Costco Wholesale Corporation (NASDAQ:COST) Q2 2019 Results Earnings Conference Call March 7, 2019 5:00 PM ET

Company Participants

Richard Galanti - Executive Vice President and Chief Financial Officer

Conference Call Participants

Christopher Horvers - J.P. Morgan

Simeon Gutman - Morgan Stanley

Chuck Grom - Gordon Haskett

Edward Kelly - Wells Fargo

Karen Short - Barclays

John Heinbockel - Guggenheim Securities

Scot Ciccarelli - RBC Capital Markets

Mike Baker - Deutsche Bank

Scott Mushkin - Wolfe Research

Operator

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

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

Richard Galanti

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

The risks and uncertainties include, but are not limited to, those outlined in today's call, as well as other risks identified from time-to-time in the company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made, and the company does not undertake to update these statements except as required by law.

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

The reported net income for the quarter came in at $889 million or $2.01 per share, a 27% increase compared to the $701 million or $1.59 per share last year in the quarter. In terms of sales, net sales for the quarter came in at $34.63 billion, a 7.3% increase over the $32.28 billion reported last year in the second quarter.

Comparable sales for the quarter, as shown in the press release for the 12 weeks on a reported basis, US was 7.4%, Canada was minus 0.3%, Other international 0.7%, for the total company a 5.4%, as well e-commerce for the 12 weeks on a reported basis was 20.2%.

Excluding gas deflation, the impact of FX and some weakening foreign currencies relative to the dollar, as well as revenue recognition, which is an impact this year, the 7.4% reported in US would've been at 7.2%, the minus 0.3% in Canada would be a plus 6.0%, other international instead of being

0.7% reported would be plus 4.8%, for total company the 5.4% reported would become a 6.7%, and again e-commerce reported a 20.2% ex-gas, FX and rev rec 25.5% plus.

In terms of Q2 comp sales metrics, second quarter traffic or shopping frequency increased 4.9% worldwide and 5.2% in the United States. Weakening foreign currencies relative to the US dollar negatively impacted sales by approximately 140 basis points and gasoline price deflation was another minus 50 basis points of impact.

Our rev rec actually benefited comp sales by about 55 basis points to the positive. These are the three factors that we adjust for and that are presented in today's release, as the adjusted column.

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

Going down the income statement, membership fee income reported came in at $768 million or 2.22%, that's up $52 million or 7.3% from a year ago. Again with weak foreign currencies if you adjusted for flat FX that would make the up $52 million another $9 million up or up 61% -- up $61 million year-over-year ex-FX.

Reported membership revenue of the plus $52 million amount, that’s -- a little more than half of that -- a little more than $20 million of that related to the membership fee increases taken in June of 2017 in US and Canada. We’re now nearing the end of that 23 months cycle to recognize the incremental benefit of the fee increases as that was deferred accounting into our P&L. The benefit to our P&L will be fully recognized in the next two quarters by the end of fiscal year. But as with these last couple of quarters, it diminishes each quarter. In Q3 we will have about half of the benefit recorded in Q2 and then in Q4 it will be very a very small benefit.

In terms of renewal rates in the second quarter, our US and Canada member renewal rates in Q2 came in at 90.7%, up from 90.5%, 12-weeks earlier at Q1 end and worldwide the rate improved to 88.3% up from 88.0% at Q1 end. So improvement in our renewal rates.

In terms of the number of members at Q2 end, the member households and total cardholders, we ended Q1 12 weeks earlier with 52.2 million member households, at Q2 end that was 52.7 million, and total cardholders increased from 95.4 million at Q1 end, this is 12 weeks later Q2 at 96.3 million.

During the quarter, we had one new opening in Coral Springs, Florida and we also relocated in Miami location. At Q2 end, our paid executive membership base stood right at 20 million. This is an increase during the quarter of 341,000 or about 28,000 per week since Q1 end. Now this includes the recent introduction of the executive membership in Korea, which is our fifth country offering executive membership. For Q2 Korea contributed a little over half of those increases.

Going down the gross margin line, reported gross margin in the quarter came in at 11.29% up 31 basis points from last year's Q2 '18 of 10.98%. The 31 basis point improvement ex-gas, FX and the rev rec would be plus 30 basis points.

I'll give you the chart and there is not a whole lot to it given that the adjustment column was not that different than the reporting column.

In terms of core merchandise, year-over-year in Q2 was up 1 basis point on a reported basis as well ex-gas deflation in the rev rec up 1 basis point, ancillary businesses up 33 on a reported basis and up 32 on an adjusted basis. 2% reward minus 3 and minus 3 basis points year-over-year. And then total up 31 basis points that I just mentioned on a reported basis and up 30 basis points ex-gas, deflation and rev rec.

The core merchandise component again was higher by 1 basis point here. Looking at the core merchandise categories in relation to their own sales, what we call core on core, margins year-over-year were higher by 8 basis points. Within the four key sub categories both food and sundries and fresh foods were up a little and soft lines and hard lines were down a little. But the net of the four departments on their own sales was up 8 basis points.

Ancillary and other business gross margin was up 33 basis points, up 32 ex-gas, deflation and rev rec primarily driven by gas and also benefiting somewhat from e-com and a few other things.

Moving to, SG&A, our SG&A percentage Q2 over Q2 was lower or better by 2 basis points both with and without the adjustments coming in at 10.0% of sales this year compared to 10.02% last year.

In the chart that I normally give out there really isn't not a whole lot to tell you. Operations was an improvement of 2 basis points in both columns, the other 2 line items that we usually point out, central and stock compensation expense were zero and zero, so the total remained at 2 basis points, so overall 2 basis points better.

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

Additionally, this past Monday, we began our new three year employee agreement. With the new agreement, we announced that we're taking our starting wages from 14 and 14.50 up to 15 and 15.50 per hour in both the US and Canada. In addition we're also increasing wages for supervisors and introduced -- and also introduce paid bonding leave for all hourly employees.

These items are incremental to the usual annual top of scale wage increases that are typically done each March. Collectively, these additional items will add about 3 to 4 basis points to SG&A over the next four quarters.

Now again this is on top of that 7 to 8 basis point impact I just mentioned that will impact the SG&A through this coming mid June. Otherwise, pretty comparable year-over-year in terms of central and stock comp and other various SG&A expense line items.

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

All told, reported operating income in Q2 '19 was up 18.4% coming in at $1.203 billion this year compared to $1.016 billion last year. Below the operating income line, reported interest expense was $3 million lower or better year-over-year, coming in at $34 million this year in Q2 as compared to $37 million last year.

The actual interest expense quarter-over-quarter each year is about the same, a little bit more -- a little delta in improvement in capitalized interest amounts. Interest income and other third quarter was better by $39 million year-over-year. Interest income itself was higher by $17 million year-over-year in the quarter, a combination of higher interest rates being realized and also higher invested cash balances. Also benefiting the year-over-year comparison were the various FX items in the amount of $22 million.

Recognize that much of this is essentially an offset to lower reported operating income and earnings in our foreign operations due to the strength of the US dollar versus many of the foreign countries, the currencies in the countries where we operate compared to last year.

Overall, pre-tax income in Q2 was up 23% coming in at a $1.250 billion this year compared to last year $986 million. In terms of income taxes our income tax rate was a little better than we had anticipated, came in at 25.8% effective tax rate during Q2 '19 compared to 27.7% in Q2 last year. For all of fiscal '19 based on our current estimates which again are subject to change, we anticipate that our effective total company tax rate for the fiscal year to be approximately 26% to 26.5%. This figure is about 0.5 a percentage point lower or better than we had previously estimated a quarter ago. This is primarily due to a Q2 tax rate that now includes a one-time benefit for certain foreign tax credits. This one-time tax benefit will continue through the end of the fiscal year, but we do not anticipate a similar type of benefit beyond fiscal '19.

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

As of Q2 end total warehouse square footage stood at the 112 million square feet. I might also add that in terms of CapEx we continue to allocate more CapEx to grow and support our operations, including as you know over the last year, year-and-a-half we had opened a second meat plant, the first one in California many years ago and then in Morris, Illinois, also a little while ago our Canadian bakery commissary in Canada. We are under construction with the big chicken plant in Nebraska. We plan to start initial processing and production later this year.

Depot expansion we are doing that in many areas around the world. Also, we -- just a month ago I believe we started up our first fulfillment automation operation near our -- next to our -- as part of our Mira Loma Depot. This is for small packages for e-commerce and we plan two more of those this year at other depots.

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

In terms of stock buybacks, in Q2, we expanded $117 million to repurchase 561,000 shares at an average price of $208.72. The $117 million of course is significantly higher than the Q1 purchases of $35 million.

In terms of e-commerce, overall again e-commerce sales increased during the quarter on a reported basis 20.2% and ex-FX and rev rec up 25.5%, continued increases in e-commerce in terms of orders and sales and profits and other metrics.

Top growth categories in the quarter, quite a few actually, grocery, consumer electronics what we call majors, hardware, health and beauty aids, tire automotive, toys seasonal, and apparel. We have now passed our one year anniversary on the grocery launch which was again a year ago October. Same day grocery delivery is now available to members within a short drive of 99% of our US locations. Two-day grocery is available anywhere throughout the Continental United States and while still these are small pieces of our total business operation they are growing nicely. We now have grocery shipments to all 50 states.

In terms of the e-commerce, in terms of new brands and items online during the quarter, we are now offering a much broader selection of Apple products, including the recent addition of MacBooks and iMacs and yes you would expect good values to our members. Also the first of what we expect several products from Sony, they just started to arrive. In terms of health and beauty aids names like Living Proof shampoo and conditioner, Murad Skin Care and Kate Somerville items. On the exercise front, NordicTrack is a new name. And finally, I had pointed out that now somewhat famous 180 serving 23 pound 20 year shelf like macaroni and cheese for $89.99. If interested, you can find that online under emergency supplies and in a few of the Costco locations.

We continue to improve our online and in line cross-marketing initiatives and we think that's continuing to drive our business. In terms of buying online and pickup in store, in the quarter, we expanded our selection within the same categories, jewelry, some electronics and handbags and continue to test pick-up lockers in 10 locations for this program.

Lastly, this calendar year, we will begin e-commerce operations in Japan early summer likely and in Australia late summer, early fall.

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

In terms of e-commerce reported for the four weeks 24.2%, and ex those adjustments -- appropriate adjustments 21.6% up. February sales were negatively impacted by weather throughout the US and Canada in a big way.

We estimate that negative impact on the total company was approximately 1% and a little more than the 1% figure in the US and Canada.

In addition, Lunar New Year and Chinese New Year occurred in February as same as last year, however, 11 days earlier this year. This is an important holiday in terms of sales strength. The holiday shift negatively impacted February's other international sales by we estimated 450 basis points to 4.5 percentage points, and total company sales by about 0.5 percentage point.

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

Foreign currencies year-over-year relative to US dollar hurt Feb comp sales by -- hurt February comp sales in Canada by approximately 460 basis points. Other international also by about the same number basis points about 4.5 percentage points, and total company by an estimated 130 basis points. The negative impact of cannibalization was about 50 basis points negative in US, 80 in Canada and 120 in other international, for total company minus 70.

Within ancillary businesses hearing aids, optical and food court had the best comp sales in February. Gas price deflation negatively impacted total reported comps by about 75 basis points. The average selling price during the four-week month compared to the year earlier was down 6.3% year-over-year, the average gallon a year ago we sold for $2.74, this year $2.56. Including the adverse impact of weather and the holiday shift in Asia, our comp traffic or frequency for February even if taking those into effect -- taking those impact into effect February was up 2.7% worldwide and plus 3% -- 3.2% in the US.

For February the average transaction was up [0.8%] for the month, again this includes combined impacts from FX, gas deflation and rev rec. So that's about it in terms of our prepared notes.

Lastly, in terms of upcoming releases we will announce our March sales results for the five weeks ending Sunday April 7th, on April 10th after the market close -- after the market closes.

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

Question-and-Answer Session

Operator

[Operator Instructions]. We have your first question, comes from the line of Christopher Horvers from JP Morgan. Your line is now open.

Christopher Horvers

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

Richard Galanti

Honestly you know we drive our business by driving sales and usually that means lowering prices on things which we continue to do, and we're also buying better all the time. Some of it’s mix, some of it -- the one category that shifted if you look back over the last few quarters of reports where we look at core on core, fresh foods has been a little down and I think the keyword here is little. I appreciate the fact that every basis points for us is $14 million plus pre-tax a year of [nearly 1 billion] [ph] but you are talking about 5 to 10 basis point swings here and there's a lot of things that impact it, whether it's freight, tariffs, some -- negative, in some cases not as bad as we thought. I think we've done a great job and we continue to do a great job particularly in fresh food organics where there's a little -- I believe there's a little less pricing pressure and some competitive pressure, but don't get me wrong, as soon as we have a good quarter next quarter we will change that.

Not giving any guidance, we know that we keep it pretty steady and we feel pretty good about it, whether it's up a few basis points or down a few basis points.

Christopher Horvers

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

Richard Galanti

I think over the last several years the new normal is better. If you go back to when gas prices sky rocketed several years ago and as they started coming down, what we saw, and what we read frankly from others is that as they came down not all of those savings were passed on to the consumer. They gave us perhaps a little bit bigger window, we're still -- I think if you ask our gas -- the people in charge of gas operations around here, we're saving the customer a little more today and making a little more because there's just a bigger opportunity of [gap][ph] there. It really comes down to that. It is still a volatile, no pun intended profitability item. It can swing back and forth, based on underlying cost of goods sold that change daily. And -- but the new normal is better in all those examples. But I'm sure there will be quarters, this was a -- Q2 was a particularly good quarter. But as I believe Q2 a year ago was a little better than the other three. But that’s not seasonal necessarily, it’s just -- there is a lot of different factors, what's going on in the news internationally, what's going on with inventory levels, world and US inventory levels, what's going on with -- inevitably a refinery shuts down for two weeks for their planned repairs, it takes four weeks. So any of those things switching from winter to summer blend and back. All those things impacted. I think we are fortunate in the fact that we turned a lot of gas. We literally turned inventory about daily and as you know we have locations with up to 24 pumps and they are backed up all the time, it’s great.

So I think we’re in a fortunate position that overall retailers whether it’s retailers that have gases in their parking lots, like supermarkets and discount stores and ourselves or full line independent retailers or the ones with the convenience stores, I think everybody seems to have been taking a little more and that's given us an ability to do so over the last couple years. But I guarantee it will evolve and we will always tell you that it was certainly a little more of a benefit this quarter than normal but it was a year ago too.

Christopher Horvers

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

Richard Galanti

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

Operator

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

Simeon Gutman

Hey, Richard. A follow up on the gross margin or the core margin. You mentioned mix helped a little to dig in, anything about mix that was either seasonal or something that is changing. You said it was always lower product acquisition cost. Can you remind us when your own [check up plans] [ph] is coming up? And then one more in that mix, can you tell us the channel mix between physical and digital, is that sort of embedded gross margin improving as well?

Richard Galanti

No, overall our gross margin online is a little lower than our company overall, part of it is the product mix itself and part of it is we are driving that business. The [banana] [ph] hasn't changed, that's been that way. We also work on a lower SG&A online as you might expect.

In terms of mix there are so many different pieces to it honestly. Part of it is, when you walk into a Costco in the US roughly 90% of the goods are -- come through our cross-stock operations. For us cross-stocks are very profitable. It's the most cost efficient way to ship stuff. Nobody can do that to the extent that we do it because of how we sell goods in pallet and large case quantities, so I mean there’s lots of little pieces to it. I think private label and continuing penetration of private label, fresh, but all these are anecdotal. There is no one thing that’s driving in a particularly large direction. We think we are pretty good at what we do and we’re constantly buying better even as it related to tariffs, which so far so good in terms of being on hold, but we don't know, what's in the future. I think bigger retailers have the ability to buy better.

Simeon Gutman

And then shifting to SG&A, in the past I think you talked about [indiscernible] your comps hold up in mid-single-digit, you’re leveraging, and that was based on some [indiscernible] of spending, there was IT, there was technology. Has anything on the spending side changed, any curve, that’s increasing, decreasing on that same mantra of about mid-single-digit comps, that [indiscernible] to give you leverage?

Richard Galanti

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

Operator

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

Chuck Grom

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

Richard Galanti

I don’t think it would have helped the margins. This question is did it hurt it or not hurt it. And probably it hurt it less than one might think but that again gets back to our ability to buy right and to send those 10% tariff items so as examples versus 25 that's a big difference, in some cases you've got your vendors along with us, ease out a little bit, sometimes not. I think it’s just one piece of what we do. The fact that organic helps us, the fact that KS helps us. The fact that we don’t talk about but we really plan through a lot on the marketing dollars that are out there now, that some of those impact cost of sales.

Chuck Grom

And I guess just a follow up on Chris’ question here, you've got three consecutive quarters in a row of the core on core, core being negative in this quarter, what’s the positive, is there anything else you could point to?

Richard Galanti

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

Chuck Grom

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

Richard Galanti

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

Operator

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

Edward Kelly

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

Richard Galanti

On the latter part of the question, there is no intentional reinvestment. I mean there is a 100 different moving parts to our company all the time and we do what we feel is right. It's kind of like a question that was asked a year ago, we were asked about what the extra earnings from the lower tax rate, will that change, what we're doing with automation online, fulfillment whatever else and the answer was of course no. We've got more cash than we spend and this will add to that and that's all good, but we're constantly figuring out what other things we can do there. What was the first part of your question? I'm sorry.

Edward Kelly

On fuel, if you’re trying to -- yes.

Richard Galanti

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

Edward Kelly

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

Richard Galanti

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

Operator

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

Karen Short

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

Richard Galanti

When you say our area, throughout the United States?

Karen Short

Well, we map it by kind of stores by state. But west was particularly strong.

Richard Galanti

Yes, we don’t disclose that. Again it was a little more than half but not all.

Karen Short

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

Richard Galanti

Yes, I mean that is starting March 4th this past Sunday, I think I indicated. On top of the 7 to 8 that will continue through June 11th if you will. So all through Q3 and the first month of the -- the first four weeks of the 16 weeks fourth quarter effective March 4th we will have that additional on top of that 3 to 4 basis points. And that 3 to 4 basis points will be March 4th to March 3rd of 2020 if you will.

Karen Short

3 to 4 basis point, okay. And then just wondering if you could call anything out in terms of tax refund data, like in terms of your expectations on driving sales and there is a lot of noise on the timeline of that but any color what you are thinking that will do the comp, certain not do I guess?

Richard Galanti

Well, honestly I never heard anybody here talk about that and I have read some of the same things that you read, it started off in the period was a little lower and now in the period was a little higher, not a lot higher but a little higher. Typically on a macro basis that impacts retail overall and whatever impact it has on that is typically little less to us. That's what we've seen historically, whether it was a change in tax rates or dividend rates or you name it, EBT, food stamps, whenever there's any kind of macro change that impacts retail across the United States, there's a little bit less of an impact to us. But we've not really seen or even know how to answer that.

Karen Short

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

Richard Galanti

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

Operator

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

John Heinbockel

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

Richard Galanti

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

John Heinbockel

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

Richard Galanti

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

John Heinbockel

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

Richard Galanti

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

Operator

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

Scot Ciccarelli

Hi, guys. Scot Ciccarelli. Richard, with your first opening in China coming up, what is the best way to think about U.S. versus international store openings over the next, call it, 2-3 years? And then related to that, any reason why we should see international profitability levels decline as you start to move into some of these new markets, like China?

Richard Galanti

Well, first of all, if you'd asked us five, six, seven years ago, by now, what percentage of our units would be outside of the U.S. and Canada -- and I include Canada as part of the original, mature, fully grown-out area -- that, by now, we'd probably be 50/50 international, outside of the U.S. and Canada. And we're not. It's 65/35, 70/30 U.S./Canada still. Part of that is the opportunities that we've had in the U.S. and Canada. And part of it is the pipeline is taking a little longer elsewhere. I think you'll continue to see that change and the direction is toward more international. But I can't sit here and tell you that it'll be 50/50 three years from now or five years from now. But, clearly, we've got more things going on.

Now, as it relates -- whenever we go into a new country, it's almost, by definition, you're going to lose money for the first few years, even if that first location or two contributes a small amount of profitability, if it does. Because you still have the central expense and the whole full thing, the infrastructure. I look back at Japan. When we first went into Japan, we opened six units in the first five years and the goal was to be at breakeven at the end of Year 5 and I think we beat it by about 10 months. But at the end of the day, fast-forward another 10-12 years past those five years, and we now have in the high-20% and we'll grow from there faster and more profitable than it was in that mid-term when we were opening several units on a small base.

But it takes time. And as we go into France, as we went into Spain, by definition, those are going to add more to the bottom line sales in that calculation of return on sales and sometimes even subtract a little at the top. The key is balancing a little of that and I think we're big enough now that, even if we overdo it a little bit on some of that new stuff, it's OK. We'll let you know if it costs us an extra basis point or two.

Scot Ciccarelli

Got it. Okay. Thanks, guys.

Richard Galanti

Why don't we have two more questions?

Operator

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

Mike Baker

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

Richard Galanti

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

Mike Baker

That's what I'm trying to clarify.

Richard Galanti

There's other things that benefited it and other things that hurt it a little too.

Mike Baker

It being the growth in earnings?

Richard Galanti

Well, gross margin and earnings, ultimately.

Mike Baker

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

Richard Galanti

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

Mike Baker

Okay. Understood. Last, real quick, SNAP. Any benefit from the pull-forward in SNAP? I don't know how much of it is your customer but it's helped others.

Richard Galanti

No, we really don't see any of that. Very little of it. Those kind of things don't really impact us.

Operator

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

Scott Mushkin

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

Richard Galanti

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

Scott Mushkin

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

Richard Galanti

Well, it has shifted. As you know, a few years ago, the average ticket was $400 or something because we sold big ticket items. We didn't have lots of little things or things that got you back to the site more frequently and more regularly. Some of that's just starting. As I talked about, the first of three planned fulfillment -- what we are calling fulfillment automation centers, we have our first one in southern California. It's literally open less than eight weeks, I believe. It's over a $100 million investment. The first one is the most expensive because you developed all the systems and everything as well. We have two other planned for depots in other parts of the country.

I would hope that that's something that's going to hit our number a little bit because it means we're doing well in it as we're growing it. We're going to see the cost of picking an item dramatically reduce because we've done it not quite manually but less automated than we'll do over time. But that's going to be an ebb and flow over time. We'll just see how it goes. I think, in the scheme of things, recognizing that e-commerce, in its entirety is still, what, 5% to 6% of our business? 5% plus of our business? Even as we hope and assume that it's going to grow at a higher rate than the rest of the company, it's still going to be in the single digits for a while.

So, those impacts -- and even with the first one, you're talking about the inefficiencies of getting something open up and running and building it up over the first 6-12 months and then the associated depreciation and the like. Those things, in the scheme of things, are not huge. As we do three and four and five of them, it's a little bigger. So is one chicken plant, so is one new concept bakery commissary a few years ago. So, all these things will be -- I would think these are things, we'll hope to balance some of them, but net-net, if they're a little drag, that's a positive.

Scott Mushkin

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

Richard Galanti

No, look, I think we, more than anybody, hate to use the word "weather" as a reason. And you see it every day. Clearly, whether it was rain, snow, cold, you name it, that impacts things like patio furniture, spring wear. But I think if you ex out the things we try to, as I pointed out on the call, if you ex out the weather, which we assume -- I think I said it was 1% in the month for the full company. A little more, therefore, in the US and Canada. We try to err to the conservative assumption on that. I mean, it's not a lot more than that but we feel comfortable in talking to the operators of the impact. And if you add that back in and you add the holiday shift in Asia, you take those things out, we're a little lower, not a lot lower, than we've been enjoying for the last several months. I guess we'll have to wait and see how March is.

Scott Mushkin

See how March is. Exactly. All right. Well, thank you so much and take care.

Richard Galanti

Thank you. Thank you, Vincent, and we'll be around to answer questions. Thank you.

Operator

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