Costco Wholesale Corporation (NASDAQ:COST) Q1 2019 Results Conference Call December 13, 2018 5:00 PM ET

Executives

Richard Galanti - EVP and CFO

Analysts

Michael Lasser - UBS

Simon Goodwin - Morgan Stanley

Chuck Grom - Gordon Haskett

John Heinbockel - Guggenheim Securities

Chris Horvers - JP Morgan

Karen Short - Barclays

Edward Kelly - Wells Fargo

Rupesh Parikh - Oppenheimer

Scot Ciccarelli - RBC Capital Market

Scott Mishkin - Wolfe

Operator

Hi, my name is Liz, and I will be your conference operator today. At this time, I would like to welcome everyone to this Costco Q1, 2019 Earnings Call. All lines have been placed in mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Mr. Richard Galanti, you may begin your conference.

Richard Galanti

Thank you, Liz, and good afternoon to everyone. I'll start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements.

The risks and uncertainties include, but are not limited to, those outlined in today's call, as well as other risks identified from time-to-time in the Company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update these statements except as required by law. In today's press release, we reported our operating results for the first quarter of fiscal 2019 and the 12 weeks that ended this past November 25th.

Net income for the quarter came in at $767 million or $1.73 a share, a 19.3% per share increase compared to $640 million or $1.45 per share last year in the first quarter. In comparing year-over-year operating results, there were three items noted in the release. One, this year's first quarter benefitted from $59 million or $0.13 per share income tax benefit related to stock-based compensation. Last year, the benefit was $41 million or $0.09 a share in the first quarter last year.

And number two, the Company also recognized an additional tax benefit this year of $27 million or $0.06 a share. This related to the implementation of the 2017 Tax Act. And the third item noted in the release, this year's first quarter results included a charge of $43 million pre-tax, or $31 million after tax, which is $0.07 a share for an adjustment to our estimate of breakage rewards for the Citi/Visa co-branded credit card program, and more on this in our discussion of gross margin.

In terms of sales, net sales for the quarter came in at $34.31 billion, 10.3% increase over the $31.12 billion reported last year in the first quarter. In terms of comp sales and the release today, for the 12 week fiscal first quarter, U.S. comp sales on a reported basis were up 11.0% and ex not only gas inflation and FX but revenue recognition, the 11% would be 8.3%; Canada reported 2.4%, ex-gas FX and revenue recognition will be plus 5.5%; Other international reported 4.0%, ex those items plus 5.8%. So total company reported 8.8% ex gas FX and revenue recognition impact 7.5% plus. E-commerce 12 weeks reported 32.3% and again ex those items plus 34%, -- 26.2%.

In terms of Q1 sales metrics, first quarter traffic or shopping frequency increased 4.9% worldwide and within the U.S. 5.2%. Weakening foreign currencies relative to the U.S. dollar negatively impact sales. Gas price inflation benefited Q1 comps and revenue recognition benefited as well. Combined those three items added about 130 basis points, essentially the difference you see between the 8.8% reported and 7.5% I mentioned above, cannibalization weighting on the comp by approximately minus 70 basis points. Our average front end transaction or ticket was up 3.7% during Q1 and excluding the impacts from gas and FX and revenue recognition, the average ticket was up approximately 2.4%.

Next on the income statement is membership, we reported an increase of 9.5% or $66 million coming into the quarter of $758 million in the first quarter of this year compared to $692 million last year. FX had a negative effect of approximately $6.4 million. So the 9.5% increase would have been about 10.4% ex-FX. Reported membership revenue again was up 9.5. About half of that's related to the membership fee increases taken back in June of 2017. And as you all know, it takes about 23 months to get through the book part of the income statement that benefit.

Our renewal rates also rose in Q1. U.S. and Canada membership we made in Q1 end came in at 90.5%, that's up from 90.4% just 12 weeks earlier at Q2 end. And worldwide rate improved to 88%, also up a tenth of a percent, up from 87.9% at 12 weeks ago at Q4 end. In terms of number of members at first quarter end, Gold Star at Q1 end was $41.3 million that compares to 12 weeks earlier of $40.7 million; business primary 7.6% and both at quarter end and -- this first quarter end and year end; business add-ons stayed at 3.3%; all told what we started the fiscal year and we ended last fiscal year with $51.6 million members, we ended Q1 at $52.2 million.

Total cardholders at year end from last quarter was 94.3, and again at this first quarter end it was 95.4. We opened six new warehouses during the quarter. Also at first quarter end, paid executive memberships came in at a total at $19.7 million, which is an increase of $442,000 or $37,000 a week since 12 weeks earlier. That's one of the biggest weekly deltas. Part of it depends on when we do different activities to get members to upgrade into as new members sign up as well. So, you'll see that fluctuate but certainly a good showing in the quarter.

Related to the annual fee increases, again I mentioned earlier, we've now past the halfway point at last year's fourth quarter. The 23 month cycle, it takes to recognize the incremental benefit from the fee increase. The benefit will continue to diminish in each of the remaining three quarters infused 2, 3 and 4, very little in Q4 actually. And again, that's based on the deferred accounting which we use.

Going down to the gross margin line, our reported gross margin in the fourth quarter was lower year-over-year by 50 basis points, coming in at 10.75% as compared to 11.25% a year earlier. Now excluding gas inflation and revenue recognition that minus 50 would have been a minus 26, and I'll start with my line items, if you want, comparing this minus 50 to the minus 26. If you just jot down two columns of numbers, the five lines; the first line is core merchandise; the second line ancillary businesses; the third line 2% reward on executive membership; the fourth line other; and then the fifth line of course total.

On a reported basis, the core merchandise year-over-year in Q1 was minus 43 basis points. Ex gas inflation and revenue recognition, the minus 43 would be minus 22. Ancillary businesses, which was a plus 5 reported; ex those items it would've been plus 11; 2% reward zero and a minus 2; other minus 12 and minus 13; and if you add up those two columns, you get to the minus 50 reported and then ex gas inflation, revenue recognition the minus 26.

Now again going to the core with minus 43 ex those items going to minus 22, that's again based on sales penetration of that as compared to the total company as well. If you look at just the core merchandise categories in relation to their own sales, what I call core on core, margins year over year were lower by 6 basis points. Subcategories within core gross margin year-over-year in Q1, both food and sundries and hard lines were up and soft lines and fresh foods were down. And then net of those four categories was a minus 6.

Ancillary and other businesses, as I mentioned reported plus 5; plus 11 ex gas in revenue recognition in the quarter; gas was up, e-com was up a little; businesses were up a little, pharmacy a couple of other things were down a little. But net of those all, they were 11 basis points ex those items. The other net fee $43 million pre-tax amount that I mentioned earlier related to the Citi/Visa co-branded card. And we put it here, because it's part of the deal is things like the rewards that are paid out to the cardholders as well as bounties that are earned and revenues that are shared. So this impacts the revenue line of our company and the sales line and therefore it impacts the gross margin percentage.

So the $43 million, this relates to our Citi/Visa co-branded credit card program. Over the past few months, we made the decision to expand our efforts to remind our members to redeem their outstanding rewards. By stepping up our reminders, we saw a step up in the redemptions relative to what we've experienced previously.

These are the rewards certificates that were sent out in February of 2018. The rewards program on the Citi/Visa card is a calendar your program. So these are the rewards certificates are sent out in February of '18, for rewards earned on Citi/Visa card transactions over calendar '17 and to expire at the end of this calendar year. The $43 million adjustment relates to two things, one to the thing I just explained. I described to the recent increase in these redemptions. And second, the additional breakage amounts now estimated on the rewards being earned and accrued on calendar year 2018 card transactions. These rewards will be sent to the Citi/Visa card holders in February of 2019. So if you see in this line as basically adjustment to our estimate of breakage on rewards earned on purchases made prior to beginning of fiscal '19. Going forward, we're using this lower reward breakage assumption.

Moving to SG&A, our SG&A percentage Q1 over Q1 was lower or better by 23 basis points on a reported basis and flat or zero without gas inflation and revenue recognition. Again, came in at 10.13% this year on a reported basis compared to 10.36% last year. Again, I'll ask you to jot down two columns and five line items. The first column of course is reported and the second is ex those items. First line is operations, core operations. Q1, '19 reported was lower or better by 23 basis points and lower or better by 4 ex those items. Central -- lower or better, I'll use a plus 9.

Central, plus 4 and plus 2. Stock compensation, which is always the biggest impact seems to be in Q1, because that's what we do our annual grants for over 5,000 employees. Stock compensation minus 4 and minus 6 and then other is zero. So your total again reported some of those three line items to plus 25 basis points are lower year-over-year on a reported basis by 23 and the second column basically flat year-over-year on ex those items basis.

The core operations complete again was lower, this primary results in sales growth, offset in part by the U.S. wage increase to hourly employees that went into effect -- to most of our employees that went into effect on June 11th. The wage increase negatively impacted SG&A by approximately 8 basis points in Q1 year-over-year, and this will continue to impact the SG&A year-over-year comparisons over the next two quarters. I believe we did it effective June 11, '17 -- in a June 11, '18 go through the same time period a year later.

Our central expense was lower or better year-over-year by 4 on a reported basis, and then lower or better by 2 without those items. Within that IT spend in the quarter was flat as a percentage of sales. Stock compensation as I mentioned, the biggest impact typically is in the first quarter, so you'll see a little bit of a difference there. Next on the income statement is pre opening expense that was $5 million higher in this year's first quarter to come in at $22 million compared to 17 a year earlier. We had one more opening this year, but there is plenty of other things going on and not just opening new warehouses with everything from chicken plants to expansion of depots and fulfillment.

All told, reported operating income in Q1 came in at $949 million compared to $951 million in Q1 last year. Two other things I mentioned this report of course is that the $43 million related to the city rewards program, as well as the hourly wage increases. Those are certainly two things that have impacted the year-over-year comparison.

Below the operating income line, reported interest expense. It was $1 million lower year-over-year coming in at $36 million compared to $37 million. And on the interest income and other, essentially flat year-over-year. Interest income within the numbers was actually $8 million better year-over-year, higher interest rates and a little higher invested cash balance, offset by FX items that amounted to about $9 million to the negative. The FX tends to fluctuate both up and down within prior quarters. In total, pretax income came in at $935 million compared to $936 million a year ago.

In terms of income tax rates, income taxes -- our reported tax rate in the first quarter was 15.9% compared to 30.4% in the first quarter of last year. This quarter's tax rate benefited from the lower federal rate related to tax law changes, as well as some favorable discrete adjustments. Notably, the $59 million tax benefit related to stock-based compensation, compared to $41 million year ago and a $27 million benefit related to the implementation of the 2017 Tax Act as I mentioned earlier before. For fiscal '19 based on our current estimates, as I mentioned each quarter, these of course are subject to change. We anticipate that our effective total company tax rate for fiscal '19 to be in the 26.5% to 27% range. This figure is a little more than a percentage point lower than what we had previously estimated, as I mentioned in our last quarterly conference call, but lower is good.

A few other items of note in terms of warehouse expansion, we've opened eight locations, including two relos, so a net of six in the first quarter. For all of '19, we expect to open 20 -- about 23 net new warehouses, as well as four relocations. The two we've opened plus two more planned for the rest of the year. Within the 23 net new, about three quarters of them are in the U.S. and about a quarter of them are international.

We're also under construction with our first Costco in China and Shanghai with the expected opening later in calendar 2019. As of first quarter end, total warehouse square footage stood at 111 million square feet. In terms of stock buybacks, in Q1, we've repurchased $34.5 million of stock 150,000 shares. I'll turn my attention to e-commerce. Overall, e-commerce sales increase continued at good levels. Both for the quarter and just last week, of course, we reported the four weeks of -- the calendar four weeks of November, which would include the first week of Q2. For the quarter, reported e-commerce came in at 32.3% up, ex FX and rev rec, they were up 26%. And as you saw last week, the numbers are a little higher than that, both for the four-week November period.

In fact, the good news is we've established all kinds of records for orders and sales during the Black Friday through Cyber Monday weekend as I'm sure many else have as well. The top growth categories in the quarter were grocery, consumer electronics, hardware, health and beauty aids and automotive. One highlight of our website refinement during the quarter was our redesign of the home categories. We feel that the refresh made departments like furniture, domestics and house wares easier to shop. With that change, we also expanded some of the product selection within the subcategories.

We've now passed our one year anniversary of the grocery launch last October. Same-day grocery delivery is now available to members within the 20 minute drive of 99% of our U.S. locations. Two-day grocery, which we do for our business center is available throughout the Continental United States. We continue to focus on providing great values on high-quality merchandise, and we had a few interesting new merchandise items online this quarter. A couple of examples of fresh white truffles, golf simulators, all types of high-end cosmetics and creams like La Mer. Pendleton in apparel in domestics, George Simonton Couture Cashmere coats, Wheels Up memberships for air travel and even a few Super Bowl packages.

And heart of the press, we went live online I think yesterday or last evening, but this morning with a online with newly complete but basically free line of Apple iMac products, both from MacBook Air to MacBook Pro to the iMac and to MacBook, and we're excited about that. And stay tuned for similar offerings in store that we’re working out the logistics of that. We've also continue to improve our online and inline cross marketing initiatives. We continue to do that in addition to drawing attention to our online offerings via these digital communications, we're leveraging that to highlighting feature and warehouse items in hot buys in store and driving traffic. We believe that certainly some of our strength traffic has to do with that.

In terms of update on buy online and pickup in-store, we've expanded the selection, no new categories but put some additional assortment and testing pickup blockers in about 10 locations for this program. Overall, these efforts continue to reveal this positive impacting our business and again most importantly, not only online but in warehouse and probably the sales in both ways.

Quickly on tariffs, there is not a whole lot new to tell you there. The big news of course in the last week or so is the fact that the planned increase on many items from 10% to 25% tariff rates effective January 1st has been pushed out I believe 60 or 90 days. And so not whole lot new for a quarter earlier. There are some items that when the tariffs have been in the 10 plus percent range have been very little impact on the sales, some has been a little more negative impact. We've particularly done a good job and it's one of the senior merchants mentioned, this is what we do with regular price increases as well, cost increases, we figure out how to get to minimize it.

And we brought in additional containers of certain seasonal merchandise early before the January 1st deadline, and we will continue to keep you posted. Lastly, in terms of upcoming press releases, we will announce our December sales results for the five week ending Sunday, January 6th on January 9th after the market closes.

With that, I'll open up to questions. And I'll turn it back to you, Liz.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Michael Lasser from UBS. Your line is open.

Michael Lasser

Within your core-on-core gross margin, it's been spending a little bit lower over the last couple of quarters. What's been driving that? Are you starting to feel the impact of your pretty rapid e-commerce sales and the margin dilution from that on your core-on-core gross margin? Then I have a follow-up.

Richard Galanti

There is two people in the room here, one senior merchant, that’s really us. There has not been lot of change. I was just looking back, if I can -- the fourth quarter, I believe year-over-year, it was lower by two. I believe in one of the two previous quarters on a year-over-year quarterly basis is in the 4 to 6 range. So, it’s really -- we don’t really view it as much more than the things that we're doing to drive our business. We get pretty excited for how to drive sales and whether it's Buyers’ Picks or Hot Buys or some of the promotional seasonal items, I think that's seen in our -- the strength of our business. The only thing that I pointed out in the past quarter or two is on the fresh side, we've seen little bit more margin pressure as there's been a little bit more retail competitive pressure out there, not only from supermarkets but Sam's as well but that's part of the business.

Michael Lasser

And my follow-up question is on the expense side, recognizing that you've been investing in wages and investing some of the tax benefit that you got. But you have put up some of the best comps we've seen in a long time and expense leverage has been modest. So when can we start to see that improve?

Richard Galanti

Well, keep in mind within these numbers, there's about 8 basis points related to specifically to that what I'll call that extra rate increase that we did in June post the tax at changes. On the IT side, we've got a heck of a lot going on. I think it still will bounce around a little bit, but having it being flat on a year-over-year basically and quarter we're starting to see that. Look, it's all sales related. There is really a lot of different things. We didn't go through all the activities we've got going on now, whether it's related to bringing into some of our depots, the returns activities, the fulfillment side with the success -- with a rapid roll out a year ago into our business centers of the two day and frankly with the success of e-commerce, including a lot of small ticket items or smaller ticket items that just the much higher penetration of bigger ticket items that we used to do be allow the small package fulfillment. We're making sure things get there on time even if it cost us a little more. So, I mean, there's lots -- I can go through a list, there's lots of little things. But I think we've got a lot of good things going on. And as long as we can keep sales going, you'll see that.

Michael Lasser

But just should we interpret that answer as, -- even if you continue this rate of sales growth, expense leverage should continue to be modest?

Richard Galanti

Well, we'll see. I mean, we never want to predict where it's going to go. Our first -- we are clearly a top line company. We clearly aren't going to do things to wages or to healthcare costs. Over the time people have always asked us how do we -- what are we doing to control healthcare costs. It's my first somewhat flip, but real answer is, expand more overseas. Healthcare costs as a percentage of sales in the U.S. are 20 to 60 basis points as a percent of sales higher than all other countries.

Our foreign pipeline, international pipeline is, it has expanded and I think you'll see that 70.30 or 75.25 U.S. versus international start to move with a little more international. So there is things that we do to ourselves based on when we do it. We've got a lot -- again, we got a lot of things going on with ancillary businesses, with expanding the whole fulfillment in risk and depot system.

I think I am beating around the bush because I think we can't really tell you where and when. We feel good about we're building to accommodate even more growth in e-commerce and on the delivery side. And we know that we'll see some of those costs associated with that come down as a percentage of those sales. But we're not going to tell you when it will take some time.

Michael Lasser

Okay. Thank you, Richard. I wish you have a good holiday.

Richard Galanti

Last one, Michael. I mentioned earlier, the stock compensation. Stock compensation is not just to a few people of this company, it's over 5,000 employees. And in many cases from warehouse manager above and buying managers and above and certainly the senior people, it's 60% to 80% of compensation. Because of our annual grants that invest currently over five years are granted in October, which is Q1. The fact that our stock price has increased as well and acceleration related to 25, 30 and 35, that was 6 basis points of it. You're not going to see that thing forever. If you look back last couple of years, you'll see that typically in the first quarter and that will ease off in the next three quarters.

Operator

The next question is from the line of Simon Goodwin from Morgan Stanley. You may ask your question.

Simon Goodwin

Richard, I missed some of the prepared remarks. So I didn't hear what the core-on-core merchant margin was. But my question is, if margins let's say came in a little lighter than what The Street was looking for, curious if you can talk about. Is the cost of business going up? Is it reinvestment? Is it investment as external factors? And then I know you don't like to comment on the reinvestment rate. But is that changed this quarter given how much of -- how good sales were and there's more dollars flowing in?

Richard Galanti

Well, in terms of -- we're not that scientific and smart about how we do it. We're merchants at heart. And when we see things work we go for it. As it relates to the core-on-core, year-over-year it was down 6 basis points. As I mentioned in the last couple of quarters, we've seen a little bit more competition on the fresh side, which is fine. We've got good fresh sales numbers, but we like others, our competitors are working in a little lower margin there and we're not going to let anybody take it away from us. But that's a small piece of that delta. There is a lot of other moving pieces to it. Part of it is related to the fulfillment side of it. We are encountering slightly smaller margins in some of that stuff as we roll it out very fast. But again, we don't really see -- in terms of are we investing more because we have it no, we invest more because whether we had or not, and we see these things working for us.

Simon Goodwin

And then just two quick ones. Can you tell us what the e-com penetration is, either the quarter or just e-com stands? And then the other piece is just cents per gallon or the gas margins, I don't know, but I'm sure you spoke about what they were in and of itself. But has the margins widened out?

Richard Galanti

Margins of gas have widened out. I mean everybody -- our sense is everybody is making more money out there. As they make more money, we make a little more money, but we sell a heck of a lot of gas. In the last -- I don't know what it was this quarter, but in the last couple of quarters, U.S. -- whereas overall U.S. gallon consumption is in the very low-single digits. We've been in the high single digits of gallon consumption, physical people coming in and filling up their tanks. And so, that's all good in that regard. What was the other piece of the question, on that e-commerce?

Simon Goodwin

The e-com benefit, yes.

Richard Galanti

I think it's just under 5%, 4.8% -- approximately 4.8, so somewhere between 4.5% and 5%, but I think 4.8%. But on that I think it was about 60 or 80 basis points impact to the comp, including revenue recognition.

Operator

We have the line of Chuck Grom from Gordon Haskett. Your line is open.

Chuk Grom

Richard, just on the other grosses again. I think you said overall down 50 ex rev rec and gas discount 26. Can you quantify with the actual rev rec impact was for 2Q, and how we should think about over the upcoming quarters?

Richard Galanti

I can't give it to you, I don't have it exactly. Revenue overall was down about half -- I will give you an extreme example though. Historically, what they call a curated travel package where we it put together, we have a commitment to the different components of that travel pack, it'd at the hotels or the cruise whatever. Historically, that was a brokerage fee, a brokerage commission. And I am making this up completely. But let's say there was $500 brokerage commission, you had no sales -- you had 500 in sales the brokerage commission and essentially no cost of sales. And so we will say that's a very high margin percentage. Now that was related to, and again I am making this up, a $5,000 cruise package or $5,500 crews package, you would have 5,500 in sales, 5,000 across of sales and above. Now, it's a very small piece of our business but that's -- for the year that $700 million of it of that revenue recognition. So, there is a lot's of moving parts within this thing.

Chuck Grom

We thought it maybe could be about 10 to 12 basis points, I don't know…

Richard Galanti

How much, what's that?

Chuck Grom

Roughly 10 basis points in the quarter, so we thought that with…

Richard Galanti

Yes, qualitatively, I'm hearing little less than half of it, so 10-some, like it's a little less than half of 22.

Chuck Grom

And then just again here just on the model and there is 2017 tax impact that you had. Was that just a onetime item in the first quarter, or is that going to repeat? It doesn't sound right, doesn't sound it will based on your 26% to 27% tax rate for the year, but just wanted to…

Richard Galanti

It was one-time. It relates to the tax act, but some of it relates to things that it started for us in fiscal 2019. And by the way, there is still some moving parts to the tax act. I mean, it's hundreds of pages. Some of things don't work completely outlined. There may be a little pluses and minuses. This was a little bit bigger than a little plus, which was good.

Chuck Grom

And then just with -- I think a year from now under the belt with cost of glossary and Instacart. I'm just wondering, it doesn't seem like it based on how strong November was. Just wondering if you think you're losing any in-store traffic from somebody just replacing that trip with buying online, either though CG or Instacart?

Richard Galanti

I think the view is it's incremental. It's hard to say when the in-store frequencies are so strong. And I don't think we done a lot of pulling of members to see is this incremental or not. But we feel that we're seeing less than we originally thought, which wasn't lot to begin with in terms of does it take away from the frequency in the store. It can't add to it. But it has opened some new markets for us or some expanded markets. Anecdotally, I have plenty of friends that come up to me and tell me that how they love it in terms of doing more -- some of their incremental food shopping that way or making it more convenient to themselves. And we're finding the people that live further away are using it more, but these are all anecdotal nothing science related to my comments there.

Chuck Grom

And then just a follow up on Simon's question about the e-commerce margins, might have saying historically it's been a margin accretive category for you where it garners the higher margin than the store margins. I just want to make sure that that still in fact correct?

Richard Galanti

No, that's never been a higher margin. It’s been a little lower margin. You've got competitive categories like lot of things which nominates the penetration and then there is cost of shipping. And so it's a little lower margin. It's a little lower margin and a lot lower SG&A, so it's a higher P&L if you will in terms of the earnings, recognizing that not every expense is allocated back to it.

Operator

The next question is from John Heinbockel from Guggenheim Securities. Your line is open.

John Heinbockel

Did you see any hardest pressure from the port congestion, either having to pay to prioritize fly product in? And are you seeing any of that today as we go into '19?

Richard Galanti

Nothing more than usual this time of year idea, again anecdotally, I know that when we had very strong produce sales on the few items like watermelons around Labor Day. When you have to get an extra container somewhere fast not shipping across, I'm just talking about truck containers or the side trailers, something you paid$1500 for might cost $3500 for that last truck. But again, these were anecdotal stories I heard. My understanding is there was a little backup in China and Shanghai, but not a heck of a lot there. And plenty of part of that is every extra container goes out there merchants like Costco were filling them to bring in things in anticipation of certain tariffs going to 25% on January 1st. Can I interest you in some patio furniture?

John Heinbockel

And then broader on supply chain, right. So if you think about, I guess calendar '19. Is the chicken plant the only lumpy thing? So I think that's still slated for calendar '19. The opening of that -- can that -- will that actually, we'll actually be able to see that in the P&L. And is there anything else lumpy like that that might impact specifically supply chain in '19?

Richard Galanti

I think first of all the plan is by early summer, they'll start processing but not 100% capacity and that will take six or eight months to get to 100% capacity. So it's really into fiscal '20, or either mid fiscal '20 going forward, it's running smoothly and we're close to full capacity. There is a few other things that aren't as big and slightly less lumpy. Last year, we opened a commissary, bakery commissary in Canada. It's by no means at full capacity yet. We're adding items that we sell but doing some things that we didn't start off doing there.

Same thing we've had a meat plant in Tracy, California for 20 plus years. We opened a second meat plant in Morris, Illinois that will handle the Midwest and East Coast. It's by no means at full capacity yet. And so there's some lumpiness and that's -- both of those latter two things have been around -- the commissary has been around for over a year, maybe closer to two and the meat plant's been around for a year-ish. And so those are some of those, when I talked earlier about -- I think Michael Lasser was talking about what other things are challenges to SG&A. There's lots of little things like that, notably some additional -- the ramp up in getting up and running fulfillment both for e-commerce and those other two day deliveries. So we've got a lot of little things going on like that. The big lumpy is going to be, I mean just by sheer size of it, is the chicken plant, but that has more to do with this. There'll be some more preopening and there'll be some, perhaps a little more depreciation.

John Heinbockel

And then just lastly, are you seeing any early signs of pickup in fresh inflation meat produce? It might be percolating a little bit. But have you seen that yet?

Richard Galanti

We haven't. One of the merchants here is shaking their head.

Operator

Next question is from Chris Horvers from JP Morgan. Your line is open.

Christopher Horvers

Thanks. Good evening. So, first of all, on rev rec. So as we think about that gross margin pressure that you experienced in this quarter, is that something you expect for the rest of the year, essentially, there's no recapture or pressure all year because of the change in accounting? And then also on the top-line front, I know you mentioned that there was a benefit to this month on the top-line in November, but that has pressure in December and January. So over the year is the rev rec impact to the top-line neutral?

Richard Galanti

That latter question is related to income. Now rev rec will be for the year, I think in our September sales release, we talked about the fact that throughout '19 we estimate that this new standard will benefit sales by about 1%. So 1 point something billion dollars. Some other things have more margin percentage in fact. But and at the end of the day, it has no impact on the bottom-line.

Christopher Horvers

But -- understood. So you had a big benefit in this sort of November month in this quarter because of e-commerce, right? And that's rev rec? So you had a bigger benefit now. So it just mitigates throughout rest of the year essentially? Or goes the other way?

Richard Galanti

Relatively speaking, there's a bigger benefit at the end of Q1 and into December because of the holidays and the strength in e-commerce.

Christopher Horvers

Okay. And then the gross margin, I know it's up and down to the SG&A line, but the gross margin impact persists over here?

Richard Galanti

Yes, typically will be an 8 to 10 basis point headwind.

Christopher Horvers

Understood. And then, in terms of the e-commerce strength in the month of November, you got a lot of stuff on website, you're advertising it more. Were you more I guess aggressive with advertising or promotions because it was Black Friday or is this just a new normalized rate of like, “Hey this is what we're offering” and sort of there's some sustainability to that growth that you saw in the month of November?

Richard Galanti

They were the same number of ads or marketing pieces. We have more e-mails that you're sending to. We've done a better job over the years of collecting e-mails. There is better values. I think a year ago we talked about not only online but in-store, better values Hot Buys and Buyers’ Picks that higher traffic and higher conversions. Those are all things -- some of that stuff is improving your site one-on-one recognizing that there are so many things we had done as well in years prior, and the values. I mean I think we've got the attention of the suppliers in many cases and they see how it’s improved their business. Particularly in a way in some cases, those products are doing as well as our competitive brick and motor operators.

Christopher Horvers

Yes, I bought a snow blower and it was like 30% cheaper than when I could find at a big box store. So in November, that was my Black Friday gift. My last question -- and they delivered it to my garage. My last question is, what percentage of e-commerce are you shipping currently versus direct from vendor? And where do you think this goes over time? And like what sort of cost savings do you generate over time?

Richard Galanti

We are shipping about 50% ourselves and that tends to be the smaller size items and small pack sizes what have you, all the big stuff and all the white cliff stuff like white goods, big electronics, furniture, Italian furniture, those typically are done by third-parties.

Christopher Horvers

Is that percentage getting up over time or just because the mix of small items goes up that's what drives it up?

Richard Galanti

We'll have to see. I mean whatever is -- what we do whatever way is most economical. My guess is there are going to be some things that we're currently doing third-party that we will bring in-house as we get better and more confident in being able to do it. If you think even going back to some basic things like what we're doing with UPS with two days drive, it's not e-commerce but it’s two day drive. What other things can we do in that box size? We are working with vendors as others I'm sure as well to figure out how to get certain products, how to minimize the freight costs by getting -- given our volumes and our predictability of certain items, how we can get closer in a more efficient way to ultimate delivery to a customer.

Operator

And next question comes from the line of Karen Short from Barclays. Your line is open.

Karen Short

Hi. A couple questions. Just on tariffs. Can you maybe just elaborate a little on what your pricing philosophy will be with respect to tariffs? Meaning will you address price I guess increases if you need to on a SKU-by-SKU basis or are you looking at the whole box more broadly and trying to figure out how you can offset with a lower price increase across the box?

Richard Galanti

It's SKU-by-SKU basis, recognizing it's a heck of a lot easier to do when you're always selling 3,800 SKUs in its entirety to start with. And again it’s part of those price points. I mean I was talking to a merchant yesterday and they're giving examples of where on a $40 or $50 dollar item, that's up 20% or 15% -- 10% to 25%. They see no change in the unit volumes. And there's something -- and first of all if it's in the 10% range, I think we've done -- we feel we've done a good job of working with the supplier, what is the supplier willing to do and to try to minimize that or if there's competing suppliers, getting in more. So there's some items that even with a 10% increase we haven't had to change the price. Now maybe we aid into our margin a little, sometimes not at all. There are some items -- bigger ticket items, where you if you go from 500 to [6.25] at 25% or that may impact the unit volume of that stuff. In some cases, in anticipation of a 25% coming, we cut that quantity a little bit on some items. So it's all over the board, but overall as you might expect here we're going to be in the last increase to the lowest. But it's clearly not subsidizing it with other things.

Karen Short

Okay. And then I guess just color -- a little more color on your comment on fresh getting more competitive with both conventional and Sam's. Can you just give a little more color on what you're seeing exactly? And then I guess the question -- bigger question I have is, I mean isn't there a possibility that Sam's continues to get more aggressive on other categories? I mean the pressure will likely spread. So I guess are you seeing any of that there or is it just limited to fresh?

Richard Galanti

Look we're respectful competitors. We've been doing this for 35 years. We're not moving away. And we feel we're in a pretty strong area. I mean within fresh it's produce and protein and whatever comes our way we'll figure it out. And I'm only -- part of challenge here in trying to be helpful to all of you guys is use of examples. It so happens that fresh right now year-over-year is down a little bit. There are times when it's been up. Right now it's notable. We still feel that we're getting more bank room from having Sam's close 63 units and certain incremental competition on certain things. And that's what we do, we compete.

Karen Short

Okay. And then just last question, you comment on such thing -- pick up lockers in 10 location. Can you maybe just elaborate like how bigger the pick up lockers, is there -- are you kind looking to be expand that or broaden it? And what kind of SKU you would be able to fit in currently?

Richard Galanti

Well, I don't think -- they won't fit a 60 inch television as an example. They are relatively small in looking I think in 10 locations. Keep in mind the items that we started with and we chose to do first of all were items where we've every time -- and again I would have bought that from new Costco but I can't have it shipped to my office and I don't want to be left on our my doorstep and so I get home from work. And so we think we've picked up a little incremental there. What we're finding is, is that many of these customers, they've shifted, they bought it that way, first of all we have more availability of items because we offer a much broader selection that if you order online and pickup in store, you guys are really limited to jewelry items, some small electronics items and handbags. All buildings right away offer the service and show you that there is more out there but it looks as a test, we will figure it up.

What we're not looking to do anytime soon is full order online to pickup in store where groceries A, we don't have the room upfront; and B, we see -- we're probably little biased that we see that not every customer shows up when they order online. And separator between dryer, refrigerated and frozen and it's very costly, and we do have an alternative now with the Instacard engine.

Operator

We have the line of Edward Kelly from Wells Fargo. You may ask your question.

Edward Kelly

Rick, you mentioned the gas business and margins rising everywhere, we're seeing that at other companies. Just thoughts on the reason for that and the sustainability of that?

Richard Galanti

I think the reason is traditional retailer -- well all companies including us, we want to make money and what we have found is, is that as prices have come down our view is, our motive, if you will, our competitor pricing has gotten bigger. What we're saving -- you can just look at every week at GasBuddy.com but we do our own price studies. What we're saving customers relative to competitor stations nearby whether they are independents, or supermarkets or nationals, we're saving more today than we’ve ever saved per gallon and we’re making more than we’ve ever made, partly because everybody else is making more, we’re able to make a little more.

How long does it last? I don’t know. It does seem there is not a heck a lot of traction on gas prices going up. We have mentioned earlier you heard us from me before we want to make a little a lot of times. As it relates to gas I mean we have been enjoying for the last several quarters on a year-over-year basis, close to high single-digit gallon comps in the US population where it's just above flat, low single-digit, so we're definitely taking market share and we're enjoying able to do that while making a little more but not a lot more.

Edward Kelly

I just want to take a step back and ask you a question about EBIT growth. If you look at EBIT growth this quarter and adjust for one-time items like the charge on the breakage, adjusted wage investment, remove the MFI benefit. If you do all that it looks like EBIT grew somewhere in sort of like the 3.5% to 4% range. That was about the same as it was last quarter, but yet your comp is 7% to 8%, fuel is contributing. I'm just kind of curious as we take a step back here, help us understand how we read that I guess, why that number is not better and then how do we think about going forward because you might not be comping 7% to 8% forever. Does the kind of flow through improve from here?

Richard Galanti

First of all, two things, you mentioned the 3% to 4%. I think as you add those two items and that impact to pre-tax is 6% or 7%. But even that -- and I say the two items, the Citi/Visa breakage as well as our payroll increase on top of everything we took because of the income tax. We knew some of that income tax was going to impact the pre-tax line in that way. The other thing you mentioned a couple of the other questions on there's lots of stuff going on here guys. And I think we're less worried about was gross margin 5 or 10 basis points different than it could have been. It could have been a lot better than what we did, we don't look at it that way, we look at what we can do to drive our business and we still want to make money. We still think long-term. We're creating a stronger and more loyal company. So I think that we're optimistic about what our future holds in that regard, I can't tell you -- I can't give you guidance of where it will go.

Edward Kelly

Thank you.

Richard Galanti

And by the way, in addition to just the payroll hitting the tax, in our case rough numbers the first full year post the tax reform it's about -- on those pre-tax earnings is a little over 300 million pre-tax. So it's a little over 400 million -- sorry a little over 300 million tax benefit, that's a little over 400 million pre-tax. 120 million that went towards those wages. We view these monies as partly our members and we are doing what we do to drive our business. Certainly what we did to remind our members of the -- those that have the Citi Visa card to drive that business which is long-term positive through their revenue share when it's used outside, as we get more and more people who have it and more and more of impact at the top of wallet. So we think again all these things are driving.

Clearly we in the first year of two-day delivery and fresh -- I'm sorry two day delivery and a big ramp-up in small package with the monies we're investing in fulfillment and the monies we're clearly delivering a package to our member even on the two-day delivery side at a more expensive price when we first started today, which is still more expensive than it will be tomorrow.

Operator

We have Rupesh Parikh from Oppenheimer, your line is open.

Rupesh Parikh

Good afternoon, thanks for taking my questions, so first on the tax rate housekeeping question. The tax rate that you gave, the guidance, does that excludes the benefits that you saw in Q1?

Richard Galanti

Yes, it excludes to those usual things.

Rupesh Parikh

Okay, great. And then on capital allocation perhaps the share buybacks again you guys are not -- you're not buying many shares back. I’m just curious on the special dividend and just how you are thinking about capital allocation going forward?

Richard Galanti

Well first of all in terms of buying back stocks we do buy it regularly. We have a metrics that we look at, we adjust periodically as the stock goes up, we buy a little less each day, there’s stock down by a little more. Even it was a small number for the quarter it was a little higher towards the end of the quarter and the beginning of the quarter. But that doesn't -- we will see what next quarter brings. As it relates to special dividends we have made no decision in that fourth special dividend, we've been asked time and time again because each of the three that we've done were spaced about 2.5, 2.25 years apart from each other. So we've been asked what happens in 2.25 years from May of '17 and we said we don't know, stay tuned and see. When we have done them, they've worked well. We still continue to generate a lot of cash in excess of our CapEx and in excess of roughly $1 billion annual dividend that is real historically about 13% a year. So it's certainly on the table but there's no promises of if and when and how much.

Rupesh Parikh

Okay, great. Thank you

Richard Galanti

And why don't we take two more questions?

Operator

And next question is from Scot Ciccarelli of RBC Capital Markets. Your line is open.

Scot Ciccarelli

Hey, guys. It's Scot Ciccarelli. Richard, as you guys change your accrual for the rewards breakage, is that something that will be a notable item on a go-forward basis or is it relatively minor and kind of just lost in the rush?

Richard Galanti

It was relatively minor, keep in mind, you're talking about an in-reward that's in the $2 billion range a little. And if you look at it, this really effected -- we started doing this a few months ago, these reminders in a bigger way. And if you look at it, is sped up or increased the ones that were going to not be redeemed through that related to 2007 calendar purchases on that card. And then we had an net loyalty accrual for all purchases in '18, we were very lower to the accrual from -- prior to this from the previous year, but that's what we do. On an ongoing basis, I think the impact to the quarter relative to our old one was about a penny a share.

Scot Ciccarelli

Okay. Got it.

Richard Galanti

It was like $6.5 million or $7 million pre-tax. So you could annualize that component on an annual basis.

Scot Ciccarelli

Okay. And then I want to clarify an answer to an earlier question I think it was from Chuck regarding the profitability of e-commerce. Can you help us -- I was also under the impression that e-commerce was a higher let's call it operating profit transaction for you, but the way you kind of phrased it, it sounds like it's a lower gross margin but maybe it's EBIT a positive contributor ….?

Richard Galanti

It's a higher -- it's a more profitable operating margin. It has a little lower gross margin and a lot lower SG&A. Maybe a lot lower SG&A is more appropriate when you return lower SG&A because there are a few things that we don't allocate that certainly to it. But like when you buy something online return to warehouse, the warehouse gets charges for that. So we try to do not a complete full but it's charged towards IT expenses and things like that. And certainly on the direct buying and what have you. But at the end of the day we view it as more profitable than the bottom-line of our company as a whole.

Scot Ciccarelli

Got it ….

Richard Galanti

What?

Scot Ciccarelli

I'm sorry. And that is still whether it’s being shipped by you or the third-party that you referenced to an earlier question?

Richard Galanti

It's all blended together.

Scot Ciccarelli

Got it. Okay. Thank you.

Richard Galanti

Okay. One last question.

Operator

And for our last question, we have Scott Mishkin of Wolfe. Your line is open.

Scott Mishkin

Hey, guys. Thanks for taking my question. So I just wanted to make sure I understood the answer to the last question of the $43 million. It sounded like $7 million -- $6 million to $7 million of it is actually not one-time it's going to be kind of an ongoing. Did I get that right or I misunderstood?

Richard Galanti

The $43 million relates to activities prior to the beginning of fiscal 2018. That's one-time in sense that goes back to anticipated redemptions higher than what had been previously reserved for both fourth calendar January 1st through December 31st, calendar '17 purchases transactions both in and outside of Costco on the Citi/Visa card. From February of '18 when they were mailed out to everybody they've been redeemed. In the last few months, we upped the amount of times where we remind our members to redeem them. That increased the redemption. So based on what we had previously thought would be redeemed and not expire as of December 31st of this year we have the annual net piece. That's a little over a third of that 42 million.

The other piece is all purchases later this year, those card members will receive a rewards certificate in February of '19, but every time a transaction is -- a reward reserved we accrue a little bit of the anticipated breakage or slippage in it. Well with our reminders we accrue a little less than that. So it's also all the purchases made from January 1, '18 through the end of August or September 2 whatever the year end was in fiscal '18, we up the accrual on that. In Q1 based on our lower breakage assumption and therefore higher accrual breakage, a lower breakage assumption, it will -- that was about just under $7 million pre-tax. That's the piece that will be ongoing.

Scott Mishkin

Okay. So I think I got that.

Richard Galanti

It was about $49 million-ish, almost $50 million. $43 million was one-time prior to Q1.

Scott Mishkin

Perfect. And then my second question which is more strategic. I mean we're seeing a lot of companies and I think a couple of questions got to this, is that, as we go more and more and more omni-channel the flow through of our sales, the profitability just kind of comes in. How do you think about Costco? I mean Costco seem not to have this problem but maybe we are seeing a little bit of it as we go more omni-channel, just the profitability of the business gets a little bit -- it comes down a little bit. How do you think about that and how should we be thinking about that?

Richard Galanti

Well I think that we were -- in my view we're fortunate that we're not impacted. If you look at traditional department stores which deliver stuff to your home and then you send 70% of it back, it's all free. That's a necessary part of their business. That's not necessarily profitable relative to the old way. Supermarkets, I don't think delivery -- to the extent you can even really take a customer or grow market share that will be incremental, maybe that the negative is offset by the positive of incremental sales. I think we've been fortunate. The way we've done it as it relates to e-commerce in general or even two-day delivery. We did go and spend hundreds, if not a $1 billion dollars around delivery. We're doing it actually as a partner of UPS limiting the things that we do and it seems to be working.

Now we're still going to improve the cost of delivery on even that because there is some -- we want to be in entire Continental United States, there are some places that are farther away so we pay a little more on that. I think when we look at to the extent it's incremental, we've found -- I think we've also benefited from things like if you look at white goods. Historically when we have limited white goods in store I think four fiscal years ago we did $50 million in US in white goods. Three years later in fiscal '18, we did $500 million, and then like 5.0 something in white goods, none of it's in store. We have displays in locations and display high end LG, Samsung, Whirlpool and like and most people want to deliver and actually the other one take it away. So all that white glove service. We have been fortunate in that regards. There is an example of because of what's happening in the world, if you look at -- you heard me mention apparel where brick-and-mortar apparel is generally down over the last few years that's given us an opening to buy certain things and historically we've put in the quantities, 99% plus of our apparel is still in-store not online, we're testing these things online. It's a $7 million category that's grown compounded for four years in the high 8s.

Furniture where we have an in store limited 20,000 to 30,000 feet of furniture for 8 to 12 weeks of the summer, after Memorial Day before Labor Day, we still do some of that in store but now as you're around online same with patio furniture which is there for 12 or so weeks January through part maybe early April and now geographically the locations that where people buy that stuff year around and have the ability to do that. So I think we've been fortunate there are some things that given our item nature of our business has helped us in that regard and perhaps offset with that. Clearly it's got -- in the first couple of years, certainly these things cost us more. Building out the fulfillment centers, where part of that success online is getting people to open email to click on something and to buy something and where those will be a few years there, and I'm sure if you figure that that but these strong sales will help that.

Operator

And this concludes today's conference call. Thank you everyone for participating. You may now disconnect.