Company Name: Costco
Company Ticker: COST US
Date: 2017-10-05
Event Description: Q4 2017 Earnings Call

Market Cap: 68,479.26
Current PX: 156.63
YTD Change($): +2.74
YTD Change(%): +1.780

Bloomberg Estimates - EPS
Current Quarter: 1.317
Current Year: 6.439
Bloomberg Estimates - Sales
Current Quarter: 30829.235
Current Year: 136674.476

Q4 2017 Earnings Call

Company Participants

- Richard A. Galanti

Other Participants

- Simeon Ari Gutman
- Michael Louis Lasser
- John Heinbockel
- Christopher Horvers
- Karen Short
- Matthew J. Fassler
- Paul Trussell
- Charles Grom
- Oliver Chen
- Peter S. Benedict
- Scott A. Mushkin
- Daniel Thomas Binder
- Kelly Ann Bania
- Chuck Cerankosky
- Robert Iannarone
- Joseph Feldman
- David Bellinger
- Mark Stiefel Astrachan

MANAGEMENT DISCUSSION SECTION

Richard A. Galanti

Financial Highlights

EPS

- In today's press release, we reported our fourth quarter and FY-end 2017 operating results for the 17-week and 53-week periods ended September 3, and our September sales results for the 5-week retail month ended this past Sunday, October 1
- For the 17-week fiscal fourth quarter, reported earnings came in at $2.08 per share, up $0.31 over last year's fourth quarter EPS of $1.77
- In comparing our y-over-y fourth quarter operating results, several items to note
- First, of course, this year's fiscal fourth quarter was comprised of 17 weeks of operations
- Last year's fourth quarter results covered 16 weeks, and we just finished a year which had the extra week in it

Citi Visa Co-Brand Credit Card Program

- Second, the improved results related to co-brand credit card as we reported in each of our first three quarters of FY2017, and the Citi Visa co-brand credit card program again positively impacted our y-over-y gross margins by 14BPS and SG&A expenses by 8BPS, and our overall bottom line in Q4 benefiting earnings y-over-y by an aggregate of 22BPS or $0.13 per share over the 17-week fourth quarter
- More detail to follow later in the call on this
- Gas profitability, the third item
- Our profits from gas during the quarter as compared to last year's fourth quarter were higher by about $40mm pre-tax or $0.05 per share

Gross Margin

- Number four, gross margin
- This year's fourth quarter gross margin included $20mm of pre-tax benefits from nonrecurring legal items, which were partially offset by about $10mm reserve charge for inventory losses attributable to Hurricane Harvey
- Together, this net $10mm pre-tax benefit represented a benefit of 2-basis-point improvement to gross margin or about $0.015 share of benefit to the EPS

SG&A

- Fifth item of note, SG&A
- This year's fourth quarter SG&A expenses included an $11mm or about $0.015 negative hit related to Hurricane Harvey
  - This represented about a 3-basis-point detriment to our reported SG&A percentage in the quarter

FX

- Number six, modernization-related IT as percent of sales only slightly higher by 1 basis point y-over-y
- Next, FX
- There's two FX items to point out
- On an operating basis compared to a year ago, foreign currencies had a very slight negative impact to earnings, less than $1mm pre-tax
- Also in our interest income and other line, the y-over-y swing in gains and losses related to accounting for our FX exposures in the other countries where we operate
- In Q4, the y-over-y swing was about a minus $12mm pre-tax or $0.02 per share hit, impacting EPS y-over-y
- Last year in Q4, we had a gain of $11mm in terms of these items
  - This year, we had a loss of about $1mm recorded in this year in Q4

Income Tax

- Number eight, income taxes

- We had favorable discrete tax items in both fourth quarters, both this year and last
- In last year's fourth quarter, discrete tax items benefited last year's fourth quarter earnings by $0.05 per share
  - This year's fourth quarter discrete positive tax items benefited EPS by $0.03, so $0.02 less of benefit this year over last year

LIFO

- And lastly, LIFO
- There was no LIFO charge or credit in this year's fourth quarter results, whereas last year's fourth quarter results had a LIFO credit of $31mm, reflecting deflation in our LIFO indices a year ago, or $0.04 per share benefit last year vs. zero this year

Sales

- Turning to fourth quarter sales, reported sales were up 16% in the quarter, including the benefit from the extra week, and reported comparable sales figure, which compares a like-for-like number of weeks y-over-y, was up 6.1%
- For the quarter, the plus 6.1% comp sales figure was helped by gasoline price inflation to the tune of about 0.5 percentage point and hurt slightly by a slight detriment from the FX impact

New Openings

- In terms of new openings, in Q4 we opened 12 new locations, 6 in the U.S., 2 in Canada, and 1 each in Australia, Japan, Iceland, and France, the last two countries being new countries for us as well
- As of our FY-end, we operated 741 locations worldwide, including 26 new buildings during the year
  - We opened 28 but two of them were relos
- This afternoon, I'll also review with you membership trends and renewal rates and update on our co-brand Citi Visa Card
- I'll discuss a little bit further about margins and expenses
- I'll discuss e-commerce results and some recent initiatives, a couple of other new initiatives as well
  - And lastly, I'll give you a recap of our September sales results for the five-week period ended this past Sunday

Q4 Results

Sales

- So onto the results
- Sales for this year's fourth quarter, the 17 weeks ended September 3, were $41.36B, up 16% over last year's $35.73B
- On a reported comp basis, Q4 comp sales were up 6.1% for the quarter on a reported basis, up 5.7% after accounting for fluctuations in gas prices and FX

- For the quarter, our reported 6.1% comp sales results were a combination of average transaction increase of 2.1% for the quarter and average shopping frequency increase for the company worldwide, 3.9% up, and within that 3.9%, it's up 4.4% for the U.S

International Performance

- In terms of sales comparisons by geography, for Q4, within the U.S, the Midwest, Southeast, and Texas regions were the strongest, with other U.S. regions not far behind
- Internationally, in local currencies, better performing countries were Japan, Mexico, and the UK
- In terms of merchandise categories in the quarter, within that in that 6% reporting comp, food and sundries up about 4%
- Strong categories include spirits, deli, and frozen
  - Hardlines up in the mid-single digits
- Overall, strongest departments results were lawn and garden, tires, toys, and consumer electronics itself were up in the high-singles

Softlines

- Softlines were up in the high-singles overall with housewares, jewelry, and home furnishing showing the best results
- And in fresh foods, comp sales were in the mid-single digits, relatively consistent across various departments of meat, bakery, deli, and produce
- Within ancillary, gasoline had strong comps in the quarter aided by higher average sell price this year vs. last, as well as very strong gallon growth
  - In addition, hearing aids were up in the mid-teens, followed by optical and food court

Membership Fees

- Moving to the line items of the income statement, I'll start with membership fees
- Membership fees were up 13.4% or $111mm y-over-y
- As a percent of sales, they were down 5BPS, that is, we expect, in part due simply to strong sales results
- Of the $111mm increase in fees y-over-y, about $15mm related to the membership fee increases we took
- A little over half of that $15mm from the fee increase is taken in our international operations last September 2016, and the balance from the June 1 increase is taken in the U.S. and Canada recently

Renewal Rate

- In terms of membership, the renewal rates are fine
- There's still some slight negative renewal rate impact from the U.S. credit card conversion last year, and we expect that to continue for at least a quarter or two
- And we continue to see increased penetration of our Executive Membership

Gold Star and Business Primary

- In terms of number of members at Q4 end, at year-end
- Q3 end we started with Gold Star of 37.8mm, and at the end of the quarter, at the end of the year, we had 38.6mm
- Business Primary was 7.4mm at each period
  - Business add on, 3.4mm
- Total member households 48.6mm at third quarter-end, and 17 weeks later at FY-end, 49.4mm
- All told, cardholders were 88.99mm a quarter ago, and fourth quarter at year-end was 90.3mm
- At year-end, paid Executive Memberships totaled 18.5mm, an increase of 274,000 since third quarter-end, which is about 16,000 per week increase in the quarter
  - Executive Members are about 38% of our member base and about two thirds of our sales

Renewal Rate

- In terms of renewal rates, at year-end, Business members renewed at 94%
- Gold Star members at 89.3%
  - These numbers are for U.S. and Canada combined, which is over 80% of our company
- And total, U.S. and Canada, 90.0%; worldwide, 87.2%, a slight tick down of [ph] a tenth or two (10:06) from the last quarter
- A lot of that, as I mentioned earlier, we believe, relates to, in the U.S, the conversion last June to the new credit card program and with auto re-bill
- And again, we expect that to continue to downtrend a little bit in the next quarter or two

Costco Membership

- While I'm on the subject of membership, I'd like to spend a couple minutes to respond to the many questions we get literally every day relating to the following concerns: one, the new member signups might be slowing; two, that the average number of member households per location seems to be coming down a little; and three, that with the increasing overlap of people having both a Costco membership and an Amazon Prime account, and the fact that more and more people are having groceries delivered by everyone, is this the beginning of something that will impact Costco?

Korea and Taiwan

- As to new membership signups slowing, we believe it's virtually are related to timing, the timing of openings, and the timing of two online new membership initiatives we undertook, one each in the past two FYs
- For example, in the first three fiscal quarters of FY2017, in these 36 weeks, we opened 16 new warehouses, including two openings with outsized signups, both in Asia, a new unit in each of Korea and Taiwan
  - Those were done last January
- Each of these locations added almost 60,000 new members to our base

New Annual Sales

- In Q4, in these 17 weeks, we opened 12 new locations, three with large signups in Japan, Iceland, and France
- Again, these three locations each opened for only 5 to 15 weeks in Q4, added a total of 180,000 members to our base, again an average of about 60,000 new members per building
  - So timing of those certainly impact the numbers in terms of averages
- Conversely, when we look at openings that cannibalize the existing nearby locations, you'll add maybe a few thousand at the most new members at that new location
- The result will drive an expected $80mm to $100mm of new annual sales in that market but lower the average number of members for each building in that market by 10,000 or more

FYs

- The other timing issue, in the last two FYs, we've done two online new membership drives, each which added an average of around 200,000 members, one a little less and one a little more
- The FY2016 event occurred in February of 2016, near the end of our second quarter
- The FY2017 event occurred in August in Q4 this year
  - So again, timing played an issue with that

U.S. and Canada

- One last data point
- If I take all of the U.S. and Canada locations and I exclude all the new openings and all locations that were being cannibalized in many cases by these new openings, the average number of members at these remaining locations grew y-over-y from the end of FY2016 to the end of FY2017 by approximately 4% y-over-y
- So our view is that we're fine, and hopefully that answers some of the many questions we've got on these questions

Value Proposition

- As to the other question, as it relates to increased delivery options, by everyone, is it impacting us and is it impacting our brick-and-mortar? A few comments
  - One, of course, our sales and our comps are strong and have even trended up
  - Two, our shopping frequency is strong and has also trended up
  - Three, our value proposition, we believe it's stronger than ever
  - Four, we're just getting started on some of the new delivery options of our own, and I'll talk about that in a minute
  - And five, we're using online and the Internet to drive businesses both to e-commerce, as well as in the store
- So stay tuned, and we'll continue to discuss that in each quarter

Citi Visa Card Offering

- Before continuing down the income statement line items, a couple of updated stats on the Citi Visa Card offering
- Again, this began in Q4 of last year in June, about June 20, I believe
- When the conversion to Citi Visa occurred in June of 2016, there were 11.4mm co-branded cards or about 7.4mm accounts being transferred over to Citi
- As of Q4 end, just over a year since the conversion, we now have 1.8mm new approved member accounts or about 2.4mm new cards, including about 270,000 new accounts during the past 17 weeks

Gross Margin, SG&A and EPS

- Overall, we're seeing the Citi Visa co-branded portfolio total spend higher y-over-y, both organically and from these new accounts
- Despite the fact that we had a partial comparison to the conversion last year since it was midway through Q4, it was still positive y-over-y to gross margin, SG&A, and EPS, as I mentioned that earlier
- I should not, though, that we'd anticipate the y-over-y comparisons to moderate, of course, as it did actually in Q4 as well to moderate starting with Q1

Costco Executive Member

  - Lastly, we continue to enhance the value proposition not only of being a Costco member but then being a Costco Executive Member, and then even better, a Costco Executive Member using the Citi Visa Anywhere Card
  - I'll share a couple of new examples of that during the remainder of this call
  - Overall, in terms of conversion, usage, and signups for the card, all good at this point

Gross Margin

- Going down to the gross margin line, our reported gross margin in Q4 was lower y-over-y by 15BPS.
- As I do always, I'll ask you to jot down a few numbers
- We'll do four columns
- The first two columns are y-over-y basis point changes for Q3
- The first column would be as reported, and the second column would be without gas inflation, and then Q4 reported, and Q4 without gas inflation
  - So those would be the four columns

Core Merchandising

- The first line item would be core merchandising
- In Q3, we reported an improvement y-over-y of plus 7BPS, without gas inflation, plus 20
  - This year in Q4, minus 8 and minus 3
- Ancillary in Q3 was plus 15 reported and then plus 19 ex inflation and gas
- In Q4, minus 1 and plus 1. 2% Reward from Executive Membership, minus 2 and minus 4

- In the third and fourth columns, plus 1 and zero
- LIFO, minus 5 and minus 5 in Q3, and minus 9 and minus 9 in Q4
  - Other, minus 7 and minus 7 in Q3
- In the two columns for Q4, plus 2 and plus 2

Gas Inflation

- So all told, on a reported basis in Q3 2017, y-over-y, we were up 8BPS, without gas inflation up 23
- And in Q4, on a reported basis, down 15, and without gas inflation, minus 9

Citi Visa Impact

- Now, mind you in these numbers, the Citi Visa impact, as I mentioned earlier in Q4, was plus 14, on a reported basis and without gas inflation
- So if you look at it that way the minus 15 would be minus 29 ex that, and the minus 9 would be minus 23 ex that
- Now overall, as I mentioned, reported margins were 15BPS down y-over-y and 9 ex gas
- And as I just mentioned taking out the Citi Visa benefit, minus 29 and minus 23

Gross Margin

- Now, within that the core merchandise component of gross margin was lower by 8 reported, but 3 excluding gas
- As I've shared before, the sub categories within our core gross margin, which is almost 80% of our sales [ph] than anywhere else (17:45), food and sundries, hardlines, softlines and fresh foods as a percent of their own sales, they were essentially flat y-over-y, notwithstanding the investing in price that we have done during the course of this
- With food and sundries and softlines being up a little bit y-over-y, and hardlines and fresh being down a little bit, again, investing in price

Ex Gas Inflation

- Ancillary and other businesses gross margin was down 1 basis point, up 1 basis point ex gas inflation
- In the quarter, higher y-over-y margin contribution in gasoline, hearing aids, business centers and travel was offset by lower y-over-y margin contribution in e-commerce, again, investing in price as well as pharmacy lower margins y-over-y

LIFO

- LIFO, I already shared with you the fact that we had a LIFO credit last year to the tune of $31mm, vs. zero this year
- So y-over-y that was the 9 basis point delta
- And Hurricane Harvey, well that was the net of two items, so I won't go through that one

- But overall margins were down relative to last year and we feel it's a function of our own initiative to drive sales and enhance member loyalty and satisfaction

SG&A

- Moving to reported SG&A, our reported SG&A y-over-y in Q4 was better or lower by 37BPS, and 31 without gas inflation, coming in at 9.97% for the year, compared to 10.34% last year
- Excluding the Citi Visa benefit, and again the Citi Visa benefit was 8BPS benefit to SG&A y-over-y lower
- Again, I'll ask you to jot down those four columns, Q3 reported and Q3 without gas
- And then Q4 reported and Q4 without gas

Core Operations

- In terms of core operations in Q3, plus 21BPS and plus means good or lower
- And plus 9 without gas
- In Q4, plus 32 and plus 27
- Central, minus 1 and minus 3
- And in Q4 reported and adjusted for gas, plus 8 and plus 7

Stock Compensation

- Stock compensation, minus 1 and minus 1 and then in Q4, zero and zero
- Other, minus 5 and minus 5
- And then in Q4, minus 3 and minus 3
  - So reported Q3, lower or plus 14BPS, reported, and flat without gas inflation
- And reported plus 37, or lower by 37BPS y-over-y, and plus 31 or lower by 31BPS ex gas
- And again, each of those numbers, that 37 and 31, you could adjust – you can look at it from a standpoint that 8BPS came from the improvement y-over-y related to the Citi Visa Card
- And while that's been a great improvement in each of the last four quarters as it was to margin, we'll start to see that benefit
  - We'll still expect to see some benefit, but it would be greatly reduced after the first full year

SG&A Performance

- In terms of our SG&A performance in Q4, the operations component again was quite good
- Strong top line sales frankly led to y-over-y improvement in payroll benefits and other items, particularly bank fees
- Central expense was lower y-over-y by 8BPS and 7 without gas
- Again, we saw a nice improvement in payroll and benefit expense percentages

- Again, offset very slightly by 1 basis point from IT modernization
- And lastly, other was worse by 3BPS that impacted negatively and that was the $11mm I mentioned earlier related to Hurricane Harvey

Preopening Expense

- Next on the income statement is preopening expense
- Last year in Q4 we had $24mm
- This year was $6mm higher at $30mm
- Last year we opened 11 new units, 11 units, 10 net of relos. Two of those 11 were international
  - This year, while we opened up only one more, 12 total, 6 were in international
- And international tend to have higher preopening
- Overall, higher year over preopening costs, again, it’s really a reflection of higher penetration from internationals

Operating Income

- All told, operating income in Q4 came in at $1.450B, up $259mm, or 22% higher y-over-y than last year’s results
- Below the operating income line, reported net interest expense came in at $53mm as compared to $39mm last year, primarily a result of the incremental new debt offering we did this past May in conjunction with the special dividend, which was discussed in last quarter’s earnings call
- Plus, there’s one extra week in Q4 this year than last year

Interest Income

- Interest income and other was lower y-over-y by $7mm, coming in at $22mm this year compared to $29mm last year
- Within that number, actual interest income for the quarter was better y-over-y by $5mm
  - However, it was more than offset by that minus $12mm of FX related items I discussed at the beginning of the call
- Overall, pre-tax income was higher by 20%, or $238mm higher in Q4, coming in at $1.419mm this year

Tax Rate

- In terms of income taxes, our tax rate in Q4 2017 came in at 34.3% for the quarter compared to 33.6% last year
- Again, as I mentioned earlier in the call, we benefited from a few positive discrete items, tax items in both fourth quarters but more last year than this year
- Our effective rate for the entire FY that we just ended came in at 35.36%
- With that, reported net income was higher by 18% or coming in at $919mm this year compared to $779mm in net income reported last year in Q4

Balance Sheet Items

Accounts Payable Ratio

- Now, for a quick rundown of other topics, the balance sheet is included in today's press release
- A couple of balance sheet info items, depreciation and amortization in Q4 totaled $441mm
- So for the entire year, depreciation of $1.370mm
- Our accounts payable ratio, if you recall last year we were converting in IT our accounting system so we paid an extra week of invoices early to make sure we weren't going to run into any snafus with that conversion on day one of the FY that just ended
- But adjusting for that, last year our accounts payable as a percent of inventories was 104%
- Reported it was 85% but 104% taking that adjustment out
  - It came down to 98% at the end of this FY

Inventory

- If you take construction payables out there and other types of payables that are not merchandise, last year's normalized number at year-end was 91%, a little down at 89%, roughly 90% in both year-ends of last year on a merchandise-only basis and normalized for that [indiscernible] (24:24) early
- In terms of average inventory per warehouse, this year fourth quarter-end it was about $12.28mm per location, last year $11.85mm, so, up about $430,000 per location
  - That's at the warehouse level
- We've broken out this time the increase in inventories elsewhere because we have quite a bit of expanded inventory with our expansion of e-commerce fulfillment locations and activities as well as some of the vertical integration things we're doing in those businesses

CapEx

- In terms of CapEx, in Q4 we expended $779mm, which for all of 2017, would put us right at $2.5B, which is about the same as FY2016
- We'd anticipate spending to be a little higher in FY2018, not only as it relates – that increase relates to the sum of everything we do, not only openings but also some manufacturing businesses that we're expanding, as well as e-commerce and some other things

E-Commerce

- Next in terms of e-commerce, we're, of course, in the U.S., Canada, UK, Mexico, Korea and Taiwan
- You should expect additional countries to be open over the next year, year and a half
- Total e-commerce sales in FY2017 came in at $4.6B, up 15% from right at $4B at the end of – for FY2016
- For Q4, sales were – profits were, of course, up
  - Total e-commerce sales were up 27% in the quarter

- Of course, that includes an extra week, 17 vs. 16 weeks, and up 21% on a comp sales basis with it trending positive during the roughly 4 months of the quarter

Online Merchandising Efforts

- As discussed over the past few quarters, much of our efforts over the past year focused on improving the functionality of our site
- We improved search, streamlined the checkout process, improved our member's ability to track their orders and automated much of the returns process
- And we also improved our online merchandising efforts by adding high-end and well-known brand names, a few examples of late, Marmot, Spyder, ExOfficio, GE Appliances and Jiffy Lube services

KS Offerings

- We've expanded our KS offerings
- We're providing new hot buys, limited-time offers with extra discounts
- We're also – we started doing what we call Buyer's Picks and unique offerings through our partnership – Buyer's Picks, and lastly, some unique offerings through partnerships with Citi Visa where we're offering, in the cases of – we've done it with Samsung Electronics, we've done it with tires and a few other things where you buy it at Costco and you use your Citi Visa Card
- On top of all the other great savings, there's anywhere from a 10% to 15% cash offer

Leveraging

- And leveraging as well, we're leveraging our global and brick-and-mortar buying power to expand and improve our online value proposition by lowering prices even further
- Lastly, we continue to build awareness of our site with Costco members through warehouse signage, special offers and targeted e-mails, and expect us to discuss some of those activities more in 2018
  - We feel that all these efforts which are ongoing will result in increased traffic and sales both online and in-store, during the past couple of quarters in particular

Online Sales

- Looking forward, we'll continue to expand these types of activities to drive our businesses
- And you'll hear more from us in the coming quarters about driving online sales with our ongoing site improvements, improved online marketing activities, and of course, along with great products and services at fantastic prices
  - That's what we do

CostcoGrocery

- In terms of what's new, three days ago we rolled out two new online delivery-related offerings, the first, CostcoGrocery, which consists of nonperishable food and sundries items
- This offers two-day delivery on dry grocery

- And a second, an expanded white label same-day grocery delivery offering through our partnership with Instacart that includes both dry and fresh grocery
- You can find both sites by going to costco.com and then clicking on the Grocery tab
- You'll then be taken to a page offering and explaining both of these new online delivery options

SKUs

- A few details about each option, as it relates to CostcoGrocery, just under 500 dry grocery SKUs, again, no fresh; free delivery with orders over $75
  - Two-day or less delivery throughout the continental United States, the boxes are up to 40-pound shipment through UPS
  - Orders are fulfilled at several of our business delivery centers
- These offer very competitive pricing and value proposition, in fact, significantly better pricing than even we had at costco.com on many of these items
  - We'd expect to expand these offerings over time

U.S

- The second option I mentioned, Instacart white label
- This is currently offered at 376 of our U.S. locations are live with it, and there'll be a number of additional U.S. locations planned – added between now and the end of calendar 2018 as our partnership expands

Instacart

- There are approximately 1,700 SKUs both dry and fresh that are offered and can be fulfilled through the Instacart white label option
- Again, I mentioned it's same-day delivery
  - It's same-day delivery
- It's also a very competitive pricing value proposition; better than before
- And again, Costco members will now have access to our promotional pricing like on MVMs as well
- Costco Executive members will also receive the 2% reward, and members utilizing the co-branded Costco Visa Card will now earn that 2% on these purchases, similar to in-store purchases
  - It's just starting this week, and stay tuned

Warehouse Expansion

- Next on the discussion list here, warehouse expansion
- For FY2017, we opened 26 net new units; about 3.5% square footage growth
- For FY2018, we'd expect to open about 25 net new warehouses, a little under two-thirds of them in the U.S., and about a third internationally

- As well, we plan to relocate 6 warehouses to better located and larger facilities
  - That compares to two to three relos in each of the last several years
- As of Q4 end, total warehouse square footage stood at 107.3mm square feet

Stock Buyback

- In terms of stock buybacks, in the first three fiscal quarters of 2017, over these 36 weeks we expended $233mm to buy just under 1.5mm shares at an average price of $156.51
- In Q4, these 17 weeks we expended a little more than that $233mm
- We expended $240mm for about 1.5mm shares at an average price of $159.21 per share
- So for the year, $473mm on stock repurchases; 2.998mm shares repurchased at an average price of $157.87

Dividend

- In terms of dividends, our current dividend stands at $0.50 per share per quarter
- That's up 11% from the previous quarterly amount
  - This yearly $2 per share annualized dividend represents a total payout from the company of approximately $880mm
- Finally, before I turn it back for Q&A, I'll discuss September sales results

Comp Sales

- For September, which is the five weeks ended this past Sunday, sales for the five-week month were $12.4B, up 12.1% from the comparable five week period last year of $11.06B
- They were up, sorry, yeah they were up 12.1%
- On a reported comp basis, September comp sales were up 8.9% and 6.2% after accounting for fluctuation in gas prices and FX
- For September our reported 8.9% comp was a combination of an average transaction increase of 4.1% and, again, that 4.1% of course includes the benefits from FX and gas, and an average shopping frequency of 4.7% worldwide and within the 4.7%, a 5.4% in the U.S

FX

- Gasoline price inflation and FX both contributed positively in the month
- Gas added 160BPS while FX was favorable in the month by 110BPS.
- Cannibalization impacted Canada in September by 325BPS.
- As you know we opened, I believe, six or seven locations on a base of 90 – low-90s this year
- So a lot of cannibalization going on there
  - While the U.S. was negatively impacted by 60BPS and other international by 155
- So, total company, 110 point points of impact in cannibalization

- And as – I'm not sure if I mentioned early, e-commerce comp sales in the month were up 30%

International Performance

- In terms of sales by geographic region, Texas and Midwest, both low double digits, were strongest with California and the Southeast regions being in the 7% range
- Internationally in local currencies, better performing countries were Japan, Mexico and the UK
- In terms of merchandise categories for September, within food and sundries, tobacco, candy and cooler were the leaders
- Tobacco, of course, we've anniversaried back in June some of the big declines and we're seeing strength since that point

Hardlines

- For hardlines, which was up low double digits, strongest department results were lawn and garden, automotive, tires, consumer electronics and toys
- Softlines, which were up in the mid-single-digit, housewares, small appliance, domestics and apparel, showed strong results – strongest results
- And in fresh foods comp sales, which were in the mid-single-digits, again, consistent pretty much across most – all four main categories
- Within ancillary, gasoline, again, had very strong comps in the month driven by both high – both price inflation and the cost of gallon of gas as well as strong comp gallon growth
  - In addition, hearing aids were up in the teens and optical was not far behind

Closing Remarks

Lastly, before I turn it back for Q&A, our FY2018 first quarter scheduled earnings release date for the 12 weeks, first quarter ending on November 26

These will be reported after market close on Thursday, December 14 with the earnings call that afternoon at 2:00 Pacific Time

QUESTION AND ANSWER SECTION

<Q - Simeon Ari Gutman>: The first – I wanted to ask one on membership and I want to ask another on gross margin. So first, on membership, the renewal rates have been moderating a little bit and there's been some explanation behind it. I think there was some credit card friction. And then, regarding – and I'm just curious if that's still the case or what's going on there. And then, as part of that, the membership growth, can you talk to the composition in the U.S. vs. international?

<A - Richard A. Galanti>: Yeah. Well, again, in terms of renewal rate, we believe the biggest issue is the auto bill. When we look back at Canada, which occurred a year-and-a-half, two years prior to the conversion up there, from its peak renewal rate I think all the way back to early FY2015, if I looked out six quarters it came down about a full percentage point. It's now, slightly – actually 0.001% above where it was a year – that year earlier at its peak. So, and when I look at the, we're now four to five, four-and-a-half quarters into it, not six, and it's down – again, it was down a full percentage point. In the U.S. and recognize, it's a little bit different scenario with conversion. But it's down about

[ph] 0.7% (36:24). So we believe that's what it is. We don't – when we look at – we talk to the membership marketing people, and we ask them about what are the reasons when somebody doesn't renew. We're getting very consistent answers of what they've heard for the last several years. So our view at this point is that we are not seeing – we're not concerned about it. We'll have to see what happens over the next couple of quarters if after that it doesn't change. But we assume it will at this point. And I'm sorry [indiscernible] (36:56).

<**Q - Simeon Ari Gutman**>: [ph] And then the membership (36:56) – if you just look at the overall membership trying to dissect what the U.S. run rate is, or how is, I guess, same unit membership trends, I guess if you can try to take out cannibalization, just the direction, and then you know what the trend lines have been in the U.S?

<**A - Richard A. Galanti**>: Well, in the U.S. and Canada, which again is 80-plus percent of our company, it was [ph] 4% (37:19). We just did that because we're getting the question every day. We can look at it. I don't have it off – we didn't do that. We actually was – we're trying to respond to some of the many questions. I think internationally, particularly since you've got newer units internationally, particularly in Asia and Australia, which is where you're impacted, less so in Mexico and UK where it's older. My sense is you'll see the same thing. It'll be positive but greatly affected by cannibalization.

When you've got – in a city in Taiwan where you've got two very high-volume units which – with well over 60,000 members per warehouse, and you open up a new one, you're still going to get a lot of new openings relative – a lot of new members relative to what we see here. But my guess it's still – that's going to cause it to come down. Again, it has more to do with timing and cannibalization than anything. I just don't have [ph] beyond (38:12) that.

<**Q - Simeon Ari Gutman**>: Okay.

<**A - Richard A. Galanti**>: Canada and the U.S. are pretty similar.

<**Q - Simeon Ari Gutman**>: Okay. And then my follow-up was on gross margin. And I don't expect you to give a clear answer, because I don't think you gave a lot on the outlook, but I'm trying to think of price investment in particular, right, there's been a pretty favorable trend up until this quarter, and I think you said down 3 ex fuel. So I guess, how do you think of the price investment? I know it's constant for the business, but you'll have some tough compares as you head into the next year both on a gross margin and an overall EBIT growth perspective. So how do you think of that as the next several quarters play out?

<**A - Richard A. Galanti**>: Well, I mean, in a couple of words, we're fine. I think what we saw this fiscal quarter in terms of sales growth, cures a lot of things, and driving it with value. We've had a good fortune of having better than expected economics from our new credit card. And we certainly – we are just starting the benefit, if you will, to the membership fee line item which will start – continue over the next 20-ish quarters, 20-ish months, the fee increase in the U.S. and Canada. That is, again, that's a fee increase that's about $240mm peaking 12 months after we started. It takes 23 months because the deferred accounting get in there. So there's plenty to go around. And our view is, is that we can do both. And we feel quite good.

<**Q - Simeon Ari Gutman**>: Thanks, Richard.

<**A - Richard A. Galanti**>: Oh, [ph] let me add (39:51) one last comment on that. I forgot to mention. A big chunk of it also is penetration of gas. Gas – while gas was great y-over-y, profitability was great. It's a much lower margin business. It's 9-plus percent of our total sales at 500 to 700 less basis points of margin. So when you've got huge increasing sales price per gallon and 10-plus percent sales growth, on 10% of your business that aided to it as well. I'll take that lower margin percentage every day for 40-extra-million of profits in the quarter.

<**Q - Michael Louis Lasser**>: Richard, on the metric you provided about 4% membership per club growth ex cannibalization in the U.S. and Canada. Is it just a coincidence that that's kind of in line with where your traffic has been trending over the last couple of quarters? Or should we think about it as your traffic growth is highly correlated that membership growth ex cannibalization?

<**A - Richard A. Galanti**>: I don't think that – I think they're separate. I mean, a lot of times – I'll give you a simple example. Here in the Seattle region, we have three locations on the east side of the lake, Issaquah, which is across the

street from where I am, Kirkland, which is where we used to be, and Woodinville. All three kind of align north to south on the east side of this Puget Sound. Last November we opened Redmond, which is where, of course, Microsoft is headquartered.

And basically, I think we had as of opening, less than 1,000 new sign-ups at the Redmond location because we have close to 80% market – household penetration in the Puget Sound, which is extreme. This is where we're headquartered and we've been forever. We've taken the average number of members per location, down from the mid-60s to the low-50s by just adding a new unit. But we'll add – here it is – $80mm to $100mm in sales in the first year in this market. So when you've got locations that are doing [ph] 250 to 300 (42:19) plus per unit, you've got to cannibalize them. So I mean that's an example of that. So I don't think the two are correlated.

<Q - Michael Louis Lasser>: Okay. Just thinking about the comp frequency or the frequency component of your comp, it would seem some of your most long-standing members are probably going to Costco about as much as they can. So is it that the newer members are building their frequency and that's where the bulk of the frequency across your population is growing? Or are you seeing growth in frequency across your entire population of members?

<A - Richard A. Galanti>: I think it's over the entire population. First of all, new members, every new member is going to presumably be more frequent every year for several years. I believe that some of the things we're doing – I didn't give an example on the call here but we've done several e-mail initiatives to members to drive them in store. We did it over the holidays with New York strip steaks at $6.99. We did it with [indiscernible] (43:32) over just a very limited – I think a 10 or so day period. These are little things, little anecdotal things but we think that we keep doing things to drive you in more frequently as well. So, I would bet that most of it, since the bulk of our sales come from the members that are more than a year, more than two years and more than three years, we're getting them in as well, [ph] a little (43:56) more frequently.

<Q - Michael Louis Lasser>: My follow-up question is on September's frequency growth of 5.4%. There's obviously a lot of moving pieces within the landscape in September between the hurricanes, you also had Amazon close on its acquisition of Whole Foods and there was a lot of noise around that. If you look at your clubs around Whole Foods, was there any impact? And what do you think drove such strong frequency growth in September?

<A - Richard A. Galanti>: Mel Brooks once said, it's merchandising. It's value and merchandising and some of the other little things we're doing here. We, as it relates to the tragic things of the hurricanes in Texas and Florida and Puerto Rico, frankly, you get a – whenever there's a pending tragedy that's on the news every day, this pending tragedy like a hurricane, you get a buildup in sales leading up to it. You're closed for a few days perhaps or more in a couple of locations but when we look – as I think I mentioned, the comp sales in Texas in September were one of the stronger regions. Now that's partly because the entire state wasn't impacted by it. So we don't think that was a big impact at all. As it relates to the publicity and the news and the noise around Amazon and Whole Foods, all we can do is perform. When we look at the value proposition, our view is our value proposition got better.

You read about Whole Foods having a giant increase in member shops or customer shops that first week. I would hope they do and I would expect them to. There's a lot of news out there. There's a lot of things. When we've done our own, we've read about the price changes, the lowering of prices, gives us more confidence that our value is even greater. So we'll have to wait and see. Nobody can predict everything. All we know is, is that our brick and mortar is strong, as strong as it's ever been and trending in the right direction even from there. And we know we've done a lot – there's 100 different things you do every day. I gave you a couple of the sound bites, the examples.

So again, at this point, we feel pretty good about what we're doing. We feel good that we've got a few delivery options for our members that, frankly, are better than the ones they were doing the day before with us or with Instacart or with anybody else. So we feel that to the extent that somebody wants to choose to use that route, they'll be able to and we'll be able to generate the sales from it.

<Q - John Heinbockel>: So, Richard, I just wanted to start on SG&A leverage, right? So both operations and central, this was about, I think, as good a quarter as you've had in a long time. Extra week play any role in that? And maybe a little more detail on, particularly, operations because that you're down [ph] 27 (46:59). You think about wages, benefits [indiscernible] (47:04).

<A - Richard A. Galanti>: The only benefit is it's one-sixteenth more of our earnings number. I mean, you [ph] could (47:11) take that [ph] 208 (47:12) and divide it by 17 weeks. But there's nothing – there's no – there's not a week with no rent expense in it because we prorate that daily.

<Q - John Heinbockel>: Yes. So if you – I mean, if you think about it, you sort of – you think about a sea change here, right, because you've typically been up in central and now down and, again, you were down quite a bit more than Q3. What is different or what was different fourth quarter vs. third? And I'm just curious of what was different and how sustainable that is.

<A - Richard A. Galanti>: Well, it's sales, I mean....

<Q - John Heinbockel>: Okay.

<A - Richard A. Galanti>: We hope it's sustainable. We've got a lot of good things going on, but we're only a little bit better predictor than you guys are at that. We feel good about the initiatives we got going on. We feel good about the monies we have to invest in price and to still drive the other line items of our income statement. And...

<Q - John Heinbockel>: Okay.

<A - Richard A. Galanti>: Yes.

<Q - John Heinbockel>: All right. And then just on the openings, right? So it sounds like maybe eight or nine, seven or eight outside the U.S. Is that sort of two Canada and maybe six or seven other international, and then, where in other international?

<A - Richard A. Galanti>: Okay. I'll tell you. [ph] Bear with me son, a moment (48:42). Yeah. I mean, basically, a couple in Canada, two or three, a couple, four or five between the three countries in Asia, another one probably in Australia. That's generally where they are.

<Q - John Heinbockel>: Okay. And then just – and then one last thing, when you think about your delivery options here, what's your sense as to how customers will use those and alter their behavior, right? So you think about the nonperishable food and sundries on the two-day, do people simply get – do you think they'll get those delivered at home and then come in to buy fresh and nonfood, some of the treasure hunt items, and not have their carts loaded with some of those sundries? How do you sort of get comfort about the impact on traffic to what you're doing?

<A - Richard A. Galanti>: Well, needless to say, we have to continue to watch that. We've had some limited experience with our relationship with Google starting a few years ago and with Instacart over the last couple of years. What we found so far is, it's more fill-in than replacement of a shop. And the key is, is if you come down a couple of three shops a year, one way is you add several more shops as fill-in or alternatives occasionally.

<Q - John Heinbockel>: Yes.

<A - Richard A. Galanti>: That's what we saw but we have very little time and data to feel comfortable about where it'll go. We have to keep getting you – we want to do both, of course. But we have to keep getting you in store because you're going to buy more and you're going to see more even if we had everything online, but we don't, of course. And one of the things I mentioned was, how do we get you in store? We are just literally scratching the surface of any type of targeted Internet – e-mail marketing initiatives. We have a very, as you know, a very loyal – hopefully, you're one of them – loyal member. And we are just scratching the surface with figuring out how to get you in stores well more often. And on the few examples – on the several examples that we tried, it's great, and we'll have to see how that goes.

<Q - John Heinbockel>: Okay. [indiscernible] (51:03).

<A - Richard A. Galanti>: I guess the one question that none of us know is, is everybody going to sit home and order stuff recognizing you've got to pay for it. And no matter who ultimately, and there'll be several of the lowest cost supplier, provider delivering to you at home, there are people that actually want to go out. There are people that actually want to go touch their fresh foods and decide, pick it themselves. And it's going change over time. There's going be an increasing percentage of online and online delivery. The question is, is in brick and mortar we've been asked for years, well, how can you drive sales if you're not offering as many alternatives and whatever else? We've done it with value. In our case, value, first and foremost is quality and low price. Over time, the percentage of delivery of fresh will change. How much so, we'll all have to wait and see.

<**Q - Christopher Horvers**>: So first question just on the SG&A front, can you talk about the IT headwind was small from a basis point perspective but, of course, your – the overall top line is accelerated. So as you think about the IT modernization and that central expense line, the underlying dollars, is that dollar growth y-over-y decelerating at this point? Or when do you think that dollar growth actually decelerates?

<**A - Richard A. Galanti**>: Basically, I think we're in the middle of that. I think it was a quarter or two ago where we actually – it was lower y-over-y by 1 basis point. And I said that's not an inflection point. Certainly even this one or zero basis point this quarter was helped greatly by sales growth. It's going to still increase. I think part of it is, is we're right at or about to enter our fifth year of "modernization" so that line will start getting fuzzier and fuzzier. We certainly added things to what we are modernizing, taking major systems and doing that we had not contemplated at first.

And so my guess is, is in the next year, assuming regular decent sales as a percent of sales, a lot of these systems, you spend $60mm or $100mm on one system, it's kind of like building a building. You start depreciating the day you open or the day you turn it on. And it was probably three to four years ago that we started turning a system on in that regard as we complete them.

So it'll be another year before we've got, if you will, the plate full with these bigger expenses that then amortize over generally five to seven years. But as sales grows, the denominator in this calculation grows, that will be an offset to it. So I'm shooting from the hip here and it's a guess, but all things being equal, sometime in the next year there's maybe an inflection point but it's going to be in the 1 or 2BPS either way, hopefully, and at some point here we'll stop talking about it.

<**Q - Christopher Horvers**>: Okay. And then you said on the Visa benefits, the gross margin SG&A, you said the word – used the term moderate but not go away. So, I think in the last quarter you talked about that, sort of, we're going to start to lap that [ph] guys (54:21) and that's going to go away. So is it just moderation or does it go away? And is that...

<**A - Richard A. Galanti**>: Well, it's moderation with a capital M. I think in the first three quarters of this FY, the sum of the benefit of improvement to SG&A and margin was 37 or 38BPS. The aggregate in Q4 was 22. Mind you, a year ago in Q4, you had a lot of things happening. You were getting off the old program and there was some detriment to that in those last several weeks anyway, the first five weeks of Q4. Then you had it. But there was also some noise and friction around getting the conversion done for two or three weeks. So my guess is, is it'll be a much – it should improve because we're seeing increased penetration of usage. We're seeing increased revenue share from people seeing the value of this card and not only at Costco but their top of wallet.

I forgot if I mentioned it on my part of this call, but using travel as an example. We just added Costco Travel to the Executive Member, first of all, effective September 1. So you get 2% on travel, which you hadn't gotten before. On top of that, if you use your Costco cobranded Visa Anywhere Card, Citi Visa Card, you get another 3% by using that on travel. So there is a 5% off unbelievable prices.

<**Q - Christopher Horvers**>: Understood. And then the last thing is, you did do – you talked about the timing of the Groupon, you know, in January or earlier and then in August.

<**A - Richard A. Galanti**>: Right.

<**Q - Christopher Horvers**>: Can you talk about what the rationale was to do it in August? I think a lot of people look out there and say hey, they see this growth in membership slowing. So, sort of a desperation pass to the end zone to buffer the numbers into the print. So maybe just talk about what the genesis of that was. What does it make you – is it

an expression that you're concerned about millennial retention or millennial customer acquisition? Just talk broadly about that.

<A - Richard A. Galanti>: No. I mean, I think, first of all, we did it because it works. We don't do it every month or every six months because we don't want to get people comfortable waiting for the next online offering with that added value [ph] it would give back – give (56:44) to them. We want them to sign up as a member and pay for it. And so it works. The timing difference is simply we have a lot going on. I believe if I recall, if I look back we did the fee increase effective June 1 and then we didn't want to do it over that month or two period of time so we pushed it out a little bit.

<Q - Christopher Horvers>: And then just from what you've seen in terms of the millennial customer from a renewal rate perspective on these deals going back in time.

<A - Richard A. Galanti>: Yeah, yeah. And by the way, going back to your question though, you asked, did we do it because we're concerned about millennial. I don't think we're smart enough to understand that. The fact is we do it just to drive membership. We recognize that it has a good millennial benefit. I don't have the one on the one that we just did, but the one we did a year and a half ago, and the one we did like two and a half, three years ago, vs. a walk in, a higher percentage of people that sign up on this – on these LivingSocial or Groupon offers are millennials, not as much as you'd expect.

I think walking in, if I recall correctly, is like mid to – 39% of those that walked in this last one were millennials. I think if I go back to the previous one it was 36% were walk-ins were millennials. Whereas as when they – millennials under this program it was like in the mid to high 40s, so about 10 extra percentage points. So, not a huge distortion or a difference between those two but it helps.

<Q - Karen Short>: Actually, just since we're on the subject of millennials, I'm wondering can you maybe just give us an update a little bit on the average age of your membership. I know you kind of give that periodically. It seems to have been trending down. Any color you can give on that?

<A - Richard A. Galanti>: I don't have anything in front of me. I know that when we did it a couple – not a couple of years, about a year ago, it was looking at U.S. members, it was 52 years vs. 54 years across the U.S. Not, you know, the entire population of U.S. adults, which was about – so we were two years older instead of a few years, earlier than that, we were four years older. I have not seen anything since that. If I have it, you can ask me, I'll find out but I don't recall.

<Q - Karen Short>: Okay. And then one of the questions I think you were asked and I didn't catch the answer if you gave it. But, do you have any color just specifically on the performance of your stores that are in close proximity to Whole Foods since the price reductions were – or took place at Whole Foods? [ph] Anything you could (59:31)...

<A - Richard A. Galanti>: Yes. We essentially overlap everywhere.

<Q - Karen Short>: Yeah. So...

<A - Richard A. Galanti>: And I'm not trying to be cute but other than reading about it on the news and the paper on Wall Street, we have not seen – and we recognize, I mean I read yesterday that there's some specialties brick-and-mortar retail stores that are impacted more than others. We don't believe we've seen an impact from it.

<Q - Karen Short>: [ph] And well, your comps would say it all (59:56) I guess but – and then I guess on the online grocery, I just want to clarify you gave 1,700 SKUs, and I think what you said was that possibly the price points would possibly be cheaper than Costco. Did I catch that right? And then...

<A - Richard A. Galanti>: No, no. It would be lower – currently, you could go to certain other parties, Google Express, Instacart as it was before October 1, costco.com, Costco Business Center, unlimited delivery within 40 or 70-mile radius of those 15 locations, shipped down in the southeast. I believe Boxed. I'm sure there's some others out there that I'm missing. When we look at the pricing that anybody, both a member and a nonmember as the case may be depending on each one and how they price their goods, what they ultimately have – what their delivery price is, this is better including on some of the items which you could buy at great value or better value than those areas on costco.com already.

<Q - Karen Short>: Got it. Okay. And then just the last question, there seems to have been some rumblings that you are looking to expand into China. I don't know if you could comment on that a little bit.

<A - Richard A. Galanti>: It's the 20-year discussion is we're looking. As a rule, until we have permits to do something, building permits to do something, we don't announce whether it's in Alabama or China. But we are looking, and at some point we'll announce something.

<Q - Matthew J. Fassler>: Richard, my first question relates to the line item that talks about core margin categories on their own sales. And I guess that line item, this is inclusive of gas, and I might not have caught the number ex gas, had been up for the first...

<A - Richard A. Galanti>: It's exclusive of gas.

<Q - Matthew J. Fassler>: So only in core categories. That number had been up, I think, each quarter of the year and, in fact, I think had been up something like 11 straight quarters. The last time it was down, I think, was in the 10 straight quarters, Q2 FY2015. I know it was flat this quarter. And the differences are not very big, but it was a bit of a break in the pattern. So was there any particular area where you invested in price? And was there a concerted effort to invest to a greater degree in price that would have led to the increases in that line item abating here?

<A - Richard A. Galanti>: Well, yes. But, again, we don't – honestly, we don't sit down. We decide like here's a bucket of money if you will, and how are we going to use it? We don't do a bunch of sensitivity analysis of it. We're merchants and – I'm not but they are here. And we look at what are the things that drive business, in retail, grocery or retail non-food as the case may be. And certainly on key items, I think I used the example of New York strip steaks where we were at $7 and $8.99 and we went down to $6.99. And by the way, we did that and still had made a decent margin because of how we bought in on – you know, we're a giant buyer of the stuff. We've done it on several items, and it works.

<Q - Matthew J. Fassler>: Got it.

<A - Richard A. Galanti>: So I think the comment you made – the point you made though is while it's not a lot directionally, it's different. That's fine. We're really not concerned about that.

<Q - Matthew J. Fassler>: Fair enough. And then secondly, so Instacart and those are prominent delivery partner, I know that prior to Amazon acquiring Whole Foods, Whole Foods had made an equity investment in Instacart. Does that have any impact on that partnership, on the future of – and obviously you're not the only partner Instacart has, and this is probably a question a lot of their business partners are having. Is that a relevant consideration at all as we think about the forward for Instacart?

<A - Richard A. Galanti>: No. In fact when we announced this – when we started – when we initiated this week our discussions both before and after that – both before and after June 15 or 16.

<Q - Matthew J. Fassler>: Great. And then finally, so the e-commerce business I know has accelerated over the past few months, and you spoke in the past couple of quarters about some of the changes that you made [ph] replatforming (01:04:35), et cetera, and the capacity you have. Are there any particular categories where you're seeing that acceleration to the extent that you know you've kind of more than doubled the pace of growth in e-commerce? And I know you're not doing fresh yet obviously, and you're expanding your e-commerce efforts with some of these brand new initiatives. But anywhere in particular where the business is taking off?

<A - Richard A. Galanti>: Well, on the nonfoods side I think we mentioned a quarter or two ago, appliances is a big area, apparel on the nonfoods area, [ph] small [indiscernible] (01:05:07) apparel and sundries. So we continue, I think, to do a better job in terms of the food and sundries side – on the dry food and sundries side, and some big-ticket items. And then I look at some of the examples. Again, it was only for a one or two week period, the Samsung deal with using the Citi Visa Card. On top of great pricing on the TV to start with, and white glove service if you want it, you got our great price and if you were an Executive Member you got 2%, and if you used the Citi Visa Card you not only got 2% –

you got that 2% because you bought it at Costco. On top of that you got a 15% cash card.

<A>: [ph] Also inline (01:05:50).

<A - Richard A. Galanti>: Yeah. And that impacted sales both inline in store as well as online. So, these are sound bites, but there's lots of them, and there's lots of [indiscernible] (01:06:02).

<Q - Paul Trussell>: First on membership, I believe the last LivingSocial deal that you ran in 2016, you signed up approximately 200,000, 250,000 new members through that program or so. Could you discuss what the more recent program led to in terms of sign-ups?

<A - Richard A. Galanti>: [indiscernible] (01:06:48).

<Q - Paul Trussell>: And then also – the number you gave earlier on the call in terms of 4% growth in the U.S. and Canada, ex-cannibalization, what would that number be all in, even if we included the club that did see some cannibalization? So just kind of overall U.S, maybe, vs. international growth in membership per club.

<A - Richard A. Galanti>: Yeah, I don't have it. I was trying to be helpful to the – one of the things I guess I want to warn, we're not going to start doing this new calculation every quarter. We thought it'd be helpful here. But we know and based on our discussions every day and week at the budget meeting that we felt that we're fine when the question has been asked about the average number of members per warehouse seems to be going down. The new total new member sign-ups seems to be – the rate of growth seems to have been slow a little bit. Again, hopefully, the data points I gave you allay those concerns. But I don't have the detail beyond that. What we did is we took – let's take all the cannibalized units. We know that's a big impact and we [ph] all (01:08:02) the new units. Many of them are in small markets. We know that's an impact. That's going to impact it.

<Q - Paul Trussell>: Understood. And on the LivingSocial sign-ups?

<A - Richard A. Galanti>: It was a little better than the one 18 months earlier.

<Q - Paul Trussell>: Fair enough. And then just on gross margins, you mentioned at the beginning of the call, the benefit, the pre-tax benefit that I think netted out to about $10mm or so. What line item within gross margins did that impact? And also just wanted to inquire what, if any, margin impact you are assuming from the new CostcoGrocery rollout? And then...

<A - Richard A. Galanti>: On the first one – I think it was a separate line item called other. That was the 2BPS.

<Q - Paul Trussell>: Okay.

<A - Richard A. Galanti>: And as it relates to the impact of the new thing, it's going to be so small to start with, we don't even know yet.

<Q - Paul Trussell>: Got it. And then just on that point, as we think about gross margins over the near term, is it fair that we should think that there could, maybe flat to slightly down would be kind of the near term run rate just given the investments in price that you've made and the moderating contribution from Visa?

<A - Richard A. Galanti>: Well, we don't guide. Visa will be moderating. But moderating still has a plus sign in front of us, even if it's small. I look back though, is we still have a chunk of those monies. We have the new membership fee increase that started in June with, again, ultimately it's $240mm that increased just the U.S. and Canada that'll hit the P&L. But the total benefit to the P&L line won't be for 23 months from June. So that's May of 2019.

So but there's plenty of money out there to do both, to be able to – when the margins go up or down a little bit, again, I get back to it. It is merchandising. We feel we've got plenty of capacity. I think that the salient point is, is any of this related to competitive issues out there? For the most part, no, it's us.

<Q - Charles Grom>: Could you just remind us the profitability of your digital business relative to the club segment? And also the SKU overlap between on both and what you think the long-term opportunity is for the SKU count on the digital side?

<A - Richard A. Galanti>: E-commerce profitability is a higher percentage of pre-tax earnings and percent of sales than the brick-and-mortar. But there are a lot of things like that. Some of the ancillary businesses are that way. But it is continued. If it's come down a little, it's simply because we've invested in price. And I would say whatever investment in price. And I would say whatever the investment in price is, that number of basis points is less than the reduction in the profitability of e-commerce because we've driven e-commerce profitability.

<Q - Charles Grom>: Okay. And is that mostly on the merch margin side or is it on the SG&A side?

<A - Richard A. Galanti>: A little of it is SG&A and a little of it's margin.

<Q - Charles Grom>: Okay. And then just to follow up on Chris's question earlier about the millennials, could you speak to membership trends and renewal rates for that category or for that cohort of individuals?

<A - Richard A. Galanti>: I don't have any new data on that other than I think what I shared last quarter. Millennials, new members generally renew at a lower rate. Every year you're stuck around, you're going to renew at a better higher rate until you're really old. And millennials generally renew at about the same rate, at least that's what we...

<A>: [indiscernible] (01:12:20)

<A - Richard A. Galanti>: ...as all first-year members. Yeah. In fact, I remember – I don't have the detail on the one we just did, but the one we did 18 months ago vs. walk-in, we saw those that signed up on LivingSocial renewed at like 1 percentage point higher rate in that first year of renewal. But again, that's +/- a little.

<Q - Charles Grom>: Okay. And then just my last question is obviously the compression in your renewal rates and the timing of the Amazon-Whole Foods deal has sort of given a lot of people concern and is obviously a focal point on the call. And I wanted to circle back to Simeon's question earlier and your answer to his question with regards to Canada because I think it gives you a good proxy for sort of the pathway for the renewal rates subsequent to the change in tender.

So could you just remind us and just go over that again? You said the peak to trough was around 100BPS from the time you rolled out that new credit card. And what was the recovery time? And therefore you think it's going be another quarter or two before your renewal rates tick up. Can you just kind of discuss that because I think it's pretty important?

<A - Richard A. Galanti>: Yes. And mind you, there's still some differences and nuance differences between Canada and the U.S. But notwithstanding those differences, Canada, I think we did the transition in early FY2015...

<A>: September of 2014.

<A - Richard A. Galanti>: ...September of 2014, which is Q1 of 2015, and we are in Canada. And then if I look out six months later, it dropped. It continued to drop for one, two, three, four, five, six quarters. And it dropped exact – I mean, I'm rounding to the 0.1% but it dropped 1.0 percentage points. The next couple of quarters it picked up half of the delta and it took another couple quarters to pick up all of the delta, another quarter-plus to pick up the rest of the delta.

This year we converted in Q4 of 2016, so we're now in Q4 past that, whereas I saw the trough in Canada, albeit some differences and nuances, six quarters out. So that would tell me it's probably a couple more quarters. But that's about as much analyses as we've done.

<Q - Oliver Chen>: Richard, as you do think about e-commerce and you become much more aggressive and considerate about what your strategies are, what are your thoughts about the framework for balancing e-commerce and the convenience factor against margins and cost control from a CapEx and expense perspective? What's your framework for how you're thinking about evaluating where you should allocate ROIC for the long term?

And our second question was just about the value proposition story, which continues to be very compelling. How are you triangulating the value proposition against core merchandise margin and also working through with vendors in terms of maximizing it for the whole system and sharing in passing on some savings to customers? And that's also a little bit related to the multi-vendor mailer and where you are with that project. Thank you.

<A - Richard A. Galanti>: Whew. It's all of the above. First of all, in terms of allocation, I mean, first of all, the base e-commerce, as we've gone to more fulfillment centers, we frankly – it's been a net positive because we've driven down transportation costs, freight costs. We've driven down time to get it to you. The improvements, the costs of the improvements to the site are de minimis.

It's just that perhaps we were a little stubborn for a long time. We had done it. It wasn't our focus. But improving search, improving the site itself, expanding distribution points, those are small pieces of $2.5B CapEx budget. So I don't really see that – we've got more than enough money to do it.

As it relates to driving business, some of these things are text, clearly. Someone else earlier asked the question, what if this thing with grocery is really successful? Well, really successful is two things. It's really successful as a business. And how does it impact people coming into – walking into Costco because we know we were going to – they're going to buy really a lot more stuff when they walk in.

So we have to do that, and we think we can manage that by using e-mail to drive people in-store as well, and the couponing and things like that.

So again, time will tell and we'll have to see where it goes. As it relates to working with vendors, it's pretty simple. Based on the volume and the efficiencies that we bring to purchasing product from a vendor, we better get the best price.

And we all hear and sometimes we read and sometimes somebody accidentally sends us something, but we all hear about the special deals or what one retailer, whether it brick-and-mortar or someone else, I think like all of us out there, we have to keep our options open. But we feel pretty good about we're getting money. Some of the successes we've had, whether it's the special deals, the examples of the special deals, working with vendors on hot items, buyers' picks, what I spoke about last February or early March in Q2 earnings call about in some cases tweaking, sometimes significantly tweaking, how we use the MVM and what items go in it, how we drive greater value and sometimes partnering with a vendor to do that, all of those things are part of the equation.

I think it's a lot easier for us to do it when we're trying to manage a few thousand items and the enormity of purchasing power we have within those items and the availability of sourcing those items from many people.

So I think we feel pretty good about what we're doing and how we're getting the moneys and how we're spending them. There's a lot going on. We'll have to wait and see. We're gratified that the things we're doing are driving brick-and-mortar traffic and comps. And we're gratified by some of these things that we were telling you over the last few quarters of earnings calls about improving the site, adding a few things, have started coming to fruition on e-commerce.

We think some of these new things, we're excited about it. But there's a lot of unknowns yet.

<A>: [indiscernible] (01:19:10-01:19:16)

<A - Richard A. Galanti>: Oh, a comment from somebody in the room here mentioned, I think appliances is great example. It used to be we sold some of appliances in store and other big ticket items like furniture. And if you know, no, we don't deliver, go get U-Haul or friend's pickup truck. Well, that's not happening today. By displaying some items in the store, we're driving more business. We're doing very well online with furniture, with patio furniture, with regular furniture, with lawn and garden type big ticket items, with electronics, including white-glove service, and now with appliances. We think appliances, part of it also is brands. Having partnerships with GE and LG and Samsung, among others, which are relatively new in the way we're doing it, we think in literally three or so years we could add $1B of sales, which we've started doing about eight months ago.

<Q - Peter S. Benedict>: Hey, Richard, just a quick one. You mentioned the manufacturing facilities during your prepared remarks. Can you talk a little bit more just about what you've done there and what kind of the strategy is and some of the benefits you see when you start to take some of that stuff in-house? Thank you.

<A - Richard A. Galanti>: Well, that's a continuation of some things we've done. Years ago, we opened our first – a ground beef plant, I think it was originally in Tracy, California. The intention is to, one, assure supply, and two – by definition of great quality – but and two, lower the price per pound of landed ground beef to our locations. We did that and more. We now have a plant in California that supplies us. It's our plant, 4-plus million pounds a week of half a dozen SKUs.

We're building a second plant on the East Coast right now because this one has been beyond capacity for a few years but we now can accommodate one on East Coast and, by the way, reduce some freight costs along the way so we'll get more efficiencies from that. The $300mm we're expending on a chicken plant in Nebraska just broke ground a month or two ago. We need over 400mm birds in the U.S. every year. This will be less than about 100mm, so just under a quarter of our need.

More importantly, we've got two other plants run by other well-known suppliers where we call them dedicated facilities. We had them retrofit them, greatly reduce the number of SKUs they're supplying and manufacturing to supermarkets, restaurants and us and other clubs, and driving. Guess what? If you've greatly reduced the SKUs and you make the manufacturing more efficient, you can say, given the week and given what happens with all of the byproduct and the markets themselves, we can guarantee sourcing and lower our costs by anywhere from $0.10 to $0.35 a bird depending on what month and what's going on out there in the markets.

<A>: Right.

<A - Richard A. Galanti>: So it has worked well for us. We're looking to do that in other things. The fact that we source produce from 44 countries, it is what makes us who we are. But we're sourcing 30 SKUs or so, not 150 SKUs.

<A>: [indiscernible] (01:22:45)

<A - Richard A. Galanti>: In Canada, we built a commissary for baking needs. We've got – so we'll continue to do that but I think the biggest single commitment we've made is this new chicken plant, but it's not like we've gone from zero to $300mm in this example. We've done a lot of things.

<Q - Scott A. Mushkin>: I know we're late. But I wanted to just kind of attack the elephant in the room. We've had a lot of questions on kind of memberships, and I think the elephant in the room, basically it's the old Peter Lynch of investing, invest in what you know, and I think a lot of people in the investment community have seen, if they're Costco members, maybe have seen that their shopping frequency to Costco dropped as Amazon's come in with things like Subscribe & Save and other programs that they've done.

So, Richard, what I wanted to – I mean, clearly, your sales are just amazing, like they speed up and they speed up and they speed up in your frequency. What are we missing in the investment community where, again, it's the old Peter Lynch thing, kind of invest in what you know, where our experience is, I think, collectively, and I hear this from a lot of investors but I also have experienced it myself in my own household, we're going to Costco less and yet your sales are so darn strong. What are we missing and why do you think we're missing it?

<A - Richard A. Galanti>: I wish it was the easy explanation. We don't see it. And that's not a good – it's a good answer from a standpoint that we don't see it and that's good to the numbers.

<A>: [indiscernible] (01:24:38)

<A - Richard A. Galanti>: To the extent – clearly, you've done some sampling yourself, Scott. Others have as well. Some of that sampling shows what you just suggested, that it appears that, including your family. Others, it doesn't show that. I don't know why. What we know is, is that we feel good – well, certainly, we feel good about comps and frequency and renewal rates subject to some of the credit card stuff. We feel good about some of the things we're getting ready to offer. If this stuff is being sold out there at higher prices and now we're going to – those prices are going to be even lowered further by us with one- and two-day delivery or with one-day to same-day delivery with fresh, we have to figure out how to communicate that to everybody, but that should continue to drive our business. We'll see. I don't have a good answer for that one.

<A>: [indiscernible] (01:25:38)

<Q - Scott A. Mushkin>: All right. That was [indiscernible] (01:25:40).

<A - Richard A. Galanti>: I think part of it is if you take – using the [ph] supermarket or (01:25:45) grocery industry, the roughly whatever it is, $900B or $1 trillion industry, everybody out there on this call and elsewhere will have their estimate of what delivery and online will be as a percentage of the total. Whatever it is today, it'll be more tomorrow, it'll be more the next day. I think everybody, even the most extreme assumption is it's not going to be 100% ever.

The question is, is it going to go from, I'm making these numbers up, from 5 to 10 and then slow down? Is it going to go to 20 or 25? Is it going to go to 40? Who the hell knows? Whatever it's going to be, we should have a piece of it. But clearly, whatever that brick-and-mortar or people actually drive somewhere and get it themselves, I think we're going to keep taking pieces of that.

An extreme example is not even on groceries, on apparel, we have a 6-plus-billion-dollar apparel business that's compounded for three and a half years at 9-plus percent while the brick-and-mortar apparel is down. I know why and we've explained why. So for every point, there seems to be a counterpoint.

Within grocery itself, part of it's the unique items. Whether it's Kirkland Signature items or some of the things we do uniquely ourselves, all those things hopefully will [ph] get in (01:27:02). If we can't get you to come in for it, we'll at least get you to come in occasionally by some of the things we do that drive you in like the strip steaks or like the Copper River salmon or like organics. And to the extent you want to pay a little more, that little more will be a lot less more than it was the day before even through us. So that's what we're going to do.

<Q - Scott A. Mushkin>: Yeah. I mean, [ph] quoting (01:27:29) I think right now it seems like with the strength of the business that our experience maybe on the investment community is a little different than what's going on for a lot of people. Hey, I had just one last one on the $75 free delivery. I've been on the site during the call. Is that if you sell items and you deliver for free for over $75 of over the order size, are the profits equivalent there with going to the store? And then thanks for letting the call go so long.

<A - Richard A. Galanti>: Repeat the question. Somebody was mentioning something.

<Q - Scott A. Mushkin>: Yeah. So, I mean, basically if it's $75, the delivery is free.

<A - Richard A. Galanti>: Yes.

<Q - Scott A. Mushkin>: Is the profit equivalent if I go over $75 and I buy on this CostcoGrocery? Is the profit equivalent there vs. the store?

<A - Richard A. Galanti>: Yes.

<Q - Scott A. Mushkin>: Yes. All right. Again, thanks for taking my question and thanks for letting the call go so long.

<A - Richard A. Galanti>: Yeah. No worries. And part of that, by the way, is what we do. I mean, it's this huge volume that we're doing like any deliverer out there including some of the ones that deliver our stuff and they're delivering stuff third party with us, but it's all about getting more things in the box. If we get you to maximize that shipment, that goes a big way. If we get the volume that we can bring to the table when third-party shippers are also looking for more volume and to spread that volume, that's all good for us and our member.

<Q - Daniel Thomas Binder>: On the topic of e-commerce, you talked about the higher profitability of an online sale. I'm just curious, if you were to take $1 of sales out of the club and transfer it to online, does the better profit online completely offset the deleverage of pulling that $1 out of the club?

<A - Richard A. Galanti>: Well, it's going to be a long time until we figured that out. At the end of the day, if all we're doing is substituting and taking sales out of brick-and-mortar and doing it online, that's a loss. That's a money losing proposition. The fact of the matter is, is if we're going to lose it, A, we should lose it to ourselves, and B, can we drive more business anyway both in-store and online? The fact that you can get under this CostcoGrocery dry items throughout the entire Continental United States within a year and 90% of it already starting two days ago, that includes lots of geographies where there's not a Costco within 150, 200 miles. So we think that we're going drive some business outside of our existing members. And by the way, they're going to become a member to do this.

So they're already doing it despite ourselves online with the limited amount of things we had at a higher price. So we think that – will there will be some – will somebody stop becoming a Costco member? Sure, there's going be somebody. Will somebody shop less in-store because they're now infilling or fulfilling some of that with buying direct? Yes. But will there be new people that didn't do it before? Absolutely. And will we figure out how to get you in the store even if you don't want to drive to the store? Yes. And we've been pleasantly surprised by some little things we've done to do that. People like deals and we do deals better than anybody.

<Q - Daniel Thomas Binder>: Second question was around renewal rates. You talked about the next couple of quarters possibly before you see that inflection. If I go back far enough, I can recall cycles where you had membership fee increases where the renewal rate would come off a little bit, not a lot. I think the last cycle you didn't see that. I'm just curious, as you look – because you just raised membership fees, is it possible that that renewal rate takes a little bit longer than just a couple quarters until you lap that fee increase next year?

<A - Richard A. Galanti>: I think it's possible. I think what you're talking about originally though is when we do an increase, you'd see almost an immediate drop in renewal rate for about a year then it'd catch back up and it'd continue on. I think it's been like at least two, if not three, cycles, so 10 to 15 years prior to that when we saw that. Recognizing there's other things that have made you want to renew your membership, having gas stations, having fresh foods, becoming an Executive Member, all those things have helped that as well. So it's hard to dissect it in that regard.

Anecdotally, what we hear, again, from membership and from membership when they survey members that have dropped, that it has virtually nothing to do with raising the fee.

<Q - Daniel Thomas Binder>: Okay. Just two other questions. On the promotional front, if I go back a couple of quarters ago, it looked like you were holding back on the MVM, hit the sales a little bit, but over the years you've gotten a little bit more business on promotion, maybe a little less on EDLP. There's been a little bit of a shift, and now I'm just listening to the call today, it sounds like you're going be more active online.

So I guess just in terms of how it fits into the message to the customer about everyday low price and whether they should wait for that promotion, do you feel like you have the right balance today? Or do you think there'll be further tweaks as you do more online and take away some of the MVM in the club?

<A - Richard A. Galanti>: Well, first of all, the letter E means every day. What we talked about – what we changed back in February-ish, we've continued. What I mentioned – did we – I gave a couple of examples what we've done online of late. So it's not substituting something else. Our collective view is that we have the ability to do all of the above, and we are doing it.

<Q - Daniel Thomas Binder>: Okay. And then my last question was just around traffic. Both, I think, in September and the quarter, and I think actually for quite a while, the U.S. traffic, or at least a couple of quarters, the U.S. traffic has been better than international. I was just curious, with a younger international store base, why would that traffic be softer? Is it strictly cannibalization, or is it something more than that as you compare it to the U.S. traffic growth?

<A - Richard A. Galanti>: I think it's two things. It's cannibalization and the newness of – it's cannibalization and new members in any state or any country in that first renewal is less than the second year renewal, is less than the third year's. And so every time they renew, they're more likely to renew the next year at a higher rate than the previous year class, if you will. And so we've got newer market units and we have cannibalization.

<Q - Kelly Ann Bania>: Just a couple more questions on the two new online initiatives. I guess first, how will the prices compare for each of them to the stores in the club? I believe Instacart has two different models, one where the prices actually match the in-store prices, but I believe there's a margin impact for the retailer. So just any comments on how we should expect or what the message to members will be on how prices will be on the online vs. in the club?

And then are there any plans in terms of testing some more auto-replenishment type programs along with this, and any plans to market or advertise this in a meaningful way?

<**A - Richard A. Galanti**>: On the latter part, I believe there's something already on the site in terms of auto-replenishment that's on there.

<**A**>: It doesn't replenish [indiscernible] (01:35:55).

<**A - Richard A. Galanti**>: Oh, I'm sorry, it doesn't replenish, but it comes up with a list based on what you bought before. And again, yes, that will be tweaked, but that was the first order of business to get it out there.

First of all, in terms of Instacart having two different models, the same price as in-store or not, and I think they only have one model with us currently prior to this week, which included however they charge for delivery or they marked up our goods. So this will be lower when you go on Instacart and even lower when you go onto CostcoGrocery or Costco, the fresh of Costco e-commerce. Did I answer that?

<**Q - Chuck Cerankosky**>: When you're looking at the various reasons people shop at the Costco clubs, are you able to look at just how much they enjoy that shopping experience? You've got great sales numbers and there's a lot of reasons to be in the store, but is there just a factor that indicates people enjoy being in the club?

<**A - Richard A. Galanti**>: Well, I'm biased but, of course, we all enjoy being in a club. What was the first part of your question?

<**Q - Chuck Cerankosky**>: Well, you've got various reasons like saving money to go to a Costco club and high quality. But is there's just flat out simply an experiential reason to be in the clubs that is driving traffic numbers that are better than a lot of other brick-and-mortar retail?

<**A - Richard A. Galanti**>: Well, I think it's several – look, Chuck, and again, I am biased, it's several things. The gas stations help. Fresh foods is second to none. And in our view, the mode around that has gotten bigger, not smaller, since June. There's Kirkland Signature items. There's treasure hunt, fresh, there's organics. So, I mean, I think it's what we do. When I go to the budget meetings every four weeks and I look at even some of the things we've got coming in for the various holidays, whether it's outerwear apparel for the winter or some of the holidays like Thanksgiving and Christmas, just I think our members should be as excited as ever about some of the exciting new things we have. They keep driving that value proposition [ph] up (01:38:35).

<**Q - Chuck Cerankosky**>: Okay. And then...

<**A - Richard A. Galanti**>: And all the things I mentioned earlier on the call. The tweak of MVM, using the e-mails to get you in to buy – when everybody out there was at $8.99 to $10.99 on choice New York strip steaks and we went from $7.99 to $6.99, that not only drives business and takes it away from chicken and ground beef, it drives traffic. And we know how to do that kind of stuff pretty well.

<**Q - Chuck Cerankosky**>: Going back to membership, our work has been showing that household formations are looking a little better than the census numbers, which are about 1mm new households per year right now. Are you seeing that in membership signups in the U.S.?

<**A - Richard A. Galanti**>: New households? I don't know. If you want to e-mail me the question, I can find out.

<**Q - Robert Iannarone**>: Rob Iannarone on for Scot Ciccarelli. Rob Iannarone on for Scot Ciccarelli. Just one housekeeping item, organic sales, can you tell us how much that was for the year?

<**A - Richard A. Galanti**>: Organic?

<**Q - Robert Iannarone**>: Yes.

<**A - Richard A. Galanti**>: It was up a little over 20% and about $5.5B.

<Q - Robert Iannarone>: Great. And one follow-up is also food-related here. Anything you're seeing changing in either inflation/deflation? Has the tone of the conversation changed with any of the suppliers you talked to?

<A - Richard A. Galanti>: It's pretty stable. I mean, everybody's hoping for a little – well, we're not hoping for inflation. Everybody is hoping for inflation. It doesn't hurt us. But it's been pretty stable. I mean, if I look at LIFO indices or any type of those metrics, we've gone from deflation to flat or literally low-single-digit basis points up on a basket, not taking gas out of the equation, which is quite inflationary right now.

<Q - Joseph Feldman>: Two quick ones. Pick up in store, I know we've talked about this before with you guys but just curious if you've changed your thinking on it at all or if there's potential to do a test like the buy online, pick up in store situation.

<A - Richard A. Galanti>: Yes. We looked at it, but at this point we're not prepared to do it.

<Q - Joseph Feldman>: Okay. And...

<A - Richard A. Galanti>: We do it with tires. You can order them online and schedule your appointment.

<Q - Joseph Feldman>: Got it. Is it a space issue or a labor issue, you think?

<A - Richard A. Galanti>: Well, first of all, to tell you the truth, in our view, and maybe we're stubborn, it's a common sense issue. You order and then you got – then we have to separate it to dry, refrigerated, frozen, and wait for you. It is clearly a space issue. I mean, we're doing literally twice the volume of some others out there, two to three times the volume vs. our two direct competitors. And I'm sure at some point we'll try it, but it's not on the agenda in the next couple months.

<Q - Joseph Feldman>: Got it. And then the other topic, I think you said the store mix for this year in new stores was two-thirds U.S., one-third international. I feel like you were trying to push more towards 50/50 the past couple years. Just anything to do that you could mention there?

<A - Richard A. Galanti>: We're still trying. There's a longer pipeline – a longer pipeline and we've had a lot going on. So we will get there and I look at it I think the good news is if you had asked me five, six, seven years ago, I don't think we'd had as many opportunities in the U.S. as we still think we have. I mean, saturation continues, but the time with saturation ultimately occurs for new locations, keeps being pushed out a little bit further.

<Q - David Bellinger>: So my first question is on the priced investments you detailed earlier. Just to be clear, did those step up in Q4 vs. the trend over the first three quarters of the year? And if so, was that in some way a reaction to the Amazon-Whole Foods deal?

<A - Richard A. Galanti>: No, there's more weeks – there's 17 weeks vs. the first three quarters that had 12 weeks, and it had absolutely nothing to do with that. I mean, we price Whole Foods twice a week in many, many markets around the country and we're kind of scratching our head.

<A>: We've done it before.

<A - Richard A. Galanti>: Yeah, we did that before the announcement of the acquisition, by the way. Have they come down in prices of some items? Sure, overall, and some of you have done your own price baskets while we read about up to 43%. It's a lot closer to zero than it is 43%. And even with something dramatic, others out there will be impacted a lot more than we are other than people wanting to have stuff delivered. And we're providing that option based on how we do stuff.

<Q - David Bellinger>: Got it. And then as my follow-up, can you just give us any comments around the recent trajectory of food price deflation and what your expectations are going into 2018?

<A - Richard A. Galanti>: It's pretty flat right now. And within fresh, you're going see variations like meat has come down a little bit. It was way up for a year. That's going be seasonal. Produce depends on crops...

<A>: Recent events.

<A - Richard A. Galanti>: ...recent events. Oil and gasoline depends on recent events, the hurricanes, but other than that, taking some of those things out, it’s pretty flat. Hello?

<Q - Mark Stiefel Astrachan>: I wanted to ask, could you give the percentage of sales that Kirkland Signature represents? And then just curious if you think about the margins relative to what else is in store given increasing competition out there and obviously the favorability of the KS products, would you think about increasing the offerings there going forward to help sort of fund and offer uniqueness within the store?

<A - Richard A. Galanti>: Yeah. Well, percentage-wise ex gasoline, even though it says Kirkland Signature Gasoline, is about 24%, 25% of our total sales, our non-gas sales. We’ll continue to add items as they make sense. We’re not really working towards the number. We think the number will keep going up a little bit because we do like it. But we remind ourselves, and our Head of Merchandising reminds our buyers every day, don’t fall in love with it because it has your name on it, and each year which items, even Kirkland Signature, we just continue because the brand does better? Maybe ours is a better value in our minds and maybe it is a better value, but we’re still not successful with it.

<A>: We keep adding new brands.

<Q - Mark Stiefel Astrachan>: Got it.

<A - Richard A. Galanti>: Oh, yeah. And by the way, part of the focus of our buyers probably before that is to find more brands. We want more brands.

<Q - Mark Stiefel Astrachan>: Got it. And then just lastly, you had previously talked about e-commerce expansion being done organically. Curious if that’s still the case or would you potentially take a look at other things, whether it’s an actual retailer, whether it’s a logistics provider, something that could help sort of bridge what you’re doing externally now with something internally.

And related to that, sort of views on competitive dynamics, meaning you buy something that isn’t necessarily something you want but something that somebody else may want that ultimately could negatively impact your business.

<A - Richard A. Galanti>: I think the latter part of that, no. That’s going be the last thing. I always joke we’re not smart enough to figure that one out. I think we’re more likely to, first of all, look for partnerships and ventures to jointly venture something rather than to buy something. As you might expect we, along with other large brick-and-mortar retailers, get calls every day about everything, whether it’s delivery services, food-related meal stuff, all kinds of stuff. And we’re fortunate in the sense that, one, we’ve got some good relationships like in the recent expansion, what we’re doing with Instacart, that helped. So I don’t see us doing that. That being said, we’ll be open-minded to anything but we’ll have to wait and see on that one.

We’ve got a lot going on right now with some of the things we’re doing that we’re excited about. And every time – when we tried something, I keep bringing up the steak idea or the steak example or the Copper River salmon answer, then figure out, what else can we do? And there’s a lot of those what elses.

And so we’ve got our plate pretty full on those kind of things. And we’ve got a – look, we just rolled this thing out. What we rolled out three days ago was a soft opening, if you will. There’s no publicity out there for it. And we have to see how it goes, what it does first.