Costco Wholesale (NASDAQ:COST) Q4 2011 Earnings Call October 5, 2011 10:00 AM ET

Executives

Richard A. Galanti - Chief Financial Officer, Executive Vice President and Director

Analysts

Laura A. Champine - Cowen and Company, LLC, Research Division

Joseph Feldman - Telsey Advisory Group

Charles X. Grom - Deutsche Bank AG, Research Division

Charles Edward Cerankosky - Northcoast Research

Nathan Rich - Citigroup

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

Daniel T. Binder - Jefferies & Company, Inc., Research Division

Sean P. Naughton - Piper Jaffray Companies, Research Division

Christopher Horvers - JP Morgan Chase & Co, Research Division

Mark Wiltamuth - Morgan Stanley, Research Division

Michael Montani

Greg Melich - ISI Group Inc., Research Division

Robert S. Drbul - Barclays Capital, Research Division

Mark R. Miller - William Blair & Company L.L.C., Research Division

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Robert F. Ohmes - BofA Merrill Lynch, Research Division

Operator

Good morning. My name is Gerri, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fourth Quarter and Year-to-Date Operating Results for Fiscal Year 2011 and September Sales Conference Call. [Operator Instructions] At this time, I'd like to turn the call over to the CFO, Mr. Galanti. Sir, you may begin your conference.

Richard A. Galanti

Thanks, Gerri. Good morning to everyone. This morning for us, we reported our 16-week fourth quarter and 52-week fiscal year 2011 operating results, both ended August 28, as well our 5-week September sales results for the 5 weeks ended this past Sunday, October 2 and announced our plans to increase our annual membership fees in the U.S. and Canada, effective November 1 for new member sign-ups and January 1 for member renewals.

I'll start by stating that the discussions we are having will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and that 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.

To begin with, our 16-week fourth quarter operating results for the quarter, reported earnings per share came in at $1.08, up $0.11 -- up 11% from last year's reported EPS of $0.97. And of course, the dollar rate figure was $0.01 or $0.02 below first call estimate. Both fourth quarters included certain items that impacted the quarter-over-quarter comparisons.

As I mentioned on our fiscal '10 fourth quarter earnings call last October 6, last year's fiscal 2010 Q4 results included a few items that in total benefited last year's reported $0.97 figure by $0.02. And while there was no LIFO charge last year in Q4 as well as the whole year, the reported dollar rate this year included a $32 million pretax LIFO charge or $0.04 a share paid to earnings.

Other items that impacted the comparison year-over-year, our foreign country earnings results again benefited from relatively stronger foreign countries on average as compared to the U.S. dollar. In the fourth quarter, FX helped earnings by a little over $25 million pretax or a shade under $0.04 a share. That is assuming FX exchange rates were flat year-over-year. Our foreign currency -- foreign country operating results in Q4 when reported in dollars would have been lower by that amount.

For the entire year, the impact of FX, assuming FX rates have remained constant in every country as compared to the dollar year-over-year, was increased pretax earnings by about $63 million pretax or $0.10 a share after tax. Again, this calculation simply takes the currency exchange rates for the prior fiscal year and assume they had remained at those levels throughout the fiscal year.

I'll also point out later in my comments preopening expenses were higher by $12.6 million or about $0.02 a share after tax, higher this year in Q4 versus a year ago given the openings -- more openings year-over-year in the quarter. For the entire 2011 year, net income came in at a reported $1.462 billion or $3.30 a share compared to $1.303 billion or $2.92 a share in last year's fiscal 2010, so up 12% in dollars and up 13% on an earnings per share basis.

If you have followed our earnings conference calls for all of fiscal 2010, I had pointed out a few items each quarter over the course of the year. Together, the pluses and the minuses added up to about a wash in fiscal 2010. This fiscal year, of course the big impact to earnings in '11 was LIFO, hitting the second, third and fourth quarters for $0.01, $0.07 and $0.04 per share, respectively, or a total of $0.12 a share for the entire fiscal year. I'll speak more about their outlook for inflation a little bit later in the call.

In terms of sales for the fourth quarter, as we reported on August 31, our 16-week reported comparable sales figures showed a 12% increase, 10% in the U.S. and 19% internationally. Excluding gas inflation and the impact of FX from the U.S. dollar weakening year-over-year, the plus 10% U.S. reported comp would be plus 6%, the 19% reported international comp would be plus 10% and the 12% total company comp would be plus 7%. So the impact from gas was about 3%, while the lift from FX was about 2%. And that again was for the fiscal quarter. As you'll see when I talk about the September numbers, the FX impact was about 1%. So while still the dollar relatively is weaker versus -- on average all over the foreign countries where we operate, that impact is diminished.

In terms of sales for the -- comparable sales for the 5 weeks of September, for the 5 weeks, our comparable sales figures showed a 12% increase, with the U.S. coming in at 11% and international at 14%. The 11% reported U.S. comp would be at 7% without the nearly 4% impact from gas inflation. And given again the year-over-year U.S. dollar's weakness vis-a-vis the other currencies in the last month, well that's changed a little bit but for the whole month, our reported 14% international comp would've been plus 10% when expressed in euros -- in local currencies. Overall, the reported 12% total company comp would've been at plus 8%, excluding gas inflation of about 3% and FX, as I mentioned, of a little over 1%. For the month, our 12% reported comp sales results were a combination of an average transaction increase of 7.5% continuing good frequency increases, an average frequency increase of a little over 4%. Other topics I'll review with you, our opening activities. We opened a total of 20 net new locations during the fiscal year that just ended, 13 new in the U.S., 3 new in Canada and 2 new each in Taiwan and Australia. As well we relocated 2 units in fiscal '11 in San Marcos, California and Chesterfield, Virginia. For 2012, our current expansion plans include 20 net new locations, about half in the U.S. and half outside the U.S. Plus, at least one relocation and, of course, the reopening of Tamasakai, Japan unit, which has been closed since the tragic earthquake of March 11 this past year. We currently operate 592 locations around the world. During the first few months of fiscal '12, basically from September through the end of the calendar year, we plan to open 7 locations, 4 in the U.S., one each in Texas, Pennsylvania, Wisconsin and Georgia. We have a relocation plan for Ontario, Canada and 2 new locations in Japan. And that's of course on top of the Tamasakai opening that will happen in early calendar 2012.

Also this morning I'll review with you our Costco Online results, our membership trends and of course, the upcoming fee increases in the U.S. and Canada effective the first of next month. Additional discussion about our Q4 operating results, of course, and our stock repurchase activities during the fiscal quarter.

Okay. On to the discussion of our results. Very briefly sales, again for the 16 weeks were $27.6 billion, up 17% from last year's 23.6%. On a reported comp basis in Q4, sales were up 12% and the 12% again would be plus 7% without FX and gas price inflation.

For the quarter, our 12% comp would be an average transaction increase of 8%, and average frequency increase again of a little over 4%. Some of you asked about what is our average sales volume per location. In fiscal '11, the average sales volume company-wide per location was $146 million as compared to $139 million the year before. It's closer to $150 million versus $146 million this year if we exclude Mexico, recognizing our Mexico operations were consolidated for the first time into our numbers during fiscal 2011.

In terms of sales comparisons by geographic region for both the fourth quarter and September, in the U.S. the strongest comps, both for the quarter and for the month of September or in the Southeast, the Midwest and California, all regions were fairly good. The 11% reported U.S. comp figure for September as an example ranged from a 9% to a 13% among all regions.

Internationally and local currencies, we continue to do well. In Canada, which is our biggest international component, 9% for the quarter in local currency and plus 10% in September in local currency. The rest of international averaged around 12% in the quarter and 9% for September. Again, continuing at relatively strong comps there as well.

In terms of merchandise categories sales for the quarter, both for the quarter and September, within Food -- I'll do those separately. For the quarter within Food and Sundries, comps were positive in the low-double digits. Standouts were deli, candy and Foods. Subdepartments ranging from -- throughout the 7 or 8 subdepartments ranging from a plus 7% to a plus 19%.

Our Hardlines sales showed positive, mid-single-digit comps. The strongest subcategories were in the low to high teens. These were tires, sporting goods and lawn and garden, offset by a minus mid-single digit majors, which of course is electronics, which represents about 1/3 of total Hardlines sales, by the way, in that category. As you'll see in a minute, in September we saw an improvement in that department. Within the positive Softline comps which were in the mid- to high-single digits, great numbers in the small electrics and jewelry, both in the 20%-plus range.

Fresh Foods was up about 12%. All Fresh Food category sales were fine. For the month of September now, Food and Sundries comps were in the high single-digit range with cooler, deli, Foods and candy leading the category. And as reported in recent months, Food and Sundries on a year-over-year basis, that's one area, as well as Fresh Foods that continues to experience inflation in the low to mid single-digit range. And that's based on talking to our buyers.

Hardlines were positive in the low single-digit range, which is the first time we've seen Hardlines positive in a while, led by hardware, sporting goods and tires. Majors, as I mentioned which was mid negative, mid-singles negative last quarter for the month, was positive in the mid-single-digit range, with TV sales both in units and dollars up for the month.

Softlines comps were positive in the mid-single-digit range led by small appliances, domestics and jewelry, experiencing softer sales in housewares and media. Media has been that way for a while, needless to say.

All departments in our Fresh Foods categories were positive double-digit. Overall Fresh Foods, again, like Food and Sundries, experiences inflation in the mid-single-digit -- low to mid single-digit range over the past as compared to a year ago. I'll talk in a minute about what we've seen in just the past month and it's mostly in bakery and Meat.

Moving down the line items of the income statement, we'll start with membership fee income. Reported in Q4, membership fee income was $590 million, up 11% or $57 million from last year's $530 million -- $533 million. It was down as a percent of sales by 12 basis points. Again, gas inflation plays havoc on a year-over-year basis points comparison. That minus 12 without gas inflation would have been a minus 6. And still, with strong sales growth, we feel the 11% increase in dollars is pretty good; 8%, by the way, if you took out the benefit of FX.

In terms of membership fees and renewal rates and loyalty, renewal rates continue at the 89-plus percent range in the U.S. and Canada and on 86% worldwide. We continue to see increasing penetration in the Executive Membership.

In terms of new member sign-ups in Q4, they were dramatically up year-over-year, up 22% in the fiscal quarter as compared to a year ago. In Q4 of course, we had 10 new openings this year; 5 of those openings, by the way, 2 in Australia, 2 in Taiwan and 1 in Japan. These added international ones accounted for much of that huge Q4 spike. But even without these 5, the 22% figure would have still been up 6%, so a pretty good showing for new sign ups.

In terms of members at Q4 end, and I'll just give you Q3 end and Q4 end. At Q3 end, primary Gold Star was 24.3%; at Q4 end 25.0%; primary Business remained at 6.3%; Business add-on went from 3.85% to 4.0%; total 34.4% to 35.3% and including Spouse cards, 62.6% up to 64%. At Q4 end, Paid Executive memberships were $11.8 million, an increase of nearly $500 million, about $450,000, or up 4% in just the third -- in the 16-week fourth quarter. That represents about $28,000 a week increase in Executive Membership penetration. Executive Members currently represent about 1/3 of our membership base and a little over 2/3 of our sales.

In terms of renewal rates, as I mentioned, they continue strong in U.S. and Canada, which is the core of our business. The Business members at Q4 end, as of Q4 end, we're renewing at 93.3%, up from 93.2% at the end of the previous quarter. Gold Star 88.1% versus 88.0%. And total 89.1% versus 89.1% due to rounding. Worldwide, it was 85.7% at Q4 end, down slightly from 86%. Again, that's a reflection of all these relatively newer warehouses over the past couple of years and generally a lower renewal rate, both overseas as well as given the newness of the concept in some of these markets.

Renewal rates for Q4 -- let's see. That's it there, I'm sorry. I'll spend a minute now talking about the announcement this morning of the pending increase planned in annual membership fees. First, the planned increases relate to our U.S. and Canadian operations.

In the U.S., our current annual fee for our individual Gold Star, our Business and our Business add-on memberships is $50 a year. The annual fee on both the Gold Star and the Business members has been at $50 since May of 2006 or a little over 5 years ago. The annual fee on a Business add-on membership increased to $50 earlier this year in order to conform with the 2 primary memberships. And now it, of course, is going to $55 as well. All 3 of these will be $55 effective on an annual basis, effective November 1 in the warehouse and effective January 1 with regard to member renewals. January renewals are mailed out near the end of November.

Also in the U.S., $100 per year Executive Membership fee is being increased to $110. This is the first membership fee increase since the inception of the Executive Membership program in the U.S. in 1997, and a few years after that in Canada.

In Canada, the current annual membership fee for both Gold Star and Business add-on members was already $50, $55 rather. And by the way in Canada, we talk Canadian dollars of course. And it was $50 for the primary Business member. So it's the $55 -- $50 primary Business member that will be raised to conform with the other 2, to all be at $55, again effective November 1 in the warehouse and January 1 in terms of renewals.

And similar to the U.S. member program, the current $100 per year Executive Membership in Canada will also go to the $110 level at this time. In all, approximately 22 million members will be impacted by this increase, approximately 1/2 of them are Executive Members and the other 1/2 are the various Gold Star business and Business add-on. Please remember that membership fees are accounted for on a deferred basis. For example, approximately 1/12 of the increase fees from any -- our January renewals will be booked in the first month, with an additional 1/12 being booked in the succeeding 12 months. So increase in net increase fees in February renewers, the increase will be booked in February to the following January and so on.

So the full impact of these increases in terms of how it hits the P&L is essentially a 23-month time line. That is, the last group of members to be billed at the new fee levels will be next December, with a booking of that $5 or $10 per year increase to accrue over that month and the succeeding 11 months.

With regard to Executive Membership, the 2% Reward associated with the Executive Membership will increase from the current $500 per year cap up to $750 per year, based of course on eligible purchases. This change, we believe, and others will help us to maintain our competitive edge.

Needless to say, we feel that the enhanced value of the Costco membership over the past 5 to 10 years far exceeds the modest $5 and $10 increase in the annual membership fee levels, and it will continue to allow us to bring our members even greater value on everything we offer.

Going down the gross margin line, our reported gross margin in the fourth quarter was lower year-over-year by 34 basis points, coming in at a 10.54% of sales as compared to a year ago fourth quarter 10.89%. I ask you to jot down some line items in 3 columns. The line items are core merchandise. The second line item would be Ancillary businesses. The third line item, 2% Reward. Fourth line item, LIFO. Next quarterly adjustments, and then total.

The 3 columns would be Q3 '11, Q4 '11 and then Q4 '11 again without gas inflation. Again, the huge volume that we do in gas plus the huge -- the 31% increase in prices year-over-year wreaks havoc on all the comparisons on a percentage basis, so we take out gas inflation to show you those numbers on an apples-to-apples basis.

Going across merchandise core, in Q3 '11 year-over-year was minus 14 basis points; in Q4 '11 minus 24%; without gas inflation, that minus 24% would be plus 2%; Ancillary minus 3%, plus 6% and plus 12%; 2% Reward plus 3%, 0 and minus 3%; LIFO minus 24%, minus 12% and minus 12%; quarterlies 0, minus 5% and minus 5%; for a total of minus 38%, minus 35% and minus 6%.

Mexico, of course, is also again -- for the first time in Q in fiscal '11 and therefore, in the fourth quarter as well, was put into the numbers. If you take Mexico out, it benefited all of these numbers by 3 basis points.

As you can see, our overall reported gross margin was lower by 35%, that's what we reported. But as was the case each quarter, these figures required a little bit of elaboration here, and explanation. In the fourth quarter, our core merchandise, as I mentioned, was 24%. And the Ancillary business gross margins, principally Gasoline impacting it, contributed plus 6%.

Our Gasoline business and its inflationary price trends during the fourth quarter this year impacts our Costco merchant comparison as I mentioned to you in the past. The sales penetration of higher-margin core business was down 2 percentage points in Q4 year-over-year, whereas the sales penetration of our Ancillary businesses, again mostly impacted by gasoline sales which is a much lower gross margin business to start with, was up 2 percentage points year-over-year in the quarter.

So again the core business, Food and Sundries, Hardlines, Softlines and Fresh Foods, were up slightly year-over-year. Its aggregate gross margin hit was the minus 24%.

LIFO as I mentioned was 12%. We continue to see year-over-year inflation as we did in Q3, although at a slower rate of impact in Q4 as compared to Q3. The minus 5 basis point quarterly amount -- and that's part of what I mentioned earlier in the call that in last year, we mentioned that the $0.97 figure included about $0.02 of benefits from a couple of items. There are a couple of miscellaneous items that again, we felt when we reported $0.97 last year that $0.95 was a more appropriate number with a couple of unusual items that actually benefited slightly our margin and SG&A.

In terms of gross margin outlook, no real margin issues. Our inventories are clean, very good physical inventories at fiscal year end. We continue to be committed to driving top line sales as we enter the Christmas holiday season and into the new calendar year.

In terms of inflation outlook and talking to our buyers, their view is that we continue to see and expect year-over-year inflation with Food and Sundries, Fresh Foods and in some non-Foods areas, although at a slower rate compared to the last 6 months.

I will mention that in September, we did -- in terms of looking at our LIFO indices slight deflation, very slight deflation from the beginning of our fiscal year, so 4 weeks earlier versus the end of September. Again versus last year, we're still seeing some inflation, but in terms of how -- what hits the

P&L in terms of LIFO, at least for the first 4 weeks we see essentially flat to very slightly down, a slight deflation.

Moving on to SG&A. Our SG&A percentages, fourth quarter over fourth quarter were lower or better by 34 basis points, coming in at $9.83 this year compared to a $10.17 last year. Again, quickly jot down 3 columns and several line items. The line items are: operations, central, stock compensation or equity compensation, quarterly adjustments, total.

Going across Q3 '11, Q4 '11 and Q4 '11 without gas inflation and operations plus 46 basis points, meaning it was lower by 46; Q4 '11 plus 44; and Q4 without gas plus 20; central plus 3 or lower by 3; Q4 '11 minus 2; and Q4 without gas minus 5, so higher by 5; equity plus 2, plus 2, plus 2; quarterly minus 8, minus 10, minus 10; for a total of plus 43, meaning in the Q3 year-over-year, we were lower by -- on a reported basis, lower by 43 basis points. In Q4 plus 34 or lower by 34; and without gas inflation plus 7 or lower by 7. Again, Mexico had a low to mid single-digit impact on those numbers for the quarter and the year, end of quarter and with and without gas.

Again in terms of editorial, operations were lower or better by 44; again, a big component of this was due to the 31% increase per gallon for gas -- price per gallon for gas during the quarter. Just like with gross margin percentages were hurt, it correspondingly helped our core SG&A by plus 24, so the 44 would be plus 20 without it.

Our central expense was a bit higher year-over-year. And really just a couple of line items, things in there on a year-over-year basis that were year-end changes, quarter-end, year-end accrual adjustments and what have you, nothing to really speak of.

Health care costs in the quarter were lower by 2 basis points. U.S. healthcare costs, however, were up 14% in the quarter and 12% for the year. In terms of the factors that will impact our outlook for expenses and other things in fiscal '12, again the main items are going to be sales trends, health care, gasoline sales, inflation or deflation and to some extent, increasing penetration of our Asian operations, which have lower overall SG&A percentages.

Next on the income statement is preopening expense. Preopening expenses were up $12.6 million higher or minus 4 basis points to the P&L, $9 million last year in the quarter versus 21.6. Last year in Q4, we had -- in fiscal '10 in Q4 we had 5 openings. This year in Q4 we had 10 net openings but 13 actual openings, so including the 2 relos and the reopening of our Makuhari, Japan location.

In terms of asset impairment and closing costs in Q4 '10, last year, we had a charge of $3.3 million for the quarter. This year $2.6 million, so no real change there.

All total operating income in Q4 '11 was up 10.5% year-over-year from $688 million last year to $762 million this year, an increase of $74 million. The bigger percentage increase -- a little bigger percentage increase if you consider last year's $0.02 that I mentioned that adds to earnings and this year's $0.04 LIFO hit.

Below the operating income line, reported interest expense was about the same year-over-year, with Q4 '11 coming in at $35.8 million versus $34.7 million last year. These amounts of course mainly reflect the interest on our $2 billion debt offering that we did in February of '07. I will mention that beginning in mid-March of '12, which is about a month into our fiscal third quarter this coming year, we plan to use existing cash to pay down $900 million principal amount of that $2 billion, which was 5-year maturing debt. And an annual pretax saving to us, we estimate of about $44 million pretax or $0.06 a share.

We get to the $44 million assumption based on an all-in rate for that 5-year, fixed-rate money of 5.37% and our current return on the $900 million that we used of about 44 basis points, so that's where we get the $44 million.

And again, that'll start that in mid March of 2012. Interest income was higher by $16 million in the quarter, $45.8 million this year versus $29.6 million. Actual interest income, this line is interest income and other.

Actual interest income was higher by about $8 million, a reflection of not only the increased cash but some increased interest earned on increased cash balances outside of the U.S. and some countries.

The other $80 million is a combination of things from -- everything from marketing to markets and FX forward contracts that we use in some foreign countries to the fact that we have -- we now consolidate Mexico instead of putting 1/2 of its earnings on this line item, so taking the 1/2 out there and spreading it throughout the entire income statement, going from the equity method previously to now consolidated, as well as a couple of other miscellaneous items. And so overall, pretax earnings were up 13%, $684 million versus $771 million this year. Our company's reported tax rate this quarter came in at 35.3%, a little lower than last year's rate of 36.1%.

A quick rundown of other topics. The balance sheet you should receive -- that was received, I'm sorry, in the press release as well of course, like always, you'll see some other information shortly that will be online.

Depreciation and amortization was $273 million in the quarter, $855 million for the year, strong balance sheet as you guys know. Our AP percent as a -- AP as a percent of merchant -- as a percent of inventories, on a reported basis, it showed that last year the fourth quarter was 105% and it was declined to 99%.

On a merchandise basis, so merchandise accounts payable versus our inventories, it actually went from 89% last year up to 91%, I think a reflection of slight improvement in increased turns and hopefully good negotiations with our -- by our buyers.

Average inventory per warehouse was up $772,000 from $10,441,000 per warehouse a year ago as compared to $11,213,000, so it's about 7%. About 1/3 of this increase relates to the stronger year-over-year FX.

Food and Sundries was up about $165,000, that's partly due to the inflation that we talked about in the past. The balance of the variance is basically spread among departments, again, good inventory showing. Overall, we feel good about how we came out of fiscal year end with very clean inventories and we feel good about our sell through so far in seasonal items and hopefully, we'll have a good season continuing throughout this calendar year.

In terms of CapEx, in the fourth quarter it was $472 million. For all of '11, it was $1,290,000,000. We'd estimate that fiscal '12 CapEx will be in the $1.4 billion to $1.6 billion range, with increases from this level expected -- from that level expected in fiscal years 2013 and '14. That's a combination of -- we would expect increased expansion activity as we've got more in the pipeline as well as an ongoing increase proportionally of some of the overseas expansion, which tends to be a little more expensive in some of these very densely populated major cities.

In terms of our dividend, in May we increased our quarterly dividend by 17% from $0.205 a share per quarter to $0.24. This $0.96 per share annualized dividend represents a total cost of the company of about $420 million.

Our costco.com and costco.ca Canada, in total, sales were up about 12% for the year and up almost 15% for the quarter. In terms of expansion, I mentioned earlier we currently are planning about 20 for the year skewed towards the end of the fiscal year in spring and summer. Again of that net 20, about 1/2 half will be in the U.S. and 1/2 in international. This is always subject to a couple of slipping one way or the other, and so one extra and one in the U.S., one less or vice versa.

In fiscal '12, if we're assuming we are in the 20 net new units, that'd be about 3.5% square footage growth. Also at fiscal year end, sum of U.S. total square footage stood at 84,415,000 square feet in our operations.

In terms of stock repurchases, we currently have repurchase authorization with the Board approval earlier this calendar year to increase the authorizations. We currently have authorization of $3.7 billion. As you know in Q3, as I mentioned, we bought -- we spent $102 million buying back 1.3 million shares. If I just annualize that $102 million of buying over those 12 weeks, that would be about $440 million. I think if you annualize at 36 weeks, you're approaching $500 million rate of purchase.

In Q4, we purchased 3.7 million shares for $294 million. Taking those 16 weeks and annualizing it, you'll get closer to the $1 billion, about $950 million at an annualized rate of purchase during the quarter.

Long term, we continue to be buyers. On a regular basis, we're not going to predict up or down where the stock's going to go. But overall, we continue -- we currently believe in the outlook of the company and clearly, we've got enough cash to not only pay for ramped up expansion and an increasing dividend, but hopefully stock buybacks as well into the future.

A quick reminder. Fiscal '12 is a 53-week fiscal year. The fourth quarter of '12 will consist of 17 weeks this year compared to a 16-week fourth quarter last year. And as I mentioned, our supplemental information pack, which includes some of the usual stats we posted on the Investor Relations site later this morning. With that, I'll turn it back over to Gerri and open it up for Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Robbie Ohmes with Bank of America Merrill Lynch.

Robert F. Ohmes - BofA Merrill Lynch, Research Division

Hey, I was hoping you could just maybe elaborate more on the fee increase, sort of the timing of it. I know it's something that you guys had talked about, but the timing of it this year and also the expected response, if any, from your customers. Do you think you'll lose anybody related to it? And I think also you mentioned something about allowing you to give even better values. Is there an anticipated impact over the next 2 years on what your store-level margin structure could look like or the way you're passing on inflation, et cetera, related to taking this membership fee increase?

Richard A. Galanti

Well, the timing is simply we just decided to do it now. We talked about it and everybody out there asks about it every quarter, but at least 2 or 3x a year when were off-campus as a senior management team we talk about it. We've always felt that our membership fees -- our membership value is greatly -- we continue to greatly enhance it. You all -- many of you know us well long enough ago that we use it in a lot of ways and recognizing all monies are fungible, but the fact of the matter is we're always going to be competitive with or without this. We'll continue to be competitive. This will allow us to continue to be competitive, offer more services and do what we do. So we're -- people ask us about the economy. We're not thrilled about it. We're thrilled that we are performing quite well in terms of shopper frequency and driving sales in the right directions, and we're going to continue to do that. So I'm not trying to be coy, but you guys know who we are. We're going to do what's right to drive our business long term. And now in terms of do we lose members? Recognize this is a -- on the primary membership, this is a 10% increase, a $5 increase on a $50 membership fee that has been $50 for the last 5.5 years and a $10 increase on $100 that has been that way for 7 to 11 years, depending on which country. And so this is not a $5 a month increase, it's a relatively small increase. We recognize with the economy, historically, we have very low fall-off from it. We don't take it lightly. We didn't take it lightly by doing it and when we do it, but we recognize that it's part of what we have done historically over 25 years, doing modest increases in the fee. But every time we've done it, we feel -- and we take a hard look at ourselves, we look at ourselves in the mirror and feel that we have continued to enhance the value of that membership by a lot more than that. And we say that sincerely. Maybe we're fooling ourselves, but we don't think so.

Operator

Your next question comes from the line of Mark Miller with William Blair.

Mark R. Miller - William Blair & Company L.L.C., Research Division

On the net store expansion now expecting 20 for fiscal '12, I think last quarter you commented you thought it'd be closer to 25. So I guess I'm curious, is there something that caused Costco to slow down or, I guess something previously unexpected in the marketplace?

Richard A. Galanti

This is probably the one number that we have most poorly predicted every quarter and every year for 15 years. We got a lot in the pipeline beyond this. Some of the expansion overseas takes longer. All I can tell you is, is that, Craig and -- Jim and Craig's goal and Jeff Brotman's goal is to get that number up. And again, I can't predict whether it's going to be -- whether there's other irons in the fire that might tweak that up a little bit. I try to be as realistic as I can going into the year and perhaps each year being even more realistic. But I -- so again, could it tweak up a little bit? It could. My guess is you're going to see like we did more recently. There's -- again, there's a lot of irons in the fire. I think you're going to see a lot of openings just past the end of this fiscal year into the next year. If Jim were sitting here or Craig was sitting here, their goal would be to get that number into the 25 to 30 range next year. But I can't -- I can only tell you what we've got going on right now in terms of what we feel comfortable that we're going to be opening. I can also assure you that those 3 and the real estate people and the operators are working very hard to speed up that process because we -- there's a lot of locations that we want to open. There's more unpredictability in terms of some of the timing and zoning, particularly in some of these foreign countries. But they're favorable to us opening, it's just it's a longer process. And again, there is more -- there are more irons in the fire now, which will speed up that process hopefully.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Okay. And then with 1/2 the clubs going outside the U.S. in fiscal '12, I guess I'm trying to integrate that into how we should think about international profitability. It looks like you should be about or now more than 45% of your profits outside the U.S. for all of fiscal '11. I don't know if you can share that exact number, but when do you think we get to more than 50% outside the U.S.? Do you think you'd get there in fiscal '12? I know FX also is a factor.

Richard A. Galanti

You're including Canada. That number sounds a little high, although you have the numbers in front of you. I don't have those -- that detail in front of me. I'd have to look at it. Clearly, the rate of increase in overseas expansion, and I include in this Canada and international, and the fact that the dollar has weakened has exacerbated it upward a little bit. My guess is, is that to the extent that, that increasing penetration has occurred in the last couple of years, it probably still increases but slows down a little bit. Again, I'm just shooting from the hip there, though.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Okay. And finally, then I'll turn it over. The new members' sign-up going up 6% outside of the new International Club openings. Was there any anomalies to that figure or what do you think explains that acceleration?

Richard A. Galanti

In terms of openings overseas?

Mark R. Miller - William Blair & Company L.L.C., Research Division

No, the new member sign-ups. I think you said it...

Richard A. Galanti

In some of these markets like the area -- and around Taipei, Taiwan or Tokyo, one where we've been very successful in the 3 Asian countries and starting off pretty darn well in the 3 locations that we have in Australia, but particularly in those 3 Asian countries, in these 20-million population cities, if you will, we get -- have membership per warehouse off the charts in terms of new sign-ups. And even after they've been open for a few years, I think in Japan, the number of members per warehouse is double our company average, darn near double our company average. And so it has to do -- it's nice when you have 5 locations in a city, the size of these cities. And there's plenty of opportunity to open more locations. And maybe that will come down over time, but there's a -- the per capita grower, that number of population per warehouse is off the charts over there as well.

Operator

Your next question comes from the line of Mark Wiltamuth of Morgan Stanley.

Mark Wiltamuth - Morgan Stanley, Research Division

Richard, I wanted to ask about the inflation pass through on Food. Are you having any margin drag from that? Obviously, we have the LIFO charge here. But when you take the LIFO out, what's the effect on margins here?

Richard A. Galanti

Yes, there's a little bit of lag and quite frankly, it's us more than anything. If I looked at the detail, I would say that we're still impacted in the Food court because we're not changing the price of the pizza and the hot dog as an example. You're going to see it in bakery for some of the commodity goods there. Even though, we've seen some reduction in some of the underlying commodity costs at bakery, it's still not back to where it was. And again, I think a couple of fiscal quarters ago, I gave a couple of examples where we're going to hold the price of a 15-pack or whatever of muffins and let the margin dwindle down on it before we take an increase. And we do, ultimately. So, but that's our doing and I don't think it's a dramatically big change of what we've historically done, it's just we have inflation now. But ultimately, you've got to pass the price increases on.

Mark Wiltamuth - Morgan Stanley, Research Division

And on that front, we just saw some softening in some of the underlying core commodities with corn cooling off last week. How long does it take for that to really hit your stores before it cycles through the packaged food companies and then gets to you?

Richard A. Galanti

Well keep in mind, as you might expect, in my view, a couple of years ago when there was starting to be inflation and actually in mid '08, there was a lot of pent-up demand, if you will, on the manufacturing side because retailers are always -- a very light inflation for a number of years. A strong -- your large retailers, the supermarkets, the Wal-Marts, Costcos, were able to push back and so, some of them will stick because there was catching up from prior stuff. Generally, it's all over the board. But generally you'll see it weekly and monthly in things like beef and pork and poultry. And you'll see it in raw materials, where we're buying certain raw materials for our bakery, you'll see it pretty quick. But you're not going to see it all proportional to what you see coming down because not all -- they didn't get all of it on the way up. And even when they got it, some of it was, in my view, pent-up demand. But needless to say, part of -- every one of our buyers' jobs as manufacturers explain why something was going up, they're out there heading back saying okay, let's come down now. And so we're, I think, as good as anybody in pushing that envelope the other way. But it takes some time; anywhere from a few weeks to a few months, depending on the categories. One other comment on that, as an example, when cotton prices were going way up 6, 8, 12 months ago. And I think I mentioned it in one of the calls, in some cases, when you're making 3-, 6-, 9-month commitments on everything from apparel to towels and things like that, there were some manufacturers, many manufacturers overseas, and Asia particularly, were basically saying, you've got to commit to quantity or we can't tell you what the price is because that's how fast the underlying commodity costs of cotton were going up. And in some cases, we and everybody else had to eat some of that as cotton prices or other things have come down. But again, we're turning back faster on average than other comparable full-line retailers in those categories. So do we get hurt? A little bit, but everybody gets hurt.

Operator

Your next question comes from the line of Dan Binder with Jefferies & Company.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

A couple of questions. First on the core gross margin, I think I have it apples-to-apples. It looks like your core was up plus 2 basis points this quarter compared to more substantial gains in recent quarters. I'm just curious if there's anything that you should point out to a change in that pace and what we should kind of expect going forward. That was the first question. The second question was on the membership -- the Executive Membership with regard to the increase in the rebate. Just curious what the sort of incremental drag is to -- that give back to the customer. In other words, I'm sure there's probably a few members that were exceeding that $500 rebate, so now that you actually have to pay them, what kind of a drag does that bring to the P&L?

Richard A. Galanti

Sure. Now I forgot what the first question was.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

The core gross margin.

Richard A. Galanti

Oh, yes. I'm sorry. The -- again, we don't view it as anything to be concerned about. It's -- we're talking about gas inflation. The other piece of gas is gas gallonage is way up. That's also on a low margin business, 8-or-so-hundred basis points, but increasing penetration in gallonage. There's lots of things, different countries, different penetration. I mean we really, as we look at it, and in terms of looking at the core, didn't consider it. It's a little lower than it has been in the last couple of quarters, but we'll keep letting you know what it is. And again, we don't read a lot into that as any trend, either up or down. In terms of the Executive Membership and the increased Reward, it's pretty small. Recognizing that to be at the $500 cap you're at $25,000 of eligible purchases, eligible purchase meaning everything but gas, alcohol and tobacco, and so -- but we're hoping it'll grow. It's well under $10 million of impact a year and we -- but we hope it would grow up, because that means it's driving business.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

Okay. And then just one final. On the other income line, when we consider that Mexico is not in that number this year, it's up quite substantially just versus where you were in the first 3 quarters. And you mentioned FX contracts. I'm just wondering if there's some bigger items in there that you can identify.

Richard A. Galanti

There really aren't. There's a few things that go both ways. FX forward contracts in a given quarter can be plus or minus $5 million. Usually it's plus or minus a couple of million dollars. I think that on a year-over-year basis, that variation was closer to the $5 million, frankly. So that's the biggest chunk.

Operator

Your next question comes from the line of Chris Horvers with JP Morgan.

Christopher Horvers - JP Morgan Chase & Co, Research Division

So Richard, on the LIFO, do you think that based on September's experience that this would actually turn out to be a benefit in the fourth quarter if we kind of stay where we are? And then can we just run rate that as we think about the experience into next year into 3Q and perhaps that lift gets better?

Richard A. Galanti

Well again, who knows? If I can extrapolate with absolute certainty the first month, we'd have -- it'd be flat, a very slight amount of credit. Who knows? I mean, if you -- assuming that there -- in terms of expectations for increases on top of current levels, the buyers generally view that there's not a lot of increases happening right now. In terms of getting price reductions on things, again, LIFO starts with the beginning of this fiscal year on August 29. So the index for the first 4 weeks, our internal 4-week period, was just a few basis points under a base of 100.00, so very slight deflation. Who knows what tomorrow brings to the extent from these levels, from August 29 levels of pricing and costing, that we see some as commodities come down, as we see some price reductions, that would be -- tend towards a credit. I'm shooting from the hip, but my guess is, is that I'd assume right now it's flat and there's no or not a lot of risk it's going to be big inflation and not a lot of risk it's going to be a lot of deflation.

Christopher Horvers - JP Morgan Chase & Co, Research Division

Right. So it's not a comparison issue. Prices actually have to come down to see the credit.

Richard A. Galanti

Right. But in terms of seeing the impact in Q3 in view of a LIFO charge, that seems to have abated at least at this point. Who knows what tomorrow brings?

Christopher Horvers - JP Morgan Chase & Co, Research Division

Yes. And obviously, we're also sensitive to what's going on with the consumer. Was there anything particular about the cadence in September that you would call out either positively or negatively?

Richard A. Galanti

Well, I think the thing that continues to surprise us is this continued 4-plus percent frequency number. We certainly appreciate and recognize that gas gallonage comps for us are strong, certainly strong relative to the U.S. consumer and that drives people into our parking lot. We recognize that people are probably eating at home more than they used to. That drives people into our parking lot. And I think those are the issues that -- so we've been somewhat blinded by the fact that we still believe that the -- we know the economies are tough. We are concerned as every one of you are out there every day with the gyrations in the market and the mortgage statistics and the unemployment statistics. We are bucking those trends in terms of driving unit frequency, customer frequency and with a little help from even inflation, dollar increases. So we're working hard to continue to drive that market share and we think we're doing a pretty good job of it. But if you ask us do we feel good about what's going on out there? No, in terms of the economy.

Christopher Horvers - JP Morgan Chase & Co, Research Division

Right. And then one final quick one. It seems like the FX will probably turn on you in the coming months from a top line perspective and get a bit worse in the spring if we just held today's rates. How does that flow through to the margin structure if it does turn in the other direction?

Richard A. Galanti

It doesn't change percentages a lot, because it's every line item. To the extent that our foreign operation is slightly more profitable bottom line, but those that you're talking about, percentages times percentages, I don't think it has a lot of impact on any percentages. Again like this past year, the 3 -- the reported $330 million of earnings, there was, I think, $0.10 in there from that, from just the change in FX. To the extent that we are relatively confident until the spring or we -- and then start to show the other way, and again, who knows? It could be a slight detriment this year, but we don't know.

Operator

Your next question comes from the line of Peter Benedict with Robert Baird.

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

Richard, a couple of questions. In the past, you've walked us through, at least qualitatively, the gross margin trend within the 4 main categories. Could you give us a sense of how that fleshed out in the fourth quarter?

Richard A. Galanti

Yes. I don't have it in front of me. I know -- I think Hardlines was up, Fresh Foods was down a little and the other 2 I don't have in front of me, I'm sorry. I know overall it was up 2. By the way, one of the things that Jim has mentioned, that less is more. Not from trying -- and we've always tried to convey, give you a lot of color on things. We're trying to wean me off of some of that going forward. Not yet, but -- and so, we'll continue to try to do that. And we'll still give you the same color of what's going on out there, though.

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

No, that's helpful. I mean would you say -- how would you characterize kind of the mood internally in terms of that core margin line? I mean is the goal still to kind of maintain and increase that? Or are you more willing to kind of give back some of that now that you've raised the fee?

Richard A. Galanti

That's a definite yes to both of those. The fact of the matter is, we do what we do. Really, we don't sit around here being terribly concerned about margin. Keep in mind over the last 10 years, the Executive Membership has hit the margin line for over 100 basis points. Penetration of gasoline, which is easily 700 or 800 basis points lower than the company average margin outside of that, probably 8-plus-hundred, that's gone from 0% 10 or 12 years ago to 8% or 9% or 10% of sales, 9% of sales. So we've hit the margin hard in a lot of ways and our margins are pretty good. So despite us being competitive out there, we're going to do what's right for the company long term. We're going to drive sales, we feel very good about our ability to do that. And again, I'm not trying to -- I am trying to be qualitative because -- but if you ask us, our goal is still to see pretax earnings as a percent of sales improve and get, have a 3 in front of it? Yes.

Peter S. Benedict - Robert W. Baird & Co. Incorporated, Research Division

All right, fair enough. And then I may have missed this, but any early read on kind of the holiday products? I mean you guys bring your stuff in so early. It would be interesting to hear, I know September overall was good, but how about those kind of holiday seasonal, trim-a-tree, that type of stuff? Any read you're getting?

Richard A. Galanti

Our seasonal sales are good. And we brought in stuff in early. We had stuff out there the last week of August, I think, starting to come in and certainly through in mid-September, so we feel good about seasonal merchandise.

Operator

Your next question comes from the line of Colin McGranahan with Bernstein.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Richard, I wanted to focus on the Executive Membership fee increase given that you've never had one, a couple of questions. One is, do you think there's anything different there about sensitivity renewal rates and whatnot? Secondly, can you give us any sense of the number of Executive Members that spend between $2,500 and $2,750 because just obviously, I'm playing math. Those are the ones that wouldn't make sense to be an Executive Member anymore given that $50 to $55 differential. And then thirdly, just same topic, but thirdly, in the past, you said Executive Members spend more. And obviously, you've wanted to make more and more members Executive. But is there a current horse thing there? I mean do people when they become an Executive Member actually spend more or people who are spending more naturally became Executive Members?

Richard A. Galanti

On the last question, clearly they spend more then they become Executive Members. They spend a lot more. I liken to a TV commercial I saw a long time ago about 2 businessmen at a business lunch and then they both reached for their wallets to pay for the bill and one says, "Let me get it, I get rewards." The fact of the matter, infinity programs work. I don't know completely why, but you talk yourself into it. And so clearly, being an Executive Member, they buy more. I think also, we have gotten better at promoting it and communicating it to the member, both at when they sign up as a new member and as well when they're coming through with a bigger amount of merchandise. And what the cashier can do when they swipe the membership card and they could show them based on their prior year's purchases, they would have behooved them to become an Executive Member. So we do a better job of it. In terms of -- let me tell you the rationale why we kept $100 fee to the last 2 regular increases. When we first did the $100 Executive Membership in the U.S. in 1997, I believe the base membership fee was $40. So it was a $60 deal. At the time that we -- 5 or so years later when we went from $40 to $45 in the base, our view was is there's lots of members out there that if you just took their prior 12 months' purchases, eligible purchases, that how many of them would be at breakeven or above at $55 -- at $50 versus $55? Then the view was at the time, there were about 2 million, 2.5 million members that in theory would benefit based on their prior year's purchases. Now if we even got 10% of them, we'd be happy. And again, I can't tell you if it was 10% or 20% or 15% or 22%, but it was something in those ranges most likely. At the end of the day, we did that again 5 years ago, 5.5 years ago. By the way, what I think has continued to surprise us is the increasing penetration of membership. Aside from that, each of the years succeeding that delta of having in theory another 2 million, 2.5 million members go into that, a bump breakeven calculation and how many of those can we get, I think we do a better job overall of getting them. I think our view at this point is, is the membership fee in the U.S. at Executive has been at $100 for 11 years. I believe 7 or 8 years or 6 or 7 years in Canada. It's a nominal increase based on the period of time that we're talking about. And keep in mind, it's -- the fee relates to the core membership of, in the case of the $100, of the $55, as well as a variety of other services. We have many members that, in our view, that became an Executive Member first to take advantage of one of the 20 or so services that we offer. And even then, they start buying more because they're Executive Members. So the fact of the matter is it does create loyalty. We have never taken the increases lightly. We feel very confident that -- we always assume that you're going to have some conversion delta with regard to somebody saying, "Well, I'll just become a regular member." Some regular member's saying, "Well, do I really need to be a member?" Well, you're talking a very small group. We feel very comfortable about the value of our membership. As you know, historically, when our membership fee structure has been higher than some of our competitors, that's never concerned us from the standpoint that we feel that our membership and the value that we provide our member is a good value. And again, we're not -- we didn't do it arrogantly; we did it thoughtfully and what we believe is modestly, and we'll go forth.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay. And so just a follow up on that, is the number still today roughly 2 million to 2.5 million members that would be on the margin mathematically?

Richard A. Galanti

I haven't looked at it lately because in terms of a breakeven, it's as good a guess as any. It's not 1 million and it's not 5 million, so sure. But again, we haven't looked at it that way since 5 years ago.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay. So you're -- then I will get off the phone. But you're not concerned about the risk because as you were closing the differential, you were incentivizing more Executive Members to then spend more. Now you're widening the differential and you're going to lose some Executive Members because mathematically it doesn't work. And theoretically as they become off Reward members, they would spend less?

Richard A. Galanti

Sure. Look, it's not -- it won't be 0. But the fact of the matter is, as many of those Executive Members that were on the cusp in that theoretical equation spend a lot more today. So many of them have gone up, not down.

Operator

Your next question comes from the line of Chuck Cerankosky with the Northcoast Research.

Charles Edward Cerankosky - Northcoast Research

Richard, when you're looking at the 2-year store opening total, it sounds like you're saying you want to be conservative in fiscal '12, but we could see some blip in the first quarter of fiscal '13. Would you be willing to talk about a 2-year, that would be fiscal '12 and fiscal '13, store opening number in square footage growth rate?

Richard A. Galanti

Well if you add '12 and '13 together, it will clearly be more because our expectation at this point is '13 will have more openings than '12.

Charles Edward Cerankosky - Northcoast Research

So maybe approaching 50 in total?

Richard A. Galanti

I would hope so, but I doubt it given the time line it takes and the efforts. I think we'll be improved in terms of grading down on the scale, but we'll have to wait and see. Again, I don't want to lead you astray. They're working hard to get that up. And there's a lot of irons in the fire, and I'd rather look at it conservatively to start with.

Charles Edward Cerankosky - Northcoast Research

When you -- switching to another subject, looking at member attitudes as their shopping the stores, comparing the third quarter to the fourth quarter sales mix, what are you seeing, what are you noticing in how shoppers are behaving in your clubs?

Richard A. Galanti

Well, we -- the sales accelerated in September versus the -- on taking out all the noise of FX and gas inflation, I mean sales accelerated. I mean, when we read everyday about the doom and gloom with consumer sentiment, we see pretty good stuff at our place, but we don't take it lightly. I mean we work hard to have that value up there and it's -- we feel very fortunate, but we're also reminded everyday by Jim and now by Jim and Craig that the key is the value proposition and being out there and being showtime-ready every day and having great stuff. And then one thing I'm very comfortable about is, is that we're doing a great job merchandising right now and we got a lot of good things going on.

Operator

Your next question comes from the line of Charles Grom with Deutsche Bank.

Charles X. Grom - Deutsche Bank AG, Research Division

Just to circle back on Dan's question on that quarter on quarter. Again, I think everybody's probably pretty surprised, including myself, that it's only up 2 basis points relative to the past couple of quarters. And I know you're not concerned about it, but can you dig into at least on Fresh Foods, why peer comps have been running up high-single to low-double in that category throughout the quarter? Is that your margins would be down in that category? I'm just trying to get my hands around why.

Richard A. Galanti

Well you know us, we like to drive sales. And also, when there is inflationary pressures on commodity items, we're not going to just take the price of something up the next Thursday afternoon to get back to the margin. We're going to lag a little bit. And certainly with volatile pricing on bakery, meat, food court, that's part of it as well.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay, okay. And were there any other categories within the 4 key business segments that was negative or was just Fresh Foods down?

Richard A. Galanti

I think a couple of them were. Again I'm sorry, I honestly just don't have it in front of me.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay. Okay, fair enough. And then I know when you guys report your, the 10-K, that you'll breakout the segment margins between the U.S., Canada, international, but just wondering if you have that handy for 2011 now that we've completed the year?

Richard A. Galanti

I don't. I have it handy, but our Securities Council is saying I don't because you can't do it until you publish it to everybody.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay. And then just on the membership fee, just wondering why $110? What was so magical about that number? I know in prior conversations that we've had, you've suggested maybe it would be $125 and you'd do like a $20 coupon. So I guess just trying to get a sense for why $110 and looking ahead, when would you look to raise the fee in Asia, in U.K. and Australia?

Richard A. Galanti

Well first of all, I think historically when everybody's ever asked about if you took the $100 up, what would you take it up? And I said, "Look, who knows?" If you say, "What could you do? You could take it to $105, you could take it to $110." And I think I probably said, "You could take it up more than that, but then you give some of that back because that would be a big increase on a percentage basis versus the quarter." Never was there any giant sensitivity analysis of what should we do here. We priced it based on what we feel. We recognize that some of it relates to the underlying membership which allows you to shop at Costco, some of it relates to the variety of services that are important and valuable that allow you to -- that has allowed to -- afforded to the Executive Member. So I don't want to be too scientific about it. We're retail merchants and we felt that, that was the right price.

Charles X. Grom - Deutsche Bank AG, Research Division

And then outside the U.S., plans to raise it?

Richard A. Galanti

There are currently no plans, but things change. And not tomorrow, 10 years from now, who knows? And I say that because right now, we focus on what we're doing here, recognizing we're a lot newer in other countries and particularly in Asia with our expansion and we'll go from there.

Operator

Your next question comes from Deborah Weinswig with Citigroup.

Nathan Rich - Citigroup

Richard, this is Nathan Rich filling in for Deb today. My first question is just on the competitive environment. Are you seeing any change in promotional intensity or pricing at either the supermarkets or any of your club competitors?

Richard A. Galanti

The only thing that has been pointed out to me in the budget meeting is more related to holiday, a few holiday items like soda pop before July 4 or before Labor Day, things that -- those types of items that supermarkets or Wal-Mart would do 2 or 3 weeks leading up. But overall, the answer would be no.

Nathan Rich - Citigroup

Okay, great. And then I just wanted to comment or to clarify your comments on inflation. You said that you're seeing inflation in Food and Sundries and

Fresh Foods in the low to mid-single-digit range. Are you expecting that to moderate kind of as we go through the next quarter or so?

Richard A. Galanti

Well again, first of all, what we know is what our buyers tell us when we ask them. What we know is when we see the LIFO index as an example, the inventory pool of Food and Sundries year-over-year for all of last year was up 5% or 6%. Now recognizing not all of that translates to the bottom line, some of that causes increased penetration of private label, which are at lower prices. So the LIFO index is not an exact science. It's an exact science of calculating the LIFO index, but it doesn't, it's not an exact, applicable to what we're seeing everywhere. It's a best guess in using that as a measurement. So when I say this on a year-over-year basis, we were still seeing low to mid single. When we ask -- when the buyer -- what we ask the buyer is when do they see price relief. In our Fresh Foods area, our senior merchandise merchants out there said that they expect relief not for 3 to 6 months in some areas simply because of commitments made by the vendor for certain materials or by us. But some things we're seeing already. So again, I think it's on a year-over-year basis, there is still inflation. From the prices today, again in the first 4 weeks, we saw very modest, almost no, but a very modest deflation, almost flat. And hopefully though, over the next 3 to 6 months, from the beginning -- as of the beginning of this fiscal year that just started 5 weeks ago, we will see some modest inflation, but there's no way to know.

Nathan Rich - Citigroup

Great. And then just my last question. Do you have the private label penetration for the year handy? And can you just discuss your kind of long-term target for private label?

Richard A. Galanti

Well, I don't have the exact number in front of me. I don't know if we've gone through every department and calculated it, but it's the low 20s. So some of you have seen the chart that I think Jim put up a couple of years ago that said the goal -- and it wasn't defined as 5 or 10 years, but probably somewhere in there the goal would to be in the mid 30s, but maybe up a size 37 with a higher proportion in the Food and Sundries and health and beauty aids and things like that. I think that's a stretch goal. It'll keep going in that direction, but there's no time line. Last fall, we started -- we introduced a variety of things and this is just examples, of canned goods, both fruits and vegetables. We continue to do that. And so there's a lot of nut items and snack items that we've done of late, and we continue to come up with new things. We had shearling boots the last couple of years and some other additional apparel items, men's dress pants on top of the shirts. And so again, I think the trend is that direction. We're not committing to exact number other than when asked -- when Jim talks to the merchants in the different departments over the last year what are your goals over the next 5 or 10 years, you get up to a number that certainly has a 3 in front of it if we continue in that direction, but there's no guarantee of how long it takes to get there.

Operator

Your next question comes from the line of Laura Champine with Cowen and Company.

Laura A. Champine - Cowen and Company, LLC, Research Division

Richard, just briefly. You mentioned that you're seeing a change in trend in electronics. Is that just lapping the deflationary issues over the past year, or is there something really changing in the product cycle there?

Richard A. Galanti

I don't know. My guess is it's only 1-month, so let's see what happens next month, frankly. It's good that it was -- had a plus sign in front of it instead of a small minus sign. At the end of the day, I'm sure it's a combination of things, including the timing of MVMs. If you recall a couple of years ago, one of the issues in things like big-ticket items like TVs and at the time laptops, was there were a fewer deals out there to be had in terms of the $300 and $400 off contributions for vendors to drive it. There's been some of that picked up. I think it's a combination of things. I certainly believe that average increased frequency helps. You walk into a Costco, what's the first thing you see? These incredible high-definition TVs with cool stuff on them. So I'm convinced that the fact that our frequency continues to be high we, if it's in front of you, some of the people are going to buy it.

Operator

Your next question comes from the line of Michael Montani with ISI.

Michael Montani

This is Mike on for Greg Melich. Richard, just 2 quick ones. The first one was on .com. Did you mention, and perhaps I had missed it, but is .com now about $2 billion in sales?

Richard A. Galanti

Yes, a little over.

Michael Montani

Okay. And then just on the traffic side, for the U.S., can you help us understand, I think it was about 4% traffic trend from the quarter, but how would that split out for the U.S. versus international?

Richard A. Galanti

We don't break it out recognizing U.S. is 72% or 73% of our company, so it's going to -- even if -- it's clear, I would guess, it's lower because where you have a lot -- when you've got newer warehouses, you've got your warehouse that are 1/2, 1.5, 2.5 years old, you're going to drive more frequency. But that may need to be lower.

Michael Montani

Okay, so it's similar. And I guess just lastly, I was going to ask about from the Executive Membership standpoint, can you share what percentage of the Executive Members today spend enough to reach the 2% off maximum of $500?

Richard A. Galanti

We don't disclose that. I'm not trying to hide it from you. Clearly, it's a small percentage.

Operator

Your next question comes from the line of Joe Feldman with Telsey Advisory Group.

Joseph Feldman - Telsey Advisory Group

A quick question, a couple of questions. Again, to go back to the fee increase and the timing of it, Richard, in past calls and discussions with you guys, it seems like you made commentary that you weren't likely to raise fees unless you felt the economy was in a better position or a little more stable that your core customer could handle it, assuming the economy was more stable. I mean should we read into the raise today that, that's the case, that your view of the world is things are kind of stable and okay going forward or?

Richard A. Galanti

I think that in the past when asked the question, and maybe guilty of trying to be helpful, you said one of the reasons. One reason would be -- I think historically, I've talked about the fact that we've always been confident on the loyalty of our member. That the fact that our renewal rates are high, the fact that we would be confident to do so, one argument against it would be the economy. By doing it now does not imply that we believe the economy. In fact, I've just recently, earlier in the conversation said, I would see if you ask senior management around here, their collective view is, is things aren't getting better faster out there. So again, there's no -- I don't think you probably can predict why we did it now versus whatever. This is what we did.

Joseph Feldman - Telsey Advisory Group

Okay. And then another question on kind of on SG&A. I mean for as terrific a job as you guys do controlling expenses and costs, I guess I'm a little surprised you didn't get a little more leverage with such a strong comp through the quarter, and continues to be strong. And I guess I was wondering, is there anything there? I know in the past you guys have done, been generous towards your employees with giving, helping offset some of the health care costs a little more than in the past. Anything that you did this quarter like that or?

Richard A. Galanti

Yes. I -- we felt pretty good about SG&A, frankly. I mean given our history of -- yes, I did mention -- remember that I mentioned the $0.02 last year, the benefit is a combination of benefit. I believe one of those, that quarterly adjustment of 10 basis points, so that was part of it as well. The fact of the matter is, is that, we, again, we choose not to do some things that might help SG&A. There's nothing new that has helped -- is hurting SG&A more. That's -- we feel pretty good about it. I think if you look at it, we've actually seen the underlying trends, relatively speaking, improve a little bit.

Joseph Feldman - Telsey Advisory Group

Got it. And then if I could just ask one last question, kind of back to that whole customer behavior standpoint. Are you guys seeing anything within the customer themselves? Like, is your core customer, are they trading down to some more of the private label, so to speak? Or are they changing their tender? Are you seeing more people use cash versus credit or the size of the transaction, is it a smaller units per transaction, things like that?

Richard A. Galanti

Well, tenders have not changed. The ongoing trend is more debit and credit for years. Those are both big numbers now. And so they still grow, but grow slightly, but we've seen no trend change in it. The average basket, surprisingly, is up a little. I know inflation helps that a little bit, but the average basket is up a little notwithstanding the fact that the frequency is up. Because people are coming in more frequently to buy food, and my guess is, so you think it would be down a little bit, but actually, it's up a little. So that makes us feel pretty good right now. And again, I think part of that is driving more people in, that the demographic of our members are a little higher end. I'd like to think that some of it are merchandising. And so all those things helped. But in terms of -- we have a little bit of binders on because our numbers have been pretty darn good, the frequency has surprised us all, that this compounding of 4% and 4% and 4% now for 2 or 3 years. And in terms of, we would say trade up to private label, but in terms of trading towards private label, there's still increasing penetration. Nothing like we saw -- and I know I mentioned back in the first half of calendar '09, right after the financial crisis at the end of calendar '08, we saw a higher rate of increase in private label faster. I think I mentioned back then that over a 6-month period, on the Food and Sundries side of our business, we saw like a 300 basis point delta in sales penetration of private label. That was unprecedented. But no, we're not seeing anything like that. It's still continuing upward, but nothing crazy like that.

Operator

Your next question comes from the line of Bob Drbul with Barclays.

Robert S. Drbul - Barclays Capital, Research Division

A couple of quick questions. First, can you give us the D&A from Q4? The second question I have is, can you give us gas gallons in September? I don't know if you gave that out. And then the third question that I have is, can you talk about the trends in audio? I think you're now cycling the loss of Apple in your stores. Can you maybe talk about the trends there a little bit?

Richard A. Galanti

Depreciation and amortization for the quarter was $273 million compared to $855 million for the year. And what was the other, next question?

Robert S. Drbul - Barclays Capital, Research Division

Gas gallonage in September. Comp gallons.

Richard A. Galanti

Yes. 10%.

Robert S. Drbul - Barclays Capital, Research Division

Okay. And how about trends in audio? Or in -- you're cycling the loss of Apple now, is that right?

Richard A. Galanti

Yes, we've never -- clearly it's down because it's 0 now. I said the fact of the matter is, is that at least in September, our majors was up year-over-year, so we are cycling it. And we go forth. I mean Apple has great products, but we're selling a lot of other things right now. There's not a lot I can say about that.

Operator

[Operator Instructions] Your next question comes from the line of Sean Naughton with Piper Jaffray.

Sean P. Naughton - Piper Jaffray Companies, Research Division

Just on the -- another question on the private label for you. Is there a big difference between, in international market fee exception, the acceptance of the Kirkland brand there versus domestic?

Richard A. Galanti

It's well accepted everywhere. Yes, we have a lot of products over there. The penetration is lower because there's less. At least, say, in the U.S., there's more U.S.-sourced goods than in other foreign countries, but it's very well accepted.

Sean P. Naughton - Piper Jaffray Companies, Research Division

Okay, great. And then secondly, just also on international, you talked about 1/2 of the warehouses going international in next year in fiscal '12. Can you talk about, are you going to any new markets and when would those potentially be on the horizon, if not?

Richard A. Galanti

There's probably no new markets in fiscal -- there will not be any new markets in fiscal '12, through August of '12. Whether it's most likely '13, we will be open in at least one new country in Europe, and by '14, 2 new countries in Europe is our best guess. And all that's subject to change.

Operator

[Operator Instructions] Your last question is a follow-up from the line of Michael Montani with ISI.

Greg Melich - ISI Group Inc., Research Division

It's Greg this time from ISI. Richard, the $1.5 billion CapEx or the $1.4 billion to $1.6 billion, do we consider that the new normal with around 20 openings, because that is historically high. I just want to know as we go international, just more expensive or .com investment? What sort of keeps it at that level?

Richard A. Galanti

International is more expensive, that doesn't account for all of it. What it partly includes is the expectation that it's going to be a busy fall next year right after the fiscal year-end, so we've got a lot. But again, as I mentioned, we have a lot of irons in the fire. So it's a combination of overseas is more expensive. The assumption is in looking our own budgets that we'll be committing to land and started construction on sites that don't hit '12, but sort of a higher amount of that now versus as compared to a year ago. There's probably an extra of $50 million in IT as we are in the process of our 3-year program, which inevitably goes longer, of modernizing some things and creating a second data center, which we haven't had before. Not a lot of them, I mean it's always a lot of money, but not a lot relative there. So all of those things add up to a little extra.

Greg Melich - ISI Group Inc., Research Division

Great. And then secondly on the theory of less is more, if you were to look overall last year, that 5% U.S. comp, what would you say was the traffic versus ticket? And the ticket, how much of that do you think was really inflation at the end of the day?

Richard A. Galanti

I think traffic was about 3.5% to 4%, probably closer to 4%, and so the rest is everything else. Inflation was probably the biggest chunk of it. But keep in mind, frequency was up, though. So that, by definition, brings your average ticket down. We're driving more frequency.

Operator

[Operator Instructions]

Richard A. Galanti

Oh, was that it? Thank you very much, guys.

Operator

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