Costco Wholesale Corporation (NASDAQ:COST) Q2 2018 Earnings Conference Call March 7, 2018 5:00 PM ET

Executives

Richard Galanti - Chief Financial Officer

Analysts

Simeon Gutman - Morgan Stanley

John Heinbockel - Guggenheim Securities

Chris Horvers - JP Morgan

Edward Kelly - Wells Fargo

Dan Binder - Jefferies

Karen Short - Barclays

Chuck Grom - Gordon Haskett

Oliver Chen - Cowen and Company

Matt Fassler - Goldman Sachs

Peter Benedict - Robert W. Baird

Scott Mushkin - Wolfe Research

Chuck Cerankosky - Northcoast Research

Operator

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

I will now turn the conference over to CFO, Mr. Richard Galanti. You may begin.

Richard Galanti

Thank you, Christy. 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 2018, the 12 weeks ended February 18th, as well as February retail sales for the four weeks ended this past Sunday, March 4th. Reported net income for the quarter came in at $701 million or $1.59 a share, a 36% increase compared to last year's second quarter results of $515 million or $1.17 a share. This year's earnings per share included $0.17 due to a net income tax benefit of $74 million as a result of the tax legislation recently passed by Congress. Excluding this benefit, net income grew by 22% year-over-year.

This afternoon, I'll start by reviewing our Q2 operating results. Beginning with sales, net sales for the quarter came in at $32.3 billion, a 10.8% increase over the $29.1 billion of sales during the second quarter of last fiscal year. This year's 12 week second quarter included one additional sales day in the United States versus last year due to the shift of Thanksgiving. But while we gained the sales day in the quarter, our pre-Thanksgiving and Black Friday holiday weekend sales fell in the first quarter this year compared to the second quarter last year. Combined these two factors negatively impacted second quarter sales results by an estimated 1.4% in the U.S. and slightly less worldwide, somewhere at or about 1%, 1.1%. The shift also negatively impacted ecommerce sales results by an estimated minus 7 to minus 8 percentage points in the second quarter.

Recall that in Q1 we had an estimated 10% improvement relative to the shift in ecommerce. I think if you look at the 24 week fiscal year-to-date comparable sales results in our earnings release, it essentially eliminates the impact from the holiday shift altogether. Now for the second quarter 12 week comparable sales results, in the U.S. we reported a 7.1% increase ex-gas and FX, 5.7%, and then we'd estimate these add to 1.4 back for the switch in the holiday. Canada 8.7% reported and 2.5% ex-gas and FX, other international reported 15.7%, 7.4% ex-gas and FX. So total company would be an 8.4% reported and 5.4% ex-gas and FX, a little over 1% of impact -- negative impact on that 5.4% from the Thanksgiving shift. E-commerce reported was 28.5% comp sales, 27.3% ex-gas and FX, and again we estimate that 27.3% was hit by about 7 to 8 percentage points related to the holiday shift, so something little over 30 ex-that.

In terms of Q2 sales metrics, second quarter traffic or shopping frequency was up 3.7% worldwide and 3.4% in the U.S. Also, these numbers are negatively impacted by the Thanksgiving holiday shift as I just discussed. In terms of the impact on FX and gas for the company FX assuming flat currency relative to the U.S. dollar over the last year, that impacted sales, the strengthening in foreign currencies impacted sales by approximately 180 basis points positive, and gas inflation contributed another 125 basis points, so together about 3 percentage points.

Cannibalization weighted on the comp to the tune of 55 basis points to the negative. Our average front end transaction or ticket was up 4.6% in the quarter, excluding the net benefits from gas inflations and strong foreign currencies relative to the dollar it was up a little over 1.5%. Our February sales results were also reported in sales release. I'll review these results at the end of the call.

Moving down the income statement for the second quarter, there is membership income is the next line item. I reported in Q2 $716 million, up $80 million from the $636 million last year second quarter and up about 4 basis points or 12.6% in dollars. Now FX, the benefit of strong foreign currencies benefit the number by about $12 million. Of the $80 million increase in membership fees increased year-over-year about $37 million related to membership fee increases. The majority of the $37 million came from fee increases taken last year in first U.S. and Canada with the smaller balances from the fee increases taken in our other international operations starting back in September of 2016. So all told, if you take out both of those, we would on a normalize basis membership fees were up $31 million or about 5%.

In terms of renewal rates, our renewal rates improved in Q2 to 90.1% in the U.S. and Canada, up from 90% a quarter earlier and worldwide improved to 87.3% as of Q2 end, up 20% from the 87.2% at Q1 end. I think the most important thing here of course is the trends we've seen with the conversion of the credit card over the last year and half in the U.S. and slightly overlapping that prior to that in Canada and happy to see that what we expected came through there and seen a slight improvement now.

In terms of members in Q2 end. At Q2 end, we had 39.6 million Gold Star members, up from 39.3 million 12 weeks earlier. Primary business were 7.5 million both quarter end. Business add-ons, which was 3.2 million at Q1 end and at Q3 end was 3.3 million. So total member households 49.9 million at Q1 end, up to 50.4 million at Q1 end. Total cardholders at 92.2 million at the end of the quarter, up from 91.5 million 12 weeks earlier.

During the quarter, we only had one opening. At Q2 end paid executive member were 18.8 million, an increase of about 46,000 from the second quarter end or about 4,000 a week. A little softer than it had been in recent quarters. When we look at the quarter ago, it started off quite a bit weaker and I'm happy to say the last several weeks have been in the high-teens low-20s on average per week.

Lastly, in terms of the portion of membership fee increases related to the recent fee increases, that year-over-year quarterly membership fee increase will continue to grow each fiscal quarter this year and into fiscal '19 given the deferred accounting treatment as to when it benefits our income statement. The year-over-year increase will peak in Q4 of this fiscal year. So the $37 million Q2 increase related to that will increase in Q3 and increase again in Q4 based on the P&L on deferred accounting. And so have again smaller increases but in the next couple of three quarters after that into '19.

Going down the gross margin line, our reporting gross margin came in at 10.98% or 2 basis points lower year-over-year. On a reported basis that minus 2 basis points, it was actually plus 11 basis points excluding gas and FX. Within that I'll have you just jab down the two columns with the four, five members in each column first column would be as reported and the second column wihtout gas inflation. The core merchandise on a reported basis was year-over-year down 20 basis points, down 8 basis points without gas inflation. Ancillary businesses up 23 basis points in the quarter and up 25 ex-gas inflation. 2% reward plus 1 and zero in those two columns, and other minus 6 and minus 6 basis points. So all told, if you add up column one the reported year-over-year gross margin change was the minus 2 basis points and ex-gas inflation was plus 11.

If we look at -- as I've done in the past, if you look at the core merchandize categories in relation to their own sales, even though again on ex-gas inflation basis, the core has contributed to the total company was minus 8. If you look at core categories on core sales, margins year-over-year in Q2 were higher by 14 basis points. Subcategories within core margins year-over-year in Q2, food sundries, hard lines and fresh foods were up, soft lines was down a little. Notwithstanding greater all of these improvements and notwithstanding greater values for our members as we continue to do it.

Ancillary and other businesses gross margin up 23% basis points and 25 ex-gas inflation. Gas represented a little more than half of that improvement, it's both the combination of these higher sales penetration and improved margins within the business. With hearing aids, pharmacy, optical business centers and travel all showing higher year-over-year gross margins and that contributed to that number as well. 2% reward again essentially at gas. Lastly in other as was the case with the first quarter, we were incurring incremental cost related to the rollout of our new centralized returns facilities. And this will continue to impact us as I said last quarter and each in the next few quarters, likely a little less each quarter and it was a down a basis point this time from 7 to minus 6. And long term, we believe it's a big benefit to us.

Moving to reported SG&A. Our SG&A percentage Q2-over-Q2 was lower or better by 21 basis points and better by 9 basis points plus 9 basis points ex-gas inflation coming in at the 10.02% of sales this year compared to 10.23% on a reported basis. And again the two columns reported and without gas inflation. The first line item would be operations plus 19 basis points and plus 8 basis points ex-gas inflation, central minus 1 basis points and minus 2 basis points, stock compensation plus 3 basis points at each column and then total, plus 21 basis points or lower better by 21 basis points on a reported basis, and ex-gas inflation better by 9 basis points.

Not a whole lot of unusual items here. The core operations component again was better by ex-gas inflation, strong top-line sales we believe led the year-over-year improvement in payroll, benefits and other traditional expenses like utilities and maintenance. Central expense higher by couple of basis points ex-gas. We've got a lot going on. Stock compensation better year-over-year by 3 basis points again strong sales and usually that's the number that's most impacting Q1 when we do the big grant every year.

Next on the income statement is preopening expenses. They were better or lower by $3 million in Q2 this year they were $12 million, last year $15 million. Now again, this year we only opened one new unit. Last year, we opened four. However, we also have quite a bit of preopening related to two big manufacturing plants that we -- one we just opened and one under construction. A new meat plant in the Midwest as well as our major new chicken plant in the Nebraska that's under construction.

All told reporting operating income for Q2 came in at $1.16 billion, up $172 million or 20% higher year-over-year from last year's $844 million number. Below the operating income line, reported interest expense came in at plus $6 million -- at $6 million higher year-over-year that $37 million this year compared to $31 million a year ago, primarily a result of last year's debt offering. Interest income and other was better year-over-year by $11 million in the quarter. Actual interest income for the quarter was better year-over-year by $5 million also benefiting this line item is the year-over-year comparison was various FX items, mostly various FX items in the amount of positive $6 million.

Overall, pretax earnings were higher by 22% or $177 million higher in Q2 coming in at $986 million this year compared to $809 million last year the same quarter. In terms of income taxes, our tax rate in the second quarter came in at 27.7% for the quarter compared to 35.6% last year. Of course, the lower tax rate for Q2 this year its results of tax law changes. The primary benefit was the result of the lowering in the U.S. federal corporate income tax rate from 35% to 21%. Given that our fiscal -- we don’t have a calendar year and it doesn’t line with calendar year. You take the number of days in each in our fiscal year, which fall before or after December 31st. In our case, it's a blended U.S. federal rate 35% for 119 days of the fiscal year and 21% at the remaining 245 days of the fiscal year, again an average of 25.58%.

The impact of that lower rate on Q2 pretax income was $52 million of the $72 million I just mentioned -- the $74 million I just mentioned. The other

$22 million is basically two main things. One is a true up of Q2 -- of Q1 recognizing in Q1 we assumed we had no reason to assume this much lower federal income tax rate, so turning up for the first quarter so that were in tune for the whole year.

The other piece is some positives and some offsets to that relating to various things that have come with the new tax legislation. Also the net impact of these items in Q2 was an additional $22 million benefit tax benefit. So total tax benefit in Q2 of $74 million. The $52 million what I'll call normalized to Q2 the $22 million related to turning up Q1 and other offsets that go along with the original change in tax laws.

Going forward, we anticipate that the effective companywide rate for the balance of '18 in Q3 and Q4 will be probably in the 29.5% to 30% range and in fiscal '19 based on what we currently know and of course all that subject to change is approximately, we assume it will be approximately 28% plus or minus. As we know more and we'll share it with you.

Overall, the reported net income was higher by 36%, coming in at $701 million in Q2 compared to the $515 million last year. Again up 22% ex the tax benefits I just spoke about. Before I leave the subject of tax law changes, a few comments as to what our plans are vis-à-vis the savings. Overall, one, we do not expect any major changes to our capital allocations plans. We're generally net positive cash flow operator notwithstanding CapEx and dividends and what have you.

Number two, as many others have done, we will use some of these savings to benefit our employees, we're working on that and stay tuned. Number three, we'll invest some of the savings to drive to continue to drive greater value to our members. This will certainly include investing in price, as well as other activities. And number four, when asked and we have been, if any of these tax savings will fall to the bottom line, the answer is yes. Most importantly, indirectly by investing and driving value, we've seen what that does and we know what that does and much of that investing in value and price comes back in greater earnings. And directly, perhaps a little but again stay tuned.

A few others items of note, warehouse expansion. As I mentioned, we opened only one unit in Q2 that's top of five net to use in Q1. Our plans for the current quarter, which will end in mid-May is two more. And then Q4 is the big quarter, it's a 16-week quarter but we plan to open net 15 units, 18 openings including three. Assuming we got there, we had 23 net openings for the year and I guess it'll 22 or 23. A little better than I think, I mentioned a quarter ago, but somewhere in those low-20s.

For all of '18 again, we expect to open something around 22 or 23 with three quarters of those in the next two quarters and most of it in the fourth quarter. As of Q2 end, total warehouse square footage stood at 108 million square feet.

In terms of stock buybacks, in all of fiscal 2017, we expanded $473 million purchasing just under 3 million shares at an average price of just under $158. In the first quarter, we expanded as mentioned $190 million at an average price of about $162.5. And this quarter just ended we expanded an additional $59 million at an average price of 187.7 per share. For now for an update on ecommerce business. We currently operate ecommerce sites in U.S., Canada, UK and Mexico, Korea and Taiwan. Total ecommerce sales for the second quarter came in at $1.5 billion, up 29% year-over-year.

Overall, our ecommerce sales increases continue at very strong levels. If you look back in Q1, ex-FX, it was positive 42.1% again there was a chunk in there that related to the benefit of the Thanksgiving holiday shift in Q2, 27.3% as I just mentioned ex-FX. Adding the first half together, again taking out the Thanksgiving shift there. First half all together was plus 33.7% and in February as you saw in the press release and I'll talk about February overall in a minute came in at 37%. So continued very strong sales growth momentum in these numbers.

We continue to prove our offerings and we continue to be up by improved member experience with better search checkout and return to processes that I've shared so that equity in the past. In the quarter, our site traffic and conversation rates and orders were up nicely year-over-year. Our warehouses are supporting costco.com with signage and tablets in the store. We now have that in the 195 U.S. buildings and that's used to help search and purchase costco.com items for members in the warehouses. We continue to capture more email addresses.

In addition, our improved content is resulting an increase in our open rated emails again driving traffic both in store and online. If you go right now to costco.com, I think it talks about hot buys. And you'll see that some of them are in warehouse only as supplies last and we think that we've got some excitement going here in terms of driving traffic both specifically in store using the Internet and emails as well as driving traffic online. A great example that is again you can look for yourself with these hot buys in the warehouse.

Online grocery, both our dry grocery two day delivery and our same day fresh delivery food cart. As I mentioned the last quarter rolled down in early October has been quite positive year-to-date and growing. We're just starting to do some limited marketing instant cart now is in 441 of our U.S. warehouses and should be in most of the remainder our U.S. warehouses by calendar year end. We continue to improve the online merchandise and services offerings. Again with not only in general but hot buys. We've improved our apparel offerings. We're doing better job of focusing and adding items that are complementary to our warehouse offerings. We're doing some great things with some big ticket seasonal items where we might be out of them given date or start them at a certain date in store, but online we get for greater availability of those. And then we're doing some other exciting things. Currently, there is over 100 high-end beauty items online.

In Q1 '18, we added the 2% reward to all travel purchases through Costco Travel that's something we have not done in the past that's a few -- to our executive members, as well if you use your Costco Visa card, cobranded card, you get 3% that way, so it will be 5% off with what’s already great values and see growth in Costco Travel. As I think I mentioned last time in the call, we're offering a very limited buy online pick up in store. These are really basically selected small sized big ticket items where many people aren't likely to want to leave them at their doorstep. So some jewelry, tablets and laptops and most recently handbags, all these things are driving shops in store. Over half the people that are doing this are shopping in store women there. But again, this is limited this is -- we'll continue to see how it works.

All these efforts that I just mentioned are having a positive impacts on our business, both online and in warehouse. And that we believe it helps for the sales momentum and increased awareness of our digital presence, as well as the traffic that we've enjoyed recently in our warehouses. In sum, we're continuing to expand these activities. It's evolving and improving. And then drive our business both online and in store and certainly some of the tax savings will go towards driving that as well.

Next, let me review the February results before we turn at March 4th. As reported in our release, net sales for the month came in at $10.21 billion, a 12.8% increase from the $9.05 billion last year. Lunar New Year and Chinese New Year that occurred in February this year as compared to January last year. We estimate that this positively impacted the other international February sales by about 4.5 percentage points and the total company February sales by a little more than 0.5 percentage point. For the first 26 weeks of fiscal 2018, we reported sales of -- we have now reported sales of $68.51 billion, 12% increase from $61.18 billion in the same number of weeks last year.

I won’t go through all the numbers that you see in the press release, but again on a four week basis, the reported 9% U.S. ex-gas effects will be 7.5%. The 8.4% reported for Canada will be a 3.2%. The 22.2% other international would still be a very strong 14.1%, and total company 10.5%

reported comp ex-gas in effects 7.7% to positive. And as I mentioned, ecommerce ex-FX 37% compared to the reported 38.1%.

In terms of regional merchandizing categories for February, general highlights from the month. U.S. regions were the strong results for the Southeast, Los Angeles and Midwest. Internationally in local currencies at Taiwan, Japan and Mexico, were the top of the list this month. Foreign currencies year-over-year relative to dollar total company benefitted by about 150 basis points, again I think for the last quarter it was 180.

Canada was helped by about 425 basis points, and while other internationals helped by about 800 basis points. The impact of cannibalization on the total company in February was about 60 basis points. And the impact on the U.S. was about 40. At Canada, where we did quite a few openings this year was about 140 basis points impact from that. Now very small impact on our international to the tune of 30 basis points.

In terms of merchandise highlights, food, sundries, comp sales for the month were positive mid-to-high single digits. Departments with the strongest results were tobacco, liquor and candy. Hardlines were up low double digits better performing departments were majors, tires and health and beauty aids, HABA. Majors were up mid to high 20s led by appliances, computers and tablets. So very strong showing there both in-store and online.

Softlines were up mid to high single digits, better performing departments included the domestics, jewelry and apparel. Fresh Foods was up in the high single digits, better performing departments were meat, bakery and deli. Within the ancillary businesses, gas also still helped by the cannibalization with gas, food court and optical had the best comp sales results in February. Gas prices were higher year-over-year and had a positive impact on our total reporting comps of about 135 basis points.

Our comp traffic or frequency for February was up 5.2% worldwide and 4.8% in the U.S. So an improvement over Q2’s frequency figures as well.

For February, the average transaction was up 5.1% for the month, which includes the impacts both of FX gas as well as the shift to the Lunar Chinese New Year.

I did want to make one other comment. As you know, we reported our earnings 45 minutes before the call and the first thing that comes out with some of the news releases very quickly and where we beat the number or we missed the number. When we look at first call and the 27 or so analysts that put numbers in there, it appears to us there were about 12 to 27 over the last month or so have adjusted their numbers, their estimates for some estimate of tax reform benefit. If you adjust based on what they were before that it looks like the first call number of 146 I believe comes down $0.04 or $0.05 by that. I am just mentioning that because there's -- this confusion out there and everybody as we report given this quarter of transition.

Lastly, our fiscal ’18 third quarter scheduled earnings release dates for the 12 week third quarter ending May 30, and we'll do the same thing it'll be an after market close on Thursday May 31st with the earnings call that afternoon at 2 o'clock Pacific Time.

With that, I'll open it up for questions. Back to you, Kristie.

Question-and-Answer Session

Operator

[Operator Instructions] First question comes from the line of Simeon Gutman from Morgan Stanley.

Simeon Gutman

First question, Richard, can you discuss what's happening with spend per member trend and it’s clearly increasing ex-gas. But can you talk about if members are spending in existing categories or new ones and then I have a follow up to that.

Richard Galanti

Well, it's a little of both. I think you also have to add in there that -- I don't have the numbers in front of me, but I'm willing to bet that I know our average price per item has come down. I mean, we've done a lot of driving greater value just on the MVMs alone, you're seeing significant savings. In some cases a small amount from us but more from our suppliers, because it drives more sales. And we're getting with 20% to 30% fewer items, more total sales and more gross margin dollars.

So I would guess that -- now to the extent that we're doing things like, I've given you examples overtime, like certain apparel items like women's athletic wear that's going from 0 to 100 million in the last few years. Certainly in the last year, year and a half we've seen a big improvement in white goods, with the advent of being supplied by all the majors. And I don't have exact numbers in front of me, but I'd be willing to guess while we'd had some of the prior first -- second quarter on annualized basis that's well over 250, 300 million a year and growing. So there's going to be a few of those things as well. It's mostly frequency when you look at it.

Simeon Gutman

Can you share what percentage of your members are spending online with you and is there any change in how frequently they're visiting?

Richard Galanti

I don't have the exact numbers, it's still -- I'm sure it's still a low number. I don't know frankly if somebody had it, if it's 10 or 20 or 25. I know that when I -- from last week's budget meeting, when we look at in terms of the number of -- the open rate of emails, it has gone up substantially. Part of that is what we're sending them. We're sending them some really high items that get their attention, including while supplies last in store on some of these items. And that get their interest.

I know we're seeing a better connect rate and again I don't want to give you numbers that I don't know exactly, but all those things are going in the right direction. As they should given as I said before there is a lot of low hanging food there, because there is a lot of things we hadn't done in the past.

Simeon Gutman

And my follow-up is just on the Visa Card, you're cycling the benefit I know we're not talking about the buckets anymore. But can you just tell us how your profit pool is performing versus your own expectations?

Richard Galanti

As it relates to Citi Visa?

Simeon Gutman

Exactly, yes.

Richard Galanti

The first four quarters, because it was so sizeable we shared with you the effective basis points of improved SG&A and margin related to how -- compared to the prior deal. We're now in the first couple of quarters, three quarters after that. For the year, it will still be an improvement but relatively small improvement. And when we started -- at the beginning of the anniversary, the first anniversary, because when you started you've got some extra money to drive things, those fall off.

We're still getting new sign-ups, we're still getting new account, we're seeing people spend more on it, we're see people spend more outside on it, which again is part of the revenue share. So I would say we're still very pleased with it. My guess is it will continue to grow this year less than our sales growth total company. And then probably consistent with that in the future from this big benefit that we started with.

Now by the way, we're using some of that as well. I mentioned the adding the executive membership. We did several things that were successful over the holidays where if on top of the fact already that if you have to Citi Visa

Card, if you buy a television for example at Costco, you automatically get 90-day return policy and a two year warranty. If you purchase it with say Visa Card, not only you get another 2% off on that on top of the 2% if you're an executive member, but you get another two-year on your warranty, so you get four-year warranty.

On top of all that, we used some of the bucket if you will to drive even greater values, which drove people in. Where there were examples I don't have them in front of me, but literally on a $1,200, $1,300 retail TV where we were already at great savings on top fiscal that, if you use your Citi Visa Card, you got $150 to $300 cash card depending on what TV and when it was. So we're clearly -- I think I mentioned last time what we see with these dollars wherever they're coming from, whether it's from that bucket from the membership fee income bucket, from tax reform bucket, you name it, there is lot of buckets right now. There is -- we believe that we can use those to drive sales in lots of ways that perhaps give us a little more octane that we would have thought.

Operator

Next question comes from the line of John Heinbockel.

John Heinbockel

So Richard, if I look at the 2019 new tax rate. Am I right that the tax benefit in aggregate is about $300 million, is that fair?

Richard Galanti

Well, take the pretax and -- well we don't know exactly. But if you look at we've been running at about 35.5 and subtract about -- and not only say 20, it's around 7 percentage points. I don't know if it's 6.5 to 7.5. You've got U.S. which is there's broad brush strokes, 70% of our earnings, so that's decide to get the benefit. You have some offsets from that, clearly some of the benefits from deferred tax foreign tax credits some things go away and things like that. So net-net, all that included we estimate that it's going to be around to 28 plus or minus.

John Heinbockel

It sounded -- you talked about the benefit to the bottom line being more indirect. So whatever that is, it sounds like the vast majority of whatever the savings is the plan is to reinvest that in some form. Is that fair? And you listed a bunch of buckets. Are they all of equal sizes? And you didn’t mentioned e-commerce bucket. Is there one of those or is that blended into the other ones you talked about?

Richard Galanti

Well, when I talked about buckets, I really talked about what are additional moneys that we've got to things we've done in the last couple of years or benefitted from during the last couple of years. Notably, credit card switch, membership fee increase and of late tax legislative changes. All those things allow us to do more of what we do. And so again, I'm not being cute, but we'll suddenly fall to bottom line, yes. We also take care of our employees. We're looking a lot of different things now. Whenever we do, it's going to be something that's permanent not a onetime bonus necessarily. And we're going to take care of things.

And we're also -- what we have seen is many of the things we've done value wise have while maybe lower the gross margin or dollars per sale unit that we've seen increase gross margin dollars because we sale heck a lot more units. And some of the things we're seeing now and the benefit of doing a better job of getting unit, even open your email. Now I don't know if we’ve gone from a D to C, or C to B or B to an A, but my guess is there is still some room for benefit there. And I think the big thing we want to communicate is we feel good about what we're doing and good about what's going on. But there is never a dull moment out there.

John Heinbockel

You've talked about pushing value. How does anything new with regard to KS in terms of product development or your pricing versus national brands, how does that play into this?

Richard Galanti

Well, I mean the one that I read about recently in the press was our new hazelnut spread, which is basically Nutella. I mean, it is literally flying off the shelf. It's a great value and it's a great quality. There is several -- in every budgeting and every board meeting we see a whole plenty of new items that we're getting ready to try and rollout, whether it's organic, shelf stable food items or apparel KS items and others cosmetics. We've got a couple of fragrance items out there under that we've tested and we're going to continue to drive. So it's lots of little things.

John Heinbockel

And then just lastly, do you guys yet know or been able to calculate the benefits you get to U.S. comp from the Sam's closings. And have you started -- I imagine you've started to see that already, right.

Richard Galanti

We started to see with after. The first week everybody rushes to get sale items on 20% or 30% off. It's small as we expected. We each have to do our own estimate, but we think we've got a little bit of sales out of it and a little bit of member signs up from it, and that's continuing. My guess is if the average Sam's Club in the U.S. as I understand is in the low 90s, people say the 63 they closed were less than that.

When I spoke to Craig immediately about it, Head of Operation, their collective view was that we'll probably get 10% or 20% of it not 50% or 70% of it. I originally thought that was low. But we do recognize not all of them are immediately closed, many of them are but some of them aren't, some of it's not the same customers and we wouldn't necessarily get it overnight and some we will. But look it’s -- with all the other buckets even a small bucket this is nice thing to have here.

Operator

Next question comes from the line of Chris Horvers.

Chris Horvers

I think a lot of investors trying to figure out the strength in e-commerce. And I know there's a lot going on in terms of what you're doing on check out and category extensions and so forth. But could you perhaps rank the benefits, whether it's -- where would you put appliances versus extending the IO versus some of the brands and versus the rollout of online grocery.

Richard Galanti

The roll out of online grocery is a very small piece of it. As that’s just started -- but it is driving traffic. I think the biggest things are awareness and cross marketing, doing more activities in store to let people know about what's online and a better job of getting people to open their emails. And that's come with the headline if you will, which is something that's really hot in store and there's also a lot. Again, if you go to the site lately take a look and again I think we are starting from a low base and a low metric given on what we haven’t done in the past.

And so you talk to our e-commerce people and our head of relative department heads of merchandising, or head of merchandising, they feel pretty good that this will continue. I'm not suggesting 40 on 40 on 40 every year. But even when they hit 30 for the first time, Bob Nelson and I are asking well what happens a year from now, the view is there's a lot of things they got going on that should continue to drive it but stay tuned we'll see. On top of that, we're getting off to a good start albeit with a conscious slow -- soft opening of both delivery sites.

Chris Horvers

And that's really my follow up. And so how is what uptake are you getting in the online grocery and could you compare the two day delivery option versus Instacart. And I think a lot of people ask us is this going to diminish the trip to the warehouse and thus the overall spend that I have goes down and then the margin rate of me as a customer also goes down. Any thoughts on that as well?

Richard Galanti

Well look the only data that we know that’s more than three months old or six months old is going back to the original data that we have from what we're doing to Google's shopping express, the longest period of time in the Bay area, where it was strongest. What we typically saw back then and again that did not include fresh though. And then we saw an existing member who is making these numbers up, they were growing their total purchase with us by 3% a year. They do it by more than 3% but they came in a couple of two to four less times and shopped online more times, several more times on that because when they shopped online, it was a lower average ticket that when they came in store. Mind you, it’s a little different we’re seeing a bigger average spend from on the Instacart side.

And some of this at the two-day and we’re actually adding some items, I think last time I mentioned we started through our business of about 10 business centers, which covers essentially the entire Continental United States, virtually the entire Continental United States. We started with our 470 or 480 SKUs out of the regular warehouse being serviced out of business centers. We’ve actually added some items to that. And I think the goal was to add a couple of hundred over the next six months. And it’s working so far but it’s new.

And so we can’t promise anything. We recognize with fresh how much of it is going to be fill in versus I’ll go few times less to Costco. What gives us a little comfort at this point, but that’s all it is, is the results that we’ve seen from the ways we communicate with our member online. But if you go on right now you'll see there are several very exciting items that are just in store and while supplies last, that drives traffic and that gets you in the store.

So as much as -- everybody is going to know somebody that's going to shop a lot less in store, because they're getting all their groceries at Costco or more stuff fresh delivered. At a better price than the day before on Instacart because the prices are better today and even the better price to costco.com, Costco, and even better of course as you come in. And we'll keep sending that message as well. But I think we're honestly at two plus years before we really know something on that. Certainly, nine to 12 months before we have any inkling of what it means.

Operator

Next question comes from the line of Edward Kelly.

Edward Kelly

So I just wanted to ask about price investment. And not so much about the quantity, but I was hoping that you could just maybe talk about the elasticity on price investment in your business and how maybe it defers from some of your traditional competitors. Whether having less SKUs less that you need to focus on less SKU overlap. How that actually impacts what you're seeing from an elasticity standpoint when you actually do make those investments?

Richard Galanti

Well, it was just a year ago when we had slightly disappointing second quarter result, partly because of the change in the number of days the MVMs were out there. And in the explaining why we did it to start with, why is this because overtime whenever you do, it gets a little stale or not in every instance but in some instances. So you try two things. Over those few months and continuing to today, we're continue to try new things with our vendors as well.

And I used water as an example. We were a great value on 40.5 liters of Kirkland Signature and the price maybe different in a given state or something based on transportation. But I think we were at 349, which is the best price out there doing heck of a lot of volume. And now we’re I believe 299 every day. Well, you can imagine our various suppliers said, well how can we do this? Well, you have huge increases in unit volumes. And guess what happened on the way to the forum.

The brand just needs to come down in price too, because they're losing market share. I think that's something that's unique about us that limited selection we could take, I get back to that word I used about more octane in the dollar that we use. You take something like that TV example, we did $30 million $40 million on one SKU in fixed rate days. And how do you do that? You do that because one, it's limited two, it's already great price and three, it's even a greater value because of what we can do with partnering with our suppliers on it. And then on top of that, there is these other buckets I gave the example of if you use your Citi Visa card. While we got some signups out of that some applications on that.

So I think that tends to be a little different. I gave the example last quarter at the end of that 10 days leading up and through Labor Day weekend when traditional retailers out there selling USDA Choice strip steaks at -- I'm making the number of 849 or 899 and we’re 799 we were at 699. And we locked up lots of newer strip steaks in the weeks preceding that. And we saw a noticeable drive into the warehouse. So I think that having -- it's a lot easier to do where you've got 3,800 items out there versus 50,000 in a supermarket or 100,000 plus in multi-general stores.

Edward Kelly

And then I just wanted to ask you about labor generally and tax reinvestment. There has been a lot of talk in the marketplace about investing in labor. I mean, we heard from Target earlier this week about moving the $12 an hour. I mean you were at the upper end of the pay scale for in terms of what you're paying your employees. But there is rising tide just lift all boats here. How are you thinking about this philosophically? Are you looking to maintain historical wage gaps that you've had. How should we be thinking about this for you?

Richard Galanti

Well, I think we always want to maintain a significant preview overall. We have to look at all the pieces of it. It's not just the headline starting range. It's not just a one-time bonus, it's also healthcare. If you look at the average used U.S. because every country is different, but relative to what's in that country it's the same types of premiums. The average U.S. wage of our 90% of our employees were hourly, when they start yesterday or 20 years ago is the 22.25 to 22.5 I believe. On top of that, whether you're part-time or fulltime, you've got a great medical dental admission plan that on average costs the company over $10,000, little over $10,000 where we pay 90% of it roughly.

So we have a great -- now by the way that covers -- and independence as well. But on average it's little over two people per covered employee. But at the end of the day, even if the bottom is scaled gets a little closer, the delta between the entire compensation is significantly greater. Notwithstanding that, we do what we're going to do even before tax law changes. We're going to do a little more because we can.

Operator

Next question comes from the line of Dan Binder.

Dan Binder

I saw you had a program out there on the auto renewals. We get $20 gift card if you signup. I was just curious how effective that program has been. And then also on membership, you've mentioned that there was a slow start to executive conversions in the quarter. I was just curious what you think that was related to and then how are you able to shift the pace on that?

Richard Galanti

Well, actually latter question our membership marketing the people are looking at it, I don't know exactly. My guess it has -- we had a strong first quarter where it averaged over 21,000 a week of new. Our sign ups during the quarter were fine. But my guess is it has to do with what did we do a year earlier or how were they collecting certain data. I am just relieved that the second half of the quarter it improved greatly. And my guess is it’s not a big issue. Now the first question?

Dan Binder

I just saw through a personal experience you have a $20 gift card offer for signing up on auto renewal for members who haven't done it yet related to the new card. I was just curious how effective that program has been?

Richard Galanti

I don't know specifically of that program. I know we do a lot of things as relates to that. We did some -- it sounds silly but we did some programs to sign up get member’s email addresses, which we do a better job when they sign up now as a new member. But we were below 50% with valid email addresses and in two instances in the last few months and about a week or 10 day period we got over a million numbers to get their email addresses by giving them something like $2 off on muffins or something.

Dan Binder

So with the improvement in the renewal rates this quarter, trends obviously reversed. Do you anticipate small improvements over the next several quarters based on that experience that you talked about on prior calls with what you saw in Canada?

Richard Galanti

I would hope so. I mean, I think just copy what happened over the several quarters after Canada. Canada is now above where it was before the conversion started 2.5 years ago. And Canada went down over six quarters for the conversion quarter six quarters and five quarters out by I believe 100 basis points the renewal rate, and now it’s two or three, tenths of a percent higher than it was before that. U.S. only went down around six tenths of a percent so now it's back up a tenth from that minus six. History should show that that will happen, but we’ll have to wait and see.

Dan Binder

And then just last item on freight. Just curious there has been a number of retailers talking about that pressure. And in some cases, it's been material impact to the earnings outlook. I didn’t really hear much on that today. I was curious if you have any thoughts and how it may impact you?

Richard Galanti

Well, the higher freight costs and availability of containers impacts all of us. It's interesting, it's not talked a lot about where I think what it’s made us do is we're doing a better job on back hauling, a more conscious effort. Historically, we always back hauled extra pallets and recycle like cardboard, corrugated and you can basically can make more dollars doing that. But we really had done a lot on back hauling supplies merchandise from vendors.

And so I think that's mitigated a little bit of late but I think it's still a net number. My guess would be it's not as impactful to us as it is to traditional retailer based on what I just said. 90% of our goods go through our cross dock people operations. You've got literally thousands put into low single digit thousands -- and several thousand trucks that are going out, trailers that are now not every one of them, but picking up things whether it's produce from Central Washington or Central California or working with suppliers, because we don’t do long haul. But we’re able -- it’s a lot easier to do these kinds of things when you got limited items.

Operator

Next question comes from the line of Karen Short.

Karen Short

So I just wanted to clarify in terms of tax reform benefits. In terms of the puts and takes we think to the rest of the year and into the fiscal ’19. Obviously, you commented on investing in employees, investing in price. Is that something that we should expect fairly quickly or is that something both of those that would have a little bit of lead time and you’re still to be determined? Just to clarify.

Richard Galanti

I’ll give you a better clarity on that in the next call. We’ve continued to invest in price over the last year and we’re going to continue to that. I think we’ve already started a little of that on the employee side. Something that will be forthcoming, my guess is in the next two months. So it will impact Q3 less than a full Q3 whatever it is.

Karen Short

On both wage and price, and then on…

Richard Galanti

On employees. On price, where I starting to do a little that but we’ve also had the benefit of various buckets, it’s not -- all these buckets are fungible.

Karen Short

And then I don’t think you gave inflation in the quarter. Wondering if you could give that both at cost and at retail?

Richard Galanti

On inflation, I think it’s -- ever so slightly up on a cost basis, which would lead me to believe that flat or slightly down on an retail sales basis given what we’re doing. We’ll go next question and then I’ll get it for you.

Karen Short

And just on Instacart, I know you did say that ticket was larger on Instacart. So I guess two questions on Instacart. One is can you maybe give a little more color on how much larger the average spend is or average ticket is on Instacart. And then obviously Sam's announced the rollout of Instacart as well. Is there anything change with your pricing strategy on your Instacart offering as a function of that announcement?

Richard Galanti

Well, to the latter no. I mean our strategy has always to be very competitive. And if we have to be more competitive, we will. And we feel we're very competitive on the things that we're doing. What was the first part of your question?

Karen Short

Just some quantification on how much bigger the average ticket is?

Richard Galanti

Well, when I say it's a little high average ticket, it's a little higher average ticket than what we experienced with like Google Shopping Express, which didn't include fresh. I believe it's a double-digit number but in the higher double-digits rather than the middle double-digits.

As it relates to inflation, when I look at our LIFO in this index that we don't use for anymore, I am not asking out or accounting people, but at some point we will. If I look at our composite year-to-date fiscal '18 among the various categories, it's deflationary by 14 basis points that's from our fiscal year-end September 3rd or 4th last year. And I would say overall it's slightly inflationary, because that is -- and looking at the turnover in the different category. So my guess is it's -- and in the last four weeks, it was exactly zero. So I would say, this is cost which would tend -- led me to believe that we're slightly -- or definitely deflationary compared to that because we're lowering prices.

Operator

Next question comes from the line of Chuck Grom.

Chuck Grom

Just trying to understand something here, so no inflation, you're investing more in price. Yet your core on core margins as a percentage of sales were up, I think you said 14 basis points, which was the best performance with the third quarter with three of the four large categories up. So can you just help us understand the improvement in the margins this quarter and looking ahead, any sustainability of that trend?

Richard Galanti

Recognizing it's not just the full core-on-core there's so many other little things. An improvement in our Travel business, which is a very high gross margin business, we don't -- the value of that plane ticket and hotel. It's the broker commission with very little SG&A associated with it. So very little cost to sales. All those things help a little bit. I think within the 80% of our business, which is core-on-core, fresh foods, hardlines, softlines and food sundries and talking to our head of merchandising two days ago, probably the two biggest rigs are what we call internally improved D&D.

It's where damage and destroy when we're having to mark things down less whatever we get from our vendors. There might be spoilage allowance or returns allowance within something. But generally speaking, we showed an improvement there. And we've also shown a little bit of an improvement with -- now I can't quantify whether that's a basis point or a few, but it's an example.

Another one is you take the example of $1000 item that we sell for $1,100 just to make the numbers up. So $100 gross margin on $1,100, it's whatever 9% or whatever it is. If we get an extra 150 off through an MVM, we're now selling it for $950 still making $100 gross margin. So we just improved our gross margin percent. You're talking about billions of dollars a year in the aggregate, low double-digits but still real money. Fresh foods penetration increases generally speaking even though fresh foods, I believe it was slightly up, but fresh foods has a higher margin department. Apparel is a higher margin department. We've had good growth.

I think in the three or four years we've seen what we call apparel and to couple of different departments, men's, women's and kids, up 9%-ish compounded for three or four years on $7 billion or so business worldwide. So that tends to be a higher margin. So my guess is it's a little things and part of it is getting our vendors, our suppliers working with them, we don't want just more money from them if we can't drive more sales to make up for it and get more dollars. So all those things help.

Chuck Grom

And then just quickly on February. I think you said that hardlines were up low doubles and majors were the highest tracking, I think mid-to-high 20s. Can you just touch that for us what let to the premier? And I presume maybe appliances where we're very strong around February, does that help that?

Richard Galanti

Computer is -- not only desktops but importantly laptops and tablets as well and appliances. Those are all very strong, and online has helped us as well in those categories in the aggregate. So some of it has to do with -- I get back to the $150 to $300 off on a TV that's already at incredibly low price if you use your Costco Visa card, all of those things help drive the business.

I want to get back to the previous question also on what I could tell you about gross margin. Years ago we started highlighting that because that’s the core business and there's lots of other things like traffic, like gasoline that’s go up or down 300 basis points in gross margin within that department and is 10% of your total Company. Whatever it is, it'll be a little better or a little worse each quarter. I think it’s more important to understand where -- I'm not suggesting I don't know what the next quarter is going to be. But Murphy's Law always tells you, we continue to feel good about what we're doing and there's lots of little pieces that affect that gross margin.

Chuck Grom

And then just one housekeeping. You guys said that there’s obviously a sales impact on the quarterly results. I think you said 140 basis points. Just wondering if there was any bottom line impact in 2Q?

Richard Galanti

Well, the bottom line impact other than the sales themselves, I mean hopefully we're doing a pretty good job of scheduling hourly employees in the warehouse. When you do a little better than your planned, you beat the heck out of the numbers because you have fewer employees doing the same work and when you miss your number a little bit, sales is richer on the SG&A line. I don't think that's that big of an issue. And probably a bigger issue which I can’t tell you the answer is, I can just tell you what the issue is, would be holidays, paid holidays.

When one of those falls in a -- that's more in our monthly budget meetings, our every four week budget meetings when the operators will have to explain some tonights. Payroll percent was up 10 or more basis points, but there was an extra -- particularly around Thanksgiving and Christmas and New Year's, or Easter event, sometimes these things will fall in a different month, different four week period that we have. So that impacts it.

Operator

Next question comes from the line of Olive Chen.

Oliver Chen

Regarding the e-commerce details, what's ahead with fulfillment in terms of how you're thinking about fulfillment speed and inventory management, and how that may flow through on a longer term basis in terms of CapEx needs and as you think about certain fixed costs associated with the march towards different fulfillment options for the consumer. And the second e-com question is just about engagement. It really sounds like awareness and marketing is a factor in driving traffic to e-com at large. What do you think are the next steps just to improve that engagement over time? Thank you.

Richard Galanti

Well, as it relates to fulfillment and the costs, we are spending more money. We're building some actual e-commerce fulfillment centers, in part because we're running out of room in some of the depots where we did it that. I think we're doing one in Tracy California, or Mira Loma, and Annex but it's a major multi double digit millions of dollars. We have a little more inventory in the system in e-commerce because we're fulfilling from closer places as we do more business.

We have a greater commitment with this delivery whereas two days us through our business -- through roughly 10 of our business delivery centers with these 500 or so items, that's more inventory in the system right while we do that, so all those things are costing us a little more in that regard that's in the numbers as well and it will continue to be. In terms of -- if you look at a CapEx Company that's a $2.5 billion range, there's always -- just when you think you're done with cross dock operations, we're adding, expanding some, adding a second one in Japan even though we only have 27 rate units right now, but geographically, it makes sense now. I'm putting one into, I believe, Australia soon. Building a bakery commissary in Canada and a chicken plant in Nebraska and a second meat plant for us in the Midwest, so all those things are a bit additive to us.

So I think as it relates to fulfillment, you'll still see some more, but it's in the 0 to 200 million a year not -- we're going to go and have to spend an extra $500 million or itself. And as we go from 0 to 200 million even, what dropped out of the another bucket there but do the same, we have cash flow to do it. We never sat down and said which can we do first because we have to limit what we do based on that ex-amount of dollars.

As it relates to awareness and engagement, short-term there is some of the blocking and tackling. I know ecommerce operations, they've engaged some outside parties to help with some of the -- what I'll call targeted marketing engagement 101 and to see what more we can do. But right now, there is still a lot to be done, we're just getting more email address, getting that over rate to continue to go up in right direction, which it is.

Oliver Chen

And you made a lot of progress with buy online pickup in-store. What are you thinking about or what you're monitoring about what made sense there, and what you think about refrigeration. Will that be an option and a good option or what items are best suited for that program? Thank you.

Operator

Next question comes from the line of Matt Fassler.

Matt Fassler

Richard, my first question relates to the ancillary business. You had a fairly subdued comparison a year ago on gas profitability presumably and obviously this year ancillary was a big contributor. And you indicated that gas was a piece of that and also some of the other businesses that you've discussed in Q&A as well. What's your thought process on gas and its contribution to margin both on the -- based on the current gas price environment, which is relatively stable and also on the comparisons they evolved through last year? Hello?

Richard Galanti

I don't what happened there guys.

Matt Fassler

I think Oliver might have been in the midst of asking a question when I was called on onto the lot. So you can do that or go to my question first.

Richard Galanti

Well, I'm not sure did you hear the answer. I answered the question related to CapEx and expansion of fiscal activates or inventory needs related to driving fulfillment. And then I answered the question he had about awareness. Did you hear that?

Matt Fassler

Some of that, so it's really…

Richard Galanti

Why don't we go on with your question and [indiscernible] get back on the line.

Matt Fassler

Did you hear my question on ancillary, Richard?

Richard Galanti

No, I did not.

Matt Fassler

The question related to the benefit that you received from ancillary this quarter, which was substantial. And some of it related to gases as you discussed and some to non-cash businesses. And taking a look back at the year ago, your ancillary margins were down sharply, gas I think has something to do with it. So what's your thought process on gas margins intrinsically relative to trend I guess on a dollar basis or penny per gallon basis in the current environment with relatively stable gas prices, particularly as you come up against I guess some more normalized comparisons in the second half of the year?

Richard Galanti

Well, a lot of the gas -- the price per gallon is up, profitability has been okay and have been pretty good. And a lot of has to gallons, I think our gallons were up 9%, 9%-10% almost 10% compared to a U.S. industry that's up in the low like 2%. On the ancillaries, I think two things. One, if I look back at last year, there was Bob what's the last year that hit us there was a catch up or something in ancillary? I think that my guess I don't have the exact number in front of me. My guess is that I know we've had strong ancillary performance. My guess is as nothing was called out last year or if it was a little disappointing, it was and so there is probably a little offset there as well. I know that many of the ancillaries are growing nicely and improving margins, bottom line margin.

Matt Fassler

And if I can just ask a second question, you're asked about Instacart already. If you think about the customer who is turning to Instacart as the program grows with you. Do you have a sense as to what the impact is or what the contribution is of legacy Costco customers who are now moving to Instacart? And how their behavior changes if at all as they shop Instacart in the store?

Richard Galanti

We don't know yet. It's just want to know yet and to do. When we look back at -- again the early days of the in the Bay area with the Google's Shopping Express, we saw it was a net increase in total spender a year with a few ship reduction in store and several deliveries more than offset it. My guess is with fresh being more dominant of course with Instacart, you might have a little bit. And what we're finding is this is more anecdotal, there are plenty of people that are using it simply fulfillment and still coming just as long, but we don't know yet.

We're also by the way finding -- signing up members that we didn't have before. And both with the Instacart White Label as well as Costco's two-day grocery where we can deliver to places that are 150 miles from a Costco, and we haven't tried to market to those people yet.

Matt Fassler

And based on your comment on size, it sounds like even though you're not for 400 clubs, it sounds like it's not material to the traffic acceleration?

Operator

We have our next question comes from Peter Benedict.

Peter Benedict

Hey Richard…

Richard Galanti

By the way, I've taken my arms off the table so I don't touch the cord and disconnect.

Peter Benedict

Matt’s had a heck of a time with Q&A the last couple of days. But anyway, we’ll move on. Can you give us a sense maybe what percentage of the business today is vertical with you guys owning product from production all the way to sale. And if you're not going to speak any numbers, maybe just which categories is that most present in and where can you where can you take that over the next few years?

Richard Galanti

Well, I don’t have a percentage calculated. But where it is, we have a hotdog plant that makes all of the Christmas season hotdogs for United States, almost all of them were at capacity. We have a meat plant in California that is over 4 million pounds a week four or five SKUs just for us. It's our meat plant. We have two optical grinding labs that grind 5.5 million to 6 million pair of prescription glasses that we sell every year. I guess you could say we have two central fill facilities both for filling prescriptions for our own pharmacies as well as mail order for ours and a few others of third parties.

We're building a major chicken plant in Nebraska that will allow us to source ourselves about 100 million chickens a year, which is less than a quarter of our needs. Although, another 30% to 40% our needs are sourced in business what’s referred to as dedicated plants. We're not the only one that does it using one of the three or four large providers that we shared all the profitability and costs related to that plant. But to say we think we can do that better than others, because we have them do many fewer SKUs than traditional retailers in that area.

We do some package of candies and nuts so that’s semi-vertical. We have a bakery commissary that we've just started production in Canada, that was done out of necessity in the two largest commissaries that they serve some of our bakery needs were acquired by the two largest grocery retailers over the last few years. But in hindsight, it seems to be working and trying to think what else. We do lots the packaging of gift baskets and clamshell type stuff that we do ourselves and that's somewhat vertical not completely.

So I don't know what all that adds up to. My guess it’s 10% or less in total maybe 5%. But at the end of the day where is it going to go in the future, I think you'll see more fees related to sourcing of foods and commodities and proteins whether it's high house produce or doing things with chickens and cows, I don't know.

Peter Benedict

On ecommerce, any plans to roll out the signage and the tablets beyond those. I think you said 195 clubs that are in today. And just how is the labor in the club you used to facilitate the buy online pick up stores. Is that a new role or are you just taking existing folks and then repurposing them?

Richard Galanti

No, we aren't rolling it out. First of all, we have employees that actually have tablet with them and particularly in areas like electronics and perhaps home furnishings seasonal items, big ticket items that in likelihood they are there and looking at it, but they still choose to buy it online. In some cases like white goods, you can only -- you can look at it there but you can only have it received and ordered online. So we're doing it but it's working so far and we expect to see in more locations.

Peter Benedict

And then just with the bulk of buy online pickup in-store. How are you staffing that from a labor perspective?

Richard Galanti

Just staff, I mean, they're going through training. They are going through third-party training in some cases we're working with our vendors in some cases.

Peter Benedict

And then last just housekeeping. The D&A number, I don't know if you gave that for the second quarter. Do you guys have that?

Richard Galanti

Which one?

Peter Benedict

Depreciation?

Richard Galanti

It will be in the queue, my apologies, we don't.

Operator

Next question comes from the line of Scott Mushkin.

Scott Mushkin

So I want to give another shot at the ecommerce question on margin. Richard, we've talked about over the last couple of years and the challenges of bringing omni-channel to retailer. I was just wondering if you could talk about how you're thinking about as you slowly go down that omni-channel road and what we should think about as margin? It seems like you're almost pricing differently in the different channels. But I was wondering if you could frame it for us as that grows as a part of your business? Clearly, not hurting yet.

Richard Galanti

Well, first of all with delivery, you've got -- somebody has got to pay for it. In some cases, we're testing to see how to include it in the price and do we charge for it, do we subsidize it, whatever. We're trying lots of different things. When you say going slowly, arguably we do a lot of things slowly. We started with ecommerce slowly 15 to 20 years ago. I look at it as, if there is some out there and that says, here in the 50 things we should be doing, let us with the menu of 50 things and we're going to choose the 10 or 50 or how that we see works for us in our environment.

And every time we -- so far when do these things it works and it works our way. And it's not unlike when we first started to business that you can't sell only 3,800 items or whatever it is and have limited categories, we recognize that value is more than just great -- the lowest price on the relative quality and quantity of something where we are second to none. But on top of that, convenience and delivery from some is as well but we can't be everything to everybody. So far that's working very well for us even as we move in some cases slowly in some of these new areas.

I think we're fortunate that we're able to find those niches. And these are item business, the same concerns the people have about are we getting our share of millennials, we are. Are they buying as much? Well, they're buying as much as the old gen whatever is did, when they were that age. But what we're finding is items that pertain well for that and we'll see. And which of these are complementary? Again, I don't know where we are five years from now. I know we have some things that we've done on the table, we all do now. I know there's some things that we're going to be doing over the next year or so to continue to grow it, and we'll see where we go.

Scott Mushkin

So my second question is with the tax and the reinvestment. Any thoughts like, our survey to consumers are they just ask is that the two stress point for consumers and going to the store at this point, parking lots and check out. Any thought on trying to ease, I mean it's a good problem to have. But mean the checkout process at Costco can back way up and of course the parking lots can. Any thoughts of using some of the money to try to ease those two friction points for consumers?

Richard Galanti

Well, what's interesting is we've got 4% traffic growth year-on-year-on-year and we put a lot of time and effort in front end to speed you out. One of the things we're concerned about with order online and pick up in store is we don't want you there if you're not going to come through. People talk about having urgent care or doc-in-the box things. We don't want you to sit for an hour waiting for a shot, and not shopping. But as it relates specifically to front end, we continue to expand, in the last probably eight years, nine years, we have reduced -- we have spent in terms of the average number of customers through an open register, an open staffed register, has gone from the low-40s to the low-50s per hour.

Now it may not seem like that but it's like being in the red light. It seems like longer than it is. That being said, I just had an offside meeting last week for a day and half. And one of the things we'll be rolling out do things at the front end, testing in about 50 locations that should continue to work on that.

In terms of the parking lots, where we can and we expand the parking lots beyond that, I can't tell you a whole lot.

By the way the other thing is we'll continue to open an infield and cannibalize units. As one of the examples I've given in the last few calls for another question was last year we opened effectively our fourth unit on the east side of Seattle and the Woodville, Kirkland, Issaquah area and a fourth one in San Jose and California. In both instances, we went from roughly, I'll call it, 60,000 members per location in the three, or 65,000, 180,000 to 195,000 members among free warehouses to maybe another 5,000 members in the market. But we added that of cannibalization $110 million to $125 million of annual sales, which is great. And so that certainly is a relief point also.

Now, I can't speak specifically one of our highest volume units in the Continental United States is in Westbury. Notwithstanding the fact that we have bought it was a retail big retail store next store at the supermarket maybe or a Kmart. But adding lots of things to it and it's hard to get another location and you're buying. So we always have items like that but we'll keep working on it.

Operator

Next question comes from the line of Kelly Bania.

Operator

Next question comes from the line of Chuck Cerankosky.

Chuck Cerankosky

I just want to explore a little bit the 15 stores, well actually 18. Flat of course in the current fiscal year, which we think about in terms of preopening expense in that period and any SG&A burden. And then how having those clubs open sets you up for the new year for fiscal '19, especially going into the holiday season.

Richard Galanti

Well some of the preopening will start before, because as you open, let's say the first several that opened in the first several weeks of Q4 much of the preopening is incurred in the monthly up to it but in Q4 is also for 16 weeks versus 12. So my guess it'll be -- clearly be higher in Q4. And I don't know necessarily how it sets us up. There may have been a few week trends we pushed to get into this year just to try to get them open. So that saves you a little bit but we do that every year.

Chuck Cerankosky

All right, thank you.

Richard Galanti

Thank you everyone. Have a good day.

Operator

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