightly lower rate overall within digital. I think this is something that we'd expect to see for a period of time to come because of those factors. You add to that that there wasn't really any impact from this in this quarter. We do have Asian warehouses that open that have a large number of members per warehouse. It can be four to five times the average that we see in the U.S. per warehouse. Some of that is really in the first year, just traveling long distances to come and see the warehouse for the first time. We do see a lower renewal rate on those warehouses. The denominator is big. It does have an impact there as well. I do think you should expect that to continue for the foreseeable future. I think to the second part of your question, that we do see it as an opportunity, especially with the digital members that are as we see more members start to sign up digitally, getting them into the warehouse, engaging with them more through more relevant and personalized communication, there's an opportunity to move those members up the loyalty curve and renewal rates more significantly.

Speaker 1
1h 0m

Part of that, in truth, is also just their maturity in general. When we look at our younger members, they generally renew at a slightly lower rate. It is not a surprise to us that that's the case. We think there's an opportunity for us to improve that renewal rate by continuing to engage with them more effectively digitally and making sure we bring them into the warehouse. That's helpful, Coller. Thanks, Gary. Good luck. Thanks. Ladies and gentlemen, this will conclude our question and answer session and today's call. We thank you for your participation, and you may now disconnect.