



Speaker 1
Start

Ladies and gentlemen, 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 Fiscal Second Quarter twenty twenty five Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. 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 Costco's second quarter twenty twenty five earnings call. In addition to covering our second quarter financial results today, we will also review our February sales results. 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 the numbers, I'm delighted to say that Ron Backris is joining me for today's call.

Speaker 2
1m 52s

I'll now hand over to Ron for some opening comments.

Speaker 3
1m 56s

Thank you, Gary, and good afternoon, everyone. Thank you for joining us today. As we wrap up the second quarter of fiscal twenty twenty five, I'd like to make a few brief comments on some of the highlights since we last spoke. While we only opened one new warehouse in the second quarter of fiscal twenty twenty five, we have big plans for the rest of the fiscal year. Tomorrow, we will open up in Brentwood, California, followed by an opening in Highlands, California the following day and four additional U. S. Openings next week, including our Sharon, Massachusetts opening on March 12, which will be our 600 U. S. Warehouse and the nine hundredth Costco location worldwide. We're projecting 28 new openings during fiscal year twenty twenty five, of which three will be relocations for 25 net new buildings. In addition to adding warehouses to serve our members, we also extended our gas station hours in North America during the quarter to make filling up at Costco more convenient for our members. Generally, our stations are now staying open an hour later than they did previously with some opening earlier as well. Our updated employee agreement took effect this week in The U. S. And Canada.

Speaker 3
3m 8s

This agreement reflects our continued commitment to provide industry leading pay and benefits for our employees. Highlights from the new agreement include an immediate \$1 hour top of scale increase, followed by an additional dollar top of scale increase on March of twenty twenty six and again in March of twenty twenty seven. The top of scale wage for U. S. Service Clerks is now \$31.9 an hour. Additionally, on March 3, our bottom of the scale wage increased by \$0.5 an hour, taking our minimum wage to \$20 an hour. The average wage for The U. S. And Canada employees is now a little more than \$31 an hour, including hourly employee bonuses, with the majority of our employees at the top scale based on tenure. Paid vacations for new employees is now offered during the first year of employment and a six week of vacation is available to U. S. Employees after thirty years of service. Our operations and merchandising teams did a fantastic job in the quarter, delivering strong operating results despite the uncertain macro environment. In particular, our Canada and other international business had an outstanding quarter, delivering record results on a constant currency basis, although reported results outside The U. S. Were negatively impacted by foreign exchange fluctuations year over year.

Speaker 3
4m 32s

As we look ahead to the remainder of this fiscal year, headwinds from foreign exchange look likely to continue. Given events over the last week, it is difficult to predict the impact of tariffs, but our team remains agile and our goal will be to minimize the impact of related cost increases to our members. About a third of our sales in The U. S. Are imported from other countries and less than half of those are items coming from China, Mexico and Canada. In uncertain times, our members have historically placed even greater importance on the value of high quality items at great prices, and our teams will continue to rise to this challenge by leveraging our global buying power, strong supplier relationships and innovation. With that said, I'll turn it back over to Gary to discuss the results of the quarter and February sales. I'll jump back on during Q and A to field some questions.

Speaker 2
5m 26s

Thanks, Ron. In today's press release, we reported operating results for the second quarter of fiscal twenty twenty five, the twelve weeks ended February 16. 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 second quarter came in at \$1,788,000,000 or \$4.02 per diluted share, up from \$1,743,000,000 or \$3.92 per diluted share in the second quarter last year. Last year's results included a tax benefit of \$94,000,000 or \$0.21 per diluted share related to the tax deductibility of the special dividend paid to four zero one participants. Excluding this discrete tax item, net income and earnings per diluted share both grew 8.4%. A couple of additional data points that may be helpful relative to our reported net income. Operating income in the quarter increased 12.3% compared to last year. This was partially offset by a \$70,000,000 year over year headwind in interest and other, and I'll share more detail on these items a little later. And foreign exchange rate movements negatively impacted the translation of international net income to U. S. Dollars by \$57,000,000 or \$0.13 per diluted share.

Speaker 2
6m 54s

Net sales for the second quarter was \$62,530,000,000 an increase of 9.1% from \$57,330,000,000 in the second quarter last year. U. S. Comparable sales were up 8.3% or 8.6% excluding gas deflation. Canada comp sales were up 4.6% or 10.5% adjusted for gas deflation and FX. Other international comp sales were up 1.7% or 10.3% adjusted. And this all led to total company comp sales of 6.8 or 9.1% adjusted for gas deflation and FX. Finally, e commerce comp sales were up 20.9% or 22.2% adjusted for FX. In terms of Q2 comp sales metrics, foreign currencies relative to the U. S. Dollar negatively impacted sales by approximately 2.1%, while gas price deflation negatively impacted sales by approximately 0.1%. Traffic or shopping frequency increased 5.7% worldwide and 5.6% in The U. S. Our average transaction or ticket was up 1% worldwide and up 2.6% in The U. S. This includes the headwinds from gas deflation and FX. Adjusted for those items, ticket would have been up 3.2% worldwide and up 2.8% in The U. S. Moving down the income statement to membership fee income. We reported membership fee income of \$1,193,000,000 an increase of \$82,000,000 or 7.4% year over year.

Speaker 2
8m 33s

Membership fee income growth was 9.4% excluding FX. The recent membership fee increase contributed approximately 3% of fee income in the quarter. Due to the effects of deferred accounting, the majority of the benefit from the membership fee increase will come over the next four fiscal quarters with the largest impact in Q4 fiscal year twenty five and Q1 fiscal year twenty twenty six. In terms of renewal rates, at Q2 end, our U. S. And Canada renewal rate was 93%. The worldwide rate came in at 90.5%. As cohorts of new members move in and out of this calculation, there could be one or two tenths of volatility in the reported number quarter to quarter. The biggest impacts come from digital promotions and Asia warehouse openings, both of which generate outsized membership sign ups, but also have lower renewal rates. We ended Q2 with 78,400,000 paid household members, up 6.8% versus last year and 140,600,000 cardholders, up 6.6% year over year. At Q2 end, we had 36,900,000 paid executive memberships, up 9.1% versus last year. Executive members now represent 47.1% of paid members and 73.8% of worldwide sales. Turning to gross margin, our reported rate in the second quarter was higher year over year by five basis points, coming in at 10.85% compared to 10.8% last year and up four basis points excluding gas deflation.

Speaker 2
10m 11s

To simplify the gross margin matrix provided in our slide deck, starting this quarter, we have incorporated 2% reward as part of the business area which generated the reward. This is split between core and ancillary and other businesses. Core was higher by five basis points and higher by four basis points without gas deflation. In terms of core margins on their own sales, our core on core margins were lower by eight basis points. This decline was due to investments in supply chain to support higher inventory and some mix changes in our non food categories. Ancillary and other businesses gross margin was higher by one basis point and flat without gas deflation. E commerce again showed considerable strength year over year, but this was offset by lower gas profitability. LIFO was lower by one basis point and flat without gas deflation. We had a \$12,000,000 LIFO credit in Q2 this year compared to a \$14,000,000 credit in Q2 last year. Moving on to SG and A. Our reported SG and A rate in the second quarter was lower or better year over year by eight basis points, coming in at 9.06% compared to last year's 9.14%. SG and A was lower or better by nine basis points adjusted for gas deflation.

Speaker 2
11m 31s

The operations component of SG and A was lower or better by seven basis points and eight basis points without gas deflation. Higher labor productivity and great cost discipline by our operators drove this improvement. Central and stock compensation were flat both with and without gas deflation and pre opening was lower or better by one basis point both with and without gas deflation, driven by fewer new warehouse openings in the quarter this year. As Ron mentioned earlier, our new employee agreement went into effect earlier this week. While there was no impact in Q2, we estimate that this will create a headwind to SG and A of 13 basis points from March 3. However, we will also lap a smaller increase from the same points in the prior year, so the net year over year basis point headwind from this wage investment is expected to be mid single digits. Below the operating income line, interest expense was \$36,000,000 versus \$41,000,000 last year and interest income was \$109,000,000 versus \$147,000,000 last year. As indicated on last quarter's call, interest income faced headwinds due to lower cash balances subsequent to our \$6,700,000,000 special dividend in January 2024 and lower interest rates.

Speaker 2
12m 50s

While we expect interest rates will continue to be a year over year headwind for the remainder of the fiscal year, we have now lapped the lower year over year cash balances following the special dividend. FX and other was a \$33,000,000 gain in Q2 this year versus a \$69,000,000 gain last year. In terms of income taxes, our tax rate in Q2 was 26.2% compared to 22.1% in Q2 last year. Recall, last year's rate benefited from a \$94,000,000 discrete item related to the tax deductibility of the special dividend paid to four zero one participants. Adjusted for this benefit, the tax rate for fiscal year twenty twenty four Q2 would have been 26.3%. Turning now to some key items of note in the quarter. Capital expenditure in Q2 was approximately \$1,140,000,000 and we estimate CapEx for the full year will be approximately \$5,000,000,000 Taking a deeper look into core merchandising sales, our nonfoods category led the way this quarter with comparable sales in the mid teens. Our buyers continue to bring in new and exciting items at great values. This included big ticket consumer electronics products such as 98 inches and 100 inches TVs, Stern pinball machines and gaming computers, all of which performed very well during the holiday season.

Speaker 2
14m 16s

For the quarter overall, Golden Jewelry, gift cards, toys, housewares, appliances, sporting goods, home furnishings and small electrics were all up double digits. Fresh in Q2 was up high single digits. This was led by double digit growth in meat, where we continue to see a shift toward lower cost proteins such as ground beef and poultry. Bakery and produce also performed well this quarter. Food and sundries had low to mid single digit comps with Cola and International Foods showing the strongest results. We continue to look for ways to increase the value for our members, both with national brand items and our private label offerings. Our goal is always to be the first to lower prices where we see opportunities to do so and the last to increase prices in the face of rising costs. A few examples of lower prices this quarter include KS refined olive oil single three liter from 29.99 to \$27.99 KS organic peanut butter from \$11.49 to \$9.99 and KS Tortilla Strips from \$5.69 to \$4.99 Another way we have been able to lower prices is by continuing to expand the local sourcing of our bulky private label items across the globe. In Q2, we introduced a KS purified water SKU for the China market that is produced in country.

Speaker 2
15m 38s

By moving production into the region, we were able to bring member savings of greater than 20% versus the prior branded water offering. Our merchants also continue to drive innovation with Kirkland Signature. Most notably this quarter, we worked with a new supplier to rework our Kirkland Signature diapers. Improvements versus the prior offering include a longer and thicker absorbent layer, softer outer cover and two times more stretch in the waistband. As well as improving the quality of this item, we were able to increase the value by 11%. Other new KS offerings this quarter include KS French Fries, KS Vodka and Soda and new KS Lager. Kirkland Signature continues to grow at a faster pace than our business as a whole. Within ancillary businesses, pharmacy and food court departments led the way. In the food court, we have introduced a new strawberry banana smoothie and are excited to announce the fan favorite Turkey Provolone sandwich is making a return in Q3. Gas comps were negative low single digits during the quarter, driven by the average price per gallon being down slightly. Now a few comments on inflation. While there was a fair bit of variability across departments, overall inflation in the quarter was low single digits.

Speaker 2
16m 57s

Fresh was the most inflationary of our categories, driven by Meat and Bakery. Food and sundries inflation remained relatively low as inflation in eggs, cocoa, coffee, cheese and corn were partially offset by deflation in commodities such as sugar, butter and flour. The supply chain continues to be relatively stable, albeit shipping delivery dates are still less predictable than they were pre COVID. In non foods, our buying teams have been proactive in ordering higher levels of inventory over the past year, which has helped support our strong sales momentum and overall we are pleased with sell through rates. Turning to digital and e commerce, we continue to make progress with our technology roadmap. The new warehouse tool in our app, which allows members to view local warehouse item availability and prices had over 43,000,000 visits. On personalization, for the first time in Q2, we sent out multiple versions of our digital MVM, differentiating the message for members based on their previous shopping behavior. We still have a lot of work to do in this area and are excited about the potential to improve the member experience through more relevant targeted messages and experiences. While strength in bullion was a meaningful tailwind to e commerce sales, home furnishings, small electrics, hardware and sporting goods were a few of the other departments that grew double digits year over year.

Speaker 2
18m 22s

Costco Logistics had a record holiday season with over 500,000 deliveries as we continue to grow share in big and bulky items. And Costco Next, our curated marketplace also had record holiday sales. We are now approaching 100 vendor sites and significantly grew average order value in the quarter. Shifting gears to alternative revenue streams, we made some improvements to our co brand credit card this quarter. The card is a great way for members to increase the everyday value they receive when shopping at Costco, offering attractive cash back rates with no annual fee. Executive members who use the card can double their cash back on the majority of purchases in warehouse and at costco.com from 2% to 4%. And last quarter, we increased the reward on gas purchases at Costco locations to 5%. On Retail Media, following our first off-site Retail Media campaign in Q1, we have entered into a number of additional similar campaigns with roughly 10 different partners live currently and many more in the pipeline. Turning now to our February sales results for the four weeks ended this past Sunday, March 2, compared to the same four retail calendar weeks last year. Net sales for the month of February came in at \$19,810,000,000 an increase of 8.8% from \$18,210,000,000 last year.

Speaker 2
19m 46s

Comparable sales for the month were as follows: U. S. Comparable sales were up 8.6% both with and without gas deflation Canada comp sales were up 3.2% or 8.7 adjusted for gas deflation and FX. Other international comp sales were down 0.6% or up 6.5% adjusted. This resulted in total company comp sales of 6.5% or 8.3% adjusted for gas deflation and FX. Finally, e commerce comp sales were up 19% or 20.2% adjusted for FX. Our comp traffic or frequency for February was up 5% worldwide and 5.8% in The U. S. Foreign currencies year over year relative to the U. S. Dollar negatively impacted total and comparable sales as follows: Canada by approximately 6%, Other International by approximately 7% and Total Company by approximately 1.8%. Gasoline prices were flat year over year in the month. Worldwide, the average transaction for February was up 1.4%, including the negative impact from foreign exchange. In terms of regional highlights, U. S. Regions with the strongest comparable sales were the Midwest, the Northeast and Los Angeles. Other international in local currencies, we saw the strongest results in Mexico, Taiwan and Korea. Moving to merchandise highlights, the following comparable sales results by category for the month exclude the negative impact of foreign exchange.

Speaker 2
21m 19s

Food and sundries were positive mid single digits. Cola, frozen foods and sundries were the strongest departments. Fresh foods were up high single digits. Better performing departments included meat and produce. Non Foods were up positive low teens. Better performing departments included jewelry, gift cards and housewares. Ancillary business sales were up low single digits. Pharmacy and Optical were the top performers and Gas was down low single digits on lower volumes. And finally, in terms of upcoming releases, we will announce our March sales results for the five weeks ended Sunday, April 6, on Wednesday, April 9, after market close. That concludes our prepared remarks and we'll now open the line up for questions.

Speaker 1
22m 6s

Thank you. And we will now begin the question and answer session.

Speaker 4
22m 39s

And your first question comes from the line of Simon Gutman with Morgan Stanley. Your line is open.

Speaker 5
22m 51s

Hi, Ron. Hey, Gary. Simeon Gutman. I will ask one question. I want to talk about sales impact and the consumer broadly. Curious if consumers' willingness to purchase either discretionary or nondiscretionary as egg prices are booming, is the consumer cutting back at all? And then it looks like your results don't show an impact, especially in Canada, both in the quarter and in February. But curious if there's any slowing in any places from tariff backlash, etcetera? Thank you.

Speaker 2
23m 26s

Yes. Thanks, Simeon. Yes. To take the first part of your question, the state of the consumer, I guess, more broadly, I think you're right in the way you described it. We're not really seeing any change in what we've seen around our members over the last really few quarters. We believe that the member is probably as much focused now on quality, value and newness as they have been for quite some time. But they are still showing that willingness to spend, but they're being very choice for where they're spending their dollars. And we think that's likely to continue and maybe even become more choice for us, the impact of some return of inflation and the potential impact of tariffs could flow through as well. I'd say we're also seeing a continued sign of what I mentioned last quarter where there's some indication that members are spending a little bit more on food at home versus food away from home overall. So that kind of I guess the macro themes that we see. When we talk about individual categories, I would say on non foods, again I think you characterized it well for us. Our merchants have done a great job of really focusing on those three key themes that we hear from our members around bringing in great items of great quality and great value.

- Speaker 2**
24m 35s
- And while there's examples of that with newness around things like gold and some of the large electronic and gaming items I mentioned, we're really seeing it being fairly broad based across all the categories that I listed on the call earlier. So generally, we're continuing to see strong trends overall in non foods. There are a couple of categories generally that have been flatter, I would say, over recent quarters, consumer electronics and apparel. We believe we're performing relatively well on those compared to the industry, but they are lower trends on those items than they would be in some of the other categories that I mentioned earlier. And we're seeing as I mentioned in some of the prepared remarks, we continue to see great trends on fresh products overall and it's really a bit of bifurcation there. We're still seeing really good growth on the more premium meat items, but we're seeing even faster unit growth I would say on some of the lower cost cut items like ground beef and poultry and pork. So overall, I think the trends that we've seen, we're not really calling out anything significantly different, but of course we're watching very closely and making sure we're reacting to what we see from our members.
- Speaker 2**
25m 44s
- On Canada in particular, as you mentioned, really the results that we reported in February are very much in line with the results that we saw seen year to date. They actually had the strongest overall comp sales when you adjust for FX and Gas out the three reported segments that we talk about with international, U. S. And Canada. But They had a phenomenal Q2. So they did come down a little bit from the trend that we saw in Q2, but still very strong results overall.
- Speaker 5**
26m 10s
- Thanks guys. Good luck.
- Speaker 3**
26m 12s
- Thank you.
- Speaker 1**
26m 14s
- And your next question comes from the line of Michael Lasser with UBS. Your line is open.
- Speaker 4**
26m 20s
- Good evening. Thank you so much for taking my question. With core on core margin being down modestly this quarter, can we take that as a sign that the recent string of margin expansion that Costco has been able to achieve is coming to a conclusion or at least a pause, especially in light of what seems to like going to be a much more inflationary environment and a difficult dynamic with having to manage through the tariffs? Thank you very much.
- Speaker 2**
26m 56s
- Yes. Thanks, Michael. Thanks for the question. I wouldn't really read too much into the individual results in the quarter on the core on core margin. Overall, we were pleased with the fact that the gross margin rate was up four basis points, so a slight improvement while we're still investing in more value for the member. And when we look at the breakdown of that core on core, it was down, as you mentioned, eight basis points. To give you a bit more color on that, food and sundry was actually up slightly, fresh was up slightly, non food was down slightly. So there was sort of a mix change in there somewhat that impacted the number as well. You may have heard me mention on the prepared remarks, but one of the things that was an increased cost during the quarter was higher supply chain costs as we had been continuing to buy more inventory, which we think will be helpful as you think about some of the unpredictability that we've seen in supply chain timing and also with the potential risk around tariffs. And really when we looked at the overall results for the quarter and saw that the core margin overall was going to be up slightly, we have that ability to be able to invest and ensure that we're continuing to take care of the member.

- Speaker 2**
28m 0s
- So we were quite deliberate on that this quarter. But again, I wouldn't read too much into the individual puts and takes. We feel good about the overall margin and our ability to keep investing in the member, while at the same time continuing to deliver the results that we delivered.
- Speaker 4**
28m 16s
- Thank you very much and good luck. Thanks.
- Speaker 1**
28m 21s
- And your next question comes from the line of Christopher Horvers with JPMorgan. Your line is open.
- Speaker 6**
28m 28s
- Thanks. Good evening. So one quick follow-up and then an additional question. Other retailers are talking about weather having a negative impact on some of their more weather sensitive businesses. So I guess turning the question upside down, do you think about the eight plus percent core comp that you saw on the February? Did you see any weather headwinds on your discretionary businesses or was it just simply offset on the ag side? And then on the tariffs, historically foods for things that come from like Mexico that are fresh foods, historically that stuff gets passed through directly to the consumer. How do you think about Costco's stance on that? There's opportunities made with eggs where you're vertically integrated and you can absorb some of the costs. But as you think about stuff like fresh food that's more commodity based, would you just pass those price increases along? Thank you.
- Speaker 3**
29m 28s
- This is Ron. As far as the weather, we experienced the same weather everybody else did the last month. And we tend to capture a lot of that back. It's just not an extended event and if it's not tied to a holiday. So, yes, we saw some hits here and there, but we recovered most of that. And there probably was a little bit of the edge on sales taken off due to some extreme weather in the Northeast and the Midwest. So we feel pretty good about how we handled through those storms. As far as the tariffs go on the grocery items, our buyers deal with those like they would any other cost increase. And there are sometimes the margins are much tighter in those categories, but they're prepared to work closely with the suppliers and see how efficient we can bring goods to market and is there anything we can mitigate in those categories. So the tariffs are very fluid right now, so it's hard to really give any predictions on what we can do. But we are prepared, our people are very well equipped to lower prices and defer any cost increase that come our way.
- Speaker 3**
30m 28s
- So we're going to do all we can should that happen.
- Speaker 2**
30m 31s
- Great. Thanks very much.
- Speaker 3**
30m 34s
- You're welcome.
- Speaker 1**
30m 36s
- And your next question comes from the line of Scott Ciccarelli with Truist Securities. Your line is open.
- Speaker 7**
30m 43s
- Hey, guys. Scott Ciccarelli. With your treasure hunt structure, you guys have a lot of merchandising flexibility. So I guess if we get tariffs rolled into China, Mexico, Canada, would the strategy be more focused on, look, it is what it is, Costco still had the best value for those products relative to others? Or would there be a more aggressive effort to find goods from less tariff impacted countries? Thanks.

- Speaker 3**
31m 9s
- It would be a little bit of both. I mean, you're exactly right with our flexibility of the treasure hunt. There's not many items that we can't find something to replace or something else to bring in, in that category. But, it's going to be a little bit of both of those strategies that we can. As we say, when it rains, it rains on everyone such as a tariff that we're all equal there. And I feel like our people are very well equipped to deal with anything coming our way with our reduced SKU model. And we can we have great partnerships with our suppliers and those items are very important to them as well. So I feel like we are well equipped to deal with whatever is coming our direction. And not knowing what that's going to be, I can't really tell you what the outcome will be. But, our people are nimble and they're ready to go at it if they need to.
- Speaker 8**
31m 57s
- Thank you.
- Speaker 1**
32m 0s
- And your next question comes from the line of Zihan Ma with Bernstein. Your line is open.
- Speaker 9**
32m 5s
- Hi. Thank you for taking my question. So a bit of a follow-up on the international side. First of all, a short term question in terms of the February sales result. Is there any timing just between January and February that led to this sequential slowdown in the other international segment? And longer term, can you just provide an update for us to understand how do you think about the long term international growth runway from here? Thank you.
- Speaker 2**
32m 33s
- Sure. Yes. On the first part of the question, there is some impact from particularly on the Asian markets, the Chinese New Year. We generally because it didn't roll up to be a meaningful enough number at our total company level, we didn't call that in our results. We didn't call it out in the January number specifically either. But yes, I would say you have to kind of look at the two months and combine the two really to understand the trend because of the impact that we would see from the Chinese New Year impacting particularly Korea and Taiwan and China. And then in terms of the long term prospects for our international business, Ron mentioned in the prepared remarks, we had a tremendous second quarter. We were thrilled with the progress that we saw across those international markets overall. And as we think about new store, new warehouses and the plan there as you may recall we talked about 25 to 30 new warehouses a year. And as we look at our long term plan we would think just over half of those would likely be in The U. S, but just under half would be in our international markets including Canada, Mexico, Asia and Europe.
- Speaker 2**
33m 38s
- And we look at all four of those as strong markets for us and opportunities to continue to expand our presence because we wouldn't see any of those as being fully penetrated today and we're fortunate in that our international markets have similar or in some cases better profitability as a rate of sales than we have in our U. S. Market as well. So we still see plenty of opportunity and they remain an important part of our growth strategy.
- Speaker 9**
34m 3s
- Great. Thank you.
- Speaker 1**
34m 6s
- And your next question comes from the line of Oliver Chen with TD Cowen. Your line is open.

- Speaker 10**
34m 13s
- Hi. Thanks Ron. Gary, we had a question about general merchandise and electronics. Would love just thoughts on what you're seeing with respect to those categories and the health of the consumer. We've also thought that you've done a great job with UPTs and innovating with international products. It would be great to hear prospects there. And then a follow-up is on the more targeted and strategic multi vendor mail as well as digital promotions and deals. What's happening there? It seems like there's some nice traction and is it driving traffic or how are you approaching the next inning of that? Thank you very much.
- Speaker 2**
34m 52s
- Sure. Thanks, Oliver. I'll just quickly rattle through. I think there were were three different components there. So on the consumer electronics, generally speaking, we believe from what we see we're growing market share, but that area would still be relatively slow. So we're flat to slight growth there, whereas the market overall though still seems to be pretty sluggish and I think we're still looking for that next wave of new innovation to really spark extra growth in that category. We did see some really nice sales around the holidays on the larger TV screens, the 98 inches and 100 inches TV screens. I think that created some new excitement and visually was very compelling in the warehouses and our operators did a great job in merchandising those and we saw some nice lift at that time of the year. But overall relatively flat as a category especially compared to many of the other non food categories where we see double digit growth currently. On the international products, I think it was the second comment you made. Yes, we're really excited about that opportunity. We continue to see at our monthly budget meetings when we have all of our operators come in, they're sharing examples of products that are resonating in each of the markets that we operate.
- Speaker 2**
35m 55s
- And very quickly because of the ability to share those ideas across the teams, we're finding ways to bring those and bring our global buying to bear and finding even better ways to bring them to our markets, but also a better value for our members. And we've seen some great growth in those opportunities and we think that will be an important part of our continued growth in the future as well. John, anything you want to add there as well?
- Speaker 3**
36m 17s
- No. And I think Gary is 100% right. And then on the multi vendor mail and the promotions, it really is excitement in that product mix. And it's a good balance of everyday low prices that our buyers work towards on ensuring the key commodities are at an everyday price that our members can count on, but also bringing in some newness and excitement and partnering with our suppliers when they want to drive some sales and we can deliver that through the multi vendor mailer. So I think the key to the success there, it is driving traffic. It continues to be a win for our members. And I think the newness and keeping it fresh has been the key to that success.
- Speaker 10**
36m 57s
- Thank you. Best regards.
- Speaker 3**
36m 59s
- Thank you. Thanks.
- Speaker 1**
37m 1s
- And your next question comes from the line of John Heinbockel with Guggenheim Securities. Your line is open.
- Speaker 11**
37m 8s
- Hey, Ron. I had a couple of holistic questions with regard to KS. When you think about new item introductions, KS versus national brands, how does that kind of compare in most years? When you think about categories where KS has a lower penetration, right, which is a lot of non foods, Where can you kind of make breakthroughs there, right, and introduce KS items that don't currently exist? And then would you think a very high percentage of the KS introductions end up being permanent fixtures in the assortment?

Speaker 3
37m 47s

Okay. The greatest opportunity we have would be in non foods. And it was something as a category that we always felt brand loyalty was extremely strong, which it is. But, you know, the the motor oil was a great example of it is now our top selling motor oil in all of our warehouses across here as a Kirkland Signature where that was a very brand related item before. Golf balls was another example of when we entered into an extremely brand loyal category that we were able to break through. So we see great success there. Our buyers continue to look at where are those opportunities that we can improve quality from the brand or meet the quality of the brand and bring a substantial value to it. So we're not in a race to develop hundreds of Kirkland items. We look at it more of a strategic item by item basis that when there's an item that with an opportunity, then that's when they'll go after that. The recent, the sandwich bags and storage bags that we did in our sundries department are a tremendous value, supreme quality and really doing very, very well. And yes, you're right, we do have a very high success rate of Kirkland items.

Speaker 3
38m 53s

I mean, but there are failures out there. There are things that we always say, Claudine and myself, our Head Merchant, we can't fall in love with our own stuff. And so we hold Kirkland Signature to the same standards we would at any branded item. If the sales are not performing, our members are not resonating with that item. It is as quick to go out as any branded item would be as well. So there's no annuities to a Kirkland item. It has to meet the same standards. But I'm very proud of the buyers that they do have a high success rate. They do their due diligence on those items and they really deliver great value to the member when we launch a Kirkland item. Thank you. You're welcome.

Speaker 1
39m 31s

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

Speaker 8
39m 38s

Good afternoon. Thanks for taking my question. So I guess, Gary, just going back to that 13 basis point headwind on the wage front, I think starting in March, is that headwind larger given it's the first year of the agreement given some of the other changes? And then just related to that given that it is a significant headwind, do you guys see any new productivity opportunities to help offset some of the increased wage pressures? Thank you.

Speaker 2
39m 58s

Yes. Thanks, Rupesh. Just to clarify to answer your question, you may recall we had a number of wage investments that we made back in March or wage investment I'm sorry we made in March and then we had another wage investment in July where we introduced a dollar increase at the bottom of the scale, on the top of the scale and a \$0.5 increase in the intervening points between those two. And then we just announced the wage increases that we've implemented this month with our new employee agreement. So overall, what you're seeing is that the investment from this time last year will drop off well, it won't drop off but we'll have cycled it. So we've made that investment now and that's embedded in the numbers that we're operating with. So the headwind that we'll see in the current quarter will be the investment from July and the investment that we've made in May. As you think about it quarter on quarter, it's about a mid single digit increase in the basis point of investment because we're essentially cycling last March's and replacing it with this new increase. So think of it as adding about your mid single digit basis point increase on our wage investment in the new quarter.

- Speaker 2**
41m 9s
- And to answer I should also say there'll probably be a sort of one time catch up in Q3 as well that will be the accrual for vacation for the full year because we're implementing that now, but we have to go back to the start of the fiscal year with that change. So there'll be an adjustment in the quarter for that as well. Outside of that to your point, we were very successful in the current quarter. Our operators in Q2 did a great job of continuing to drive productivity and continuing to improve efficiency, so that we actually still were able to achieve SG and A leverage as you heard me talk about earlier of nine basis points actually on the core. And so our goal will be exactly the same is to continue to find ways to be more efficient because we are committed to continue to invest in our employees as part of our code of ethics is to make sure that we're delivering industry leading wage and benefits for our employees. So that'll be a continued part of the strategy, but that also includes being more highly productive and finding ways to fund those through labor productivity and continuous improvement.
- Speaker 2**
42m 8s
- That's certainly the expectation we set for ourselves.
- Speaker 8**
42m 12s
- Great. Thank you. I'll pass it on.
- Speaker 1**
42m 16s
- And your next question comes from the line of Gregg Milich with Evercore ISI. Your line is open.
- Speaker 12**
42m 22s
- Thanks. I had one clarification on my question. The clarification was on inflation. I heard up low single digits. Is it fair to say that grocery was slightly above 1% and then maybe general merchandise was deflationary? And then I wanted to ask about alternative media.
- Speaker 2**
42m 40s
- Yes. On the inflation side of things, so fresh was our highest of the three categories and particularly in meat was the highest there. Food and sundries would have been very low single digit inflation, but still inflationary. And I would say important to know I guess that the trend was a little bit of an increase during the quarter because if you recall last quarter we shared that inflation was flat. So we did see some increase in inflation as the quarter progressed and I'd say meat was the largest of those, food and sundries would have been next and non foods has been deflationary relative to recently that's sort of even in itself out now as we cycle some of the deflation from the supply chain about a year ago.
- Speaker 12**
43m 22s
- Got it. Thanks. And then on the alternative media, you talked about building that out. Could you help frame it a little bit, Gary, and the strategy behind it? I mean, some of your peers have shown 4% or 5% of digital revenues can be the advertising business. How do you guys think about that?
- Speaker 2**
43m 43s
- Sure. I think overall, I know I've mentioned this previously as well in discussions, but we do have an alternative profit stream today where we generate significant value through a large co branded credit card program, the travel business that we have and we have a revenue e commerce ad revenue stream that comes from many of the suppliers that participate on our website today and that's a few hundred million dollars. So there are a number of areas today where we generate value in that space. Having said all of that, we do believe that the new sort of retail media theme which is really going after the marketing dollars that the CPGs are spending is a significant growth opportunity for us. We are though in the very early stages of that. We need to continue to build out the infrastructure and the capabilities and I would say we're not only building those out to deliver on a retail media platform that we want to create for CPG suppliers, but also to build out more of a sort of personalized capability for our own membership experience. So delivering more targeted and relevant messaging and sort of think of it as the right offer, the right communication through the right channel to the right member at the right time.

- Speaker 2**
44m 48s
- And this is really the capability that we're building for ourselves today and it will take some time to do that. So it's likely to be a multi year roadmap as we build those capabilities I would say. But we did at the same time launch this sort of offers media channel so that we can start to really test and learn and grow capability with our CPG suppliers and there's been a lot of interest and appetite to really build that capability and as we mentioned on the call, we now have 10 campaigns live and we see a lot more in the pipeline. From our perspective though, we've also mentioned this in the past is that I wouldn't think of it as Costco really coming out and declaring a new revenue stream with a new margin profile. We'll think of it very much as being how do we generate that fair share of that value so we can reinvest it in our members and continue to drive our overall loyalty member engagement and drive top line sales. So a little bit of a different approach for us than you probably hear from some of our peers and others.
- Speaker 12**
45m 45s
- One more reason for a bigger executive rebate. Exactly. All right. Thanks, Gary. Good luck, guys.
- Speaker 4**
45m 53s
- Thank you.
- Speaker 1**
45m 55s
- And your next question comes from the line of Edward Kelly with Wells Fargo. Your line is open.
- Speaker 4**
46m 1s
- Yes. Hi. Good afternoon, guys. Hi. I wanted to ask you about throughput in the stores. Maybe you can talk just a little bit about, like, where you are from a standpoint of initiatives to drive better throughput. I know you're scanning now when people are coming in. I'm sure what you're doing with that data. But then when you think about checkout and exit, and obviously it's a high class problem, but it's very busy. And then, you did mention extending hours on the gas stations. Is that something that you maybe could take to the stores that would help with that problem? Thank you.
- Speaker 3**
46m 39s
- You know, that is a very good question. The speed of the checkout is one of our primary focuses right now and what uses of technology we have. Scanning at the front door was very helpful for our operations, really kept our people informed on what traffic looks like and they can adjust to opening up registers and closing registers. And we saw some great improvements in productivity from that as well. That was just a foray into the whole technology thing. So we see many things going with self checkout, how we can improve that. And so that is indeed one of our biggest areas of focus for technology in our warehouses is how we can get members through quickly and turn parking spaces and do those type of things is a big push for us. Scanners. Yes. The scanners were very big win for us. I'm sorry.
- Speaker 4**
47m 31s
- Yes. I'm sorry. Would you consider extending store hours? I know that's probably logistically a lot harder than it sounds. Just curious your thoughts there.
- Speaker 3**
47m 41s
- That is something that is not off the table. We do look at that. I mean, our gas expansions, we have 60 U. S. Gas stations going through different they're at a different phase and expansions now. We did see some demand from the commuters both at the early hours and the evening hours. So I think that that's going to be a real benefit to those folks as well. But we will continue to look at the warehouse hours. No plans at place at this time though.
- Speaker 4**
48m 8s
- Okay. Thank you.
- Speaker 3**
48m 10s
- You're welcome.

- Speaker 1**
48m 12s
- And your next question comes from the line of Chuck Grom with Gordon Haskett. Your line is open.
- Speaker 13**
48m 19s
- Hey, thanks very much. I wanted to just go back to the digital MVM and was curious how vast that effort has been at this point in time. I guess maybe how many members received the digital MVM and are you replacing the paper MVM? And then I guess the ultimate question is, I guess, what have you learned so far in terms of elasticity or response rate?
- Speaker 3**
48m 42s
- It allows us to do different things that, you can imagine the print process is quite extended. So we're our merchants are two months out when they're putting together the mailed MVM, which is still very effective. I mean, it's still very effective when these arrive in people's homes. The digital MVM gives us quite a bit of nimbleness that up till the day before we put that out there, we can, you know, the vendor wants to jump in and wants to drive some sales, and it really gives us a lot of flexibility. So our buyers have taken some items out. They run the digital MVM for ten days compared to the twenty eight or so that we'd run the regular MVM. And you may be able to let other vendors now get into this type of communication to people. And it really drives a lot of sales, but it has been incremental to the mailed MVM that we have out there. So we found it to be very effective. And it's, you know, we're talking 40,000,000 people are getting this kind of a imprint in their email on what kind of activities. One of the biggest open rates we have in our email is what's going on in their warehouse nearby.
- Speaker 3**
49m 45s
- And so when members get to see new items that are arriving and, items that are on a special deal from the supplier, it's very effective for us in driving traffic.
- Speaker 2**
49m 54s
- And Chuck, maybe just to build on the part of your question that was tied to more of the targeted element of the communication. Yes, think of it as our first sort of foray into how do we be a little bit more targeted by using our membership data to make the message more specific to how you shop with Costco as a member. So, how frequently you're visiting us, what are the type of products that you're buying and then kind of reprioritizing the way in which the individual items are messaged on the communication to reflect more that's relevant for you and also the messaging that's really driving the communication to the member at the top of the email that's sending out the message as well. So it's really that first step for us into saying rather than one size fits all, how can we start to adjust that without changing the way we go to market, but just making the communication part of that more relevant. And the early signs were encouraging around the level of engagement and the change in behavior that we saw as a result of that. So certainly more to come on that front.
- Speaker 13**
50m 53s
- And just a quick follow-up Gary, just I guess when did you guys start that effort?
- Speaker 2**
50m 57s
- That was this last month.
- Speaker 3**
50m 59s
- The digital mailer has been for years, but more personalized was this month.
- Speaker 4**
51m 5s
- Yes. Right, Right. Okay, cool. Thank you.
- Speaker 1**
51m 10s
- And your next question comes from the line of Kelly Bania with BMO Capital Markets. Your line is open.
- Speaker 14**
51m 18s
- Hi. Thanks for taking our questions Ron and Gary. Wanted to just ask about membership fees. Obviously, you've had the increase in U. S. And Canada that's flowing through. But any update on where you are at with other international countries and if it's the right time for any changes there and maybe just also an update on the other international countries' executive programs if there's any plans for any additional rollouts there.

Speaker 2
51m 49s

Yes. Thanks, Kelly. So on the membership fee, first of all, yes, we increased the membership fee in Australia in fiscal year twenty twenty three. Mexico actually increased last year as well. That was in September. And actually we just announced in Japan and Korea a membership fee increase as well. So we don't have them all on the same cadence. They tend to be tied to their own individual plans and when the membership fee was introduced and when they've previously had changes. So it doesn't always follow the same cadence of The U. S, but we are changing membership fees in those countries or have already and other countries will continue to look and review on their own sort of cadence. So continuation of previous strategy there is very much the plan. And then on executive membership, typically we look at it from the basis of when we reach enough scale in an individual market. We have executive membership in a number of the Asian markets. We have executive membership in Australia and The UK as well because again they've reached a level of maturity in size. But the exciting part there I'd say is that if you look at Canada and The U. S. That have the highest level of executive membership penetration, as you go down that maturity curve, Asia would be next, but would still have a meaningful opportunity to continue to grow executive membership more towards The U. S. And Canada conversion rates and Australia and The U. K. Would be further behind Asia as well.

Speaker 2
53m 10s

So as they go through the maturity curve, it's one of those areas where we see opportunity to continue to increase executive membership penetration. And as we grow some of our newer markets and smaller markets into larger number of warehouses, we'll continue to evaluate the opportunity to introduce executive membership there as well.

Speaker 1
53m 30s

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

Speaker 15
53m 36s

Hey Ron and Gary, thanks for taking my question. I was wondering, excuse me, if you could talk a little bit about the average ticket trends in The U. S. Ex gas and give a little more color on mix versus number of items versus inflation impact? And if anything is changing there in terms of how you're getting to average ticket ex gas? And maybe related to that, I was just kind of curious if sugar and butter and flour are deflationary, why is bakery inflating?

Speaker 2
54m 8s

Yes, sure. I'll take the second one first. It's easy. It's really eggs that's causing the major pain there. It's kind of offsetting unfortunately just the percentage growth that we've seen in eggs has far outweighs the deflationary situation on those other items. In terms of sort of mix in the basket, I'd say we've been really pleased over the last twelve months because if you'd looked at our results twelve months ago, we'd have seen consistency in the visit growth which has continued to be the case and that's been something that has been a trend that for the last two or three years that we've been extremely pleased with and seeing that continued frequency of increase in visits. But about a year ago, we would have been flat to negative on the overall sort of basket size. And as you look at the change that we've seen over that last twelve months, partly I think because of the improvements that we've seen in non foods growth over that period of time and as we've continued to deliver great assortments and great quality and great value for our members, we've already seen our merchants and operators do a really good job of turning the corner in that situation and growing the number of items in the basket and the overall basket size.

Speaker 2
55m 17s

Up until this quarter, as you know, inflation has been relatively flat for us, so any improvement that we were seeing at that point would have been largely driven by items in the basket versus the or upselling in terms of better or bigger products by the member versus inflation driving that growth. But obviously that could change this year depending on what we see with inflation and also with the potential introduction of some tariffs.

- Speaker 15**
55m 44s Got it. Thank you.
- Speaker 1**
55m 47s And your next question comes from the line of Joseph Feldman with Telsey Advisory Group. Your line is open.
- Speaker 16**
55m 55s Yes. Hi, guys. Thanks for taking the question. I had two kind of quick ones for you. First, on gas volumes, I think I heard you guys say the volumes have been down and we heard that from another company you know pretty well, Gary. And I was just wondering what is driving that. It's a little surprising to me to hear that the volumes were down. The other question was about stores. If you could just remind us the kind of new versus existing market balance of stores and also U. S. Versus international for the year? Thanks.
- Speaker 2**
56m 29s Sure. Yes. On the first part of the question, so the comment that we made about gallons being down was very specific to February. So if you look at our year to date results, we would be positive in gallons on gas. I would say that there isn't a huge amount of growth and I suspect the market generally may be flat to down, but we've been growing our market share as we look at the year to date. It's a little bit difficult to talk about one particular month because as Ron mentioned earlier, certainly weather can have an impact on those things. So we'd look at probably the trend over a slightly longer period of time and say generally gallons are up, but it's low single digit growth in gallons versus compared to the growth that we see in other parts of the business today. On new stores, I've got that one. This year we'll open 15 locations in The U. S, Three in Canada and we'll have seven in the other international countries that will open up. And that's pretty typical for a normal twenty five warehouse year for us.
- Speaker 4**
57m 29s Got it. Thanks guys. Good luck with this quarter. Thank you. Thanks.
- Speaker 1**
57m 35s And your final question comes from the line of Mike Baker with D. A. Davidson. Your line is open.
- Speaker 4**
57m 42s Okay, thanks. First, as a lifelong resident of Sharon Massachusetts, I'll just say that the entire town is really excited for your nine hundredth store. The buzz is high. My question also on gas, I'm just wondering the extending the hours, has that led to incremental gallons? Are you seeing customers take advantage of that? And then a second question, just periodically, we ask about your price gaps versus others. How do you see those right now, particularly with some inflation creeping back in? Thanks.
- Speaker 2**
58m 22s Thanks. Yes. On the first part of the question, yes, we've been pleased so far with the member reaction and we are seeing an improvement in overall usage of the gas stations. So that's it's early days of course, but so far we've been pleased by the member response. And then so what's the second part of the question?
- Speaker 15**
58m 42s The pipe caps versus competitor.
- Speaker 2**
58m 44s Yes. So really this is something that we tend to look at we really tend to view ourselves as our own biggest competitor. Every period we have our budget meetings and we look at our prices and our goal at every meeting is to find where can we find ways to lower costs and lower prices for our members. So I would say we feel really good about our price gaps. We generally the price changes that we're making are proactive versus reactive to others, but if we do find any area in those meetings where we believe we need to adjust typically the operators in those markets have adjusted those prices before we've even gotten to the meeting. So overall, we believe that the focus on delivering the best value and quality and pushing ourselves to always get better is what's important and we think that certainly reflects in our overall value that we're offering today.

Speaker 3
59m 34s And we hope to see you next week in Sharon, Mike.

Speaker 4
59m 36s I will be there.

Speaker 3
59m 38s All right.

Speaker 4
59m 39s I'll see you. I'll say hello.

Speaker 3
59m 40s All right. Thanks, Mike.

Speaker 1
59m 44s And ladies and gentlemen, this concludes today's call and we thank you for your participation. You may now disconnect.