Q2 2019 Earnings Call

Company Participants

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

Other Participants

- Christopher Horvers, Analyst
- Chuck Grom, Analyst
- Edward Kelly, Analyst
- John Heinbockel, Analyst
- Karen Short, Analyst
- Mike Baker, Analyst
- Scot Ciccarelli, Analyst
- Scott Mushkin, Analyst
- Simeon Gutman, Analyst

Presentation

Operator

Good afternoon. My name is Vincent and I'll be your conference operator today. At this time, I would like to welcome everyone to the Q2 Earnings Call and February Sales. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will a question-and-answer session. (Operator Instructions)

Thank you. I'll now turn the call over to your speaker today, Mr. Richard Galanti, CFO. Sir, you may begin.

Richard A. Galanti {BIO 1423613 <GO>}

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

In today's press release, we reported operating results for the second quarter of fiscal 2019, the 12 weeks ended February 17th as well as February retail sales for the four weeks ended this past Sunday, March 3rd. Now to the first two weeks of February fell into this second fiscal quarter with weeks three and four of February are the first two weeks of our fiscal third quarter.

The reported net income for the quarter came in at $889 million or $2.01 per share, a 27% increase compared to the $701 million or $1.59 per share last year in the quarter. In terms of sales, net sales for the quarter came in at $34.63 billion, a 7.3% increase over the $32.28 billion reported last year in the second quarter. Comparable sales for the second quarter, as shown in the press release for the 12 weeks on a reported basis, US was 7.4%, Canada was minus 0.3%, other international 0.7%, for the total Company of 5.4%. As well e-commerce for the 12 weeks on a reported basis was 20.2%. Excluding gas deflation, the impact of FX and some weakening foreign currencies relative to the dollar as well as revenue recognition, which has impacted this year, the 7.4% reported in US would have been a 7.2%. The minus 0.3% in Canada would have been a plus 6.0%. Other international instead of being 0.7% reported would be plus 4.8%, with total Company, the 5.4% reported would become a 6.7%. And again, e-commerce reported at 20.2%, ex gas, FX and rev rec, 25.5% plus.

In terms of Q2 comp sales metrics, second quarter traffic or shopping frequency increased 4.9% worldwide and 5.2% in the United States. Weakening foreign currencies relative to the US dollar negatively impacted sales by approximately 140 basis points and gasoline price deflation was another minus 50 basis points of impact. Rev rec actually benefited comp sales by about 55 basis points to the positive. These are the three factors that we adjust for and that are presented in today's release as the adjusted column.

In addition, weather conditions adversely impacted Q2 sales by around 0.5 percentage point and cannibalization weighed in on the comps by about minus 70 basis points. In terms of front-end transaction or what we call ticket, average front-end ticket was up 0.4% during the quarter and excluding the impacts from gas deflation, FX and rev rec, our average ticket was up approximately 1.8%.

Going down the income statement, membership fee income reported came in at $768 million or 2.22%. That's up $52 million or 7.3% from a year ago. Again, with weak foreign currencies, if you adjusted for flat FX, that would make up $52 million, another $9 million up or up 61% -- up $61 million year-over-year ex-FX. Reported membership revenue of the plus $50 million -- the plus $52 million amount, that's a little more than half of that, a little more than $20 million of that related to the membership fee increases taken in June of 2017 in the US and Canada. We are now nearing the end of that 23-month cycle to recognize the incremental benefit of the fee increases, what's known as deferred accounting into our P&L. The benefit to our P&L will be fully recognized in the next two quarters by the end of the fiscal year, but as with this last couple of quarters, it diminishes each quarter. In Q3, we will have about half the benefit recorded in Q2 and in Q4, well, there will be a very small benefit.

In terms of renewal rates in the second quarter, our US and Canada member renewal rates in Q2 came in at 90.7%, up from 90.5% 12 weeks earlier at Q1 end. And worldwide, the rate improved to 88.3%, up from 88.0% at Q1 end. So improvement in our renewal rates. In terms of the number of members at Q2 end, member households and total cardholders, we ended Q1 12 weeks earlier with 52.2 million member households, at Q2 end that was 52.7 million and total cardholders increased from 95.4 million at Q1 end, this is 12 weeks later at Q2 end 96.3 million.

During the quarter, we had one new opening in Coral Springs, Florida and we also relocated a Miami location. At Q2 end, our paid Executive Membership based right at 20 million. This is an increase during the quarter of 341,000 or about 28,000 per week since Q1 end. Now, this includes the recent introduction of the Executive Membership in Korea, which is our fifth country offering Executive Membership. For Q2, Korea contributed a little over half of those increases. Going down to gross margin line, reported gross margin in the quarter came in at 11.29%, up 31 basis points from last year's Q2 '18 of 10.98%. The 31 basis point improvement ex gas, FX and rev rec would be plus 30 basis points.

I'll give you the chart, there's not a whole lot to it, given the adjustment column is not that different than the reporting column. In terms of core merchandise year-over-year in Q2 was up 1 basis point on a reported basis as well ex the gas deflation and the rev rec up 1 basis point. Ancillary businesses up 33 on a reported basis and up 32 on an adjusted basis. 2% reward minus 3 and minus 3 basis points year-over-year and then total up 31 basis points as I just mentioned on a reported basis and up 30 basis points ex gas deflation and rev rec.

The core merchandise component again is up -- was higher by 1 basis point here. Looking at the core merchandise categories in relation to their own sales, or what we call core-on-core, margins year-over-year were higher by 8 basis points, within the four key subcategories, both food and sundries and fresh foods were up a little and soft lines and hard lines were down a little. But net of the four departments on their own sales was up 8 basis points. Ancillary and other business gross margin was up 33 basis points, up 32 ex gas deflation and rev rec, primarily driven by gas and also benefiting somewhat from e-com and a few other things.

Moving to SG&A, our SG&A percentage Q2 over Q2 was lower or better by 2 basis points both with and without the adjustments coming in at 10.0% of sales this year compared to 10.02% last year. In the chart that we normally give out, there really is not a whole lot to tell you. Operations was an improvement of 2 basis points in both columns. The other two line items that we usually point out, central and stock compensation expense, were zero and zero. So the total remained at 2 basis points. So overall, 2 basis points better.

In terms of that 2 basis points better, we feel it was a pretty good result, given that we're still facing the headwinds from the US wage increases to our hourly employees that went into effect last June 11, 2018. As mentioned in the past couple of fiscal quarters, those wage increases negatively impacted SG&A by about 7 to 8 basis points during Q2 year-over-year and it will continue to impact SG&A comparisons through Q3, which ends May 12 and into the first month of our 16-week fiscal fourth quarter to anniversary on that June 11th.

Additionally, this past Monday, we began our new three-year employee agreement. With the new agreement, we announced that we're taking our starting wages from $14 and $14.50 up to $15 and $15.50 per hour in both the US and Canada. In addition, we are also increasing wages for supervisors and introduced -- and also introduced paid binding leave for all hourly employees. These items are incremental to the usual annual top of scale wage increases that are typically done each March. Collectively, these additional items will add about 3 to 4 basis points to SG&A over the next four quarters. Now, again, this is on top of that 7 to 8 basis point impact I just mentioned that will impact SG&A through this coming mid-June. Otherwise, pretty comparable year-over-year in terms of central and stock comp and other various SG&A expense line items.

Next, on the income statement is pre-opening. Pre-opening expenses were actually lower by $3 million, coming in this year at $9 million compared to $12 million last year. This year, again, we had two openings, one net opening and one relocation. Last year, we actually just had one opening. There's other activities that relate to pre-opening as well. Year-over-year, primarily the difference was due to the $4 million in Q2 last year related to our -- opening of our new meat plant in Morris, Illinois, slightly offset by higher warehouse pre-opening this year due to the additional opening.

All told, reported operating income in Q2 '19 was up 18.4% coming in at $1.203 billion this year compared to $1.16 billion last year. Below the operating income line, reported interest expense was $3 million lower or better year-over-year, coming in at $34 million this year in Q2 as compared to $37 million last year. The actual interest expense quarter-over-quarter each year is about the same, a little bit more -- a little delta and improvement in capitalized interest amounts. Interest income and other for the quarter was better by $39 million year-over-year. Interest income itself was higher by $17 million year-over-year in the quarter, a combination of higher interest rates being realized and also higher invested cash balances. Also benefiting year-over-year comparison were the various FX items in the amount of $22 million. Recognize that much of this is essentially an offset to the lower reported operating income and earnings in our foreign operations due to the strength of the US dollar versus many of the foreign countries -- currencies in the countries, where we operate compared to last year.

Overall, pre-tax income in Q2 was up 23% coming in at $1.215 billion this year compared to last year $986 million. In terms of income taxes, our income tax was -- our income tax rate was a little better than we had anticipated, came in at $25.8 million -- 25.8% tax -- effective tax rate during Q2 '19 compared to 27.7% in Q2 last year. For all of fiscal '19 based on our current estimates, which again are subject to change, we anticipate that our effective total Company tax rate for this fiscal year to be approximately 26% to 26.5%. This figure is about a 0.5 percentage point lower or better than we had previously estimated a quarter ago. This is primarily due to a Q2 tax rate that now includes a one-time benefit for certain foreign tax credits. This one-time tax benefit will continue through the end of this fiscal year, but we do not anticipate a similar type of benefit beyond fiscal '19.

A few other items of note. Again, we opened a net one unit during Q2. Opened two, including a relo. In Q3, we have three new openings planned and no relos. We actually opened this morning in Bayonne, New Jersey. And in late April, we plan to open our 16th location in Korea. And in early May, our 11th location in Australia. The big expansion quarter for us this year is Q4. We plan to open a net of 12 units, 14 openings, including two relos, including our first opening in China in Shanghai in the City of Minhang and also our third unit in Spain, which would be our second in the Madrid area. Though many of these could slip a little bit, but our current best guess right now is 14 openings, including two relos. So a net of 12.

As of Q2 end, total warehouse square footage stood at 112 million square feet. I might also add that in terms of CapEx, we continue to allocate more CapEx to grow and support our operations, including, as you know, over the last year, year and a half, we had opened a second meat plant. The first one in California many years ago and then in Morris, Illinois. Also a little while ago, our Canadian bakery commissary in Canada. We are under construction with the big chicken plant in Nebraska. We plan to start initial processing and production later this year. Depot expansion, we're doing that in many areas around the world. Also, we, just a month ago, I believe, we started up our first, what we call, fulfillment automation operation near our -- next to our -- as part of our Mira Loma depot. This is for small packages for e-commerce and we plan to do two more of those this year and other depots.

In terms of two-day grocery, which as you know we started in October about a year and a half ago, we did that out of 10 or 11 of our business centers around the country. We're in the process of moving those -- these operations to 10 -- out of 10 to 11 business centers to six of our depots over the next several months. I think we've done our first one and we've got several more planned, it'd be right around the end of spring beginning of summer.

In terms of stock buybacks, in Q2, we expended $117 million to repurchase 561,000 shares at an average price of $208.72. The $117 million of course is higher -- significantly higher than the Q1 purchases of $35 million. In terms of e-commerce, overall again e-commerce sales increased during the quarter on a reported basis 20.2% and ex FX and rev rec up 25.5%. Continued increases in e-commerce in terms of orders and sales and profits and other metrics. Comp growth categories in the quarter, quite a few actually, grocery, consumer electronics, what we call majors, hardware, health and beauty aids, tire automotive, toys seasonal and apparel.

We've now passed our one-year anniversary on the grocery launch, which was again a year ago in October. Same-day grocery delivery is now available to members within a short drive of 99% of our US locations. Two-day grocery is available anywhere throughout the continental United States. And while still these are small pieces of our total business operation, they're growing nicely. We now have grocery shipments to all 50 states.

In terms of e-commerce in terms of new brands and items online during the quarter, we're now offering a much broader selection of Apple products, including the recent addition of MacBooks and iMacs. And yes, you would expect good values to our members. Also, the first of what we expect several products from Sony, they've just started arrive. In terms of health and beauty aids, new names like Living Proof shampoo and conditioner, Murad skincare and Kate Somerville items. On the exercise front, NordicTrack is a new name. And finally, I had point out that now somewhat famous 180 serving 23-pound 20-year shelf life macaroni and cheese for $18.999. If interested, you can find that online under emergency supplies in a few of the Costco locations.

We continue to improve our online and in-line cross-marketing initiatives and we think that's continuing to drive our business. In terms of buying online and pickup in store, in the quarter we expanded our selection within the same categories, jewelry, some electronics and handbags and continue to test pickup lockers in 10 locations for this program. Lastly, this calendar year, we will begin e-commerce operations in Japan early summer likely and in Australia late summer, early fall.

Finally, I'll turn to our February sales results. The four weeks ended March 3, 2019 compared to the same period a year ago. As reported in our release, net sales for the month came in at $10.72 billion, an increase of 5.0% from $10.21 billion the year earlier. In terms of comparable sales, US on a reported basis for the four weeks was 6.0%, ex gas, FX and rev rec, that 6.0% would be 5.7%. Canada on a reported basis zero ex gas, FX and rev rec plus 4.8%. Other international reported minus 5.9% and again adjusted with ex those things minus 1.2% plus the total Company came in at a 3.5% reported and at 4.6% ex those items. In terms of e-commerce, reported for the four weeks 24.2% and ex those adjustments, appropriate adjustments 21.6% up.

February sales were negatively impacted by weather throughout the US and Canada in a big way. We estimate that negative impact on the total Company was approximately 1% and a little more than the 1% figure in the US and Canada. In addition, Lunar New Year, Chinese New Year occurred in February the same as last year. However, 11 days earlier this year. This is an important holiday in terms of sales strength. The holiday shift negatively impacted February's other international sales by -- we estimated 450 basis points or 4.5 percentage points and total Company sales by about 0.5 percentage point.

Looking at January and February combined effectively eliminating the impact of that holiday shift, the comp for other international for the eight weeks was 0.2% reported and plus 4.9% ex FX, gas deflation and rev rec. US regions with the strongest results in February were Midwest, Northeast and Southeast. And internationally, the strongest results were Mexico, Japan, UK and Spain. Spain of course is relatively new with two locations.

Foreign currencies year-over-year relative to the US dollar hurt Feb comp sales by -- hurt February comp sales in Canada by approximately 460 basis points. Other international also by about the same number of basis points, about 4.5 percentage points and total Company by an estimated 130 basis points. The negative impact of cannibalization was about 50 basis points negative in the US, 80 in Canada and 120 in other international, for total Company minus of 70. Within ancillary businesses, hearing aids, optical and food court had the best comp sales in February. Gas price deflation negatively impacted total reported comps by about 75 basis points. The average selling price during the four-week month compared to a year earlier was down 6.3% year-over-year, coming the average gallon a year ago we sold for $2.74, this year $2.56 a gallon.

Including the adverse impact of weather and the holiday shift in Asia, our comp traffic or frequency for February even after taking those into effect -- taking those impact into effect, February was up 2.7% worldwide and plus 3% -- 3.2% in the US. For February, the average transaction was up eight-tenths of a percent for the month. Again, this includes combined impacts from FX, gas deflation and rev rec. So that's about it in terms of our prepared notes. Lastly, in terms of upcoming releases, we'll announce our March sales results for the five-weeks ending Sunday, April 7th, on April 10th after market close -- after the merger closes.

With that, I'll open up to Q&A and turn it back over to Vincent. Thank you.

Questions And Answers

Operator

(Operator Instructions) We have -- your first question comes from the line of Christopher Horvers from JPMorgan. Your line is now open.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks, good morning, Richard. So a question on the core margins. The core margins performance this quarter was much better sequentially, I think, everyone was sort of taken by surprise by the core margins ex gas in the last quarter and now they're looking much better. So can you put into context what sort of drove that change and any commentary about how you're thinking about core margins as you look forward?

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

Honestly, we drive our business by driving sales and usually that means lowering prices on things, which we continue to do and we're also buying better all the time. Some of it's mix, some of it -- the one category that's shifted if you look back over the last few quarters' reports when we look at core-on-core, fresh foods has been a little down, and I think the key word there is little. We -- I appreciate the fact that every basis points for us is $14 million plus pre-tax a year of $140 plus billion, but you're talking about 5 to 10 basis point swings here and there's lots of things that impacted, whether it's freight, tariffs, somewhat negative, some cases not as bad as we thought. I think we've done a great job and we continue to do a great job particularly in fresh food organics, where there is a little -- I believe, there is a little less pricing pressure -- or competitive pressure, but don't get me wrong. As soon as we have a good quarter, next quarter, we will change that. Not that I'm giving any guidance, we know that we keep it pretty steady and we feel pretty good about it, whether it was up a few basis points or down a few basis points.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. And then just a question about the gas margins industry-wide. I understand, there are few ways that I guess impacts margin. But if you just focus on the fact that it seems like the core cents per gallon has improved across the industry, the independents maybe and the integrators has taken a little bit more and that's given you some room to take a little bit more. So can you talk about what you're making sort of per gallon, I guess, relative to, say, last year and maybe a couple of years before that? And as you think about the upcoming year, is there anything that you're seeing that would suggest that that core profitability of every gallon sold is also going to revert back to what it was a number of years ago?

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

I think over the last several years, the new normal is better. If you go back to when gas prices skyrocketed several years ago and as they started coming down, what we saw and what we read frankly from others is that as they came down, not all of those savings were passed on to the consumer. That gave us perhaps a little bit bigger window and we're still -- I think if you ask our gas -- the people in charge of gas operations around here, we're saving the customer a little more today and making a little more because there is just a bigger opportunity of gap there. It really comes down to that. It is still a volatile no-pun intended profitability item, it can swing back and forth based on underlying cost of goods sold that change daily. And -- but the new normal is better and all those examples, but I'm sure we will -- there'll be quarters, this was a -- Q2 was a particularly good quarter. But as I believe Q2 a year ago was a little better than the other three. But that's not seasonal necessarily, it's just -- there's a lot of different factors. What's going on in the news internationally? What's going on with inventory levels, world and US inventory levels? What's going on with inevitably a refinery shuts down for two weeks for their planned repairs and it takes four weeks? So any of those things switching from winter to summer blend and back. All those things impacted. I think we're fortunate in the fact that we turn a lot of gas, we've literally turned our inventory about daily. And as you know, we have locations with up to 24 pumps and they're backed up all the time, it's great. And so I think we're in a fortunate position that overall retailers, whether it's retailers that have gases in their parking lots, like supermarkets and discount stores and ourselves or full line independent retailers or the ones with the convenient stores, I think everybody seems to have been taken a little more and that's given us ability to do so over the last couple of years. But I guarantee, it will be volatile and we will always tell you that it was certainly a little more on the benefit this quarter than normal than it was a year ago too.

Q - Christopher Horvers {BIO 7499419 <GO>}

So then just a quick one on that. So of the 30 odd basis points in ancillary this quarter, should we assume some portion of that comes out next year in the second quarter, as in like anything that you would say is one-time that we should put back next year on behlaf of it?

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

I would -- I wouldn't use the word one-time, I'd say unpredictable. I mean, it truly is not predictable. We -- I mean, we know that when demand rises at the beginning of summer, that impacts every -- gas prices has a little bit more positive pressure on them. And when prices are going up, not only for us, but when I read the profitability of gas and other big retailers, supermarkets and Walmart alike, it impacts them as well. When price is going up, we are making a little less. When price is going down, we make a little more. We, I think, are in the enviable position of being extreme and as overall the retail environment has chose to make a little more, it gives us an ability to make a little more, a little less than a little more and still make more but even be greater savings to our members. I mean -- and that's the thing that we focus on and are we saving our member more than we used to, and we are.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Thanks very much.

Operator

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

Q - Simeon Gutman {BIO 7528320 <GO>}

Hey Richard. A follow-up on the gross margin or the core margin. You mentioned mix helped a little, can you dig in anything about mix was seasonal or something that is changing? You said, we would always lower product acquisition cost, can you remind us when that your chicken plant is coming up? And then one more in that mix. Can you tell the channel mix between physical and digital? Is that sort of growth, embedded gross margin improving as well?

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

Overall, gross margin online is a little lower than our Company overall, part of it's the product mix itself and part of it is we're driving that business, but that hasn't changed. That's been that way. We also work on a lower SG&A online as you might expect. In terms of mix, there's so many different pieces to it, honestly. Part of it is when you walk into a Costco in the US, 90 -- roughly 90% of the goods are -- come through our cross-dock operations. For us, cross-docks are very profitable. It's the most cost efficient way to ship stuff. Nobody can do that to the extent that we do it because of how we sell goods in pallet and large case quantities. So I mean, there's lots of little pieces to it. I think private label and continuing penetration of private label, fresh, but all these were anecdotal. There is no one thing that's driving in a particularly large direction. We think we're pretty good at what we do and we're constantly buying better, even as it related to tariffs, which are so far so good in terms of being on hold, but we don't know what's going to happen in the future. I think bigger retailers have an ability to buy better.

Q - Simeon Gutman {BIO 7528320 <GO>}

Right. And then shifting to SG&A, in the past I think you talked about as long as your comps hold up in mid single-digit, you're leveraging. And that was based on some intuitive rate of spending, there was IT, there was technology, has anything on the spending side changed, any curve that's increasing, decreasing and that same mantra of about mid single-digit comps that should be enough to give you leverage?

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

Well, hopefully, it will. While -- the word monetization, I think, has finally been retired around here. We're still spending a lot and we're going to continue to spend a lot. As some of these new things come online, like the chicken plant, like the fulfillment automation, these are $50 million to $100 million plus items, chicken plant is more, where a bigger chunk of it is things like equipment and software that is depreciated over a shorter period of time than steel buildings. And so almost these are hitting us a little. I think the fact is we've been fortunate with our sales levels. As they go down, that will hurt us a little. We're achieving our current SG&A with all the things that we haven't talked about, some of these other items that impacted the other way. There are lots of little things. We're not terribly worried though if some of these things -- if sales were to come down a little and some of these were going to be impacted. So be it. We're going to do what we do and drive the top line.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thanks, Richard.

Operator

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

Q - Chuck Grom {BIO 3937478 <GO>}

Hey, good afternoon, Richard. Just on the pricing front. I'm curious, how you guys are handling increases in certain categories, including any of those that may be impacted by tariffs? Just -- are you looking to pass along those increases and do you think that may have helped out the core margins at all here in the second quarter?

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

I don't think it would have helped the margins, is question is did it hurt it or did not hurt it. It probably hurt it less than one might think, but that again gets back to our ability to buy right. And to the extent there is 10% tariff items in those examples versus 25%. That's a big difference. Some cases, you've got your vendors along with us eating into that a little bit, sometimes not. But I think it gets back, that's just one piece of what we do. The fact that organic helps us, the fact that KS helps us, the fact that we don't talk about nor will we plan to a lot, all the marketing dollars that are out there now. That -- some of those impact the cost of sales.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. And I guess, just to follow-up on Chris's question. Any of the three consecutive quarters in a row of the core-on-core, core being negative in this quarter. What's the positive? Is there anything else you could point to --?

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

I wouldn't read a lot. Look, we're happy about it and you are -- hopefully, you're happy about it. It's not -- it's how we run our business. We didn't sit there and say, hey, let's get it up a little higher. It is a few basis -- it is -- I know we're a basis point company for you who have known -- for you guys who have known us for 30 plus years, we talk basis points. It's some minor switches. It's nothing that we've changed dramatically and there's so many different moving parts to it frankly.

Q - Chuck Grom {BIO 3937478 <GO>}

Understood. I guess, the other bright spot here in the quarter was the renewal rates are ticking up nicely, if you look back at the cadence in '18, they were pretty steady, but they're showing a nice uptick both in US and worldwide. Just wondering, if you could comment on that improvement?

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

Well, we like it. Look, we focus on all the things that we feel we should be focusing on, customer service, great products, great services at the best prices. We've been fortunate, notwithstanding the fact that we really don't have a PR department per se that there has been a lot of good press about us, about peripheral signature, about our e-commerce site and customer satisfaction. I think that we've been blessed that some of the weakness that traditional brick and mortars or digital formats have had in some ways have helped certain other discounters like ourselves and hopefully that will continue.

Q - Chuck Grom {BIO 3937478 <GO>}

Great, thanks.

Operator

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

Q - Edward Kelly {BIO 21274619 <GO>}

Yeah, hi. Good afternoon, Richard. I wanted to start with just a follow-up on fuel. If we were thinking about trying to strip out fuel and the impact, do we take the majority of the 33 basis points in order to do that? And then, is there any intentional reinvestment to sort of consider as we think about this?

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

On the latter part of the question, there is no intentional reinvestment. I mean, there's a hundred different moving parts to our Company all the time and we do what we feel is right, we -- it's kind of like the question I was asked a year ago, we were asked about would the extra earnings from the lower tax rate, will that change. What we're doing with automation, online, fulfillment or whatever else and the answer was, of course, no, we've got more cash than we spend and this will add to that and that's all good. But we are constantly figuring out what are the things we can do there. What was the first part of the question, I'm sorry? Stripping out fuel.

Q - Edward Kelly {BIO 21274619 <GO>}

If you're trying to -- yeah.

A - Unidentified Speaker

Well, we don't disclose every component. It certainly was the biggest piece of it.

Q - Edward Kelly {BIO 21274619 <GO>}

Okay. In the last quarter, you mentioned a little bit of competitive pressure, specifically talked about Sam's and fresh. I'm just curious, if you could give us an update on the competitive backdrop, what you're seeing? And then as part of this, it seems like we're starting to see maybe a little bit of food price inflation. Just curious on your thoughts on pass-through, I guess, and expectations for the year.

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

Well, I think the key word on price -- on inflation is little. We're not seeing other than the tariff impacts on things. But in terms of food and what have you, it is frankly very little. And some -- over time, it will go up. Our comments over the years have continually been, we'll be the last to go up and the first to go down and I think that holds true as well. In terms of the comment last time on Sam's, that was an interesting comment because I think after the call, the headline in the press was that's why things -- margins were down. And the fact of the matter is, as we call it out because we're pretty transparent, Sam's and others, but Sam's has been more competitive and as we are -- as are we. And that's the nature of the business and it has been for 30 years. We see that continuing and I think the fact is continuing, we still show improvement in some of these things is a good sign for us.

Q - Edward Kelly {BIO 21274619 <GO>}

Great, thanks guys.

Operator

Next question comes from the line of David Schick from Consumer Edge Research. Your line is now open. David Schick, your line is now open. Your next question comes from the line of Karen Short from Barclays. Your line is now open.

Q - Karen Short {BIO 20587902 <GO>}

Hi, thanks very much. Sorry to harp on this gas margin question, but -- or gas profit question. But is there any way you could just help us get a feel for how much you benefited EPS this quarter because as the data we saw on gas margins for the quarter throughout year whole market area was just astronomically high gas margins?

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

We see our area throughout the United States.

Q - Karen Short {BIO 20587902 <GO>}

Well, we map it by kind of stores by state.

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

Okay.

Q - Karen Short {BIO 20587902 <GO>}

But West (Multiple Speakers) has been particularly strong.

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

Yeah. We don't disclose that, again it was well more than half, but not all.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then, I guess, just wondering a little bit in terms of the wage increase that you called out for March, is there anything to think about in terms of the basis point impact as we get into the next quarter?

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

Yes. I mean, starting March 4th this past Sunday, I think I indicated -- on top of the 7 to 8, that will continue through June 11th, if you will. So all through Q3 and the first month of the -- the first four weeks of the 16 weeks fourth quarter. Effective March 4th, we will have that additional, on top of that, 3 to 4 basis points.

Q - Karen Short {BIO 20587902 <GO>}

Okay. So --

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

And that 3 to 4 will be March 4th to March 3rd of 2020, if you will.

Q - Karen Short {BIO 20587902 <GO>}

3 to 4 basis points, okay.

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

Yeah.

Q - Karen Short {BIO 20587902 <GO>}

And then just wondering, if you could call anything out in terms of tax refund data like in terms of your expectations on driving sales and there's a lot of noise on the timeline of that, but any color what you're thinking it will do to the comps or not do, I guess?

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

Well, we -- honestly, I don't -- I haven't heard anybody here talk about that. And I've read some of the same things that you've read, started off in the period, it was a little lower. Now, in that period, it was a little higher. Not a lot higher, but a little higher. Typically on a macro basis, that impacts retail overall and on whatever impact it has to that, it's typically a little less to us. That's what we've seen historically, whether it was a change in tax rates or dividend rates or you name it. EBT, food stamps, whenever there's any kind of macro change that impacts retail across the United States, there's a little bit of less of an impact to us. But that was really -- we've not really seen or even know how to answer that.

Q - Karen Short {BIO 20587902 <GO>}

Okay. And then just last question. I know that you want to -- don't want to have people get in the habit of assuming that there will be a special dividend on a regular basis, but any thoughts on your philosophy on that as it relates to the timing within the Sear's who are at a two-year mark?

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

Yeah. I mean, our thoughts continue as they have been. The 3 we did were about two and a quarter years apart, but that doesn't mean anything going forward. It's still a topic on the table and we continue to talk about it, along with other things. So really, not a whole lot of news to tell you about.

Q - Karen Short {BIO 20587902 <GO>}

Okay, thank you.

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

Yeah. Thank you.

Operator

Your next question comes from the line of John Heinbockel from Guggenheim Securities. Your line is now open.

Q - John Heinbockel {BIO 1508150 <GO>}

So Richard, what are you guys seeing with regard to inbound freight? Is that a slight directional drag? And then if -- what do you -- if anything, what are you doing to mitigate that?

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

I'm shooting from the hip a little on this one, but I believe while it's been up a little bit because of new restrictions on how many hours long haulers should drive and just capacity and truck capacity out there, it's gone up for everybody. I believe we internally look at it in our freight department as a freight factor, a premium factor, a fuel factor whatever we call it as yet. And it's up a little less than it was a couple of months ago, but it's still up and it's come down a little bit from where it was, but it's still up from a year ago is my guess.

Q - John Heinbockel {BIO 1508150 <GO>}

Okay. And you've had the adjustment item right in gross margin related to some supply chain investments, not there now. Does that -- is that now gone for the duration or does that come back with other supply chain investments that you might make, whether it's the chicken plant or other depots?

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

One of the things was the return centers we talked about for a few quarters, but I think there is more things happening that impact us a little bit, negatively at the start. We opened a new meat plant, major capital expenditure. First, it takes a few things out of our Tracy meat plant that goes to the East Coast. With Tracy, we couldn't accommodate all our needs just from that plant. And then you've got a new plant that's starting with its own, even though we know how to run one, it has its innate inefficiencies when you first start and it's low and not full capacity. Same thing with the commissary, which is more of a learning experience two years ago, over the last two years up in Canada. I think all these things will impact us. A comment I made earlier is we're not going to point out each one of these, but in the aggregate, my guess it's still a little bit of a drag, which is offset by other things, most particularly sales.

Q - John Heinbockel {BIO 1508150 <GO>}

And then lastly, there was a period there where you stepped up growth of the business centers for a period of time. What's the philosophy now on where they go US or internationally as part of your expansion over the next couple of years?

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

I think right now we have one in Canada and, what, 16 I believe -- 16 in the US. I would expect one or two a year for the next couple of years, but there's -- which is not really a change of what we thought. The change was several years ago when we went from zero to eight over a 1 million years over a long period of time. And then we started opening a couple a year and so we'll continue to open a few, but we're not -- it's part of the plan, but our focus is regular warehouses and quite frankly a lot of the infrastructure things that we're doing now.

Q - John Heinbockel {BIO 1508150 <GO>}

All right.

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

(Multiple Speakers) bigger way.

Q - John Heinbockel {BIO 1508150 <GO>}

Yeah, thanks.

Operator

Your next question comes from the line of Scot Ciccarelli from RBC Capital. Your line is now open.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Hi, guys. Scot Ciccarelli. Richard, with you first opening in China coming up, what is the best way to think about US versus international store openings over the next, call it, two to three years? And then related to that, any reason why we should see international profitability levels decline as you start to move into some of these new markets, like China?

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

I think first of all, if you'd asked this five, six, seven years ago, by now, what percentage of our units would be outside of the US and Canada, I include Canada as part of the original mature fully grown out area. That -- by now, we'd probably be 50-50 international outside of US and Canada and we're not, it's probably -- it's well -- it's 65-35, 70-30 US-Canada still. Part of that is the opportunities that we've had in the US and Canada and part of it is the pipeline is taking a little longer elsewhere. I think you'll continue to see that change and the direction is toward more international. But I can't sit here and tell you that it will be 50-50 three years from now or five years from now. But clearly, we've got more things going on. Now, as it relates whenever we go into new country, it's almost by definition you're going to lose money for the first few years, even if that first location or two contributes a small amount of profitability, if it does, because you still have the central expense and a whole full thing in the infrastructure. I look back at Japan. When we first went to Japan, we opened six units in the first five years and the goal was to be at breakeven at the end of year five and I think we beat it by about 10 months. But at the end of the day, fast forward another 10, 12 years past those five years and we now have in the high 20s and we will grow from there faster and more profitable than it was in that mid-term when we're opening several units on a small base, but it takes time. And as we go into France, as we went into Spain, by definition, those are going to add more to the bottom line sales in that calculation of return on sales and sometimes even subtract a little of the top. The key is balancing a little of that and I think we're big enough now that even if we overdo it a little bit of some of that new stuff, that's okay, we'll let you know if it costs us an extra basis or two.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. Okay, thanks guys.

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

Why don't we have two more questions?

Operator

Next question comes from the line of Mike Baker from Deutsche Bank. Your line is now open.

Q - Mike Baker {BIO 4323774 <GO>}

Thank you. A couple of clarifications. One, to Karen Short's question, you said the gas was about half of it, a little more than half or a little less than half of it. Half of what? Was that the year-over-year increase in earnings or operating profit dollars?

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

No. First of all, I said it was more than half, I didn't say it was a little over half. It's substantial, but we try not to be that specific. Clearly, there's a lot of things that helped our earnings this quarter year-over-year, as evidenced by improvement in core-on-core. And the fact is evidenced by those things that hurt you a little bit that we don't pick out each one. Gas certainly helped, but again, I think Karen had mentioned that she's done some studies in terms of profitability and it's a good piece of it, but it's not entirely. There's (Multiple Speakers) there's other things that benefited and other things that hurt a little too.

Q - Mike Baker {BIO 4323774 <GO>}

It being the growth in earnings?

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

Well, gross margin and earnings, ultimately.

Q - Mike Baker {BIO 4323774 <GO>}

Okay, thank you. Understood. One of the question -- I thought that you said that the ancillary margins were helped mostly by gas, we get that, but you also said helped by e-commerce. So are your e-commerce margins getting better year-over-year? And if so, why is that?

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

I believe the e-commerce bottom line margin improved a little, but also the sales are stronger than the rest of the Company. So it's penetration as well.

Q - Mike Baker {BIO 4323774 <GO>}

Okay. Understood. Last real quick, snap anything -- any benefit from the pull forward on snap, I don't know how much of it is your customer, but (Multiple Speakers)?

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

No, we really don't see any of that. That'd be very little of it, those kind of things don't really impact us.

Q - Mike Baker {BIO 4323774 <GO>}

Understood. Appreciate the clarifications. Thank you.

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

Thank you.

Operator

Last question comes from the line of Scott Mushkin from Wolfe Research. Your line is now open.

Q - Scott Mushkin {BIO 7138867 <GO>}

Hey, Richard. Thanks for taking my questions. So I just want to go back to e-commerce. I know you touched on it in the quarter that it was a little help for the margins. But you're putting a lot of money into it, it sounds like two-day, one-day grocery. I was wondering, if you could walk us forward on e-commerce and what do you think it's going to do to margins as you go forward?

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

Well, every company allocates things or put things in different -- in silos. In our e-commerce, the one-day grocery is not part of e-commerce. Even though you go online to order, it's really the Instacart engine and it's in warehouse. They come into our warehouses, they shop, they deliver the same day. And so that's not part of the e-commerce numbers. That and a couple of other things would actually increase the percentage increases a little bit, but it's still so small, it wouldn't have that much of an impact.

Q - Scott Mushkin {BIO 7138867 <GO>}

And then the rest of the e-commerce business, as you -- I think you said you're building out some fulfillment for e-commerce and I think it's for more consumables. How are you guys thinking about margins on that business as we move forward because the mix is going to shift, I think?

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

Well, it has shifted. As you know a few years ago, the average ticket was $400 or something because we sold big ticket items. We didn't have lots of little things or things that got you back to the site more frequently and more regularly. Some of that's just starting. As I talked about the first of three planned fulfillment, what we are calling fulfillment automation centers, we have our first one in Southern California, it's literally opened less than eight weeks, I believe. It's over $100 million investment. First one is the most expensive because you develop all the systems and everything as well. We have two other planned for depots in other parts of the country. I would hope that that's something that's going to hit our number a little bit because it means we're doing well and we're growing it. We're going to see the cost of picking an item dramatically reduce because we've done it not quite manually, but less automated that we can well do over time. But that's going to be a net inflow over time, we'll just see how it goes. I think in the scheme of things, recognizing that e-commerce in its entirety is still, what, 5% to 6% of our business, 5% plus percent of our business. Even as we hope and assume that's going to grow at a higher rate than the rest of the Company, it's still going to be in the single-digits for a while. So those impacts -- and even with the first one, you're talking about the inefficiencies of getting something open and running and building it up over the first 6 to 12 months and then the associated depreciation and alike, those things in the scheme of things are not huge. As we do three and four and five of them, it's a little bigger, so is one chicken plant, so is one new concept bakery commissary a few years ago. So all these things will be -- I don't think that these things will help to balance some of them, but that -- if they're a little dragged, that's a positive.

Q - Scott Mushkin {BIO 7138867 <GO>}

All right. And then last one, I guess it's last question. But February sales and traffic, anything to read there, seems like it was a little slower than we've been seeing? I guess, any thoughts there, any --?

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

Yeah. Look, I think we more than anybody hate to use the word weather as a reason. And you see it every day. Clearly, where there was rain, snow, cold, you name it, that impacts things like patio furniture, spring ware. But I think if you ex out the things we try to -- as I pointed out on the call, if you actually -- the weather, which we assume I think I said it was 1% in the month for the full Company, a little more there for in the US and Canada, we try to add to the conservative assumption on that. I mean, it's not a lot more than that, but we feel comfortable in talking to the operators of the impact. And if you add that back in, you add the holiday shift in Asia, you take those things out, we're a little lower, not a lot lower than we've been enjoying for the last several months. I guess, we have to wait and see how much is.

Q - Scott Mushkin {BIO 7138867 <GO>}

See how much is, exactly. All right. Well, thank you so much. Take care.

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

Thank you. Thank you, Vincent. And we will be around to answer your questions. Thank you.

Operator

This concludes today's conference call. You may now disconnect.
