Q4 2018 Earnings Call

Company Participants

- Richard A. Galanti, Executive Vice President, Chief Financial Officer & Director

Other Participants

- Beryl Bugatch, Analyst
- Christopher Horvers, Analyst
- Chuck Grom, Analyst
- Edward J. Kelly, Analyst
- Gregory Scott Melich, Analyst
- John Heinbockel, Analyst
- Jonathan Livers, Analyst
- Josh Kamboj, Analyst
- Karen Short, Analyst
- Kelly Ann Bania, Analyst
- Matthew J. Fassler, Analyst
- Michael Lasser, Analyst
- Oliver Chen, Analyst
- Paul Kearney, Analyst
- Peter S. Benedict, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. My name is Brittany, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q4 Earnings 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.

I would now like to turn the call over to our host, Mr. Richard Galanti.

Richard A. Galanti {BIO 1423613 <GO>}

Thank you, Brittany, and good afternoon to everyone. I'll start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements.

The risks and uncertainties include, but are not limited to, those outlined in today's call, as well as other risks identified from time to time in the company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made and the company does not undertake to update these statements except as required by law.

In today's press release, we reported operating results for the fourth quarter of fiscal 2018, the 16 weeks ended September 2. Net income for the quarter came in at $1.043 billion, or $2.36 per share, a 13.5% increase compared to the $909 million or $2.08 per share in the 17-week fourth quarter last year. If you normalize the number of weeks, it's about a 20% increase.

In terms of sales, net sales for the quarter came in at $43.4 billion, a 5% increase over the $41.4 billion last year, again 16 versus 17 weeks, on a comp basis, which is on a like week basis, comps were up 9.5% for the quarter. Sales for the 52-week fiscal year 2018, they increased 9.7% to $138.4 billion from $126.2 billion last year in the 53-week year. On a comp basis for the year as well, we reported a 9.5% comp.

Now comp sales for the fourth quarter were as follows. And again, it's in the press release. In the U.S., on a reported basis, it was 10.8%. Ex-gas and FX, it would have been a 7.8%. Canada reported was a 5.7% for the 16 weeks. On an ex-gas and FX, it was 4.6% and Other International, 6.7% reported, a 6.9% ex-gas and inflation – gas inflation and FX. All told, total company, as I mentioned, reported a 9.5%, ex-gas and FX is 7.2%. As well, e-commerce, which we've started reporting about a year ago on a monthly basis as well, e-commerce for the 16 weeks was at 26.2% comp and ex-gas and FX at 26.3%.

In terms of Q4 sales metrics. Fourth quarter traffic or shopping frequency was up 4.9%, both on a worldwide basis as well as in the U.S. Weakening foreign currencies relative to the U.S. dollar negatively impacted sales by about 25 basis points, and gas inflation benefited Q4 comps by about 260 basis points.

Cannibalization, by the way, weighed on the comp by about 55 basis points to the negative. Our average front-end transaction was up 4.4% during Q4, and excluding the impacts of inflation and FX, our average ticket was up a little over 2%.

Next on the income statement line, membership income. We reported $997 million or 2.30% of membership fee income in the Q4 of 2018. Last year, in the 17-week quarter, it was $943 million, 2 basis points lower. So on a reported basis, $54 million increase or up 5.7%. Again, on the like weeks basis, up a little over 12%.

Of this normalized 12% number increased year-over-year in Q4, a little over half related to membership fee increases, the majority of which came from the $5 and $10 annual fee increases taken last June 1 in the U.S. and Canada.

In terms of membership renewal rates, renewal rates rose in Q4. And our U.S. and Canada membership renewal rate at Q4 end stood at 90.4%, that's up from 90.1% at Q3 end 16 weeks earlier. And our worldwide rate improved to 87.9%, up from 87.5% at Q3 end.

In terms of number of members at Q4 end. At Q4 end, we had 40.7 million Gold Star households. That's up from 16 weeks earlier, 40.0 million. Primary business, 7.6 million, up from 7.5 million. Business add-ons stood at 3.3 million, both at Q3 end and Q4 end. So all told, we went from 50.9 million member households a quarter ago end to 51.6 million at Q4 end.

In terms of cardholders. We ended the year with 94.3 million cardholders, up from 93.0 million at Q3 end. During the quarter, we had 13 net new openings. Also, at Q4 end, paid Executive Memberships stood at $19.3 million. That's an increase of 229,000 exec members during the 16 weeks, or about 14,000 increase per week, which by the way, is the same average for the whole year.

Related to the annual fee increases. The year-over-year quarterly fee income benefit peaked in this quarter, the fourth quarter. It will continue to be additive to our numbers during the upcoming four quarters, very little in Q4 of 2019 but during the four quarters, but will moderate each quarter and this is due to the nature of deferred accounting treatment of the fee increases.

Going down to the gross margin line. Our reported gross margin in the fourth quarter was lower year-over-year by 35 basis points, coming in at 10.92%, down from 11.27%. And that 35 basis point negative, excluding gas inflation, was minus 9 basis points. As I always ask you to do, we'll jot down two columns of numbers. One is the Q4 2018 reported, and then Q4 2018 ex-gas inflation.

The first line item will be core merchandise. On a year-over-year basis, on a reported basis, core merchandise gross margin was down 44 basis points year-over-year, ex-gas inflation, was down 22 basis points. Ancillary businesses were plus 14 basis points reported and plus 21 basis points ex-gas inflation, 2% reward, plus 1 and minus 2 basis points; other was minus 6 and minus 6 basis points year-over-year. And if you add those two columns up, you get 35 basis point negative, which we reported, and the minus 9 basis point, which I just mentioned on an ex-gas inflation basis.

Now the core merchandise component, again on a reported basis was lower by 44 basis points and lower by 22 basis points ex-gas inflation. That still takes into account the sales penetration of the different categories. If you look at the core merchandise categories in relation to their own sales, the core merchandise margin categories in terms of their own sales, quarter-on-quarter, if you will, margins year-over-year in Q4 were lower by 2 basis points. Within food and sundries and hardlines it was up a little, softlines and fresh were down a little. But all told, it was minus 2 basis points on quarter-on-quarter.

Ancillary and other business gross margins, I mentioned, was up 14 basis points reported and up 21 basis points ex-gas inflation, that's because of the extra good margins as well as the sales penetration. Other was minus 6 basis points as was the case in the first three quarters of fiscal 2018, I've mentioned to you that we're incurring some incremental costs, primarily related to the rollout of a centralized return facilities throughout the country. And that was – during the quarter, that was a 4 basis point detriment, which is relatively speaking, an improvement from the first three quarters.

In addition, we're cycling some one-time items that last year in the quarter, which net-net benefited last year's quarter by 2 basis points. That was a positive legal settlement offset by some impact from last year's Hurricane Harvey.

Moving to SG&A. Our SG&A percentage was lower or better by 15 basis points. And – but on an ex-gas deflation and FX, it was worse by 8 basis points, coming in at a 9.82% of sales this year, that would be the 15 basis points lower than the 9.97% on a reported basis.

Again, for ease of explanation, we'll jot down two columns of numbers, Q4 2018 as reported, and then Q4 2018 ex-gas inflation. Core operations is the first one, lower by 16 basis points – I'll say plus 16 basis points, and minus 4 basis points or worse by 4 basis points on ex-gas inflation basis. Central, minus 4 basis points and minus 7 basis points; stock compensation, zero and zero; and other, it was a benefit, plus 3 basis points and plus 3 basis points. And again, you add up the columns, you get on a reported basis; we were lower or better by 15 basis points in ex-gas inflation higher or worse by 8 basis points.

Now, the core operations component so the U.S. wage increase that went into effect in June 11 to our hourly employees in the U.S. that negatively impacted SG&A by 6 basis points. And as I mentioned, probably last quarter, this will continue to impact the SG&A comparison over the next three quarters of June 11 through June 10 of next year.

Central expense was higher year-over-year in Q4 by 4 basis points, 7 basis points ex-gas inflation. IT expenses were about 2 basis points of that, and the balance coming from a lot of small changes in a variety of miscellaneous items, frankly, but net-net, it added up to a minus 7 basis points ex-gas.

And lastly, other was better by 3 basis points, they're related to expenses occurred last year on the SG&A line as well from the Hurricane Harvey.

Next on the income statement, preopening expenses, about the same year-over-year. This year came in at $31 million; last year was $30 million, so $1 million higher. Last year in the quarter, Q4, we opened 15 openings, 13 net, plus a couple of relos. This year, we had 12 openings, 8 in the U.S. and Canada; and 4 international. All told, reported operating income for the 16-week Q4 of 2018 came in at 1.446 billion. This compares to 1.450 billion in the 17 weeks results of the last year in the fourth quarter.

Below the operating income line, reported interest expense was $5 million lower year-over-year, coming in at $48 million this year in Q4 compared to $53 million last year. Interest income and other for the quarter was higher year-over-year by $29 million. Interest income itself was higher by $11 million, despite one less week year-over-year, a combination of higher interest rates earned on the cash proceeds – cash that we have, as well as our higher invested cash balances. Also, benefiting the year-over-year comparison were positive year-over-year FX items that in total amounted to $14 million. Overall, pre-tax income was higher by 2%, or $30 million, in this year's 16-week quarter coming in at 1.449 billion this year versus last year's 17 weeks results of 1.419 billion.

In terms of income taxes, our tax rate in Q4 2018 came in at 27.4%, and 28.4% for all of fiscal 2018. This compared to 27.4% for Q4 compared to last year's Q4 of 34.3%. Now this quarter's tax rate benefited, of course, from the income tax reform that was effective January 1 as well as some favorable discrete tax adjustments. For fiscal 2019, based on our current estimates, which of course, are subject to change, we anticipate our effective total company tax rate to be approximately 28%.

A few other items of note. During – in all of fiscal 2018, we opened a net of 21 new units plus four additional relos. Of the 21 net, 13 were in the United States and 8 were international. For 2019, we expect to open 20 plus – low 20s net new warehouses. About three-quarters will be in the United States and about a quarter international, as well we plan to relocate four units that are located in larger facilities, same number as we did this year.

We're also under construction with our first Costco in China and Shanghai with the opening expected late next September. As of Q4 end, total warehouse square footage stood right at 110 million square feet.

Next subject, stock buybacks in Q4. We repurchased $89 million worth of Costco stock or 419,000 shares at an average price of $211.35. For the all of 2018, we repurchased $322 million at an average price of $183.13 per share.

Moving to e-commerce activities. Overall, e-commerce sales increased – increase has continued strong levels for the quarter coming in at 26.2% and for the year at 32.2%. First and foremost, we continue to deliver great values for our members as well we continue improving and slightly expanding our offerings including some new brands and higher end brands.

We continue to improve the member experience as well. This past fiscal year, our site traffic, conversion rates and orders all improved year-over-year. Online grocery, both our dry grocery as well as our – our dry grocery two-day delivery as well as our same-day fresh delivery. The latter through Instacart and others like Shipt are growing nicely but still a very small part of our company sales.

In terms of online two-day grocery, which is the dry side, we're generating sales in all 50 states, including the 6 states where no physical Costcos are present. Still relatively small to our company.

We continue to improve the online merchandise and sales offerings and services offerings with Hot Buys and Buyer Picks (sic) [Buyer's Picks] and buy online and pickup in store and we'll continue to do exciting merchandising activities. Overall, all these efforts we feel are positively impacting our business, both online and in warehouse, and are helping our sales, increasing member awareness of our digital presence, as well as increased traffic that we've enjoyed in our warehouses.

The next subject I'll touch on is tariffs and their impact on our business. As you know, there are many moving parts and it's extremely fluid starting with the actions and reactions by both the U.S. and Chinese governments. What actions are we exploring and taking in some short-term and some long-term? Accelerating shipments before tariffs go into effect, recognizing there's a limited ability to do so. Everybody's trying to. Working with suppliers to see what can be done to reduce and/or absorb some of the costs, and in some cases reducing order commitments on certain impacted items.

Alternative country sourcing, sure, but again, it's where possible and feasible, it's a limited ability, and it takes time. Five, taking advantage of lower pricing on some U.S. items because of the reverse, if you will, such as pork, nuts and soybeans.

In summary, we'll have to see how customers and competitors react to tariffs and what impacts it will have remain to be seen.

Our last topic, as was noted in this afternoon's press release, we plan to report in our Form 10-K a material weakness in internal control related to general IT controls. These controls relate to internal user access and program change-management over certain of our IT systems that relate to our financial reporting processes. I can tell you that there have been no misstatements identified in the financial statement as a result of the deficiencies and we expect to timely file our Form 10-K.

In terms of remediation, remediation efforts have begun, but material weakness will not be considered remediated until the applicable controls operate for a sufficient period of time and we conclude, through testing, that the controls are operating effectively. We expect that the remediation of the material weakness will be completed prior to the end of fiscal 2019.

Lastly, in terms of upcoming releases, we will announce our September sales results for the five weeks ending this Sunday, October 7; next week on October 10.

With that, I'll turn the call back over to Brittany for Q&A. Thank you. Brittany?

Q&A

Operator

And at this time, we have a question from Michael Lasser.

Q - Michael Lasser {BIO 7266130 <GO>}

Good evening, Richard. Thanks a lot of taking my question. With the core gross margin down 2 basis points, the expectation was that you'd be taking some of the tax reform and investing it in the value proposition, particularly price. So have those investments been made? And if they have, has it just been (00:17:32)?

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

Hello?

Q - Michael Lasser {BIO 7266130 <GO>}

And where do you think your pricing gap currently stands with others in the marketplace that have been investing in price?

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

Well, keep in mind, we invest in price as it's in our DNA. Certainly, over the last few years, there's been several buckets, if you will, that we've talked about, starting with a credit card transition that afforded us some great savings, some of which we used to invest in price, if you will.

Next was the – what's occurred generally every five or six years, a fee increase in June of 2017 and then of course the tax reform. And all those things, I think, has afforded stability. So I don't know, it's not like this one thing, but these monies are fungible, and we're not only investing in price, we're investing in infrastructure, that we would have done anyway, mind you, with the initial successes of two-day and one-day fresh. So there's a lot going on.

And in terms of how we feel competitively, I can tell you every four weeks when we meet for our day and a half budget meeting in each of the – in the U.S., as an example, each of the – all regions, including foreign regions, but in the U.S., the eight geographic regions, they do price shops compared to our direct competitors and we feel very good about those – where we stand competitively.

As it relates to monies that traditional retailers, whether supermarkets or the other big-boxes, look, it works and it helps, but we think it impacts other traditional retailers a lot more than it does us. I think, we've seen, as evidenced by our strong traffic numbers and, frankly, our strong comps in store, we feel pretty good about where we stand on that.

Q - Michael Lasser {BIO 7266130 <GO>}

And (00:19:27) when you've been accelerating your e-commerce growth and its growing at a very nice clip. So would you consider further doubling down on some of your e-commerce investment in light of the fact that you've been able to show growth through both channels?

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

Well, I – doubling down is – yes – there could be lots of definitions of doubling down. I think we are. I mean, we certainly are putting a lot of focus on it, and I can tell you within IT, we've got a lot of efforts going into fulfillment and sourcing and you name it.

I think part of our long term nature DNA is, is that we're going to do what we feel comfortable doing and grow it nicely. We've got a lot of activities in that area. We've added brands, we've added some categories, but for us, doubling or tripling 3,000 or 4,000 SKUs to 8,000 or 9,000 is a lot for us.

But there are plenty of opportunities that we're seeing not only on adding products, but the way we do it. We feel that the one- and two-day delivery options that we now offer at, frankly, better prices than our items were being offered by other third parties before, dramatically better pricing, should help us – should help that process.

We're finding the ability to benefit not only with e-commerce, but using online and e-mails to drive traffic into the warehouse, again, with Hot Buys and perhaps in some cases, some targeted buys, and online and e-commerce, to be able to sell some items that were seasonal in nature that we might only have for 8, 10, 12 weeks, notably patio furniture, lawn and garden or furniture during the summer.

The Patio, Lawn & Garden, we generally were in and out of that stuff for 10 to 12 weeks. Now we're in it 52 weeks online, and there are some real sales to be had there. So part of it's on us though to keep that awareness going and improving that awareness. So I think we're doing a better job of it, but we have more to do there.

Q - Michael Lasser {BIO 7266130 <GO>}

Great. Good luck, thank you very much

Operator

And your next question comes from the line of Simeon Gutman.

Q - Josh Kamboj {BIO 21155105 <GO>}

Hi. This is Josh Kamboj on for Simeon Gutman. Thanks for taking our question. Your comps have been very strong for the last few quarters. If you look at the basket that consumers are buying, would you attribute the strength more to capturing a broader set of categories or are customers trading up within your core consumable categories? And if the former, which new categories are you seeing the more success in?

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

It's really pretty balanced. I think not only for us, but other non-food retailers, like Walmart and Target and certainly Best Buy, electronics has been strong and there is some higher price points there, in general. Apparel has been helpful to us, so we've had continued strong results for several years now in apparel both brand and Kirkland Signature. And we keep trying to put another can in that package. So I think all those things help, but I'll say it's more broad-based than specific.

Q - Josh Kamboj {BIO 21155105 <GO>}

All right, thank you. And then just as a quick follow-up. Looking at the consumer health through your lens now, gas prices have leveled off for a while and beginning to rise again. Are you seeing greater sensitivity in any of those particularly your (00:22:50) categories?

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

Well, we haven't yet, but again, every day is a new day. One thing I – we've found that when gas prices were going down, some retailers were taking down as much as they could have in our view, which is fine with us. We could have down a little more, but still we're able to make a little so that's helped us, and enhance that value proposition.

Generally, when prices go up, same thing, we generally can find where people are more conscious. And now – I remember back in the first part of calendar 2008 when the economy was on fire and gas prices were north of $4 and some were saying it's going to $5. We saw a big increase in comp gallons. Same thing we're seeing – in the last couple of years, we've enjoyed a big increase in comp gallons because of that value proposition.

Q - Josh Kamboj {BIO 21155105 <GO>}

All right. Thank you.

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

Yeah. And it's hard to say how that impacts our numbers. Our numbers have been fortunately pretty good.

Q - Josh Kamboj {BIO 21155105 <GO>}

All right. That's helpful. Thank you.

Operator

And your next question comes from the line of Chuck Grom.

Q - Chuck Grom {BIO 3937478 <GO>}

Hey, thanks a lot. Richard, just first question is on ancillary part of the gross profit margin composition that you provided. Just wondering why the ancillary line was up 14 basis points. So it's a big reversal from the third quarter.

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

Well, the big thing is gas. Gas is now low-double-digit-percent of our total sales on a price point that's 20-plus-percent higher per gallon than a year ago. And while it's a low-margin business relative to rest of the company, its margins had improved year-over-year. So on that penetration that helped us.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. So (00:24:48)...

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

E-com has helped a little as well.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. So e-com is sort of captured in that line item, okay?

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

Yeah. Yeah.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. Thanks. And then...

(00:24:58)

Okay. And then the second question is, I know you guys have talked about – you've talked about sort of store targets in the low 30s. Now you're talking low 20s. Just wondering why the – are the deceleration and then number of openings planned for 2019?

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

Yeah. Well, look, we have a budget that's – it's between 20 and 25, and so coming in at a low 20s just to be conservative. We've got more on our plate. If you look at this year, this coming year, it's like 0.75%, 0.25% U.S. There's more in the pipeline now internationally, but that pipeline takes longer to get through. It's a longer pipeline. And so I think you'll see that change, best guess, in 2020 and 2021. If I was a betting person, over the next five years, beyond 2019, probably some number in the mid-20s is a likely number, but we'll have to see. That's subject to change.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. And then just last question on e-commerce. What do you think about the impact from consumers buying online? Have you seen any change and how they're shopping in-store? In other words, are they coming less frequently to the store? And I don't think you're too concerned about, but if you could just kind of flesh out maybe the entire basket for – and trends for the total household when you blend in the store trips along with the online buying habits.

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

Well, I mean, the fact that traffic is actually as strong as it's ever been, we enjoyed like a 4.2% average compounded annual traffic increase for seven years from 2009 to 2015. And I know everybody was concerned, you guys – everybody was concerned when it got down to the low 3s. And we've enjoyed it back in the 4s now, and 4.95% the last couple of months, I believe. And so it's hard to say it should have been higher than that if e-commerce? We think it's been net additive. But it's hard to say at this point.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay, great. Thanks a lot.

Operator

And at this time we have a question from John Heinbockel.

Q - John Heinbockel {BIO 1508150 <GO>}

So Rich, let me start with the – the difference from the minus 22 basis points margin ex-deflation and the minus 2 basis points in their own categories. So that's – it's obviously adverse mix, and I think that that's may be picked up a little bit the last six months. What's the primary driver of that? Is that mostly the strength in electronics? Or are there other factors at work?

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

It's not mix, no, electronics margins are generally where they've been. It's not a big issue there. It's gas, you've got a business that's – what percentage of gas in our business now? 12%, 13%?

A - Operator

12%.

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

12% of our total company sales is gas on a much different margin structure.

Q - John Heinbockel {BIO 1508150 <GO>}

Yeah. But I think, when you pull out the – right, so ex-gas deflation, right, I think margins were down 22 basis points, but they were down only 2 basis points, right, when looked at in their own categories. The difference between the two is not mix-driven?

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

Well, it maybe mix-driven somewhat, but keep in mind, there's lots of other things that go into margin. There's the ancillary businesses that have higher – margin – if you think about pharmacy and optical, they're – their gross margin, which is sales minus cost of sales is a higher gross margin than the 14 or 15 we talked about because it includes professional optometrist and pharmacist. So it's kind of like what is the price that the customers buying it all in at that. And you've got other categories that have – ancillary categories or services that have higher margins. So all those things go into the mix.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay. But you're seeing penetration of KS continue to rise and is it rising same as it had been, faster or slower?

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

I think it's been consistently rising, not faster or slower. I mean, keep in mind, there's still new items out there, and – but, you've got a lot of items that start out at $10 million and $20 million or $30 million. The big items, like toilet paper and water, we saw a big growth over the last couple of years in water as – where we brought the price down from $3.49 to

$2.99. I'm just looking down a list, of late, Kirkland Signature 14-cartridge razor blades – razor blades with a handle. Several – the organic cheeseburger in the food court, fragrances – the KS Fragrances, all kinds of beverages.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay. And then just separate topic. You obviously were doing some stuff with (00:29:49) on a limited basis. And I think you wanted to keep it limited. Is it still just applying to those items, like the notebooks and the bags or is there an idea of expanding that?

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

Well, we've talked – in the past, we've talked – we've mentioned things like jewelry, some limited electronics items like tablets and small-sized items as well as handbags, high-end handbags and things. We have expanded it to some additional electronics items. But it's still – we still want to do it our way. We think that these are areas where we've been surprised at. Many people are buying it because it's convenient and then they're going to come by the shop. Not to suggest these are all incremental shops, by no means, but while they are in there over half of them are just not picking up the item. They're going into the shop. But frankly, shop – at a higher – much higher average than the average shop. So far, so good, we'll see.

Q - John Heinbockel {BIO 1508150 <GO>}

All right. Thank you.

Operator

And your next question comes from the line of Karen Short.

Q - Karen Short {BIO 20587902 <GO>}

Hi, thanks. I just wanted to start with e-commerce for a second. Can you just give us an update on where e-commerce is as a percent of sales? And then I wanted to see if you could give us a little color on how you think about the growth rate of e-commerce going forward?

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

I'm sorry, what's the last part of the question?

Q - Karen Short {BIO 20587902 <GO>}

How to think about the growth rate of e-commerce going forward?

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

Well, I mean, the number's right around 5% of sales. I think a shade under – I'm sorry, a little over 4%. And, look, we're going to drive as much as we can. I think a few months ago, when we went from a string of monthly 30-pluses to 23% or something, people were disappointed a little bit out there. We feel very good about it. I think we've shown in the last couple of months – I can't say anything about September, that will be next week, but we've seen – the numbers we feel we – look, we have the benefit of having not focused on the lot for many years, and now taking advantage of that in a big way.

And I mean the example of some big-ticket seasonal items, like home furnishings and furniture at one part of the year and adding 40 extra weeks of offerings, if you will, offering it online now as well as what we've done with white goods and the success there. Then three years, we've gone from $50 million to $500 million in white goods sales, which has been helped, of course, by the brands willing to sell us good high-end stuff and our ability to sell it.

Q - Karen Short {BIO 20587902 <GO>}

Okay. That's helpful. And then just in terms of the tariff commentary they made, any way you could give us some sense of what percent of product is imported from China today, and where you kind of see that going in the next few years?

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

It's really hard to. No, we don't want to give out specifics. There've been some of the analysts out there that have done some estimates that are – seemed to be within the range. But it's fluid. But the real answer is, is things can change overnight.

What can change is demand for an item that if the prices have to go up 15% or 25%. But yes, we've experienced, not dissimilar things. I mean, in Mexico, when you've got a bunch of U.S. sourced goods historically, and with the peso to the dollar has changed dramatically from MXN 3 to MXN 8 to MXN 10, and then from MXN 10 to MXN 14, and more recently – in the last couple of years from MXN 14 to the MXN 18 to MXN 20 range, that will have a dampening effect on certain products. And so it has less of a dampening product impact. So it's really too early to tell.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And just last question, I guess, can you just give us inflation in 4Q, both on – at cost and at retail, and then expectations for inflation, given all the narratives from vendor's base, calling out passing on cost increases?

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

I don't know. I don't have that. Off the top of my head, on a cost basis, and this is purely like looking at LIFO indices and not on sales, because some categories have a higher penetration, it's very small – it's slightly inflationary, but I'm talking about capital S on the word slightly.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then what are your thoughts, just generally, because there have been a lot of narratives from the vendors in terms of passing on price increases? Where do you guys kind of stand or what are you seeing on that front?

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

Well, I mean, again, our DNA is, is we want to be the last to raise the price and we want to work with any supplier to figure out how we not do that. But ultimately, you can't eat all these, and – but we feel competitively we'll keep doing what we do that we're usually the last to raise the price and the first to lower it.

And I think we have – as a company, one advantage is, is that, we don't have to sell every brand alternative, every size alternative, every SKU alternative in a given item. And there are times when, I think, we – our buying power is in effect – the octane of that buying power is more than $138 billion of purchasing power, because it's too much number of limited items and not only brands competing, but also what we know about many of these items because of our private-label nature. So unfortunately, I think some opportunities that, perhaps, make it a little easier for us. But nothing's even.

Q - Karen Short {BIO 20587902 <GO>}

Yeah. That's helpful. Yeah. Thanks.

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

Thank you.

Operator

And your next question comes from the line of Christopher Horvers.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks. Good evening. So first question is, you mentioned in the release that there have been no misstatements found related to the internal control weakness. What's so – is that – behind this, is there any risk that there could be a misstatement of the financials in the future? Or is it more about you're sort of just fixing the systems and getting the testing done?

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

Well, keep in mind first of all, that we feel comfortable, and we feel that our – ultimately our auditors feel comfortable (00:36:13) we would have expressed the level of comfort we did in the press release about the time that there's no misstatements (00:36:20) we filed on time, including the K.

The issues had to do with internal user access. So people within IT or contractors and when somebody who may have had access to something they should have. And sometimes that they – once they should have had that access relieved, it took a little too long to do so. So the controls weren't in place. We should have done a better job.

We went back as far as we could and looked back as far as we could in some systems for the entire fiscal year, which is what you want to do. In some of the newer system, there was no look back ability for some certain things. I can tell you with all the look backs that we have done, and then our outside help has done has found no issues whatsoever in terms of misstatements or breaches.

So that's what we can tell you. But we can't be more positive than that until we release the 10-K.

And so, I don't want to belittle it. It should have been fixed, but it was internal to us, not external. And we will go from there.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. That's very helpful. Can you also talk about sort of the like an organic MFI growth number, sort of ex-FX in the 53rd week? It looks like all-in that that number was running a little bit below 5% in the first half of the year, and then in the third quarter sort of picked up over 5%, and then in the fourth quarter nearly 6%. Is that sort of rough math that you're seeing sort of like MFI comp accelerating (00:38:03)?

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

Well, that's a pretty good rough math. But keep in mind, one of the issues is on the deferred accounting. The U.S. and Canada, $5 and $10 fee increases that went into effect June 1 of 2017. So in effect, I believe that, in total was about $245 million. Well, over the next 12 months, using that number as the example, that's how much more we have in our checking account.

Based on deferred accounting, it takes 23 months to get that into the P&L. And so part of the increase from Q3 relative – year-over-year Q3 relative to year-over-year Q4 is you peak in 12 months hence if you think about it. Somebody who got a $10 increase for the first time, their renewal happened to be in June, that $10 was effectively $0.80 a month for 12 months, right, June to May. Somebody who got it 11 months later, in May, they paid it for the first time, but 11 months after the first person did, that'll hit the $0.80 a month for months 12 through 23, rough numbers. So if you will, at month 12 is when you peak, in terms of that getting, what I'll call the full effect of one-twelfth of the $270 million – $245 million as an example.

So I think a little of it probably has to do with that. I wouldn't suggest that of what used to be a 4% increase became a 5% and it's now a 6%. Some of that increase is related to that.

(00:39:30)

So yeah, and some of them, of course, is related to how many openings we have and where the openings are. When we opened a very successful unit on the East side of Seattle and Redmond a year and half ago with three other units on the East side including Kirkland and Issaquah, where we're headquartered here and one other, we went from a 195,000 members or 65,000 per building on average. Maybe we add another 8,000 or 10,000 over the next year. We reduced the average members, but we added net of cannibalization of $120 million, $130 million of extra sales in year one and we'll grow from there. So when you do that, that changes that growth metric a little bit.

Similarly, when we opened in Australia or Asia, we're afforded huge numbers of new sign-ups in the first year, with a lower renewal rate. But nonetheless, there have been openings where we've had 40,000, 50,000 new members with the company average for all warehouses whose average age is probably in the high-teens, if not low 20s, an average in the low 60s of warehouses – of that 60-plus thousand members. So international impacts it, a few of the LivingSocial things that we've done once every year – a year or two. All those things impact that number a little bit.

Q - Christopher Horvers {BIO 7499419 <GO>}

Okay. So, I guess, fighting through all the noise, how would you describe sort of like sort of MFI comp trend over the past 12 months? Has it improved?

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

I would say, well, if you take out the benefit of the fee increase.

Q - Christopher Horvers {BIO 7499419 <GO>}

Yeah.

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

...and you take out the difference of weeks, my guess is, a bit about the same. I'm guessing, we picked up a little from some of the Sam's closings, the 63 Sam's closings. We opened up a couple of units less than we did a year ago. And I think proportionately, a few less international units. I don't have that in front of me.

So, all those things we'd tweak in a little bit one way or another. I think overall, the fact that our renewal rates have improved and continue to improve finally after the impact of the transitions with credit cards in the U.S. and Canada makes us feel pretty good about it.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. And then last question, could you give us how many Visa cardholders you have in the U.S. currently and how does that compare to what you entered in with from an Amex cardholder perspective?

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

I don't have that number in front of me. It continues to grow. I believe that in the U.S., our Visa tenders – total Visa, not just the co-branded card, is just – is approaching 50%, in the high 40s. And it's probably 55/45 to Costco co-brand Visa. That could be 60/40. I don't have that number in front of me.

But it continues to grow. We continue to get sign-ups. And I think when somebody sees some of the things we've done with some of those monies, talked earlier about investing in price, when you could buy something like a high-end television, that's already great value with Costco. And then when it's on MBM or coupon, it's another $200 off. And on top of that, if you use your Citi Visa card, not only you'd get a cash card – and this is not on every item, but in terms of promotional things that we've done over some of the holidays, it's really worked. And so those are the kinds of things that we've used that for.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Thanks very much.

Operator

And your next question comes from the line of Edward Kelly.

Q - Edward J. Kelly {BIO 21274619 <GO>}

Yeah. Hi. Good afternoon. So, Rich, I wanted to ask you about complement. I mean, if you could just maybe reflect a little bit on the impressive run that you've had. It wasn't long ago in the U.S. that comps had kind of slowed to the low-single digits, which now seems like a one-off. The comps now are above historical, what you would think, I guess, historical norms. Can you just talk about what you think is driving that incremental strength? And then how should we be thinking about, I don't know, I guess, what I would call, mean reversion and the timing around that? And what is the real mean? And is 2016 even relevant to think about?

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

Look, I don't know. I remember when – now in 2016, what we did a little bit to hurt ourselves when we changed up the MBMs and greatly reduced the number of promotional days of shopping, if you will, and then we changed that over a quarter – over a few months and we got it back to where we were. There was also add on that the conversion of credit cards, where you had a lot of people that were auto-renewal on credit card, that lost that auto-renewal.

Any member under the old Amex program that was using a different Amex card at Costco, whether it was the Delta card or a hotel card or Starwood card, all those things, some of those became auto-renewal, members opted in to just to have auto-renewal. Well, when we switched from one card – one network to another, all those non-cards weren't bought by the acquirer. All those auto-renewals went off. So I think some of that is tied up into that 2016 year.

I also think that some of the things we've done was Buyer's Picks and Hot Buys and collecting e-mail addresses. Again, we're proud of the fact that we've greatly increased the number of e-mail addresses we have. Some will look at it and say, why didn't you do this all along, we didn't, and we're now benefiting from that. So all those things I think have helped. And hopefully, that new normal will continue for a while, but every day is a new day.

Q - Edward J. Kelly {BIO 21274619 <GO>}

And then just circling back on e-commerce growth. Obviously, you started the year strong. You had actually mentioned something, Richard, about people being a little bit disappointed when it slowed. Did that surprise you at all that it slowed the way it did? And then can you talk about how grocery is ramping relative to your expectations, two-day, same-day and are there any metrics that you can share on it relative to the basket size, margin, et cetera?

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

Well, in terms of when renewal rates or whatever comps slowed a little bit. I remember when shopping frequency had slowed a little bit after this incredible run from 2009 to 2015. I remember, at the end of 2009, when we achieved, I think, a 3.8% or 4.0% frequency, up from historical average of like 1.7%, I was the first to say and remind people, if it's a lot lower than 10%, it's still a good two-year stack because this is not sustainable, and then for four years, we enjoyed it.

But I think if you look at the things that we've done merchandising-wise, the added brands we have, the better communications tools that we could communicate with our members. And really that low-hanging fruit that we are benefiting from a trough (00:46:16) of, as one of my colleagues just said, great merchandise at low prices. I mean, there's a lot of good things that we've had going on for ourselves. And I think that'll – that should continue. We still have a lot of buckets here.

Q - Edward J. Kelly {BIO 21274619 <GO>}

Sorry, if I wasn't clear but I meant on the e-commerce comp or e-commerce growth, and what we've seen recently there relative to how you started the year. Has that small slowdown surprised you at all? And how has like two-day and same-day delivery?

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

Definitely. So the e-commerce slowed – well, we say slow down, it went from a low 30s number to a low to mid 20s number. I'll throw it – the two-year stack back at you. We feel very good about it. We feel very good about what we're doing and we think we've got a lot of new things to come on and to expand it. And we still have a lot of, if you will, funds in the bucket to drive business in that direction as well.

And the brands that are willing to sell us that had – and historically had been, so all of those things up. But I think, again, the biggest thing is we're focusing on it. But we're focusing in on our way. We don't need to buy a company and we're finding out that there's lots of opportunities for us doing some of the things that we want to do.

Q - Edward J. Kelly {BIO 21274619 <GO>}

Great. Thank you.

Operator

And your next question comes from the line of Scott Mushkin.

Q - Paul Kearney {BIO 19179305 <GO>}

Hi, guys. Thanks for taking the question. This is Paul Kearney on for Scott. Just a question on growth going forward and also just business today, where do you think you are in terms of wallet share of current customers? And what's the biggest opportunity to grow wallet share of the customers? And also, if you got to divide, going forward, where most of your growth is coming from? Is it coming from wallet share? Is it coming from acquiring new members or continued unit growth in new markets? Thanks.

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

Yeah. Well, look, frequency is up, average sale is up. We know there's an example when we (00:48:14) that we don't add a lot of new members. We have a lot of loyal members that are shopping a lot more frequently.

We know that our success with both – when we're asked the question, what are the big two or three things that impact – that helped our sales? I think generally speaking, we've – we all generally feel it's our strength in fresh foods, which continues to grow and improve. It's our gas stations, which gets you in the parking lot. And the Executive Membership and we're doing a better job of now e-mailing you. So I think all of those things have helped. But as our Head of Merchandising would say, it's great merchandise at low prices and some of these Buyer Picks (sic) [Buyer's Picks] and Hot Buys have helped as well.

Q - Paul Kearney {BIO 19179305 <GO>}

Great. Thanks. And one quick follow-up and maybe it's too early to tell. But are you seeing any changes in membership trends, I mean for your clubs that are more like heavily using Instacart? So is Instacart delivery for non-members leading to any uptick in memberships for those clubs? And thanks.

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

Instacart and our others – third parties like Shipt and others and Instacart is the big one and we have good relationships with them. And it's growing nicely. But it's still a pretty small part of our – we have not discerned any big difference there.

What we've looked – and this is anecdotal, not statistically valid, but when we looked at it, you take a group of loyal Costco members, and then a group within that group, who had like characteristics of average basket to shopping frequency, and almost – and they're loyal, and then you have them – some of the members start using Instacart, some of them are using it to fill in some of it, that may reduce their annual shops by a few and increase this way several. The key for us though is making sure they still get into Costco occasionally. And so far, we've seen a net increase in that, but it's a very small population and it's a very small size in its entirety at this point.

Q - Paul Kearney {BIO 19179305 <GO>}

Great. Thank you.

Operator

And your next question comes from the line of Scot Ciccarelli.

Q - Jonathan Livers {BIO 22055228 <GO>}

Hi. Yes. Richard, thanks for taking my question. This is Jonathan Livers on for Scot Ciccarelli. Just a question on e-commerce as well, as it continues to be a focus and you've made sizable investments there and still putting up pretty impressive growth. Could you tell us what percentage of e-commerce has shipped by your stores versus shipped by vendors?

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

Very little, if – I mean – 50% is us, but not to the warehouses, just us shipping directly from our e-commerce fulfillment centers. Very little is done at the warehouse.

Q - Jonathan Livers {BIO 22055228 <GO>}

Okay.

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

And by the way, that is only the business center with our two-day dry.

Q - Jonathan Livers {BIO 22055228 <GO>}

Got you. Okay. I appreciate that. Thanks so much.

Operator

And your next question comes from the line of Oliver Chen.

Q - Oliver Chen {BIO 15320650 <GO>}

Hi, Richard. Regarding e-commerce, as it becomes a bigger percentage of your total business, what are the main dynamics in terms of the margin impact there? And you have been speaking about this, but what are your main – how would you prioritize the main drivers to drive the awareness growth of e-com and the kinds of initiatives that you're pursuing as that seems like a big opportunity.

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

Well, again, we've said before, first and foremost, we wanted to get to the facility. And there's certainly, in some categories like white goods and big-ticket, physical ticket items as well, e-commerce is the way to go in a big way, and we've certainly benefited from that. We don't see e-commerce taking over our brick-and-mortar. We've also tried to figure out how to do some of the e-commerce or delivery-related activities that some members want, and then we could provide the savings too, but doing it our way. And so I think, there's still plenty of low-hanging fruit. And we don't want to you get comfortable in just shopping at Costco online, unless there's not a Costco within a 100 miles.

Q - Oliver Chen {BIO 15320650 <GO>}

Okay. And Richard, from a modeling perspective for CapEx for next year, what are some of the major buckets? And how should we think about how that will unfold?

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

Yeah. Well, first and foremost it's warehouses. And to the extent there's a few more international, a couple of more. IT is a few hundred extra. I mean, not extra from the year before, but in general. We've got a chicken plant, which is north of $300 million, a big chunk of that is expended in fiscal 2019 and we've already started spending money. The cheapest money was the acreage, the expensive money is the facility and all the equipment and everything. And the whole fulfillment – I guess, what's new would be some things like the chicken plant, would be some of the fulfillment activities we have on two-day delivery and e-commerce, small package e-com, where that will be a savings, frankly, to us, but we're just – we were doing a lot of those things a lot more manual than even we need to do.

Q - Oliver Chen {BIO 15320650 <GO>}

Thank you. That's helpful.

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

(00:53:42) delivery days. So yeah, there's a few extra things. I think the number would still be in the very high 2s-ish, low...

Q - Oliver Chen {BIO 15320650 <GO>}

Okay. And lastly, the Multi-Vendor Mailer. Are you pretty pleased with the state of it now? Is it in the right place? I know it's an important document, and you've been thinking about making sure that it's efficient with respect to the breadth and depth?

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

Well, I think, we're pleased, other than a year and a half ago, year and a nine months ago, when we changed the number of MVM days in the warehouse, which hurts frequency in the warehouse and once you change that back, the fact that we've reduced the number of offerings in an MVM by 20-plus percent and increased the total value by more than that and by net positive. And it's definitely working in terms of what we want to get out of it.

Mind you also, we've taken some of those items, not every item works the same way, sometimes, some items that have been regular to get to stale, sometimes, we've got to shake it up a little bit or change the value proposition. Sometimes, we take it out of the MVM and do it in a different way with these hot buys and Buyer's Picks. So I think we've, in a way, added to the arsenal a little bit, and it's working. But it'll still evolve some more.

Q - Oliver Chen {BIO 15320650 <GO>}

Yeah. And do you believe that tariffs will contribute risk factors with consumer confidence? Like what are your thoughts on how that may interplay because we're in such a great backdrop currently?

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

Look, on an item given basis, when you have an expensive discretionary item, take like a patio set, I'm just using that as an example, you're going to have a little less demand probably. Is it going to change? And mind you, there's a few items on the food side that are going the other way because this – an example is of pork, where something like a third of the U.S. pork goes – is exported to China. That's changed. And, therefore, pork prices are way down. There's a great savings. That's creating opportunities. Same thing with nuts, same thing with soybeans, I believe. I'm just giving you some anecdotal examples.

So you're going to lose some and win some. How it impacts, I think everybody feels that tariffs, people smarter than me don't like them. And so it's probably a small net negative. Certainly, whatever negative it is, we can weather it better than others.

Q - Oliver Chen {BIO 15320650 <GO>}

Thank you, Richard. Thanks a lot. Have a great night.

Operator

Your next question comes from the line of Greg Melich.

Q - Gregory Scott Melich

Hi, thanks Richard. I have a couple questions. One was on gasoline, obviously, it grown a lot, but what was the gallon growth in the quarter? And did it – did penny profit actually improve? It sounds like it did, but I just want to see if that's the case.

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

The gallon increases were the low double digits, 11%, 12%, 11% or 12%...

Q - Gregory Scott Melich

Got it.

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

...which is huge compared to the U.S. economy.

Q - Gregory Scott Melich

Right. Got it.

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

That's also – that's from new gas station as well, but I think the comp has got to be in high singles.

Q - Gregory Scott Melich

Got it. And how many new – I mean, stations are at most of the clubs that you can have them, right? Is there a penetration number you have?

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

Well, new openings we're getting them more so than that. And international, we're still adding where we can. I think in Australia, with 10 locations, we've got 4 , maybe 5, with gas. Mexico, we're adding some. Japan, we have a few. U.S. and Canada, certainly, is more saturated with gas stations and you can say we're not going to have 117th Street East River Drive.

But where we can, generally speaking, when we relocate, we do. A good example in your neck of the woods is when we took the old land occupied or constrained Hackensack Costco and moved it to Teterboro and then turned Hackensack into a business center. The Teterboro is – I'm guessing here 20,000 square feet larger with all the bells and whistles with a gas station and with a lot better parking. And so a few here and a few there that way.

Q - Gregory Scott Melich

Got it. And then a follow-up on the co-branded card. If I did my math right, sort of, upper 20s percent of the tender now would be on your card in the club. If I remember correctly, the part of the benefit of this is getting people top of wallet and getting them to use it everywhere. Do you have any sort update on the usage of how much more is being used outside of Costco? And, therefore, how much more loyal that member is in terms of using the card, and then coming back to the club?

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

I'll just say, yes, we do. We do have that information.

Q - Gregory Scott Melich

Okay. Is it the same, is it back to where it was with Amex, I guess, is what I would say or above?

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

I think it's quite a bit above.

Q - Gregory Scott Melich

Quite a bit above.

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

Yeah. And continue to grow. And actually, keep in mind, part of that is the fact that it can be used in more places. So if we get – whichever of those cards was your top of wallet, you have more potential to use it today than you did before.

Q - Gregory Scott Melich

That's great. Good luck. Thanks a lot.

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

Thank you.

Operator

And your next question comes from the line of Matt Fassler.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Hello, Richard. Good afternoon. How are you?

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

Good.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

My first question relates to SG&A. Trying to figure out a couple of the moving pieces. First of all, it looks like the wage increase that you've discussed probably drove the SG&A higher by a bit less than a percentage point. So not an overwhelming increase. Just trying to benchmark the year-on-year increase when you exclude the factor of the extra week a year ago.

I went back and you weren't terribly granular, I think, on last year's call about the expense profile of that extra week. So as we think about the apples-to-apples increase because clearly the SG&A seems like it's going to or might increase at a slightly accelerated rate with the wage increases. How – was that an average week that you would've had for the extra week a year ago? Are there expenses that don't get carried in for the extra week?

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

There's little if any expenses, and some of our accounting people were saying virtually nothing. So the week are fully allocated. It's not like if we took an annual expense and divided it by an extra week or had a free week at the end of the year, we don't. We do it by the number of days in a year. And so nothing there. What was the other part of the question? There was – I don't have a (01:00:48) response for it.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

I think you've got that one.

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

In terms of the wage increases related to the tax reform. At the time we did that, we announced that it was going to be somewhere between $110 million to $120 million a year.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Yeah, understood. And so I guess, partial impact here in Q4, given the June implementation.

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

Right. Till June 11, that was about three quarters -even though Q4 is normally a 16-week quarter, not a 12-week, it was about 12 and the 16 weeks business.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Understood. Secondly, your inventory increase was a bit higher, I know you did speak to frontloading some receipts in anticipation of tariffs. Was that a factor? Anything else moving the inventory in that direction?

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

When I look at the list category – category-wise, electronics year-over-year is higher by choice, some of it's volume, but a little of it is what you've just mentioned. And I think the last thing is as we clearly have increased our inventory levels, particularly in e-commerce and delivery-related items.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Great. And then finally, on renewal rates. You seem to have shaken off some of the cobwebs that emerged, I guess, in the period after the credit card transition. Your U.S. and Canada renewal rate is back to where it was in the third quarter of 2016, so I guess, the best in nine quarters or so, and even more so for the worldwide rate. Have we sort of shaken the cobwebs off now? And are we – do you think there's more room to move higher here? Or do you think we're kind of back at the level where we're likely to plateau?

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

Who knows? I think we feel good about the loyalty and what we're doing to drive loyalty. There are some things that impacted either a little up or a little down, and then depends on rounding, rounding the next 10th or not. When we do one of those – I think we've done four of them now in the last four or five years like the LivingSocial or the thing like that, you'll get an extra 200,000-250,000 members in a 10-day period or 12-day period.

And by definition, you have a lower renewal rate on them in your hands. So that hurts you a little bit. When that anniversaries a year later, it helps you a little bit. So there's lots of little things like that. But when we look at the underlying the rates and I look at even taking a country like Australia, which is only 10 locations, its renewal rate is lower. It's still in the 70s, but it's relatively new. The average age of those locations is, what, four years-ish maybe. And I look at the last four years, I only noticed it because I'm going there next week. And its renewal rate has consistently improved for the company in each of the last four years, which is consistent with what we've seen in other countries. So I think the bellwethers, of course, are U.S. and Canada, where we're mature, the average age of these locations are – is it 20s? And so far so good, but...

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Thank you. Got you.

Operator

And your next question comes from the line of Peter Benedict.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Hey, Richard. A clarification just on the CapEx, I just wanted to make sure we heard you right. So CapEx this year, high 2s, maybe low 3s, with the incremental increase driven, I guess, a part of it by the chicken plant. Is that the way we should think about it?

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

Yes. Typically, our own internal budgets are $200 million to $300 million above where we come out. I believe this year, we – maybe we're $100 million above, right at 3 or 3.1 but – and that includes the beginnings of the chicken plant, some additional things we're doing with fulfillment. Yeah. So I think overall, something in the high 2s or I think we've graduated from 2.5 to 2.8 range to 2.8 to 3.1 range.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Got it. Do you have the fourth quarter CapEx number?

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

Not yet.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Okay.

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

It will be in the K, in a couple of weeks.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Yeah. Okay. On the international openings, I mean you've said 75% of the clubs this year are going to be in the U.S. But you've said you've got a bigger pipeline internationally, they take longer. But is there a timeframe where we should be thinking about when non-U.S. club openings will account for more than half of your openings? Is that a couple of years down the road?

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

If you had asked me a couple of years ago, I'd say it's three years around the road. If you ask me today, it's probably two to three years around the road and I could be wrong by a year further. We do definitely have more in the pipeline. And we've also been surprised by more opportunities in the U.S., that we – if you go back to 10-plus years ago, some of the cities we're in today, we would have said, no, we're not going to go there. There's somebody else there already and it's not that big of a town. But we're finding success in those examples. And so I think we – ultimately, international, I don't know what it is, whether it's three years or four years from now or two years from now.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Right. Okay. Last question just around brands, both yours and others, which categories beyond white goods are you seeing kind of an incremental step-up in your ability to get premium brands? And then what was the private-label penetration for 4Q and for the year?

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

Well, I can't give you the latter number, but in terms of ability to get new brands, apparel continues. Cosmetics, some specialty food items, but those are fewer and further between. Sporting goods, any? Sporting goods to some extent.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Okay. Great. Thanks very much.

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

Yeah.

Operator

And your next question comes from the line of Kelly Bania.

Q - Kelly Ann Bania {BIO 16685675 <GO>}

Hi, thanks for taking my questions, Richard. Wanted to just ask about – with e-commerce now about 4% of sales, just curious what percent of your members are really engaging online? And I guess, in connection with kind of the renewal rates question, as you look at those members that are engaging online, are they renewing at a similar rate or a higher rate? Just curious how that could influence the renewal rates over time?

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

We don't disclose how many of our members. It's increasing dramatically, but from a smaller base, because we hadn't tried (01:07:33) in the past. As it relates to – I'm guessing – I know that an Executive Member is more frequent and more loyal than a Gold Star member. An Executive Member with the Citi Visa card comes more often, and spends more, and is more loyal than that. I would guess that somebody who's using an online, if they come from the warehouse and they're using online in addition to that, that's more loyal than their respective groups of those other things. But beyond that, when you've got somebody that's just using online, I don't know off the top of my head.

Q - Kelly Ann Bania {BIO 16685675 <GO>}

Okay. And just a clarification on the CapEx, I think you mentioned some spend there going towards the two-day delivery program. I guess what exactly is that for?

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

Well, the two-day delivery was about seven or – most of that's e-com fulfillment. There's some additional expenditures in some of the business centers, including building a couple of new business centers in geographies that will greatly reduce the what I'll call, the outsized UPS piece relative to the current mileage that has to be travelled to get those packages to their customers.

Q - Kelly Ann Bania {BIO 16685675 <GO>}

Okay, got it. And maybe just one last one on wages, you've obviously been making investments, but with the announcement this week from Amazon going to $15, just curious if you see more pressure from that or broadly speaking and how you plan to over the next couple of years?

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

Well, first of all, we've raised our entry-level wages to $14 and $14.50 in the United States in the past year related to tax reform. We give increases at top of scale every year. Even though our starting wage is $14 to $14.50, an employee who's been here over a number of years can get up into the equivalent of the low – the mid-40s to the mid-50s on an hourly basis over time on top of great health benefits.

So at the end of the day, we feel very good about where we are. An employee starting today on a full-time basis, it takes about five years to get to top of scale. And I think our average U.S. hourly wage is in the mid-22s, $22.5, roughly, which, we believe, dwarfs any other retail or retail-type entity out there on a big scale.

And I believe that you'll see more pressure on it. And by the way, there are some geographies around the country, even before we've raised it to $14.50, we were already above that. We started at a $22 above that because of necessities. The Bay Area – parts of the Bay Area would be an example.

Q - Kelly Ann Bania {BIO 16685675 <GO>}

Thank you.

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

One more question?

Operator

And your last question comes from the line of Budd Bugatch.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Hi Richard. Thank you for taking the question. And thank you for lasting this long on the call. Most of my questions have been answered, but just on e-commerce. Can you give us the e-commerce impact on comps? Do we have that number?

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

I'm sorry, the comps?

Q - Beryl Bugatch {BIO 1504748 <GO>}

Yeah. The e-commerce impact on comps. Well, how many basis points do they impact the comp?

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

It's somewhere in the 70 or 80 basis point range.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Okay. Thank you. And...

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

It's north of 50 basis points and it's not 100 basis points.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Say again?

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

It's north of 50 basis points and it's below 100 basis points or so...

Q - Beryl Bugatch {BIO 1504748 <GO>}

Okay.

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

I think it's in the mid to high.

Q - Beryl Bugatch {BIO 1504748 <GO>}

And can you talk a little bit about the demographics of the membership sign ups by age? What does it look like? Are you – is your average age of members reducing and getting younger? And what about the sign up distribution?

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

Well, we feel very good about the sign ups, but by the way, when they were called Gen Xers or Gen Zs or whatever they were called before that, that's when you generally sign these people up. Where we – I think we're in the very high 30s or low 40s in terms of younger people signing up, which is consistent with what we've seen. What was the other part of the question?

Q - Beryl Bugatch {BIO 1504748 <GO>}

Well, that was the...

(01:12:01)

...impact on the base.

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

I think I haven't seen that. I need to find that out myself. I haven't seen that since we told people that our average member in the U.S. went from 54 to 52.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Okay.

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

And that was a number of years ago.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Okay. And the last on e-commerce, is there e-commerce activity outside of the U.S.? And can you talk about the strength that you might see there?

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

Well, we're in U.S., Canada, Mexico, UK, Taiwan and Korea. And over the next year and a half I think we have two other countries planned. And, look, it's growing nicely in other markets. I frankly think in the U.S. e-com business dwarfs the others and it's probably had the biggest benefit other than starting off from a very small base, because of where we had taken and combined inline and online buying together a year or two years ago, and I think that we've seen a big benefit from that and we'll do that elsewhere, but it works.

Q - Beryl Bugatch {BIO 1504748 <GO>}

Okay. Thank you very much. Good luck on the next periods.

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

Thank you very much.

Operator

And this concludes today's conference call. You may now disconnect.