Costco Wholesale (NASDAQ:COST) Q1 2012 Earnings Call December 8, 2011 11:00 AM ET

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Operator

Good morning. My name is Dawn, and I will be your conference operator today. At this time, I would like to welcome everyone to the First Quarter Fiscal Year 2012 Operating Results Conference Call. [Operator Instructions] Thank you. Mr. Richard Galanti, Chief Financial Officer, you may begin your conference, sir.

Richard A. Galanti

Thank you, Dawn. Good morning to everyone. This morning's press release reviews our first quarter 2012 operating results for the 12 weeks ended on November 20.

Let me start by saying the discussions we're 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 12-week first quarter operating results for the quarter, as you saw, our reported EPS came in at $0.73 compared to last year's EPS reported at $0.71.

As was noted in this morning's release, there were 2 large onetime items totaling $0.07 a share that hit this year's Q1 results. The first of these items was a settlement of an income tax audit at Costco Mexico. During the first quarter, Costco Mexico recorded an after-tax charge to their income tax line, which when expressed in U.S. dollars was $24 million. Since we consolidate Costco Mexico's operating results, the full Costco Mexico P&L is included in our income statement, including the $24 million hit to our income taxes line. The offset to this $24 million was a $12 million benefit to our income statement on the non-controlling interest line item near the bottom of the income statement. This represents, of course, our joint venture partner's 50% share of this hit.

So in total, the impact to Costco's net income, as a 50% owner in Costco Mexico, was $12 million or $0.03 per share after tax. The $12 million number is a tax number, so it's after-tax, of course.

The second of the 2 onetime items was a $17 million or $0.04 per share charge to the SG&A line for our contributions to the Washington State I-1183 liquor initiative. Washington State voters approved the initiative by a 59% to 41% vote. The $17 million expense is not tax-deductible under U.S. tax law so again, it's a $0.04 a share hit to our EPS.

In terms of sales for the first quarter as was reported in the press release, our 12-week reported comp sales figures for Q1 showed a 10% increase, 10% in the U.S. and 11% internationally. Excluding gas price inflation and the impact of FX, the 10% reported U.S. comp would be fixed and the 11% reported international comp and local currency would be at 10%. And for the company overall, excluding both of those, the 10% reported number would be at plus 7%.

Other topics of interest of review, our opening activities and plans, we opened 4 new locations during the first fiscal quarter of 2012 which ended November 20, one each in Pennsylvania, Texas, Wisconsin and Georgia. For all of fiscal 2012, our current plan of 20 net new locations, 11 of which will be in the U.S., one each in Canada and the U.K.; and 7 in Asia, 3 in Korea and 4 in Japan. This week, we -- in fact, of the 4 in Japan, this week we will open 2 of these new Japan units. And with these openings, we'll end the calendar year and this week with 598 locations around the world.

I'll also briefly talk about costco.com, our membership trends and, of course, the recent increase we took in our U.S. and Canada annual membership fees. I will discuss further on, of course, gross margin and SG&A in the quarter and our stock repurchase activities during the quarter.

Very briefly again, sales for the 12 weeks were up 12.5%, $21.2 billion this year in the first quarter versus $18.8 billion a year earlier. On a comp basis again, the 10% for the quarter excluding gas and FX was up 7%, comprising of a 6% U.S. without gas and a 10% international expressed in local currencies. The 10% reported comp was a combination of the average transaction increase of 6% for the quarter and an average frequency of increase of 4%. Of course, the 6% includes FX and gas as well.

In terms of sales by geographic region, geographically, Northwest has been pretty consistent for the past few fiscal quarters in the high single-digit positive range. California has been in the 9% to 11% positive range, in fact, a shade higher towards the high end of that range in the most recent quarter.

Rest of the U.S., Northeast in the mid single digits; Southeast around 10%; and Midwest in the low double-digit comp increase.

Internationally in local currencies, again we are also doing fairly well, averaging in local currencies 12% in the fourth quarter, 11% -- I'm sorry, 12% in the fourth quarter of '11 this past summer; 10% in the first quarter, which we're reporting today, of course; and 11% in the recent November, 4-week November reporting month.

We are seeing the positive tailwinds of gas and FX subsiding a little during the quarter. For example during the quarter, FX was a slight benefit to the comp. In November, it was a slight detriment implying that we've seen that crossover to where the dollar weakness relative to all the other foreign countries is a slight -- shows a slight strength. And gas has come down a little bit from its higher level of inflation in the first quarter as compared to just November.

In terms of merchandise categories, in the first quarter, which is essentially September, October and most of November, within Food and Sundries, comps were in the high single-digit positive with food, candies, deli and refrigerated being relative standouts. We continue to see year-over-year inflation in many of the food-related areas, while again, not increasing inflation over the last few months, but as compared to a year ago.

Our Hardlines sales show slightly positive comps overall, with slightly negative comps in electronics, offset by sales growth in tires, automotive and hardware -- sales strength rather in tires, automotive and hardware.

Within the mid to high single-digit Softline comps, small electrics, jewelry and domestics were the positive standouts. And media, of course, books, CDs and videos continues to be one of the weaker departments.

And within Fresh Foods, it was up 11%. All sub categories were pretty close to that number and showed strong results, again, partly from inflation year-over-year.

Moving on to the other line items in the income statement, membership $416 million a year ago or 2.21% of sales, $447 million or 2.11% of sales this quarter, so up about a little under 8% in dollars or $31 million and down 10 basis points, again reflecting the things I just mentioned earlier in terms of comps -- impacts of comps and continued a good showing in terms of dollar of increase, we think.

Strong renewal rates continue, 89% in the U.S. and Canada and 85% worldwide and just continue to see an increase in the penetration of the executive membership program.

Our new member sign-ups in Q1 company-wide were up 15% year-over-year. This was largely due to the strong international openings this past year in Asia and Australia. But even in the U.S., there was a small increase in year-over-year membership sign-ups.

In terms of numbers of members at Q1 end, at fiscal year end we had 25 million Gold Star Members. That's 25.5 million 12 weeks later at the end of Q1. Primary business 64 and 64; business add-ons 38 and 38. All told, 35.2 million households at year end, 35.7 million households at first quarter end.

And including add-on card, the spouse cards, 64.0 million as of now to 64.9 million.

At quarter -- first quarter end, Paid Executive memberships totaled $12 million, and we're up about 270,000 from 12 weeks earlier. So still getting about 23,000 a week increase during the past quarter. Again, our executive member base is about 1/3 of our member base and a little over 2/3 of our sales.

In terms of member renewal rates, as I mentioned, they've -- they actually have strengthened slightly. In the U.S. and Canada, we ended up at an 89.2% for the first quarter, up from 89.1% at the end of the fiscal year, so just tweaking up a little bit.

Total worldwide has tweaked down a little bit, from an 85.7% down to an 85.4%. That's due in large part many of these new openings, particularly in Asia and Australia. We're getting substantially higher-than-average sign-ups, and in the first year as you tend to have lower renewal rates to start with. So again, that's a smaller piece of the pie but nonetheless, still at 85.4% for first quarter end.

As you all know, we recently increased our annual membership fees in both the U.S. and Canada, essentially from $50 to $55 for primary memberships and from $100 to $110 for Executive Memberships. This again is in the U.S. and Canada. These increases became effective as of November 1 for new members signing up in the warehouses and will become effective January 1 for renewals. It was back in late November and December when we mail out the January renewals.

In all, approximately 22 members -- 22 million members are impacted by this increase, approximately 1/2 of whom are executive members. In terms of the timing of these increases hitting the income statement, remember that the membership fees are counted for on a deferred basis. For example, approximately 1/12 of the increased fee for that $5 or $10 increase from our January renewers will be booked in the first month that they pay it, with an additional 1/12 being booked in each of the succeeding 11 months. So increased fees from our February renewals will then be booked in essentially February to the following January and so on. So no impact, of course, in Q1. Very, very little impact in Q2, a small amount of impact in Q3 and more meaningful in Q4 and the first few quarters of fiscal '13. The full impact of the increase is essentially a 23-month timeline, given the deferred nature of accounting for this. For example, the last group of members to be billed these increased fee levels will be next December of '12. And then, of course, that $5 or $10 increase will be booked to our income statement over the next -- over the -- that month and the succeeding 11 months.

And with regard to Executive Membership, as you know, we raised the cap on the 2% reward from $500 per year to $750 per year based on eligible purchases.

Now going onto the gross margin line, the gross margins reported in the first quarter were down 35 basis points, 10.62% down from 10.97% a year ago.

As usual, I'll ask you to make 4 columns and 6 line items. And the columns are a little different. We basically have -- the first 2 columns are Q4 '11 results, and the second 2 columns will be Q1 fiscal '12 results. The first 2 columns for Q4 will be reported as reported and the second one without gas inflation, again, the dramatic amount of sales of gas. And in fact, that there's been big inflation, whether this inflation or deflation impacts the percentages of margin and SG&A, so we try to share that with you. So again, columns 1 and 2 will be reported, and column 2 will be without gas. And then for Q1 '12 as well, reported and without gas.

And at the line items, the first one is merchandising core. The reported in Q4 '11 was minus 24 basis points year-over-year; Q4 '11 without gas plus 2; Q1 '12, minus 32 reported; Q1 '12 without gas minus 10; ancillary plus 6, plus 12, minus 2 and plus 2; 2% reward 0 and minus 3, and then 1 and minus 3; LIFO minus 12 and minus 12. And there was no LIFO in Q1, 0 and 0; other minus 5 and minus 5, and 0 and 0. So those all add up to -- in both quarters, quarters 4 and quarter 1, the reported margin year-over-year was down 35 basis points. And Q4 without gas, that minus 35, without gas is a minus 6. And in Q1, the minus 35 is a minus 11.

Now let me explain a little bit of this to you now. Our core merchandise gross margin for Q1 was, again, reported minus 32. Again, the lower margin gas business represented about 8.5% of our sales in Q1 last year and about 10.5% of sales in Q1 this year. So fully 200 -- a little over 200 basis points increase in sales penetration on a margin business significantly lower as well. So not only is it total margin but more importantly, the piece that we're taking out here is the year-over-year inflation in gas, which distorts the denominator in these calculations. So this alone resulted in a 24-basis-point minus 24-basis-point impact to our overall company gross margin.

While gross margins in our core merchandise business, that's Food and Sundries, Hardline, Softlines, Fresh Foods, still was lower year-over-year by 10 basis points. It's the lower aggregate sales penetration by inflation that caused it to be down so much in the reported.

Food and Sundries and Fresh Foods were slightly lower year-over-year while non-foods, Hardlines and Softlines, which is smaller percentage in total, was positive.

I know many of you will ask why is gross margin net of gas impact down year-over-year 10 basis points, and what does that mean? There are 2 factors I want to mention here. First, we did choose to be a little more aggressive in pricing going into the fall and Christmas holiday season. We all see what's going on in the economy. We've been aggressive on inventory levels, and we wanted to drive our top line sales. We believe we have done that. This had an impact on the comparison of gross margins year-over-year in Q1, but it's no secret that this is what we do and we feel that it was appropriate to do that over the last few months.

The second factor that impacted the year-over-year comparison of Q1 gross margins can be seen in our interest income and other line, which showed a dramatic increase in Q1 year-over-year. I'll go into more detail in a minute about that. But approximately $8 million of the year-over-year variance, in fact, $9 million of income this year in the Q1 versus $1 million of income last year, this was due to FX gains related to the purchase of foreign currencies in our foreign operations, by the way, related to the purchase of foreign currencies at a rate more favorable than the rate used to record the foreign merchandise payables. For example, Canada buying merchandise that is payable in U.S. dollars. They will buy either contracts or convert some of them into U.S. dollars. GAAP accounting requires that these FX results be included as a component of interest income and other, even though from our perspective it is related to buying and selling of merchandise. In fact internally, we credit this to the buyers' margins and then take it out of the margins for GAAP reporting purposes.

The same thing happened to a slightly lesser extent in Q4. Prior to that, we haven't seen the kind of volatility in this. Usually, it's been a couple million positive, a few million negative. But we wanted to point that out because it's certainly part of the reason that we saw, both this quarter and the last quarter, the underlying core margin, x gas being a little bit further down.

So for Q1 overall, we were aggressive on pricing. And again, $9 million or 4 basis points was down below the line in income statement under those FX items I mentioned.

And lastly, with respect to gross margins, we booked no LIFO in either Q1 '11 or Q1 '12. So far this year through the end of Q1 '12, just for the first 12 weeks, our LIFO index as for our U.S. inventories is ever so slightly deflationary, not enough to warrant even booking that small amount as a positive.

Now moving on to SG&A, our reported SG&A percentages Q1 over Q1 were lower or better by 18 basis points coming in at a $10.13 this year compared to $10.31 last year. Again, we'll have the same 4 columns for SG&A report: Q4 reported, Q4 without gas, and Q1 reported and Q1 without gas inflation.

The line items, the first one is operations. Q1 reported -- Q4 reported, just to give you some perspective, Q4 reported was plus 44 basis points, so lower or better by 44, without inflation plus 20; in Q1, plus 28 reported and plus 9 without inflation; central, minus 2 and minus 5; and for Q1, plus 4 and plus 2; equity compensation, plus 2 and plus 2; and then for Q1, minus 6 and minus 7; the quarterly adjustments, which is minus 10 and minus 10 for Q4 reported in without gas; and in Q1, it's minus 8 and minus 8. That minus 8 is the $17 million I-1183 charge to SG&A.

All told, reported plus 34 or lower by 34 basis points year-over-year in Q4 '11 as compared to the prior Q4. Without gas inflation, the 34 will really be plus 7. The reported was for this quarter, again was 18 basis points better or lower versus, again adjusting for gas inflation minus 4.

Now again, the core operations plus 28 without the big gallon gas -- price per gallon gas inflation would have been only plus 9. And by the way, the 9 basis points in core, payrolls were a little more, I believe, in all of that, a big part of that. And we certainly have been working on driving more efficiency in the warehouse.

Our central expense is lower year-over-year in Q1 by 4, again adjusting for inflation, better by 2. Our compensation expense, as I mentioned, are ready. It's -- year-over-year, the delta there has to do with one. There is a substantially -- the grants in last year were substantially higher than the ones going out of the equation from 5 years ago. And finally, as I mentioned, the $17 million expenses for I-1183 hurt SG&A by 8 basis points, reported SG&A.

Overall, SG&A percentage improved a little in the fiscal quarter. And we will continue to focus on the things that I've talked about in the past about driving efficiencies in the warehouse, I think, in these tough times. It's maybe a little easier to do that, but not on the backs of our employees' wages or health benefits.

In terms of factors that will impact our outlook in the future, it's the things that we all know about. Sales trends, of course, are paramount, healthcare and gasoline sales and inflation, deflation, which we'll take out for you.

Certainly as we expand overseas, particularly in Asia and Mexico and Australia, which have lower SG&A that increasing sales penetration to the extent we continue our plans to open more units overseas should help that a little bit.

And next on the income statement is pre-opening expense, $12 million last year in the quarter, $10 million this year, so $2 million lower and a basis point better. Last year we had 8 openings in the first quarter; this year only 4. But this year's $10 million number included a little over $3 million for the 2 Japan openings that are opening tomorrow and Saturday, so in the first couple of weeks of -- the first 3 weeks of Q2. But the pre-opening is in Q1.

In terms of provision for impaired assets and closing costs, we had a charge last year of $4 million. This year we had a credit of $1 million due to a small gain on the disposition of a piece of property, so $5 million year-over-year swing for the quarter.

All total reported operating expenses in Q1 came in at $525 million last year, up $18 million to $543 million this year. This year's $543 million figure includes, of course, the $17 million I-1183 initiative charge and does not include because it's below the line that $9 million I mentioned. And I discussed that's in the interest from another line that, in terms of how we manage our business internally, relates to our buyers and their -- and buying of merchandise.

These amounts mainly reflect the -- hold on, I forgot a line here. Below the operating income line, reported interest expense was about the same in both quarters, both first quarters, Q1 '12 coming in at $27 million compared to $26 million a year earlier in the quarter. These amounts mainly reflect the interest expense on our $2 billion debt offering that we did in February of

'07. As I mentioned previously, we anticipate paying off $900 million of this $2 billion of debt in mid-March of 2012, so a few months from now.

On an annual basis beginning with the debt paydown, the anticipated annual pretax interest expense savings to Costco, given that we're paying about 5.4% debt and foregoing interest income of sub-50 basis points on our current cash investment, it's around $44 million pretax per year. But again, that'll start in mid-March.

Now turning to interest income and other. As you noticed, there was a big increase in this number year-over-year. In Q1 last year, it was $6 million. In Q1 this year, it was $37 million. Again, try to give you a little bit of light on that. It has to do with the FX things I mentioned, as well as Costco Mexico. We'll go through that.

Actual interest income for the quarter came in at $10.5 million versus $7 million a year earlier, so better by about $3.5 million. The other component of interest income and other amounted to $23 million this year in the aggregate versus a loss of $4 million last year or better by $27 million year-over-year.

15 of that positive -- or that 27 variance relates primarily to a gain on U.S. dollars held at our Mexico joint venture. Again, because of the strengthening of the dollar revenue to the peso and the fact that historically we, Costco Mexico, have kept -- the goal is to keep about half of our excess cash down there in dollars, recognizing the volatility in the currency and recognizing that they buy many goods that are sourced to the U.S.

With the strengthening of U.S. dollar -- let me go back here. Okay. Yes, so that $15 million variance, basically Costco Mexico, again we consolidate those numbers, had $12 million of income just related to the fact that they held U.S. dollars compared a year ago in the quarter when they had a $3 million loss for the same reason.

With the strength of the U.S. dollar year-over-year compared to the peso, our Mexico operations benefited from an FX gain or a U.S. dollar-denominated cash. Again, GAAP accounting is just how you take care of it.

Because we own 50% of the venture, half of that gain was deducted as part of the noncontrolling interest line down below, such that the total benefit from us was approximately $7.5 million pretax.

Much of the remaining year-over-year benefit of the approximately $12 million of that $27 million I talked about related to our buyers managing the cost of foreign currency denominated. The foreign currency inventory purchases for our operation as previously disclosed. And to a lesser extent, the required mark-to-market accounting for our foreign exchange.

As I discussed earlier, buyers consider what they have done to manage foreign exchange rates and pricing merchandise associated gross margins. Again, I think you'll see in the last 2 fiscal quarters and why I'm pointing it out now is that it's how we run our business, we've never seen big changes in it in terms of level of volatility as we have in the last couple of periods.

Overall, pretax income was up 10% versus last year's Q1, from $504 million last year to $553 million this year. And excluding I-1183, pretax income would have been up -- would have been $570 million or up 13% year-over-year.

Our tax rate, it came in again as a reported 40.8%, certainly higher than last year's 34.2%. Excluding the 2 items mentioned in the press release, our effective Q1 tax rate was 35.3%. Still about a point higher -- a percentage point higher than last year where we had a onetime benefit of a discrete item that made it up about 1% higher than -- it was 1% lower than it would have been.

Now for a quick rundown of other topics. Depreciation and amortization, $205 million in the quarter. Balance sheet, I don't have to tell you, is strong. Accounts payable on a reported basis, accounts payable as a percent of inventories last year was 105%. This year was 99%. But more importantly -- that -- a lot has to do with construction payables. More importantly, merchandise inventories as a percent of inventory -- merchandise accounts payable as a percent of inventory was 91% last year and 92%, up a shade this year. Average inventory warehouse was up 8% from $11.8 million last year at Q1 end to $12.8 million this year, up $966,000.

Now recognizing we don't know exactly what the exact inflationary number there is, but using the various LIFO indices and what we see coming to the front end, if you assume 3% to 5% inflation or 3% or 4% inflation, even at 3% inflation, that would be about a little under half of that $960,000 increase. Much of the balance of this increase is spread across many departments. Of course, that's related to that inflation, perhaps a little more inventory as well in the likes of jewelry and electronics.

I might add, though, in talking to our head merchant yesterday, asking about any issues related to year end and seasonal markdowns, and he felt that we are quite clean going into the end of season here.

In terms of CapEx, our first quarter '12 CapEx was $343 million. For the year, we expect to be $1.5 million or a shade under. This compares to CapEx last year of $1.3 million. Some of the higher end year-over-year estimated CapEx is due to both the higher penetration and number of units planned overseas, particularly in Asia, and a little bit more ramp-up, hopefully going near the end of this fiscal year going into fiscal 2013.

Dividends, as you know in the spring, we raised our dividend from prospectively $0.84 -- $0.82 a share to $0.96 a share on an annual basis. On an annualized basis this dividend, $0.96 per share annual dividend, represents the cost to the company of about $420 million.

At costco.com in the first quarter, sales were up 9%. And in terms of expansion, I mentioned we're going to open 20 units this year: 4 in Q1; 2 in Q2, which are the 2 Japan openings this quarter; 4 -- net of 3 in Q3, 4 plus 1 relo. In the fourth quarter, we have 11 planned and so far, we're on track to do those. Inevitably, 1 or 2 of those may slip into the next fiscal year, but we'll see how that goes.

In fiscal '11, assuming we do 20 net new units, that will be 3.5% square footage growth. In fiscal '12 -- in fiscal '11, it was 3.5%. Assuming we opened 20 this year on a base of 592, that will be also about 3.5% square footage growth. And, again, as I mentioned, the 20 would include 11 in the U.S., 1 each in Canada and the U.K., 3 in Korea and 4 in Japan.

Some of you asked for a square footage. At Q1 end, our total square footage was 84,982,000 square feet.

In terms of common stock repurchases, during the quarter we purchased an additional 2.1 million shares for a total of $173 million. All told since inception back in mid '05, we purchased 110 million shares for just under $6.2 billion.

There are supplemental information packet, which include some additional stats, will be posted on the Costco Investor Relations site later this morning.

So before I turn it back to Dawn for Q&A, hopefully I've explained a few of the nuances of this quarter's income statement. Of course the 2 items I mentioned in this week -- this morning's press release, as well as the $9 million in the interest income and other line that relates to the buyers' purchasing and selling a merchandise and effects to essentially 1/2 on a pretax basis, 1/2 of that $12 million of income from holding U.S. dollars in Mexico. So a little bit unusual in a few of these things, but nonetheless, hopefully we've given you some transparency and particularly that big interest income and other line.

With that, I'll turn it back to Dawn for questions and answers.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Deborah Weinswig with Citigroup.

Deborah L. Weinswig - Citigroup Inc, Research Division

Richard, can you talk a little bit about inflation in the core categories that you're seeing it in? And what's your outlook for the rest of the year?

Richard A. Galanti

Well, certainly Fresh Foods. I mean again, I hear anecdotal items all the time, including last week's budget meeting from our Fresh Foods people, and they give examples of anywhere from 5% to 8% on many meat, pork and poultry items. In produce, you see it all over the board because it's not only the economy, it's demand from overseas, as well as crops, what happens with the weather. And across non-food categories, while we did see -- actually, I'm thinking November, on the call, we mentioned that in electronics and TVs, first time in as many months as I can remember, we actually saw the average selling price for TV go up a little bit versus down. A lot of that has to do with the fact that the TVs yet again are getting better, crisper and cheaper. So people are upgrading, perhaps spending more for TV but getting a large television with more clarity or whatever it is these days. And so -- but across many categories, of course, jewelries continue to be inflationary. Now again, the thing I want to differentiate between is just when we talk about inflation, it's year-over-year. In the last 3 months, we actually again have seen less than 20 basis points delta in the LIFO index year-over-year. As I looked, these are just some samples, and these are inflationary items in just the last 3 months. Again, these are anecdotal. But I look across things like -- blueberries are 60% up. I assume the blueberry crop was very good this year. Grapes were up 20%. Prawns were up 12%. I'm just looking down the list here. Other types of blueberries were up only 12%. And then I look on the deflationary items -- yes, peanut butter is quite a bit up. On the deflationary side, gas is actually slightly down in the month. Although that -- I'm sorry, in the month compared -- not compared to a year ago, compared to the beginning of this fiscal year. Various electronics items might be down on an exact item 10% to 25%. But again, the average selling price on some items have gone up as I mentioned. Butter was down 10% to 15%. So again, it's a mixed bag. When you ask -- when I ask the buyers -- if I asked them 2 or 3 months ago, aside from there's been a little bit of lessening of continued inflation as compared to the previous month, when do you see prices coming down a little bit? And the kind of the pad answer from 3 to 6 months -- from 2 or 3 months ago about looking forward 6 months was in 3 to 6 months. If you ask them today or last week, it's in 3 to 6 months. So I don't think we know completely with that regard. But the feeling is that prices have perhaps flattened down a little bit more of late, but still inflationary compared to a year ago.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then in terms of basis points, how much of your gross margin deterioration should we think of as price investments? And should we think of this as a 1-quarter investment? And also, on the same topic, we saw Sam's last quarter with a 28-basis-point gross margin decline, which is the first time, I think, in at least 12 quarters. And they're talking about price investments as a new strategy. So just wondering if there's a more aggressive pricing stance in the club industry overall?

Richard A. Galanti

Well, there's 100 different reasons, honestly, including different countries, including the ancillary businesses, some of which work on significantly more margins because we look at it as a margin of the item on the selling floor, which includes direct labor and supplies in the optometry and the pharmacy and things of that sort. So we -- I can tell you Sam's is ever competitive, and I think they would say the same about us. We do not view this as really competitive-related. It's more us-related, frankly. And in terms of will it sustain itself, we'll see. I'm not trying to be cute about it, but it's by no means all of the reason, whatever somebody thought it was going to be and what it was. But it's certainly a component of it.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then last question, as you open more clubs outside the U.S., how does that change your return on invested capital outlook?

Richard A. Galanti

Well if it goes like we hope it goes, it'll be positive. But that's -- tomorrow could be another day. We'll see. I mean as we've shared with you, one of the reasons that we have increased the proportion of locations overseas is because we're doing well. And we've had great returns so far in Asia, and 3 of our best openings ever were in Australia. And so we're excited about that. But what moves the needle of course, short-term, is the existing results on the whatever 500-plus out of our 600 units that are in the U.S. and Canada. But the answer -- the simple answer is yes.

Operator

Your next question comes from the line of Robby Ohmes with Bank of America.

Robert F. Ohmes - BofA Merrill Lynch, Research Division

Richard, the question -- there are just 2 questions. The -- I guess the first is, can you talk about the categories where you were most aggressive on pricing in this quarter? Maybe a little more detail there. And then maybe also on the sort of the inventory investment that you're talking about that was made same thing, maybe the same categories, maybe speak to us about where the inventory investment was as well.

Richard A. Galanti

In terms of where we're sharp, we're always going to be sharpest on items that are those high visibility consumer items, whether it's milk or ground beef and steaks or Advil or Tide, those key competitive items where $0.50 or a $1 makes a big difference in some of these items because it's a wow. As well, given the season, it was across many items in non-foods. Again if we could take, and I'm not going to give you a specific example, but if we can take an item that -- and I'm making this up, but retails for $179 or $189 and we're normally $139 and we can go to whether it's $119, that's huge. And because it's -- the savings versus traditional retail is that much greater. And many times it works, and sometimes it doesn't in terms of driving sales. But overall, each buyer in each department looked at different things that they felt would be high-impact items. And again, I don't want to overemphasize this whole aspect because it's different. We were talking about this yesterday. It's different than late '08 when we said, "Hey, the economy is in crisis, and this is all new to us." And the market was down 30% or 40%. And people had house values are going down. And we wanted to do something to drive sales specifically on a handful -- in a big way, on a handful of very high volume items. This is more across the board, the general feeling. But there are clearly ways for us to get margin. And it's a balancing act, and we felt we did what was right for our customer and for our business in terms of continuing to drive sales. When we look across categories, again if I look at the $966,000 per warehouse, just dividing the increase in inventory divided by a number of warehouses at quarter end, again you've got to figure roughly 1/2 of it is inflationary. But there's no sub department that is more -- and then listen, there's about 25 sub departments, 27 sub departments. There's no sub department that's more -- that even has 3 digits in it. So it really is across the board. Certainly, the biggest ones on list would be as you'd expect, as I mentioned, jewelry and electrics.

Robert F. Ohmes - BofA Merrill Lynch, Research Division

So just to clarify, was this -- is this really a holiday strategy? Or should we sort of expect you to be maybe a little more aggressive in price over the next year or so as you're sort of rolling through the membership fee increase?

Richard A. Galanti

I think yes, yes, yes and no, no, no. I mean, it's -- I don't -- again, I wanted to try to explain why some of the margin is down a little bit. We don't view it -- it's something that we look at every day and every week. Certainly, as Jim and how Craig has said constantly we are, first and foremost, a top line company that drive sales. And we think we are investing in the future. I don't know if it's another quarter or 1/2 quarter or 2 years. We'll let you know each quarter. And I'm not trying to be coy but, as you know, we don't give specific direction.

Operator

Your next question comes from the line of Adrianne Shapira with Goldman Sachs.

Adrianne Shapira - Goldman Sachs Group Inc., Research Division

Richard, can you talk...

[Technical Difficulty]

Adrianne Shapira - Goldman Sachs Group Inc., Research Division

My question was about talking a little bit about the categories as we're heading into the holiday season, maybe give us a sense of what's working, what's not, talk about sort of the Consumer Electronics, how that's faring. And then specifically on Softlines, it seems that the category had been stronger the last 2 quarters, up low doubles, the last 2 quarters, up high singles and now mid singles. Maybe give us some color in terms of what trends you're seeing in Softlines.

Richard A. Galanti

Okay. Let me just pull my notes out here a little bit. Well in terms -- I mean, what's -- in terms of what's working and what's not working, it's really -- I got to tell you over the last 6 and 8 months, it seems like it's been the same thing. Certainly food is strong -- Fresh Foods is strong. Certainly, jewelry is strong in part because of inflation. Significant inflation on some of those items. Across many of the non-foods mid-ticket items we've seen relative strength, but not as -- not on -- that we've mentioned a couple of each month, whether it's housewares or small electrics and things like that. Within electronics, if I look at the last couple of months and quarters, again it was slightly -- I believe in November, electronics was slightly up year-over-year as a percent. And for the quarter, I think it was slightly down. So the trend during the last 3 months was up a little bit. And of course, a lot of that has to do with TVs, which we mentioned, I think, in the call was up in the high to mid single digits in dollars in the past month. And so it continually amazes me that -- and I think in the 4 weeks of September, we sold just a shade under 300,000 televisions, which is a mind-boggling number. So it really is across the board. Now within the other one you mentioned, Softlines, let me just look real quick.

Unknown Executive

Jewelry and apparel.

Richard A. Galanti

Jewelry and apparel. But in terms of it, I think, trending down, I don't think -- I know men's and women's apparel tend to fluctuate up and down based on what we're getting in. And I don't have the other detail on that in front of me here. Let me see that. In November, I'm just looking here. Again, the ones we mentioned were hardware -- I'm sorry, and Softlines. Small appliances was strong. Women's apparel was double digits. Men's apparel was mid single. No real -- nothing that stands out there, Adrianne.

Adrianne Shapira - Goldman Sachs Group Inc., Research Division

Okay. And then my other question. As it relates to the pricing environment, it sounds as if this is more proactive than reactive in terms of your decision to be a bit more aggressive. But can you give us a sense of what's out there on the competitive landscape? Clearly now BJ's private what you're seeing out of them. Walmart has obviously been very vocal of kind of winning back the holidays and going after the weekend and the entire season pretty aggressively. So if you could just kind of give us a sense, characterize what you're seeing out there, how intense, how aggressive and maybe in response to your aggressiveness as well.

Richard A. Galanti

Well, I would agree with your comment of proactive as compared to reactive. Who is our toughest competitor? Clearly, Jim and Craig. But outside of Jim and Craig, it's -- Sam's is our most direct competitor more so than BJ's in terms of intensity. Although BJ's has gotten stronger than they have been. But I think I mentioned as long as a year ago, there seem to be a period of time for a couple of years where we less and less see to price shop them a lot. We are now over the last year. So BJ's got a little tougher, but we feel very strongly that again, we're being proactive in this and not -- there's not this, "Oh no, there's something new happening out there." But Sam's has always been tough, and we are pretty tough ourselves. So I don't -- I'm not trying to sound arrogant about it, but again, we aren't seeing a lot. The -- outside of that, certainly we recognize that in some categories like media, the Internet is changing that landscape. And you see that in our warehouses. We've -- over the last year, we've reduced a little bit of square footage of things like CDs and DVDs and to a lesser extent, books, because there are still plenty of people that want to buy physical books. And we've done other things. In the 1-Hour Photo, you -- there's a lot of very cool things that we do with prints on canvas and photo books and things like that -- that's actually driving that business with a plus sign in front of it. So we -- but in terms of competition, for those of you who noticed for a lot of years, it's the same things. When our numbers are good, we scrutinize them more. We have -- you've seen that our strength in some of our overseas items and our overseas locations like Asia, like Mexico, like Canada, which is, of course, segmented out and shows a higher margin, we want to make sure that we're competitive, not just because there's a competitor across the street, but because we want to be strong up there. So we are cognizant of the economy and our strength, and we want to make sure that that's going to continue.

Adrianne Shapira - Goldman Sachs Group Inc., Research Division

Okay, Richard. And then just on the buyback, could you give us any sense of the appetite there? Obviously we know you could do more if you opted to, but give us any sense of pace and appetite going forward.

Richard A. Galanti

Well I think if you look at last year, I think we did about 6 something, $640 million. I don't have it in front of me. And I think in the fourth quarter, it was annualized closer to $1 billion, $950 million, let's say. If you take the 12 weeks that we spent -- where we spent $173 million, that is roughly about $750 million. So that's a little bit down than the annualized figure in Q4. But as we've told everybody, we are an ongoing buyer as long as we feel that the outlook continues and we do, not just for us, but for the crazy world that we live in. And so we have, essentially, a daily buyer. We tend to do that in a matrix format that if the stock is going up, we're buying a little less a day. If it's going down, we're buying a little more, recognizing we don't -- we can't predict exactly. And certainly there was a lot of strength during the quarter. So there were days when we're buying on an annualized basis. I mean, if you just do simple math, if you're buying 25,000 shares a day, that's about $0.5 billion a year. If you buy 50,000 a day, that's about $1 billion a year. And when people have talked about where do I put my model for the next 5 years and says, "A, we don't know." But certainly, that $1 billion number a year is a starting point. Is it a little less than that? It could be. Could be a little more, sure.

Operator

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

Charles Edward Cerankosky - Northcoast Research

The money you spent to get prop 1183 passed, can you give us some analysis, which you expect to get back from that or boost in liquor sales in Washington, I guess, starting from 0 when it takes effect middle of next year?

Richard A. Galanti

Well first of all, the $17 million, I think the total was about $19 million, a little under $2 million was booked in Q4, small enough that we didn't even talk about it. And -- but on that money, it's probably priced more than we wanted to spend to start with than we thought we would spend. But as we go forward, once you're into it, you do it. Generally speaking, in states where we sell spirits, it's about 2% of sales. And I don't have the exact amount of sales, but it will be a decent return on even that larger investment. But we -- keep in mind, we do it more because of the principle that our mission is to sell merchandise to our members at the lowest price. And you can see even with higher taxes on the spirits in Washington, we believe that our members are going to be able to buy spirits at lower price. And that's what we do for a living.

Charles Edward Cerankosky - Northcoast Research

Okay. Looking at gasoline, the gasoline category, Richard, can you give us a sense of how same-store gallons moved and how the profitability per gallon was?

Richard A. Galanti

Well as you know, historically, in terms of the latter part of that question, profitability is -- generally is better when prices are going down and worse when they're going up. Although in the last year, both of those extremes have come in to the center a little bit more. So even when it's going up a little, we're making a little more than we used to. And then when it's going down a little, we're making a lot more but a little less than we used to. In terms of comp gallons, if I look at comp gallons over the last year, generally, a 10-plus range. I think in the most recent month or recent quarter, it was 6%. So still a positive.

Charles Edward Cerankosky - Northcoast Research

All right, good. Looking at how the consumer is behaving in this Christmas season, especially the transition from the first fiscal quarter into the holiday season, how do you judge their discretionary spending mood compared to where you'd like it to be or even last year?

Richard A. Galanti

Well I mean, I think we, again, began this fall Christmas holiday season aggressive in terms of merchandising and -- but still scared about the world and the economy and the purchasing power. Again, I think we've generally done better than the consumer confidence indices would suggest. But we're still not thrilled. We'd like it to be better. Overall, again I think -- I can't tell you what is beyond November. But through November, we were pretty pleased with the numbers.

Operator

Your next question comes from the line of Sean Naughton with Piper Jaffray.

Marc M. Snover - Piper Jaffray Companies, Research Division

This is actually Marc Snover in for Sean. Just a couple of quick questions. First, I wonder if you can just comment on anything you're seeing with the consumer right now, both negative and positive as far as trading down, trading up, increases that you're seeing in private label sales or anything like that. And secondly, also as it relates to Asia overall, wondering what's your -- what you feel the opportunity is there. It's up since the last time you commented on it. I think in Japan, you said that you believe you could probably have around 49, 50 stores there at full penetration. I wonder if you're seeing anything currently in that market that might cause you to up that.

Richard A. Galanti

Sure. I apologize, what was the first question again? I was writing down the second question.

Marc M. Snover - Piper Jaffray Companies, Research Division

Oh yes, absolutely. So just anything positive or negative you're seeing in the consumer right now, so as far as trading up, trading down brands or...

Richard A. Galanti

Yes, right. In terms of trading up and down, we probably don't see as much of that as other types of retail, whether it's lower end discounters or general discounters and others, partly because we don't allow us to do it. I mean, we try not to trade down merchandise in terms of what we're presenting. We're still trying to upsize up-quality merchandise. Certainly, nothing like we saw after late '08. In the first half of '09, I remember we saw trading down in patio furniture and trading down in some of the meat items and things like that. We're not seeing any of that right now. In terms of increasing penetration of private label, again that's more evolutionary than revolutionary right now. I would say in the first 6 months of '09, it was more revolutionary. I think anecdotally I mentioned back then, and again, that was right after the financial crisis of late '08, in the first 6 months of '09, we saw up to 300-basis-point increase in sales penetration of private label in the Food and Sundries side of our business, which is 60% of our business. And that's unprecedented. Normally in a given year, you might see 50- to 100-basis-point improvement as we add items and so forth. So I'd say it's more the evolutionary path right now. But we keep coming out with new stuff and that we will expect to see that grow. When Jim has been asked in the past, recent past about that, if it's currently -- this private label is currently in the low 20s, kind of our goal over the next however many years, not 2 or 3, but not 10 or 12, we'd like to see it in the low 30s. But that's going to take time.

Marc M. Snover - Piper Jaffray Companies, Research Division

Great. And then as far as your opportunity in Asia?

Richard A. Galanti

Oh yes, Asia. Look, we're doing more than we did a year ago, and that was more than we did 2 years ago. Yes, I think the 49 number you look at, Japan goes back to when we had like 5 units in Japan instead of the 12 weeks we'll have by the end of this week. But 11 we'll have by the end of this week. And what was -- and I think the 49 was based on -- I think I remember saying back then, who knows what that is going to be. If we continue to be successful, certainly -- and how do we give 49 instead of 50, I'll never know. But at the end of the day, if you look at the -- both the population and the retail economy of Japan compared to Canada where we have 85 units or so, it could be a lot more than 49. But right now, opening for this year is a lot more than 1 or 2. And we've got more in the pipeline, so we'll just keep going north. But I can't predict what it will ultimately be. I know in Taiwan and Korea, if you go back 5 years ago on those kind of template and slides, where will it be, what's the potential of the market, I think in each of those countries, we had 5 to 7 units. And we said one day we might have 15. More recently, in the last year I've seen that slide that says a potential 25 each. So again, the number is increasing. It's still going to be slow. It's not like we're going to see us open 20 units in year 3, hence, from now.

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 quick question. Any -- have you seen any change in the pace of new member sign-ups, either Gold Star or Executive since you guys raised, I guess, the fee on November 1 for the -- for new members?

Richard A. Galanti

No. And that has really been -- it's been a non-issue so far, recognizing -- the big question is, is what are renewers going to do, not what a new person coming in the store -- the warehouse is going to do starting November 1. But even when it was originally announced in the press release, I mean -- and talking to our Head of Marketing and Membership yesterday, he basically indicated that it's in the low -- very, very low hundreds of even comments in blogs, in Twitters and Facebook things. So -- and 90% of them are positive. Anecdotally, like are you kidding? I say that every week when I get gas, are you kidding? I say that every week when I get flowers. So I think our members are our best defenders of the fact that it's not been an issue. We'll have to -- we'll give you more color on that in a couple -- in a quarter and 2 quarters from now when we've got 3 and 6 months of renewers under our belt.

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

Okay, great. And then just -- did you give us the average price per gallon of gas in the first quarter? That's a number we'd like to have.

Richard A. Galanti

It's up 26%. In Q1, it was $3.52. In Q1 a year ago, it was $2.79.

Operator

Your next question comes from the line of Greg Melich with ISI.

Gregory S. Melich - ISI Group Inc., Research Division

Richard, I want to follow up a little bit on the gross margin. If I caught it right, you said that non-food was actually up slightly a little bit. So I was curious, was that category or mix? Or what area was that occurring?

Richard A. Galanti

I was more on Hardlines and Softlines. But yes, and I don't think -- I don't know off the top of my head. I haven't looked at the sub detail, Greg.

Gregory S. Melich - ISI Group Inc., Research Division

Okay. So maybe the other way that -- all that pressure you didn't see there, the 6 basis points, since it was all on the food side, I imagine the cadence food a quarter was that it will be more towards the end. And is that true? And given that it's a holiday kind of focus and your quarter end at the 20th remind us of how your holiday sales tend to play out. I imagine the weekend before Thanksgiving is a pretty big one for you. But if you could remind us on that, that will be helpful.

Richard A. Galanti

Well, a lot of it was not just seasonal. I mean, it was seasonal fall as well. I mean, we -- if you recall, even in Q4 year-over-year, kind of the core was up only 2-basis-point net of gas inflation, which was less than it was in Q3 -- in Q3 and Q2 going back year-over-year, it was much more positive. So I think it's trended a little bit. I don't -- I wouldn't suggest that the last month was much more of an impact than the first month, other than sales penetration of the last month but not in terms of percentages, maybe a little but not much. I don't have all the color on that in front of me.

Gregory S. Melich - ISI Group Inc., Research Division

Okay. And then just going back to the first part of the question, on the non-food side of it. Was there any impact from the runoff of some of the Apple product that you were cycling? I guess -- I know you got rid of them around this time last year.

Richard A. Galanti

We finally anniversaried the sales hit to that, so that's a small help going forward. I want to see -- probably -- a big chunk of our Apple sales were iTunes charge, which had a decent margin. Probably on the iPod, it was a little lower than the average margin, but not meaningful, not a meaningful delta to affect our numbers.

Gregory S. Melich - ISI Group Inc., Research Division

So that shift will not change. Okay, great.

Richard A. Galanti

I don't think so.

Operator

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

Aaron Goldstein - JP Morgan Chase & Co, Research Division

It's actually Aaron for Chris. Can you maybe dive into the core SG&A margin rate? And do you see or do you expect the leverage point to improve throughout the rest of the year? How is healthcare costs impacting that as well?

Richard A. Galanti

Yes, healthcare is still -- the dollars are still rising in the high singles, which is a little better than the low doubles in terms of dollars. Workers' comp has turned the other way a little bit, so it's hurting us a little more, although workers' comp in aggregate dollars is not nearly as big as all of healthcare. But, again, the core SG&A, the payroll was good. I would hope and expect that to continue. I mean, one of the emphasis is -- emphasize -- one of the things that we emphasize in the last couple of quarters is overtime. And as wonderful as we think we are sometimes in terms of efficiency of operations by just focusing on it and the warehouses, we've cut thousands of hours of overtime. And so time and a half is a lot more expensive than time. And -- so, again, that's a piece of it. But I think again, nothing does more for you than a tough economy to make you focus on it. So I don't know if it's going to get -- if the inflection points or the threshold points based on sales comps has come down. Well, I think it's come down compared to a few years ago. And I think we've got further to go. As you know or as I mentioned to many of you, probably 30-plus of Craig's 40-plus years in retail had been in operations. Clearly, he is focused on that. And of course, he has a great merchant in Doug and the people under Doug on the merchandising side. So to worry about more merchandising things. But I think Craig is very focused on the operations side of our business and driving costs. And that being said, it isn't easy. And, again, we're -- I think if you look over the last 8 quarters of what we've said, generally it's been towards payrolls trickled in a little bit better and probably a little bit better and better than the last couple of quarters.

Christopher Horvers - JP Morgan Chase & Co, Research Division

Great. And then maybe just looking as gas prices have receded a little here, have you seen any negative impacts at all on traffic trends?

Richard A. Galanti

Well no, I mean our traffic remains at 4%. It's almost scary to us because we keep saying when it's going to subside a little bit. It's just month after month we're doing pretty well. As I mentioned, the [indiscernible] comp in Q1 was 6%. I don't have Q4 in front of me. I don't have the exact number. I'd bet you it was 8% to 11%. I don't remember. It's probably 10%. So yes, it's come down a little. But the overall frequency -- and when we talk about that frequency number, that's front end frequency, not gas. So we got more people coming in to get gas. A fraction of those people are coming into the warehouse.

Operator

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

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

First question just on the other income. There was a big variance, and I think I understand the $8 million piece that is hedged on merchandise purchasing. But help me understand the $15 million piece on cash a little bit. And how much cash are you holding in Mexico? And if the peso weakened versus the dollar over the course of the quarter and certainly versus the year-ago, why is that such a big benefit?

Richard A. Galanti

Well, that's exactly what happens. So what happens is any company in any country, if they hold foreign currency, they have to market to market at the end of the fiscal period. So in Mexico, our strategy from time beginning or for many years has been, not exactly, but to hold about 1/2 of their excess cash in dollars. And that has basically been agreed to by the shareholders of Costco Mexico. Us 1/2 of that and Commercial Mexicano 1/2 of that, recognizing that the peso historically has been weaker. And recognizing further that we end up buying a lot of U.S. goods. But that's not to do with managing payables each month, but that has to do with an ongoing basis. We buy U.S -- we buy goods that are payable in U.S. dollars. So when Costco Mexico, I think at year end in dollars not how many dollars they held, but if you converted their entire cash into dollars, it was around $300 million. So let's say -- and these are not exact numbers but let's say half of that was being held in U.S. dollars, that'd be $150 million during Q1 the peso weakened quite a bit. I don't have the exact number, but it was 10% on 150. There's $15 million. And now by the way, that has hit us and hurt us last year in the same fiscal quarter -- in Q1 of '11, we had a $3 million hit. Now we didn't talk about it because there's $3 million and that it's noise, because there's lots of things in our P&L to go positive and negative. The other thing that makes this line item stand out more than ever before, it was fiscal '11 when we started to consolidate Mexico into our numbers rather than just having half of Mexico's income on this line. So it's still a little convoluted, but again this bigger volatility could easily have been the other way if the peso strengthened. Now I hope that I don't have to in the future every quarter talk about another line item here but because it was so such big amount, if I look at the last 4 fiscal quarters, just this particular item, it was again about $9 million of -- I'm sorry about $11 million in Q1 '12 to the positive. But again -- I'm sorry about $9 million in Q1 '12 to the positive. Again -- I'm sorry about $11 million in Q1 positive, it was in Q4, it was not that big of a positive. In Q3, it was a $4 million loss. And in Q2, it was a $2 million loss. So again historically we haven't talked about it, but this was the biggest it's ever been and really stood out.

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

Is the fact that you're holding U.S. dollars in Mexico, that is what your mark-to-market, not pesos into dollars?

Richard A. Galanti

Right. Because Costco Mexico's P&L is recorded to have a gain based on its dollar holdings. After that gain is ours. Kind of silly...

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

And you just mark-to-market over the course of the quarter. So if the peso stays where it is, it doesn't matter where it was a year ago.

Richard A. Galanti

Exactly.

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

But we can't predict it's going forward other than watch the peso over the course of the quarter.

Richard A. Galanti

Right. If you look at it again, none of us know exactly what it's going to go, but if you look at what's happened generally there's been a couple of big jumps in the peso weakening versus the dollar on a long term basis. And so by doing this, it's been a little better with the benefit, but certainly not something you can count on.

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

Okay. And then I may have missed it, did you talk about e-commerce.com growth?

Richard A. Galanti

Yes, it was up 9% in the quarter. I think that's down from the low double-digits in last year in the fourth quarter. The only other big news there is that we are looking -- we are in the process of re-platforming costco.com. That will happen in the -- towards this, probably sometime in the second calendar quarter of next year. As I've shared with people as they've asked, right now our.com site, the search engines can't search on it. So if you just punch in Kirkland Signature into Google, you're going to be a ways down before you see costco.com. So there's some simple things that we're doing there. And of course, we're looking to expand .com overseas, but that will be not next Thursday, that will be over the next 2 to 3 years.

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

Okay. Anything particular about the deceleration?

Richard A. Galanti

No. Keep in mind, we've taken a relatively slower approach to .com. I mean we don't do a lot of marketing for it. We sell a lot of big-ticket items. We have less than 37 or 800 items on there. And I think again one of the big things is, is since search engines can't search, you punch in television or something else costco.com doesn't come up. You punch in Kirkland Signature and the first thing -- I'm not going to tell you all to go do it now, but the first thing it does -- and costco.com doesn't come up. And that's because we have an old system that we -- starting about 8 months ago began the process of adjusting to re-platform it.

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

And then finally I know we kicked this around a bunch already, but on the little bit more aggressive pricing, it sounded like there's a little bit of a philosophy change. And obviously this is the first quarter of core merchandise margin down that we've seen in a couple of years. What exactly did you see, or feel that you said now is the time to kind of get a little bit more aggressive on the margin?

Richard A. Galanti

I don't think it was a great aha moment around here. It was more we've had good numbers, particularly doing well in overseas countries. And as I've said many times over the years, Jim has been toughest when we're doing well, and that's a good thing. It keeps us reminded that we got to where we are because we're tough on pricing, and let's make sure we continue to do that. So again, I'm trying to walk the line between not -- we don't view it as big of an issue other than it's certainly part of the issue and I felt obligated to let you know that certainly part of the margin issue is it. But it's not giant mind set change in terms of what we want to do.

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

I'll slip one past in here. Are there any additional political contributions we should know about going forward?

Richard A. Galanti

Well, no. Absolutely not.

Operator

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

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

Follow-up on e-commerce. Your growth here is tracking now at similar to your overall business x gas, whereas the consumers' obviously shifting faster to e-commerce. And so do you think that re-platforming change will change the trend for you? Or Richard, what other changes might the team be thinking about? And then specifically as it relates to shipping, we're seeing more retailers moving towards incentives in that area. Might that be something you'd also consider?

Richard A. Galanti

There are several things we're looking at. But again, I don't want to over emphasize that because keep in mind its 2% -- 2% or 3% -- 2.5% of our business, and our goal is to get you in the store with the giant chickens, and the gasoline and everything else. And great giant chickens, I might add. We have great merchants out there doing that. We recognize that this is a very profitable business, as a percent of sales it's more profitable than our whole company overall. But we also want to stick to some of our disciplines. We recognize we continue to change a little bit, and we'll continue to do that. But we don't want to go crazy and say oh my God, I do believe that some of the promotional stuff and free shipping stuff, which is catching everybody's attention. That hasn't helped us for sure. But I don't see us going to a free shipping route. Certainly that has not really been talked about. Other than how do we communicate to our members. We feel very open and honest about communicating what our all-in price is. If we keep having great value and time and again we have great value relative to all the other guys out there, we'll continue to drive that business. And if it starts heading the other way, we'll figure out what we need to do to change that. But we don't really see that other than certainly there's been a lot more cyber promotions out there right now that we're not prepared to do.

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

Okay, and then just on the gross margin, there's a lot of puts and takes. But as we move through this fiscal year, you're going to come across some normalization, presumably in this gas price impact on the margins. Would you think that later in the year the company might be in a position to see rising gross margins again at this -- based on what you see today? Or is it more aggressive pricing possibly offsetting that opportunity?

Richard A. Galanti

I'd love to give you my thoughts, but I can't really guide you there. In terms of just looking at inflation versus deflation in gas, that's the $64,000 question. In Q1 a year ago, as I mentioned, the average selling price was 279. In Q2, the average selling price a year ago was 301. In Q3, it is 363, and it was also 363 by coincidence in Q4. It actually went down a few cents in September. 358, 348 in October and 344 in November. So it actually is ever so slightly deflationary but compared to Q2, of the price in November at 344, and the price in Q2 last year at 301, so that's a 13% or 14% increase, not a 26% increase. So it will be less of an impact. And all things being equal, it will finally pencil up, who knows? Yes, but there's a change in the back half of this year will be very little impact.

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

Okay, and then my last question is on the membership fee growth x currency. How do you look at the trend here versus where you were through the back part of last year? We don't get exactly the membership for your group and it was x that currency. So how do you look at that trend?

Richard A. Galanti

When we look at that compared to our budget, we feel great. I mean everything's -- we're signing up new members even in the U.S., net new members, which is a positive given as a percent of -- openings as a percent of total U.S. openings. We're seeing our renewal rates strengthen a little bit in the U.S. and only going down overseas simply because you got a lot new units that have lower first year renewal rates. And so assuming those trends continue, I think we feel very good about it.

Operator

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

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

In the past you, and still now you've been sensitive to keeping the comps at a certain level. Your comparisons start getting more difficult obviously, you had pretty good year this past calendar year. I'm just curious as you lap some of that, if you have any plans of doing incremental investment in either inventory or price to keep that level up?

Richard A. Galanti

I'll let you know when we get there. Yes, certainly traditionally those are the kinds of things we do, but we're not going to go crazy. Certainly opening more units overseas helps your comps a little bit. Because they're starting off at a higher rate, or helps your sales growth a little bit, not your comp necessarily. But as Jim mentioned to us at the budget meeting last month, I think it was last month. They said, "Guys, it's no secret that this is what we do for living. But I don't want -- I'm trying again to explain Q1, but not get people concerned that there's this big sea change out there. Because there's not."

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

Right. What about in terms of the online businesses? As you noted before, there's a lot of cyber promotions out there. But if you look outside of just around the Thanksgiving Day weekend, you've got a lot of retailers both Big Box and pure online that are enhancing their web offerings. Is there anything that you're doing, other than the search changes that you talked about to stand out in the crowd a little bit more? Whether it's adding more items to the site, or offering more discounts, or whatever?

Richard A. Galanti

No. And we want to -- we had to recognize that the Internet is different than brick-and-mortar. We also can't be too alarmist about what's going on out there. We're going to -- we are doing a few more MVM, multi-vendor mailers, there's some more couponing for just costco.com. Other than that, I don't think we're doing a whole lot more.

Operator

The next question comes from the line of Faye Landes Consumer Edge Research.

Faye I. Landes - Consumer Edge Research, LLC

Can you just talk a little bit about private label in the quarter? What you've experienced and how that flowed through, if at all, to the gross margin?

Richard A. Galanti

Well, private label is up slightly. Generally speaking and looking at the past few years, private label penetration has been up from 50 to 100 basis points year-over-year. Probably in a given quarter, you're not going to see that much of a dramatic change other than we're adding new items. The same thing with margins, the difference between the brands and the private label margin could be as much as 6 or 800 basis points, and as little as 1 or 200 basis points, on an item by basis. A lot of times -- I used the example years ago when we went to a private label diaper because diapers are an item that is retail football-ed all the time. It was an item that our realized gross margin across the country on $300 million of branded diapers was probably in the mid-single digits. If we've shifted at a lower price point because private label is a little price point but we've shifted to a price point in the low double digits. So there you've got 500-plus basis points. I'm sure there are plenty of items where it's a lot less than that. But that is the positive.

Faye I. Landes - Consumer Edge Research, LLC

So it's a positive.

Richard A. Galanti

I would guess -- did it move the needle in Q1, I don't know.

Operator

Your next question comes from the line of Joe Feldman with Telsey Advisory Group. Joe, your line is open.

Richard A. Galanti

Joe left. Next.

Operator

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

Charles X. Grom - Deutsche Bank AG, Research Division

Guys I was just hoping I could ask a question about if you expect any major operational changes with Mr. Sinegal's departure near term?

Richard A. Galanti

Not really. Keep in mind, as in the press release, he's going to be around for the next year in a consulting capacity. Many of you who know Jim, that's a big shadow there. And he's just spent a lot of time, no doubt, traveling and with Craig. And we don't really see any sea changes out there. Particularly -- and when Craig has been interviewed, even in the local newspaper, his view is it's more of the same, focusing on value. If anything, I think, since Craig 20-or-so months ago became President, he's elevated his game in terms of understanding what has gotten to us, where we are, in terms of that discipline of value, and you can see the DNA around here is pretty intact.

Charles X. Grom - Deutsche Bank AG, Research Division

And just one follow up. Just wondering if I can get a little bit more color, I know a lot of people have asked, but just about less leverage in the 1Q kind of versus Q2 despite the better core comp. Just if I could get a little more detail. I'd appreciate it.

Richard A. Galanti

I'm sorry, say that again?

Charles X. Grom - Deutsche Bank AG, Research Division

Trying to get a handle on a little bit less leverage in the first quarter kind of versus fourth quarter, despite the better core comp?

Richard A. Galanti

I can't -- it's so hard to pinpoint. There's hundreds of things going on. Penetrations in different countries. Year-end accruals that in either way. We try to look at the big ones and let you know if they are. But I can't necessarily put my finger on that exactly, other than the trend has been good. If it was a little less in Q1 than Q4, then so be it.

Operator

Your final question comes from the line of Robert Carroll with UBS.

Robert W. Carroll - UBS Investment Bank, Research Division

Richard just one quick last one on the pricing. Is there any link to be made with the timing of some of the model pricing investments, along with the membership fee increase? I mean should we think about that as a way of almost investing in pricing in order to ensure continued high renewal rates for when the members see the increase?

Richard A. Galanti

Well, money is fungible whether it's pricing or membership and everything else. We're going to keep doing what we're doing. Clearly, it's not an exact direct link because fee increases, in terms of when we earn them starting really until January when we're getting the cash into Q3 when we're getting something in the books. So I view those as independent.

Robert W. Carroll - UBS Investment Bank, Research Division

And so then as you start to see the membership fee income ramp up, and some of that's recognized through the next couple of years. I mean we shouldn't necessarily think about a curve on pricing investments following that?

Richard A. Galanti

What I've read into some of the analysts out there. Some of them assume majority of us going that way, some of them assume the minority of it's going that way. We really can't predict that, other than saying that as our numbers are good and we -- the numbers for the company, not membership but just as our earnings continue to progress, and we feel strong about member loyalty, and we look to the economy. We're going to continue the work to drive sales. And this is just another arrow in the quiver.

Okay, well thank you, everyone. Have a good day and holiday. Go shopping at Costco.

Operator

This concludes today's First Quarter Fiscal Year 2011 Operating Results Conference Call. You may now disconnect.