Company Name: Costco
Company Ticker: COST US
Date: 2018-10-04
Event Description: Q4 2018 Earnings Call

Market Cap: 101,519.63
Current PX: 231.68
YTD Change($): +45.56
YTD Change(%): +24.479

Bloomberg Estimates - EPS
Current Quarter: 1.608
Current Year: 7.720
Bloomberg Estimates - Sales
Current Quarter: 34165.400
Current Year: 151810.524

Q4 2018 Earnings Call

Company Participants

- Richard A. Galanti

Other Participants

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

MANAGEMENT DISCUSSION SECTION

Richard A. Galanti

Q4 Highlights

Operating Results

- In today's press release, we reported operating results for Q4 FY2018, the 16 weeks ended September 2
- Net income for the quarter came in at $1.043B, or $2.36 per share, a 13.5% increase compared to the $909mm or $2.08 per share in the 17-week fourth quarter last year
- If you normalize the number of weeks, it's about a 20% increase

Sales

- In terms of sales, net sales for the quarter came in at $43.4B, a 5% increase over the $41.4B last year, again 16 vs. 17 weeks, on a comp basis, which is on a like week basis, comps were up 9.5% for the quarter
- Sales for the 52-week FY2018, they increased 9.7% to $138.4B from $126.2B last year in the 53-week year
- On a comp basis for the year as well, we reported a 9.5% comp

Comp Sales

- Now comp sales for Q4 were as follows
- And again, it's in the press release
- In the U.S., on a reported basis, it was 10.8%
  - Ex-gas and FX, it would have been a 7.8%
- Canada reported was a 5.7% for the 16 weeks
- On an ex-gas and FX, it was 4.6% and Other International, 6.7% reported, a 6.9% ex-gas and inflation – gas inflation and FX
- All told, total company, as I mentioned, reported a 9.5%, ex-gas and FX is 7.2%
- As well, e-commerce, which we've started reporting about a year ago on a monthly basis as well, e-commerce for the 16 weeks was at 26.2% comp and ex-gas and FX at 26.3%

Sales Metrics

- In terms of Q4 sales metrics
- Fourth quarter traffic or shopping frequency was up 4.9%, both on a worldwide basis as well as in the U.S. Weakening foreign currencies relative to the U.S. dollar negatively impacted sales by about 25BPS, and gas inflation benefited Q4 comps by about 260BPS.
- Cannibalization, by the way, weighed on the comp by about 55BPS to the negative
- Our average front-end transaction was up 4.4% during Q4, and excluding the impacts of inflation and FX, our average ticket was up a little over 2%

Membership Income

- Next on the income statement line, membership income
- We reported $997mm or 2.30% of membership fee income in Q4 of 2018
- Last year, in the 17-week quarter, it was $943mm, 2BPS lower
- So on a reported basis, $54mm increase or up 5.7%
- Again, on the like weeks basis, up a little over 12%
- Of this normalized 12% number increased y-over-y in Q4, a little over half related to membership fee increases, the majority of which came from the $5 and $10 annual fee increases taken last June 1 in the U.S. and Canada

Membership Renewal Rate

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

Gold Star Household

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

Cardholders

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

Fee Income

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

Gross Margin

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

Ex-Gas Inflation

- The first line item will be core merchandise
- On a y-over-y basis, on a reported basis, core merchandise gross margin was down 44BPS y-over-y, ex-gas inflation, was down 22BPS

- Ancillary businesses were plus 14BPS reported and plus 21BPS ex-gas inflation, 2% reward, plus 1 and minus 2BPS
  - Other was minus 6 and minus 6BPS y-over-y
- And if you add those two columns up, you get 35 basis point negative, which we reported, and the minus 9 basis point, which I just mentioned on an ex-gas inflation basis

Core Merchandise

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

Gross Margin

- Ancillary and other business gross margins, I mentioned, was up 14BPS reported and up 21BPS ex-gas inflation, that's because of the extra good margins as well as the sales penetration
- Other was minus 6BPS as was the case in the first three quarters of FY2018, I've mentioned to you that we're incurring some incremental costs, primarily related to the rollout of a centralized return facilities throughout the country
- And that was – during the quarter, that was a 4 basis point detriment, which is relatively speaking, an improvement from the first three quarters
- In addition, we're cycling some one-time items that last year in the quarter, which net-net benefited last year's quarter by 2BPS
  - That was a positive legal settlement offset by some impact from last year's Hurricane Harvey

SG&A

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

Core Operations

- Again, for ease of explanation, we'll jot down two columns of numbers, Q4 2018 as reported, and then Q4 2018 ex-gas inflation

- Core operations is the first one, lower by 16BPS – I'll say plus 16BPS, and minus 4BPS or worse by 4BPS on ex-gas inflation basis
- Central, minus 4BPS and minus 7BPS
- Stock compensation, zero and zero; and other, it was a benefit, plus 3BPS and plus 3BPS
- And again, you add up the columns, you get on a reported basis
  - We were lower or better by 15BPS in ex-gas inflation higher or worse by 8BPS
- Now, the core operations component so the U.S. wage increase that went into effect in June 11 to our hourly employees in the U.S. that negatively impacted SG&A by 6BPS.
- And as I mentioned, probably last quarter, this will continue to impact the SG&A comparison over the next three quarters of June 11 through June 10 of next year

Central Expense

- Central expense was higher y-over-y in Q4 by 4BPS, 7BPS ex-gas inflation
- IT expenses were about 2BPS of that, and the balance coming from a lot of small changes in a variety of miscellaneous items, frankly, but net-net, it added up to a minus 7BPS ex-gas
- And lastly, other was better by 3BPS, they're related to expenses occurred last year on the SG&A line as well from the Hurricane Harvey

preopening Expenses

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

Interest Expense and Cash Balance

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

Tax Rate

- In terms of income taxes, our tax rate in Q4 2018 came in at 27.4%, and 28.4% for all of FY2018
- This compared to 27.4% for Q4 compared to last year's Q4 of 34.3%
- Now this quarter's tax rate benefited, of course, from the income tax reform that was effective January 1 as well as some favorable discrete tax adjustments
- For FY2019, based on our current estimates, which of course, are subject to change, we anticipate our effective total company tax rate to be approximately 28%

Net New Warehouses

- A few other items of note
- During – in all of FY2018, we opened a net of 21 new units plus four additional relos
- Of the 21 net, 13 were in the United States and 8 were international
- For 2019, we expect to open 20 plus – low 20s net new warehouses
- About three-quarters will be in the United States and about a quarter international, as well we plan to relocate four units that are located in larger facilities, same number as we did this year

China and Shanghai

- We're also under construction with our first Costco in China and Shanghai with the opening expected late next September
- As of Q4 end, total warehouse square footage stood right at 110mm square feet
- Next subject, stock buybacks in Q4
  - We repurchased $89mm worth of Costco stock or 419,000 shares at an average price of $211.35
- For the all of 2018, we repurchased $322mm at an average price of $183.13 per share

E-Commerce Activities

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

FY

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

Online Two-Day Grocery

- In terms of online two-day grocery, which is the dry side, we're generating sales in all 50 states, including the 6 states where no physical Costcos are present
- Still relatively small to our company
- We continue to improve the online merchandise and sales offerings and services offerings with Hot Buys and Buyer Picks (sic) [Buyer's Picks] and buy online and pickup in store and we'll continue to do exciting merchandising activities
- Overall, all these efforts we feel are positively impacting our business, both online and in warehouse, and are helping our sales, increasing member awareness of our digital presence, as well as increased traffic that we've enjoyed in our warehouses

U.S

- The next subject I'll touch on is tariffs and their impact on our business
- As you know, there are many moving parts and it's extremely fluid starting with the actions and reactions by both the U.S. and Chinese governments
- What actions are we exploring and taking in some short-term and some long-term? Accelerating shipments before tariffs go into effect, recognizing there's a limited ability to do so
- Everybody's trying to
- Working with suppliers to see what can be done to reduce and/or absorb some of the costs, and in some cases reducing order commitments on certain impacted items
- Alternative country sourcing, sure, but again, it's where possible and feasible, it's a limited ability, and it takes time
- Five, taking advantage of lower pricing on some U.S. items because of the reverse, if you will, such as pork, nuts and soybeans

Summary

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

Our last topic, as was noted in this afternoon's press release, we plan to report in our Form 10-K a material weakness in internal control related to general IT controls

- These controls relate to internal user access and program change-management over certain of our IT systems that relate to our financial reporting processes

I can tell you that there have been no misstatements identified in the financial statement as a result of the deficiencies and we expect to timely file our Form 10-K.

Remediation

- In terms of remediation, remediation efforts have begun, but material weakness will not be considered remediated until the applicable controls operate for a sufficient period of time and we conclude, through testing, that the controls are operating effectively

- We expect that the remediation of the material weakness will be completed prior to the end of FY2019
- Lastly, in terms of upcoming releases, we will announce our September sales results for the five weeks ending this Sunday, October 7; next week on October 10

QUESTION AND ANSWER SECTION

<**Q - Michael Lasser**>: With the core gross margin down 2BPS, the expectation was that you'd be taking some of the tax reform and investing it in the value proposition, particularly price. So have those investments been made? And if they have, has it just been [audio gap] (00:17:32)?

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

<**Q - Michael Lasser**>: And where do you think your pricing gap currently stands with others in the marketplace that have been investing in price?

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

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

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

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

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

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

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

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

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

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

<Q - Josh Kamboj>: Your comps have been very strong for the last few quarters. If you look at the basket that consumers are buying, would you attribute the strength more to capturing a broader set of categories or are customers trading up within your core consumable categories? And if the former, which new categories are you seeing the more success in?

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

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

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

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

<Q - Josh Kamboj>: All right. Thank you.

<A - Richard A. Galanti>: Yeah. And it's hard to say how that impacts our numbers. Our numbers have been fortunately pretty good.

<Q - Chuck Grom>: Richard, just first question is on ancillary part of the gross profit margin composition that you provided. Just wondering why the ancillary line was up 14BPS. So it's a big reversal from Q3.

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

<Q - Chuck Grom>: Okay. So [indiscernible] (00:24:48)...

<A - Richard A. Galanti>: E-com has helped a little as well.

<Q - Chuck Grom>: Okay. So e-com is sort of captured in that line item, okay?

<A - Richard A. Galanti>: Yeah. Yeah.

<Q - Chuck Grom>: Okay. Thanks. And then...

[indiscernible] (00:24:58)

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

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

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

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

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

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

<A>: 12%.

<A - Richard A. Galanti>: 12% of our total company sales is gas on a much different margin structure.

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

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

<Q - John Heinbockel>: Okay. But you're seeing penetration of KS continue to rise and is it rising same as it had been, faster or slower?

<A - Richard A. Galanti>: I think it's been consistently rising, not faster or slower. I mean, keep in mind, there's still new items out there, and – but, you've got a lot of items that start out at $10mm and $20mm or $30mm. The big items, like toilet paper and water, we saw a big growth over the last couple of years in water as – where we brought the price down from $3.49 to $2.99. I'm just looking down a list, of late, Kirkland Signature 14-cartridge razor blades – razor blades with a handle. Several – the organic cheeseburger in the food court, fragrances – the KS Fragrances, all kinds of beverages.

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

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

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

<A - Richard A. Galanti>: I'm sorry, what's the last part of the question?

<Q - Karen Short>: How to think about the growth rate of e-commerce going forward?

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

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

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

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

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

<Q - Karen Short>: Okay. And just last question, I guess, can you just give us inflation in Q4, both on – at cost and at retail, and then expectations for inflation, given all the narratives from vendor's base, calling out passing on cost increases?

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

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

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

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

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

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

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

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

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

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

<Q - Christopher Horvers>: Understood. That's very helpful. Can you also talk about sort of the like an organic MFI growth number, sort of ex-FX in the 53rd week? It looks like all-in that that number was running a little bit below 5% in H1, and then in Q3 sort of picked up over 5%, and then in Q4 nearly 6%. Is that sort of rough math that you're seeing sort of like MFI comp accelerating [indiscernible] (00:38:03)?

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

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

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

[indiscernible] (00:39:30)

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

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

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

<A - Richard A. Galanti>: I would say, well, if you take out the benefit of the fee increase.

<Q - Christopher Horvers>: Yeah.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Hot Buys have helped as well.

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

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

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

<Q - Jonathan Livers>: Just a question on e-commerce as well, as it continues to be a focus and you've made sizable investments there and still putting up pretty impressive growth. Could you tell us what percentage of e-commerce has shipped by your stores vs. shipped by vendors?

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

<Q - Jonathan Livers>: Okay.

<A - Richard A. Galanti>: And by the way, that is only the business center with our two-day dry.

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

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

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

<A - Richard A. Galanti>: Yeah. Well, first and foremost it's warehouses. And to the extent there's a few more international, a couple of more. IT is a few hundred extra. I mean, not extra from the year before, but in general. We've got a chicken plant, which is north of $300mm, a big chunk of that is expended in FY2019 and we've already started spending money. The cheapest money was the acreage, the expensive money is the facility and all the equipment and everything. And the whole fulfillment – I guess, what's new would be some things like the chicken plant, would be some of the fulfillment activities we have on two-day delivery and e-commerce, small package e-com, where that will be a savings, frankly, to us, but we're just – we were doing a lot of those things a lot more manual than even we need to do.

<Q - Oliver Chen>: Thank you. That's helpful.

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

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

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

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

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

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

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

<Q - Gregory Scott Melich>: I have a couple questions. One was on gasoline, obviously, it grown a lot, but what was the gallon growth in the quarter? And did it – did penny profit actually improve? It sounds like it did, but I just want to see if that's the case.

<A - Richard A. Galanti>: The gallon increases were the low double digits, 11%, 12%, 11% or 12%...

<Q - Gregory Scott Melich>: Got it.

<A - Richard A. Galanti>: ...which is huge compared to the U.S. economy.

<Q - Gregory Scott Melich>: Right. Got it.

<A - Richard A. Galanti>: That's also – that's from new gas station as well, but I think the comp has got to be in high singles.

<Q - Gregory Scott Melich>: Got it. And how many new – I mean, stations are at most of the clubs that you can have them, right? Is there a penetration number you have?

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

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

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

<A - Richard A. Galanti>: I'll just say, yes, we do. We do have that information.

<Q - Gregory Scott Melich>: Okay. Is it the same, is it back to where it was with Amex, I guess, is what I would say or above?

<A - Richard A. Galanti>: I think it's quite a bit above.

<Q - Gregory Scott Melich>: Quite a bit above.

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

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

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

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

<Q - Matthew J. Fassler>: I think you've got that one.

<A - Richard A. Galanti>: In terms of the wage increases related to the tax reform. At the time we did that, we announced that it was going to be somewhere between $110mm to $120mm a year.

<Q - Matthew J. Fassler>: Yeah, understood. And so I guess, partial impact here in Q4, given the June implementation.

<A - Richard A. Galanti>: Right. until June 11, that was about three quarters -even though Q4 is normally a 16-week quarter, not a 12-week, it was about 12 and the 16 weeks business.

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

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

<Q - Matthew J. Fassler>: Great. And then finally, on renewal rates. You seem to have shaken off some of the cobwebs that emerged, I guess, in the period after the credit card transition. Your U.S. and Canada renewal rate is back to where it was in Q3 2016, so I guess, the best in nine quarters or so, and even more so for the worldwide rate. Have we sort of shaken the cobwebs off now? And are we – do you think there's more room to move higher here? Or do you think we're kind of back at the level where we're likely to plateau?

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

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

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

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

<Q - Peter S. Benedict>: Got it. Do you have Q4 CapEx number?

<A - Richard A. Galanti>: Not yet.

<Q - Peter S. Benedict>: Okay.

<A - Richard A. Galanti>: It will be in the K, in a couple of weeks.

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

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

<Q - Peter S. Benedict>: Right. Okay. Last question just around brands, both yours and others, which categories beyond white goods are you seeing kind of an incremental step-up in your ability to get premium brands? And then what was the private-label penetration for Q4 and for the year?

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

<Q - Kelly Ann Bania>: Wanted to just ask about – with e-commerce now about 4% of sales, just curious what percent of your members are really engaging online? And I guess, in connection with kind of the renewal rates question, as you look at those members that are engaging online, are they renewing at a similar rate or a higher rate? Just curious how that could influence the renewal rates over time?

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

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

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

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

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

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

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

<Q - Beryl Bugatch>: Most of my questions have been answered, but just on e-commerce. Can you give us the e-commerce impact on comps? Do we have that number?

<A - Richard A. Galanti>: I'm sorry, the comps?

<Q - Beryl Bugatch>: Yeah. The e-commerce impact on comps. Well, how many basis points do they impact the comp?

<A - Richard A. Galanti>: It's somewhere in the 70 or 80 basis point range.

<Q - Beryl Bugatch>: Okay. Thank you. And...

<A - Richard A. Galanti>: It's north of 50BPS and it's not 100BPS.

<Q - Beryl Bugatch>: Say again?

<A - Richard A. Galanti>: It's north of 50BPS and it's below 100BPS or so...

<Q - Beryl Bugatch>: Okay.

<A - Richard A. Galanti>: I think it's in the mid to high.

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

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

<Q - Beryl Bugatch>: Well, that was the...

[indiscernible] (01:12:01)

<Q - Beryl Bugatch>: ...impact on the base.

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

<Q - Beryl Bugatch>: Okay.

<A - Richard A. Galanti>: And that was a number of years ago.

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

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