Q2 2021 Earnings Call

Company Participants

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

Other Participants

- Brandon Cheatham, Analyst
- Chris Horvers, Analyst
- Chuck Grom, Analyst
- Edward Kelly, Analyst
- Greg Melich, Analyst
- Karen Short, Analyst
- Michael Lasser, Analyst
- Mike Baker, Analyst
- Rupesh Parikh, Analyst
- Scot Ciccarelli, Analyst
- Scott Mushkin, Analyst
- Simeon Gutman, Analyst
- Spencer Hanus, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to Q2 Earnings Call and February Sales Conference.

I would now like to hand the call over to your speaker today, Mr. Richard Galanti. You may begin your conference.

Richard A. Galanti {BIO 1423613 <GO>}

Thank you, Blena, and good afternoon to everyone. I will start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements. The risks and uncertainties include but are not limited to those outlined in today's call as well as other risks identified from time to time in the company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made and the company does not undertake to update these statements, except as required by law.

In today's press release, we reported operating results for the second quarter of fiscal 2021, the 12 weeks ended February 14th as well as February retail sales results for the 4 weeks ended this past Sunday, February 28th. Reported net income for the quarter was $951 million or $2.14 per share compared to $931 million or $2.10 per diluted share last year. This year's results included $246 million pretax or $0.41 per diluted share and costs incurred primarily from COVID-19 premium wages.

Net sales for the quarter increased 14.7% to $43.89 billion from $38.26 billion a year ago in the second quarter. Comparable sales for the second quarter of fiscal '21 were as follows. For the 12-week period, US comps were reported at 11.4%, and excluding gas deflation and FX, 12.6%. Canada reported at 13.4%, ex-gas deflation and FX, 10.6%. Other international reported at 21.5%, ex-gas deflation and FX, 17.7%. Also, total company reported at 13.0%, and ex-gas deflation and FX, 12.9%. E-commerce on a reported basis was 75.8%, and ex-FX, 74.8%.

In terms of the second quarter comp sales metrics, our traffic or shopping frequency increased 1% worldwide and up 2.7% in the US on a year-over-year basis during the quarter. Our average transaction or ticket was up 11.9% total company and 8.5% in the US during the second quarter. Foreign currencies relative to the US dollar positively impacted sales by approximately 110 basis points and gasoline price deflation negatively impacted sales by approximately 100 basis points. I'll review our February sales results a little bit later in the call.

Going down the income statement, membership fee income came in reported at $881.5 million or 2.01% compared to $816.4 million or 2.13% in the quarter a year ago, so up $65 million or 8%. Excluding the impact of FX, the $65 million increase would be $56 million, which would represent a 6.9% increase, excluding the impact of FX. No openings occurred in fiscal -- in the second fiscal quarter both this year and last year in the fiscal quarter.

In terms of renewal rates, the US and Canadian renewal rate came in at as -- for Q2 at 91.0% as of Q2 end. This was up 0.1% from the 90.9% at the end of the prior fiscal quarter. Worldwide, our total company renewal rates were 88.5% as of Q2 end, also up 0.1% from the prior quarter's number of 88.4%.

In terms of number of members as of Q2 end, both member households and cardholders. In terms of households at Q2 end, we came in at 59.7 million, up from 59.1 million 12 weeks earlier. And total cardholders at 108.3 million, up from 107.1 million 12 weeks earlier. As of Q2 end, paid executive members were 23.8 million, an increase of 506,000 during the 12 weeks since Q1 end.

Moving down the income statement to the gross margin. This year's gross margin came in at 10.96%, 2 basis points lower than last year's second quarter on a reported basis of 10.98%. Excluding gas deflation, it would have been 11 basis points lower. As I always ask you, we do a little chart here to show some of the components of margin. Two columns, reported and the second column without gas deflation. First line item would be core merchandise. On a reported basis core merchandise margin year-over-year was -- came in at plus 71 basis points, ex-gas deflation plus 63 basis points. Second line item, ancillary businesses, minus 53 basis points. And then without gas, minus 55%. 2% reward, minus 6 and minus 5. Other, minus 14 and minus 14. So, all told, on a reported basis year-over-year, minus 2 basis points. And again, ex gas deflation, minus 11 basis points.

So, as you can see from this chart, the core merchandise component was higher by -- ex gas deflation by 63 basis points. Similar to the last several fiscal quarters, sales penetration has shifted to the core business, resulting in higher contribution of our total gross margin dollars coming from the core operations versus a year earlier.

Looking at the core merchandise categories in relation only to their own sales quarter-on-quarter, if you will. Margins year-over-year were higher by 71 basis points. Fresh foods was again the biggest driver here. With strong sales in fresh, we benefited from the efficiencies -- efficiency gains and labor productivity and significantly lower spoilage. That being said, the other three major merchandise categories, food and sundries, soft lines and hard lines, all had higher margin percentages year-over-year in the quarter as well.

Ancillary and other business gross margin was lower by 53 basis points and by 55 basis points ex gas deflation in the quarter, with most of the negative impact coming from gas and to a lesser extent from the aggregate of travel, hearing aids, pharmacy and food courts, offset a little bit by a positive impact from e-com. Costco logistics, which was our Innovel acquisition a year ago, impacted ancillary margins by 6 basis points to the negative. 2% reward, you can see, was impacted negatively by 5 basis points, implying that more of -- higher penetration of our sales are coming from the executive membership group. And other is the minus 14 basis points, all this is attributable to the costs of COVID-19 or about $60 million of the $246 million previously mentioned. These are the direct costs for incremental wages allocated to our manufacturing production and fulfillment operations.

Moving on to SG&A. Our reported SG&A in the second quarter was higher or worse year-over-year by 11 basis points on a reported basis, coming in at 9.89% versus 9.78% a year earlier. The minus 11 ex-gas deflation would have been a minus 3. Again, doing a little chart of comparison with two columns, both reported and then without gas deflation. First line item would be operations, a plus 31, so lower or better by 31 basis points core operations was on a reported basis. Without gas deflation, plus 38, so lower or better by 38 basis points. Central, minus 3 basis points and minus 2. Stock compensation, plus 3 and plus 3. And other, minus 42 and minus 42. You have those columns up on a reported basis, again, SG&A was higher year-over-year by 11 basis points and ex-gas deflation higher by 3.

The core operations component. When we -- you look at that was better by 31 or 38, excluding the impact from deflation. SG&A in the core, excluding the COVID-related expenses, which I'll discuss in a moment, was significantly leveraged with the strong core merchandise sales increases. Central, again, minus 2. Ex-gas deflation stock comp, plus 3. Both small year-over-year basis points changes together pretty much awash. And other was a minus 42 basis points hit to SG&A, which were incremental wage and benefit costs related to COVID or $186 million of that $246 million total amount. So, $60 million of the $246 million hits the margin and $186 million of the $246 million hits SG&A.

I'd like to take a minute here and discuss our COVID-related expenses and how they're changing effective this past Monday, March 1st. Over the past 12-month period, March 2020 through February 2021, company-wide, we expended approximately $1.060 billion pre-tax on COVID-related items. Of this amount, approximately $825 million related specifically to the $2 an hour extra hourly pay. The remaining $200 million plus was made up of several other items, including the few month period where employees 65 and older were paid to stay home. This was early on during the original lockdowns. Cleaning and mask supplies, paying wages to several -- for several weeks to our third-party demo service employees and assisting employees with paid childcare leave, which continues.

With the $2 an hour extra pay having been paid in for full year, that extra amount has been discontinued as of this past Sunday, February 28th. And effective March 1st, a few days ago, we have implemented a permanent wage increase for hourly employees, as well as most salaried warehouse employees. In the US and Canada, we are permanently increasing our starting wage and most wage steps above that by a $1 an hour. And increasing our top of scale hourly wage by $0.45 an hour on top of the previously planned $0.55 an hour increase for top of scale. With these changes, our entry level hourly wages will increase from $15 and $15.50 an hour to $16 and $16.50 an hour. Similar type increases are occurring in other countries, where we operate.

With this change, along with the reduction and/or elimination of several components of the $200 million plus expenses I just discussed, on a going forward basis, this $1 billion plus expensed over the past 12 months will be reduced by a little over one-half starting March 1st, which is week -- the beginning of week three in the current fiscal third quarter.

Next on the income statement is preopening expense. Pretty much the same year-over-year. This year came in at $9 million compared to last year's $7 million, so $2 million higher. In both fiscal quarters, there were zero openings, although this relates to upcoming openings as well. All told, reported operating income for the second quarter of 2021, including the $246 million mentioned earlier, showed an increase of 5.8% coming in at $1.340 billion this year compared to $1.266 billion last year.

Below the operating income line, interest expense was $40 million this year versus $34 million last year. Interest income and other for the quarter was lower by $26 million year-over-year, interest income itself was lower by $19 million due to lower interest rates. Additionally, FX and other was lower by $7 million. Overall, reported pretax income in the second quarter was up 3.3% coming in at a $1.319 billion this year compared to $1.277 billion a year earlier.

In terms of income taxes, our tax rate in the second quarter was 26.4%, a little higher than the 25.9% recorded in Q2 of last year. For all of '21 based on our current estimates, which of course these are always subject to change, we anticipate that our effective normalized total company tax rate for the fiscal year to be in the 26% to 27% range.

A few other items of note in terms of warehouse expansion. As I mentioned, we -- there were no openings in Q2. There were eight net new openings in Q1, so eight year-to-date. In the second half of the fiscal year, but this quarter, in the full fiscal quarter, we plan to open 13 more net new units, 5 of those will be in the US, 3 will be in Canada and 5 will be in overseas. Regarding CapEx. In the second quarter of fiscal '21, we spent approximately $573 million. Our full year CapEx spend is still estimated in the $3 billion to $3.2 billion range.

Moving on to e-commerce. E-commerce sales overall for the quarter ex-FX increased 75% year-over-year. A few of the stronger departments, over-the-counter pharmacy, garden and patio, small electrics, health and beauty and majors, including consumer electronics. Total online grocery grew at a very strong rate in the second quarter. The comp numbers just mentioned follow our usual convention and which excludes our third party same-day grocery program, which was up 450% year-over-year in the quarter. If we include the third party same-day in our e-com comps, the 76% reported comp number would have been 96%.

Costco logistics, formerly known as Innovel, continues to fulfill a greater percentage of our delivery and delivery items and has steadily increased since its acquisition a year ago March. In Q2, we made it a priority to enhance our white glove service, which includes assembly of complex installation. It's now standard on many items and offered as an upgrade on many others.

Turning to COVID-19 and some of the issues and impacts surrounding it. We continue to enjoy strong core merchandise sales. I think, our buying teams have done a great job, keeping our buildings stocked despite outsized demand on some items and some supply chain challenges as well. From a supply chain perspective, overseas freight has continued to be an issue in regards to container shortage and port delays. This has caused timing delays on certain categories, including furniture, sporting goods, lawn and garden and even some food and sundries items, like seafood, imported cheeses and oils. We expect these pressures to ease in the coming months, but it's impacting everyone, of course.

Regarding the pressures from high consumer demand, examples of areas where we have some supply issues on the non-food side, certain electronics due to chip and component shortages like TVs, computers and smart home related items, exercise equipment, bikes and outdoor activity items, lawn and garden items and appliances. On the food side, canned beverages have some shortages due mostly to the aluminum can issue shortages. Bacon is up 45% in pounds, and so for whatever reason there is a lot of demand there. So, there is a little bit of challenge there. Gloves, surface cleaning wipes and sanitizing sprays and some paper goods. Fresh foods overall is looking pretty good.

Our three warehouse curbside pickup test -- our three warehouse curbside pickup test in Albuquerque is ongoing. We don't really have a lot to add at this time as the test is recent and continuing. The pilot is going well and members have responded to it and basket size have actually surpassed our expectations. Our focus, of course, is how can we be more efficient at doing it to determine if this offering can become scalable and make economic sense for us.

Turning to our February sales results. The 4 weeks ended this past Sunday, February 28th compared to the same period last year. As reported in our release, net sales for the month of February came in at $14.05 billion, an increase of 15.2% from $12.2 billion last year. Again, going down the numbers that were in the release. On the US reported basis, we're up -- on a same-store sale basis, we're up 10.3%. That's both reported and with out gas and FX. Canada reported 21.6%, ex-FX 15.7%. Other international 25.7%, ex-FX 20.6%. Total company, 13.8% reported, ex-gas and FX 12.3%. Within those numbers, e-com 91.1% reported and without gas and FX 89.4%. As with the quarter, these numbers would -- e-com numbers would be higher if we included the third party same day fresh.

When we discussed last year's February sales results, we pointed out that the fourth week last year had a big uptick in sales. That kind of was the beginning of what we felt was a little bit of consumer -- pressure for consumers to buy in for fear of lockdown, again, primarily related to consumers buying ahead of the anticipated COVID lockdowns and closures. That positively impacted last year's February sales by approximately 3 percentage points. Similarly, sales in week four of this February -- this week, week four of this year February were lower as we anniversaried that unusually strong week from a year ago. The estimated negative impact to the February month was approximately 3.5 percentage points. So, the reported numbers of 13.8% and ex-gas and FX of 12.3% would have been higher excluding that impact.

Our comp traffic or frequency for February was flat to last year worldwide and up 0.7% in the US. Again, some impact of that last week. Worldwide, the average transaction was up 13.8%, which included positive impacts of 140 basis points from FX and 10 basis points of gas inflation. Foreign currencies year-over-year relative to the dollar benefited February comps in Canada by 540 basis points, other international by approximately 570 basis points and total company by 140 basis points. Gas price inflation again positively impacted total reported comp sales by about 10 basis points, whereas the average selling price was about a 1 percentage point higher year-over-year. In terms of regional and merchandising categories, the general highlights. US regions with the strong results were Southeast, Midwest and Texas. Internationally in local currencies, we saw the strongest results in Korea, UK and Japan.

Moving to merchandise highlights, the following comp sales results by category for the month and these exclude the positive impact of FX. Food and sundries were in the positive high single-digits. Departments with the strongest results were liquor, frozen foods and cooler. Hard lines were positive in the high 20s. Better performing departments were toys and seasonal, sporting goods, hardware and majors, which again is both white goods and consumer electronics for the most part. Soft lines were up and also up in the low 20s. Better performing departments included housewares, small appliances and home furnishings. And finally, fresh foods were up in the low 20s. Better performing departments included meat and deli. Ancillary business sales, as mentioned earlier, were down and they were down in terms of sales in the mid single-digits in February, primarily due to lower year-over-year sales in food court, hearing aids and gasoline.

Overall, a relatively good fiscal second quarter, impacted, of course, by COVID expenses, impacted both plus and minus by various aspects of our business due to COVID. And certainly as I mentioned in the ancillary, gas had the biggest of the ancillary hits. Finally in terms of upcoming releases, we will announce our March sales results for the 5 weeks ending September -- Sunday, April 4th on Wednesday, April 7th after the market close.

With that, I will open it up to Q&A and turn it back to Blena.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) Your first question is from Michael Lasser of UBS. Your line is open.

Q - Michael Lasser {BIO 7266130 <GO>}

Good evening, Richard. Thank you for taking my question. My first question is on the gross margin expansion that Costco has experienced over the last few quarters. Can we assume that as sales flow that you're just going to get back a lot of these gross margin gains, the shrink is going to go up and all the efficiencies that come along with double-digit comps go away or is there anything that Costco has learned that its now doing differently that will allow it to hold on to these gross margin gains?

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

Well, first of all, I don't think we're doing anything dramatically -- we're going to do anything dramatically different. I mean, we're already pretty aggressive on a lot of things and, of course, we're always trying to drive sales with aggressive value and pricing. Probably the one area, which can be a challenge or will be a challenge at some point is fresh. The particular strength in fresh foods for the last several quarters on a year-over-year basis has been the strong fresh has led to a higher labor productivity, which is part of the cost component of that, if you will, manufacturing businesses as well as lower spoilage or, what we call, damage and destroyed. In many cases, given the strength, you're not throwing away as much stuff at the end of the day or week and you're again being much more productive from a labor efficiency standpoint. At some point, that will subside is my guess. Beyond that, we feel pretty good about our ability to be very competitive and price along that way.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay. And you said going -- on the wage expense, going forward this $1 billion plus expense will be reduced a little by half starting March 1st, given the permanent wage increases. So, we should just take half of the $1 billion, so $500 million of expense that Costco has incurred over the last four quarters, and that's going to go away or it will be, even though your wages will be increasing, your SG&A dollars should go down?

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

Well, SG&A, and then as I mentioned earlier, the COVID-related premium wages, the $2, that $800-plus million, a piece of that hit margin because of our manufacturing businesses, the labor involved on the manufacturing side that's part of cost of sales. And so, again, if you looked at those proportion, I think of the $246 million, we said $60 million related to margin hit and $186 million related to SG&A hit. A simple guess would be to take that type of percentage of these numbers and apply quarterly maybe a little bit more to SG&A than that -- those percentages. And so, yes, if you looked at the $1.060 billion that we talked about and we save a little over half, so simple math would suggest that a little over half of that should come back, although we'll stop talking about COVID-related expenses too as we've now anniversaried it.

Q - Michael Lasser {BIO 7266130 <GO>}

Understood. Thanks again, Richard.

Operator

Your next question is from Simeon Gutman of Morgan Stanley. Your line is open.

Q - Simeon Gutman {BIO 7528320 <GO>}

Hey, Richard. How are you? My first question is also on gross margin. Can you -- I just want to clarify because there was a big swing in the reported number. Core on core looked pretty healthy, very similar to the prior quarter, you said I think plus 71. And so, the big swing here was pretty much mostly gas or all gasoline? And can you remind us when does the gasoline margin compare peak? Does it get worse before it gets better?

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

A year ago in the third quarter, we pointed out that it helped us, but it's -- like it is gas, it is volatile. And the profitability in gas goes up and down dramatically. It's a meaningful business for us. And as prices go up, we generally make less, which has happened of late, and not -- I think not just for us, but the supermarket chains, the other discount stores that operate, chains of gas stations. And so, we again directionally try to point that out each time. But there is no rhyme or reason, it could change on a dime.

Q - Simeon Gutman {BIO 7528320 <GO>}

Fair enough. And I guess just to clarify, but it is right the core looks like it was consistent with prior quarters, the big swing in the reported was just -- then the remainder was mostly due to gas in this quarter, right, why it was down --

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

Right. Gas was more than half of all those other things (inaudible). Surely travel is impacted, as you well know right now, probably the food courts because we're still not open with seating essentially, optical as well. So, all those are impacting, but gas is -- was the prime mover there. I was looking back at last year, what we call -- again, what we call, warehouse and other businesses, which again gas is a (inaudible). When there are big swings, it tends to be gas is the biggest component of that. A year ago in Q1 versus a year earlier, that'll be Q1 '20 versus '19, that number -- I don't have the detail on gas, but it was 19 basis points to the positive and Q2 year-over-year was 2 to the negative and Q3 was 21 to the positive and Q4 was 71 to the negative. So, you can see it fluctuates. This year in the first quarter, it was 20 to the negative and now 55 to the negative. And again, there is a lot of components to that number, not just gas, but gas generally tends to be the big mover there.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay, that's helpful. And then my follow-up question is on SG&A. If you look at SG&A year-to-date, so Q1 and Q2, and you exclude all the premium pay, right, where you're excluding it from this year, even from last year, it looks like SG&A is still taking a step up year-over-year, but higher than what looks normal like in prior years. And I don't think that's incremental wage changes, I don't know if there is anything else that's changed in the business this year-to-date from an SG&A perspective. You'll have easier comparisons because the premium stuff starts coming up in the back half, but is there any reason why you structurally stepped up in the first half of this year?

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

Well, dollar -- well, I think it's the strong sales. As a percentage of sales actually, I think you'll find it goes directionally better.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay. Yeah. I was just looking on -- yeah.

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

Yeah. I'm looking at core operations for all of fiscal '20 versus all of fiscal '19. Ex-gas deflation basis was lower or better by 25 basis points. Again, that's not -- we separate that below the quarterly stuff or the unusual stuff, the COVID stuff, but the core business was lower or -- had lower or better SG&A percent by 25 basis point for the entire year. This year in the first two quarters, it was plus 62 and plus 38, so that's on average 50.

Q - Simeon Gutman {BIO 7528320 <GO>}

Fair enough. Okay. Thank you, Richard.

Operator

Your next question is from Chris Horvers of JP Morgan. Your line is open.

Q - Chris Horvers {BIO 7499419 <GO>}

Thanks. Good evening. So, one to follow-up on the February commentary. So, last February, February 2020, you did a 9 in that last -- or you did a 12 in that last week added 200 basis points. So, that would suggest you did about a 20 in that the last week of February. And just running the math, that would suggest that you were just slightly down, if it was 350 basis point headwind, down maybe on like a stack basis maybe like 1% or 2%. Is that right?

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

No, I think -- I agree with what you said about last year. This year, the first three weeks were a little over 17 and the last week brought that 17 down to 13.8.

Q - Chris Horvers {BIO 7499419 <GO>}

Okay. So, you were down --

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

Yeah. Maybe I explained it differently each year, but yeah, the -- basically the 13.8 reported for the first three weeks was low 17 and the fourth week caused it to be a 13.8 for the whole four weeks.

Q - Chris Horvers {BIO 7499419 <GO>}

Right. So, you comped down -- right. So, you comped down high teens basically. So that -- so as you look ahead, it's interesting because -- but at the same time, as you look forward, the comparisons remain tough, but you also meter traffic in your stores quite aggressively. I mean, I think peers were up double-digits in the month of March and April and you were actually down in April. So, can you talk about to what degree do you think you actually left business on the table as we think about just trying to model out against these comparisons going forward?

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

Well, I can't speak for others. We're frankly thrilled with our sales numbers and our -- and how we've done over the course of last year. As you look at both March and our fiscal third quarter, March, this giant step up in sales and traffic and hoarding, if you will, by customers started week four February and lasted through about 2.5 weeks into March. So, we'll talk about it specifically when we report March sales. As it relates to the fiscal quarter, which is essentially mid-February to mid-May, I don't have the exact dates in front of me, but that 12-week, period, it included not only that tough comparison for those 3, 3.5 weeks, which include week 4 February and weeks 1, 2 and part of 3 in March, but also when there was a lockdown and an offset that in kind of late March into April and even early May, we had some very tough compares. And so, that will make, in our view, all things being equal, an easier comparison. So, I think there's going to be a plus and a minus that probably add up to about even, we'll see. The next challenge, of course, will be Q4, which is mid-May through the end of August. That's when we enjoyed comps in the 12% to 15% range on an ongoing basis into September and October as well. But for Q4, where we saw a lot of strength, not only on the food side, but on the non-food side as people were buying things for the home as they weren't traveling going to sporting events and the like.

Q - Chris Horvers {BIO 7499419 <GO>}

Okay. And I just want to fall back up on the February math, sorry to delay this. But it was -- were you actually modestly positive in that last week or just under-comped the average and it brought it down?

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

Modestly positive, yes.

Q - Chris Horvers {BIO 7499419 <GO>}

Got it. Understood. Thanks very much.

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

Yeah.

Operator

Your next question is from Chuck Grom of Gordon Haskett. Your line is open.

Q - Chuck Grom {BIO 3937478 <GO>}

Hey. Thanks a lot, Richard. I know gas gallons have been a drag on the top line. But when you look at your business geographically and overlay that with markets that are maybe a bit farther along in the reopen process, just -- I'm wondering if you've noticed any improvement in gas gallons?

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

You are -- a little bit. Overall, I mean, our gas gallons year-over-year, I think in -- was February the quarter, in the quarter were down 9% or 10%, which is an improvement -- relative improvement. And within that in some of the regions like in the South, Texas, Florida, you've seen a little better improvement.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay, great. Thank you. And then just on the balance sheet, inventory dollars were up 17 -- roughly 17%, it was a little bit ahead of sales. I guess, how are you feeling about the currency of inventory as you transition out of current trends or some of those spring items?

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

Yeah. We made a conscious effort a couple of months ago. I think on the -- even on the last quarterly call, we talked a little bit about some of the challenges with port delays both on the foreign side where the merchandise is coming from, as well as the ports along the West Coast of North America, in particular, and container shortages. So, we were front-loading and not everything came in short. So, we have front-loaded items that are not seasonal items or front-loaded extra inventory of basics. And so, I'm not concerned about that at all.

Q - Chuck Grom {BIO 3937478 <GO>}

Got it. Thank you.

Operator

Your next question is from Mike Baker of DA Davidson. Your line is open.

Q - Mike Baker {BIO 4323774 <GO>}

Hi, thanks. I just wanted to ask about your view on inflation versus pricing in the market. One of your big competitors talked about being satisfied with their price gaps, which maybe means there will be a little bit less pricing pressure out there. So, how do you think about that? And again, how do you think about inflation despite mid-year sort of moderating a little bit, but now with commodity costs back up, maybe it goes up again from here?

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

Well, I'd say in the last several months, we've seen a little more inflation than we had in part because of some of the container shortages, freight costs are a little higher, there are some high demand items or product shortages due to supply chain in general that have gone up. When they asked on a broad stroke basis on some of these items, what type of inflation we're seeing, sometimes as much as 2% to 4%, sometimes less than that. And on meat, it's trended upward in the mid-singles, pork in the high-singles, that's why bacon -- I mentioned bacon. And -- but we feel good about our competitive ability. Where -- we always want to be the last to raise and the first to lower and -- but we feel -- again, as you look at our margins, we feel good about where our margins are coming in and our ability to be very competitive out there.

Q - Mike Baker {BIO 4323774 <GO>}

Okay. That makes sense. So, are we seeing panic buying in bacon yet or we're not at that point yet?

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

Probably tomorrow because I mentioned it.

Q - Mike Baker {BIO 4323774 <GO>}

Yeah. Exactly. I'm heading there tonight. Thanks.

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

Yeah. Thank you.

Operator

Your next question is from Karen Short of Barclays. Your line is open.

Q - Karen Short {BIO 20587902 <GO>}

Hi, thanks. I wanted to get back to this SG&A and/or, I guess, gross margin question. So, when I look at the EBIT growth in this quarter versus sales growth and I back out COVID costs, the second quarter was by far the narrowest gap. So, 3Q, 4Q, 1Q and 2Q, like you are a third of what you were in 1Q, like half -- more than half of -- or less than half of what you were in 4Q, 3Q. So, it clearly is a question of like the gross profit dollar growth versus the SG&A growth. So, I guess, I'm wondering, can you just talk through that a little bit more because the change in this quarter just is somewhat glaring?

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

Well, I think, again, Karen, it gets back to gas. Gas is a high sales dollar number and the impact to -- somebody put me on mute please, the impact to gas is both dollars and average price to lower gross margin as well. That's really the biggest piece of it.

Q - Karen Short {BIO 20587902 <GO>}

Right. But I'm talking EBIT dollar growth, excluding COVID costs, versus the sales. So, I guess -- yeah. I mean, I guess, sales I have to adjust for gas, but it just still sounds like a very widespread -- or wide --

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

Well, again, without being specific, dollar specific, the biggest dollar impact year-over-year in profitability, if I -- when I mentioned these various pluses and minuses was gas.

Q - Karen Short {BIO 20587902 <GO>}

Okay.

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

And it's a combination, it's a 10%-ish piece of our business, which had a lower gross margin and lower dollar price per gallon, both of those things would -- in terms of lower sales, lower profits and that's impacted.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then just turning to the forward look on gross margin. Obviously, appreciating the fact that shrink and the fresh strength will hurt potentially gross margins as we get into the next couple of months, but ancillary should, I guess, help offset some of that, appreciating gas may is -- you can't predict that. But can you maybe talk through the dollar buckets, gross profit dollars in the other categories within ancillary?

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

Well, again, travel should improve, recognizing how much it will improve, we'll wait to see, but it's starting to improve a little bit. Food courts will improve, the same thing as we start to put out seating and expand what we offer there. Now, when that occurs and how that occurs, we're not going to -- we're probably going to do it in certain regions first and go from there. Gas is the big unknown and the big guesstimate of which direction it goes each week, but we'll again try to point that out to you.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then --

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

Here, we've seen -- we have seen a period improvement in hearing aid and optical.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then just last one from me. Is there any impact to the SG&A dollars from the enhanced white glove service that you could call out?

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

There's better efficiencies, although keep in mind, we have really grown this thing fast of taking our -- some of our existing -- not only have these departments grown dramatically in the last year, we were using third parties for a lot of it. And we continue to push more on there and to improve the service to lower the price. And so, I think you should see that should continue to improve, but it was not without its cost to accomplish all that in the last quarter.

Q - Karen Short {BIO 20587902 <GO>}

Okay, thank you.

Operator

Your next question is from Paul Lejuez of Citigroup. Your line is open.

Q - Brandon Cheatham

Hey, everyone. It's Brandon Cheatham on for Paul. I was wondering, if we could circle back on the inflation question and kind of go through some of the puts and takes of inflation items that you'll be anniversarying coming up in the coming quarters.

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

Well, I don't think we're anniversarying any of it soon, it's just starting to happen in the last month or two. And again, a lot of it has to do -- in our view, you've had a little bit of inflation over the last year with -- on things like paper goods because there's just a huge demand and the shortages. But in terms of some of the recent things, with container shortages and port issues, some supply issues on chips and components of big ticket items, cost of steel is up 50% to 100%, all those things impact that. I think it's more -- this has happened in the last several months versus a year ago.

Q - Brandon Cheatham

Got it. Can you quantify the impact of freight costs and some of the container issues had on this most recent quarter?

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

I can't off -- with the notes that I have in front of me. I mean, anecdotally, if you look at what is the cost per container coming over, it used to be -- it's up 10% to 15%.

Q - Brandon Cheatham

Okay, That's helpful. That's it from me. Thank you.

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

Yeah.

Operator

The next question is from Scott Mushkin of R5 Capital. Your line is open.

Q - Scott Mushkin {BIO 7138867 <GO>}

Hey, guys. Thanks for taking my questions. So, I kind of wanted to think about the business a little more strategically, Richard. And I understand we went through a period where you did the Citibank deal and then you guys didn't talk too much about it, but you really expanded your fresh offerings, which I think helped the clubs and drive some traffic. I was wondering, if you think about the business over the next couple of years and we think about kind of self-help initiatives, where do you think there's some levers that you guys can pull?

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

Well, I think, first of all, some of them are ongoing, Kirkland Signature continues to be something that will continue to increase the offerings that we do. There aren't any giant billion-dollar ones, items like -- there is a handful of items like paper towels and toilet paper, water that are huge. There's the K-Cups and those things that are in the hundreds of millions of dollars, but there is lots of 20s to 100s out there and we continue to do that with all kinds of quality organic packaged food items as well. I think one of the things that we've seen from some of our vertical integration is starting to pay off. We've got the chicken facility at full capacity now, we've got a great bakery commissary, we -- two years ago, we opened a second meat plant. We're seeing some improvement from that.

We're also starting to identify items that historically we manufactured in one place generally the United States and then shipped all over the world, whether it's roasting of nuts and cashews. And -- yeah, and doing -- bringing all that product from where it's grown to the US for roasting and packaging and shipping out worldwide. We now have a supplier in Asia that is doing all the needs for Asia, Australia and dramatically we're able to dramatically reduce the price and drive sales and drive bottom line dollars for us. We're doing that with all -- we're looking at all kinds of avenues to do that with, from paper goods, to things like that as well. So, I think these are long-term opportunities, but there should be a lot of them over the next several years.

Also, e-com, notwithstanding our start back in the early 2000s, we like everybody has -- that's become more important over the last year, in particular. It's approaching 10% of our business and continuing to grow nicely and we're driving -- we're getting better at doing it and getting more clicks and the like in that regard. So, I think ecommerce -- and then the big and bulky, our acquisition of Innovel last March. All you see now, and we've pointed out I think for the last three fiscal quarters, 6 or 7 basis point hit to gross margin as it relates to the -- it's like in manufacturing business, service business that goes ultimately back into our cost of sales (inaudible) costs, notwithstanding the fact that that has helped drive sales of big and bulky items and in fact lowered the prices to our members on some of those items. So, we think that that's -- as expected, it was going to be earnings dilutive at the operation standpoint for the first couple of years and be fine there. But more -- as importantly, if not more importantly, a growing big and bulkiest part of our business. We're seeing big -- continued big increases for mattresses, to white goods, to exercise equipment, notwithstanding the fact that there has been some shortages in some of those items.

Q - Scott Mushkin {BIO 7138867 <GO>}

That's great. Thanks for all the color. It was perfect.

Operator

Your next question is from Scot Ciccarelli of RBC Capital Markets. Your line is open.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Thanks. Good afternoon, guys. So, as you guys get food inflation on meat, pork, et cetera, are price increases there a direct pass-through to the customer or do you guys try to be sticky on some of your prices the way you have been with rotisserie chickens, for example?

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

Yeah. I don't think we'll be as extreme as the old chicken example from 15 years ago, where we stuck -- we continued to stay at $4.99 and figured out ways how to do that, but certainly we are -- we want to be the last -- we want to be as sticky as possible and hold off and we'll wait until our costs has come through the system. But overall, particularly on fresh items, those prices probably change more often than not both at traditional supermarkets as well as the Costcos of the world.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. And then --

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

In fact, the other thing I want to mention is, we're a little unique in terms of our product mix when you look at it. We're selling part of our meat business is prime. And those are the types of things where we can get a strong margin for us and show even greater savings because the markups traditionally on something like that special item are even higher at traditional retail outlets. So, we think overall we're in a good stead in that regard.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

That's helpful, Richard. And then you did mention your chicken plant is -- I think it's been for a bit fully up and running, are you generating the efficiencies you guys originally anticipated when you first went down that road?

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

We're pretty close. I mean, we're at full production, which is similar. There has been some puts and takes. We -- as we built it, we decided to put in additional things that we think provide for higher quality product, like air chilling and things like that. The COVID expenses certainly have impacted us more than -- nobody had planned for it. So, that, of course, should improve over the next year. I think it's -- the feed costs, we've been fortunate. Historically, we've been -- in the first year, we were fortunate, feed costs are coming up a little bit, but we're also finding that the chickens are growing a little better than we thought. And so, all those things add up to -- we feel pretty good about it.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Great. Thank you very much.

Operator

Your next question is from Greg Melich of Evercore ISI. Your line is open.

Q - Greg Melich {BIO 1507344 <GO>}

Hi, thanks. I just -- I want to start just to clarify the inflation at the risk of being fourth comment on it. You said that there are items that are higher, right, but the 2% to 4% comment, Richard, was that saying what you actually think it is now in your average ticket or was that just saying some items or in other words just, would you estimate the whole benefit is like 1% or 2% right now?

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

Yeah. Some categories are in that 2% to 4% range and some are a little -- I mentioned like meat and pork a little higher than that, produce is flat, but we don't do LIFO anymore. But I think if you looked at our costs on average, the view is probably flat to up 1%, 1.5%, but somewhere in that range. That's a guess.

Q - Greg Melich {BIO 1507344 <GO>}

Okay. Fair enough. Thanks for that clarification. Second is, what -- you went through another renewal rates. I guess, as you're thinking about it now, what do you think you could really get renewal rates to? And maybe tied in with some of the other things you have to really drive loyalty, like the credit card program. Any update there in terms of what sort of engagement you have with it, what percentage of customers or sales are on the card to help us understand where that renewal rate could be trending?

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

Sure. Well, look, what we internally call the triple play is not only getting to become a member, but upgrade to the executive member and then to apply and get the Citi Visa card. Recognizing that not everybody that applies for it gets it based on credits. That credit decision is made by the issuing bank, not by us. And the -- I'm sorry, I lost my train of thought. Renewal rate. In terms of improving renewal rate, as we do add people to the credit card and to executive membership, both of those things tend to increase -- provide for more loyal customer or a high renewal rate. Also, we're doing more things to get to auto renew, whether it's on the Citi Visa card or working on some other areas right now as well. To the extent we get you to auto renew by almost de facto, there's going to be a high renewal rate on those as well. First and foremost, it's the -- ultimately, it's the things we do to make you want to remain a member of Costco. And we think that some of those things like upgrading to executive membership, which we've shown you continues to be part of our quarterly positive there as well as getting more people to auto renew. Can you hear me?

Q - Greg Melich {BIO 1507344 <GO>}

Yeah, I can. (Multiple Speakers)

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

We heard that.

Q - Greg Melich {BIO 1507344 <GO>}

And then last, is there any hope on travel bookings, any sort of glimpses there or is that still depressed?

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

It is coming back, but it's the same thing I said back in the springs -- in the summer when there were some easing of COVID statistics and people were starting to book out for Christmas and even into the winter and spring of 2021, but they did it knowing that there was generally full cancellation capabilities. We're now seeing -- and as you might expect, many of those things were canceled. Now we're seeing the same thing again. We've also -- travel department, we're doing pretty well relatively speaking on car rentals. And as it relates to travel and hotel bookings, we have added some additional domestic items and Mexico items for the domestic -- for the US domestic market as well. Hawaii and Mexico are pretty strong. Again, within the relative framework, there's some 4 and 5 star things that we've gotten in other parts of the world, which we wouldn't talk to us a few years ago. But -- so we're optimistic it's going to come back and expected and we've certainly I think improved our offerings.

Q - Greg Melich {BIO 1507344 <GO>}

Excellent. I -- just putting heart pressure monitors across from the bacon going forward.

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

There you go.

Q - Greg Melich {BIO 1507344 <GO>}

Thanks. Good luck.

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

There is a fast food retailer out there that has an interesting name for that, anyway. Why don't we have two more questions?

Operator

Your next question is from Greg Badishkanian of Wolfe. Your line is open.

Q - Spencer Hanus {BIO 21658453 <GO>}

Hi. This is Spencer Hanus on for Greg. My first question is, how should we think about how much of those -- of the share gains that you have this year you'll retain? And then the low single-digit comp in the last week of February, how does that compare your -- to your internal expectations?

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

Let me answer the last question first. I mean, we -- all we knew is that week 4 February compared to a year ago and weeks 1 and 2 and part of 3 of March were going to be tough compares. I think we -- we actually did a little better than we thought, but still it was a low number, given the strength a year ago. And I'm sorry, what was your first question?

A - Unidentified Speaker

Market share.

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

The TV market share. Look, at the end of the day, some of it's going to be sticky and some of it's not. We all personally hope that restaurants will reopen and we'll all be able to go out and enjoy and socialize. That will impact retail food sales at Costco and supermarkets and the likes to some extent. That being said, there are other retail formats, whether it was restaurants and food that have closed for good, apparel retailers, other general merchandise retailers. So, in some ways, some of the stickiness unfortunately relates to certain aspects of retail that have closed for good. And some of it will be that they've gotten more comfortable buying some of these things from the likes of Costco. I hope we lose some of it to the examples of restaurants and the like and other stores that were impacted as they can reopen. And -- but I'm sure that we will end up keeping a little bit of it as well.

Q - Spencer Hanus {BIO 21658453 <GO>}

That's helpful. And then for the new members that you've recruited during COVID, how are they different than previous cohorts? And are you expecting to see renewal rates in line with the overall company average?

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

Whenever we sign up a member, if you look at our 90-point-whatever-percent renewal rate in the US and Canada, that includes some 10-year plus members that are 93% or 94% or 95% and includes some members that -- in the last two years that might be mid 70s to mid 80s. So, you're always -- from year zero to year one of renewal, it's going to be a lower rate. And year one to year two, it's a combination of two-year members plus some new one year members picks that renewal rate up. So, my guess is some of these new ones, again, they're going to follow that format. The other thing though is in some cases, we think we've gotten new members sometimes in markets where we don't even operate physical stores, not a lot, but it can't hurt.

Q - Spencer Hanus {BIO 21658453 <GO>}

Got it. Thank you.

Operator

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

Q - Rupesh Parikh {BIO 15915617 <GO>}

Good afternoon and thanks for taking my question. So, Richard, I just wanted to ask you just about e-commerce fulfillment capacities. You guys have obviously registered very strong growth last several months. So, just curious where you guys are from a fulfillment perspective and whether you would expect to see a step-up in investment going forward?

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

Well, I think there has been a step-up in the last couple of years and it's continued this year. We are building additional fulfillment as we speak -- fulfillment capability. We're getting better at it, but so is everybody that have seen this kind of wild growth. In some ways, we think it may be easier for us because of the fewer items. We're doing the two-day grocery still through our business centers, which works pretty smoothly. So, it is a larger percentage of the $3-ish billion we spend every year than it used to be, but certainly the biggest single percentage is still opening new warehouses.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Okay, great. And then maybe just one follow-up question. So, clearly, you guys -- sorry, go ahead.

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

In addition to physical capital expenditures, there's also IT capital expenditures, which is part of our CapEx as well. And there is a lot of investment in that around everything from e-commerce, from mobile app, to fulfillment and the like.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Okay, great. And then just given the announcement on the increase in minimum wages, do you see any other levers going forward that can offset some of the wage pressures that we've seen maybe on a multiyear basis in your business?

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

From the beginning -- I used to think about that question 30 years ago, and what we find is that we're always able to -- because we've got a great employee base and -- that are hard working and loyal and know that we care -- we as a company -- they're cared about, I think that we feel that we've seen over the years everything from inventory shrink, to labor productivity -- certainly, we measure these things too, but labor productivity and a lot of it has to do with coming up with ideas, many of which are -- these ideas come from our employees that are on the ground, if you will, working in the meat department figuring out how to be more efficient with pounds per hour -- per labor hour. So, we've always figured out ways, not worried about, let's figure out how to save it and then we can give it -- pass it on to them, let's pass it on and we'll get there from an efficiency standpoint. And it seems to have worked for us.

Yeah. Other things like we now have self checkout in 50% or 70% of our 558 Costcos in the US. It will be in virtually all of them and we'll see it in other countries as well. That's a savings that took us a while to believe part of it and to figure out. I think we're on the third format of it -- version of it, but it's working in our environment the way we want it to, and we see savings there. So, we're constantly figuring those things out and we attribute a lot of that to many of these good ideas don't come from the rooms here at the office, they come from the people out on the floor.

Q - Rupesh Parikh {BIO 15915617 <GO>}

Okay, great. Thank you.

Operator

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

Q - Edward Kelly {BIO 21274619 <GO>}

Hi, Richard. Thanks for squeezing me in here. I just wanted to go back, first of all, on the ancillary gross margin. You talked about gas being a bit more than half, so the remainder is pandemic-related, I guess, 15, 20 basis points. Has that drag been consistent there since the pandemic began? So, if I look back over the other quarters, whatever sort of remainder there would just be the gas movement?

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

Yeah. Yeah, it's -- I think it was worse last year in Q3 and it -- but it's been similar, it's improving a little right now, but still negative year-over-year. The big delta is, as you had gas in quarters where we talked about gas was a big positive, it offset -- more than offset some of these other negatives.

Q - Edward Kelly {BIO 21274619 <GO>}

Right. Okay. So, we have that coming back when life normalizes. And when you look at the other segment of the gross margin, how much of that's going to come back because the 16 -- will the wage increase play a role there, so should I assume only half of that comes back?

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

Well, I think from simple math, we talked about the $246 million for this quarter in total for COVID-related. And of that, $60 million impacted margin. So, $60 million over $246 million, whatever that percentage is, a little under 25%. And on an annual basis, we talked about $1.060 billion and a little over half, so just take half of that. That's kind of the net improvement or pretax improvement in margin from that. I'm sure if there is other outliers, we'll explain them to you as we go into each quarter. Some of the things -- that's the easy one because it's big and we know what we're doing with it. The unknowns are, how quickly will travel come back? Travel is a very high margin, low SG&A business. Food courts, it will improve dramatically once we get tables out there everywhere, and that's not going to happen tomorrow afternoon, but it's going to happen, God willing, over the next several months.

Q - Edward Kelly {BIO 21274619 <GO>}

Okay. And just one last one for you. So, on the core, historically, the core margin really hasn't been up. It's obviously doing very well right now. Going forward, I mean, you could still have maybe mix benefit from things like stimulus, but don't we eventually just sort of assume that what we've seen over the last few quarters sort of normalizes back to pre-COVID level and we take the margin down by that amount?

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

I feel a little stronger than that in terms of the positive. I think that on the fresh side, yes, at some point when you have your tougher year-over-year compares, you're not going to get those big basis point improvements from spoilage and labor productivity. Now, some of it though at these new levels, you have more productivity. We're not going to necessarily lose it all, but if it's a tough compare, you lose a little -- you lose some of it. So, yes. On some of the other categories, particularly as we increase Kirkland Signature, as we sell certain things within fresh that are specialty items where we can get a full margin, show an even greater savings in some cases, some of the vertical integration, some of the things I mentioned like the nuts and cashews, these are all little things, but those tend to offset some of those things. I'm not suggesting we're going to keep it all, but I think that we're going to do better than people -- than the question has a concern about.

Q - Edward Kelly {BIO 21274619 <GO>}

Great. Thank you.

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

Thank you. Well, thank you for listening. We're all here. If you have any additional questions, you know who we are, and have a good afternoon. Thank you, Blena.

Operator

You're welcome, sir. And ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect