Costco Wholesale Corporation (NASDAQ:COST) Q3 2019 Earnings Conference Call May 30, 2019 5:00 PM ET

Company Participants

Richard Galanti - EVP & CFO

Conference Call Participants

Michael Lasser - UBS

Edward Kelly - Wells Fargo

Josh Kamboj - Morgan Stanley

Scot Ciccarelli - RBC Capital Markets

Chuck Grom - Gordon Haskett

Christopher Mandeville - Jefferies

Karen Short - Barclays

Gregory Melich - Evercore ISI

John Heinbockel - Guggenheim Securities

Scott Mushkin - Wolfe Research

Erica Eiler - Oppenheimer

Operator

Good afternoon, ladies and gentlemen. My name is Jerome, and I will be your conference operator today. At this time, I would like to welcome everyone to the Costco Third Quarter Earnings Conference Call. 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.

Now, it’s my pleasure to hand the call over to Mr. Richard Galanti, Chief Financial Officer, the floor is yours.

Richard Galanti

Thank you, Jerome, and good afternoon to everyone. I will 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 third quarter of fiscal 2019, the 12 weeks ended May 12th. Our reported net income for the quarter came in at $906 million or $2.05 per share. This compared to $750 million or $1.70 per share last year. As mentioned in the release this year's third quarter benefited from a nonrecurring tax item of $73 million or $0.16 per share.

Excluding this item, earnings for the fiscal third quarter were up 11% year-over-year. Net sales for the quarter came in at $33.96 billion, a 7.4% increase over the $31.62 billion sales figure last year and the quarter. Comparable sales for the third quarter were as follows. For the 12 weeks on a reported basis U.S. was 7.0%. Excluding gas inflation, FX and rev rec it was seven -- it would have been a 5.5%. Canada reported at a 1.3%, ex those items, a 5.1% positive.

Other International reported 1.7%; ex those items a 6.9% to the positive. So total company we reported a 5.5% comp sales figure for the 12 weeks.

Excluding those three items almost negated each other coming in at 5.6% excluding those items. E-commerce was 22% for the quarter on a reported basis and 19.5% ex those items.

In terms of Q3 comp sales, our third quarter traffic or shopping frequency increased by 3.7% worldwide and up 3.4% in the U.S. In terms of the impact of the items of gas, FX and rev rec, weakening foreign currencies relative to the U.S. dollar negatively impacted sales by about 130 basis points. Gasoline price inflation impacted sales by a small amount plus 10 basis points and rev rec benefited comp sales by about 110 basis points. So the net of the three about a minus 10 basis points.

Our average front-end transaction or ticket was up 1.8% during the third quarter. And excluding the impacts from gas, FX and rev rec, our average ticket was up approximately 1.9%.

Next on the income statement membership fee income. We reported membership income in the third quarter of $776 million or 2.29% of sales. This is up $39 million or 5.3% from last year's $737 million. FX had a negative impact on that number that impacted the $39 million increase would have been about just under $10 million higher than that ex-FX.

Our reported membership fee revenue again was up to $39 million or 5.3%. In addition to FX impacting that to the negative it does have the benefit of the fee increases we took almost two years ago. Really the last fiscal quarter of that those increases that we took in June of 2017 in the U.S. and Canada.

We now have effectively completed that 23-month cycle that takes to recognize the incremental benefit from the fee increases. The benefit to our P&L in Q4 will be very small less than $1 million. In terms of renewal rates, at Q3 end, our membership rates -- renewal rates remain strong. In the U.S. and Canada membership renewal rates came in at 90.7% the same as it was a quarter ago. And worldwide the rate was 88.3%. That figure also the same as of Q2 end.

In terms of the number of members at Q3 end, the number of member households we had was 53.1 million at Q3 end, that's up from 52.7 million 12 weeks earlier. In terms of total cardholders, we came in at 97.2 million, up from 96.3 million 12 weeks earlier at Q2 end.

During the quarter, we opened three new warehouses one each in the United States, Korea, and Australia. At Q3 end in terms of paid Executive members, they stood at 20.4 million which was an increase of 406,000 during the quarter or 34,000 per week.

Korea was actually a very small piece of that increase, so we've had a good continued increases in Executive Member penetration in other countries as well, most notably U.S. and Canada. Going down the gross margin line, our reported gross margin in the third quarter was lower year-over-year by six basis points coming in at 10.99% versus last year's 11.05%.

Now, excluding the items that I've excluded before FX rev rec and the like the six basis point lower number would be actually plus five basis points excluding gas inflation and rev rec. If I ask you to jot down a couple of numbers here, two columns both reported and an ex-gas inflation and revenue recognition for the third quarter of 2019 as compared to a year earlier. The first line item here would be core merchandise.

On a reported basis year-over-year in the quarter it was reported one basis point lower. Ex-gas and rev rec it was nine basis points positive; ancillary businesses minus three and minus one basis point; 2% reward, minus two and minus three. And something [along those lines] [ph] you'd have the reported number six basis points lower and ex-gas and rev rec five basis points higher.

One thing you all note compared to last -- the second quarter, in the second quarter we had a big increase in ancillary business margin as we pointed out last quarter's earnings release. The core merchandise component here again lower by one basis point. If you look at the core merchandise categories in relation to their own sales core-on-core if you will margins year-over-year were higher in Q3 year-over-year by 21 basis points. The subcategories within the quarter all four named subcategories food and sundries, hardlines, softlines and fresh foods were all up year-over-year in the third quarter on their own sales.

And that's a trend that we've seen last quarter. It was up less than that amount in Q1, down a little bit year-over-year. Ancillary and other businesses gross margin again lower by one basis point on the ex-gas and rev rec. Nothing really to speak off in terms of things there.

Moving to SG&A. Our SG&A percentage Q3-over-Q3 was lower or better by six basis points coming in at 9.92% of sales this year. This compares to 9.98% reported last year. Ex gas inflation and rev rec it was higher or slightly worse by five basis points.

Again to jot down a few numbers here in the two columns. Reported in the second column without gas inflation and rev rec gas inflation and rev rec. Our core operations on a reported basis was better by seven basis points so plus seven. Ex rev rec minus two. Central, minus one and minus two basis points. Stock compensation zero and minus one. Summing up those two columns, again on a reported basis SG&A was lower or better by plus six basis points and ex those other items worse by five basis points.

Now the key thing here is within the seven basis points of improvement or rather the minus two basis points ex gas and rev rec, that’s notwithstanding the fact that we're still facing pretty big headwinds from the U.S. wage increases to our hourly employees that went into effect in June of 2018 as well as additional wage increases implemented in March of 2019. Both of these wage increases negatively impacted SG&A during the quarter, representing about 10 to 12 basis points of the year-over-year variance.

In Q4, the estimated impact will be about minus five to six basis points, which is the residual impact from June of 2018 plus the March 2019 increases. And then we'll tick down to three to four basis points and that's what we estimate in Q1 of 2020. Central, nothing to speak out there. It was higher by two basis points on an ex gas and rev rec basis. Stock compensation flat year-over-year and then [again] [ph] minus one.

Next on the income statement is preopening expense. Preopening expense came in at $14 million this year into Q3, up $6 million from a year ago. We have one additional opening, three opening this year versus two last year. There was also about $2 million of preopening expense in the number related to the chicken plant that we plan to start at the beginning of production in later this summer.

Additionally some of these quarters expense relates to our higher number of openings we have in Q4 in Qs one through three in the first 36 weeks of this year, we will open a total of 10 new locations in Q4 we have 11 planned. So there was some remnants in the beginning of some of the preopening there.

All told, reported operating income in Q3 was up 5% coming in at $1,122 million this year, compared to $1,067 million last year. Below the operating income line reported interest expense was $2 million lower or better year-over-year coming in at $35 million versus $37 million. That's just a slight difference in capitalized interest amounts.

Interest income and other for the quarter was lower by $5 million year-over-year. Interest income itself was actually higher by $11 million year-over-year. However, various FX items in the amount of a minus $16 million negatively impacted the year-over-year comparison. Overall pre-tax income in Q3 was also up 5% coming in at $1,123 million this year versus $1,071 million last year.

In terms of income taxes, our reported tax rate in Q3 of fiscal 2019 was 18.5%, compared to 28.8% in Q3 last year. As was mentioned in today's release this quarter's earnings and our tax rate benefited from a nonrecurring $73 million item. Excluding the $73 million item, our third quarter tax rate would have been 24.9%. We estimate that our effective total company tax rate for fiscal Q4 of fiscal 2019 to be more in the 26.5% to 27% range.

A few other items of note. In terms of expansion, as I mentioned, we've opened through the third quarter to-date a total of -- actually opened 12 units -- I'm sorry opened 13 units, but that includes three relocations and so net of 10. In Q4, we'll open 13 locations which includes two relos, so net of 11 which should put us in terms of net new openings for the fiscal year at 21, the same number that we had in fiscal 2018.

About three quarters of the openings this year are in the U.S. and about quarter internationally. This also includes our anticipation of opening our first Costco in China, in Shanghai tentatively scheduled to open on August 27th right before the fiscal year ends.

As of Q3 end, total warehouse square footage stood at 112 million square feet. In terms of CapEx, while our new warehouse openings remains in the low 20s, the CapEx then is in line with prior years. Excuse me; it's in line with prior years. We've got a lot of money being spent on fulfillment, both e-commerce and grocery expansion and automation, the chicken plant which is what we mentioned; as well as ongoing expansion and depot infrastructure as well as IT modernization.

In terms of stock buybacks in Q3, during the third quarter, we expended $44 million repurchasing 192,000 shares at an average price of $226.57. To-date we've expended $195 million or 903,000 shares at about a $216 per share price. As a reminder, the last Board meeting, the Board approved the reauthorization of a stock repurchase program. They authorized a new $4 billion program that will remain in effect through April 2023.

In terms of e-commerce, overall our e-commerce sales increased as we mentioned in a comp basis 19.5%; reported 22%; 19.5% ex-FX and gas. I might point out by the way that these numbers do not include the increases that we're seeing with Instacart. Instacart comes into our warehouses and purchases and that goes into warehouse sales.

The top growth categories in the quarter were electronics, health and beauty aids, furniture, small appliances, automotive, and optical. And new brands and items online during the quarter include high end televisions from Sony and Samsung as well as the latest generation of Apple products from AirPods to iMax and the like.

Other things will include things like bare minerals beauty cosmetics. Sales highlights for the quarter included some significant diamond repurchases one in the $400,000 range and big-ticket items like golf simulators that sold for $14,000 each which we sold during the fine pay period.

We also continue to improve our online and in-line cross marketing initiatives. A lot of push notifications for start and end of warehouse promotions. E-mails featuring hot items and suggestions for Mother's Day and other holidays like Cinco de Mayo.

During the quarter, we also completed the rollout of six regional grocery distribution centers located within our existing depots. You'll recall that previously we had fulfilled since late 2017 when we began the two-day grocery, we did that through our business centers. As it expands, we pushed into our depot operations and we'll also have in those cases regional assortments.

An update on in terms of our buying online and pick up in store, in the quarter, we began rolling out additional pickup lockers. Over the last several months we've had been locations, but we're in the process of rolling that out to one additional 100 locations over the next four or five months before the September through December holiday season.

Continued growth in Costco app use among our members. We continue to experience that with new features recently added like pharmacy orders and pick up notifications, easier shopping ability on member savings events, photo center, and various push notifications and expect several additional new features are planned for July in the upcoming months thereafter.

We continue to focus on getting merchandise to customers faster. Some of that has to do with where we locate the merchandise in these depot and other ancillary operations. As discussed last quarter, we will begin e-commerce operations in Japan later this summer; and Australia late summer early fall.

Next thing I want to touch on for a minute is the whole question of tariffs. I'm sure we'll be getting some questions on that, so a few comments. As we indicated a couple of quarters ago in our earnings release, there continue to be a lot of moving parts, although some of the moving parts are getting bigger and but it is still pretty fluid.

The actions that we took then and we continue to take where we're able to -- not in a big way we're accelerating shipments before certain tariffs we pull into effect or will be increased as a percentage of the tariffs although there is limited ability to do that. We worked with suppliers. We've gotten to potentially every supplier on every item as you might expect to see what we can do to both reduce cost and figure out how to do that.

In some cases, we've reduced order commitments on certain items. We look at alternative country sourcing where possible and feasible, although again, there's a limited amount of the ability to do that. And we've taken advantage of lower pricing on certain U.S. items that have been impacted the other way.

In summary, we'll continue to see our customers competitors react to this. What's interesting is if you -- as you know this list three which is the biggest of the three lists of potential tariff items, those were listed back in September of 2018 at 10% tariffs and we're going to go to 25% at December -- as of December 31st of 2018. That data continue to move although it's now moved into its in fact it 25% for items that I believe are exported after meeting. So we're just starting to see some of those impacts.

As you might expect it's all over the Board in terms of every activity of the vendor is different. In some cases, it's being passed on. In some cases, we're able to work to figure out how to move merchandise and then the impact of when the price increase does go through. It has a different impact of how it affects sales. We think that we are in a good position in terms of our size and our ability and our relationships with our vendors and we'll keep you posted how it goes.

This last piece that again includes -- it's the biggest list of the three lists and includes things like furniture, luggage, banks, vacuums, gross, and more items like that. That's pretty much it on our side. And lastly in terms of upcoming releases, we will announce our May sales results for the four weeks ending this Sunday June 2nd, next Wednesday June 5th after the market closes.

And with that I will open it up for Q&A and turn it back to Jerome. Thank you.

Question-and-Answer Session

Operator

[Operator Instructions] Now, our first question comes from the line of Michael Lasser from UBS. Michael, you are now live.

Michael Lasser

Good evening. Thanks a lot for taking my question. Richard, how are you going to comp the $400,000 diamond ring? It's going to be tough next year.

Richard Galanti

Well, do you have an anniversary coming up.

Michael Lasser

Even if I did, I can't afford it. My question relates to the comp. The traffic’s been moderating a bit, should we think about this as just more reversion to the mean? Or do you think that there's something else going on?

Richard Galanti

Well, look every time it reminds me of a few years ago when we saw a slight moderation in traffic and it was, oh my God, this is the new normal. And our answered then was we don't know what the -- we don't know if it is or it isn't. What we know is we've got a lot of exciting things going on in buying. We certainly -- the different buckets of money we talked about over the last few years whether it's the fee income for membership fee increases, the credit cards switch, the tax reform, all those things don't go away. They in fact grow each year a little bit. And so I think that we feel that we're in a good position to keep driving it.

As it relates to where it goes from here, we'll have to see. We think relatively speaking our value proposition is as strong if not stronger than it's ever been out there. And we'll have to see where it goes. Now what are some of the headwinds? Recent headwinds included the weather and other things that started back in February. Certainly this new word with a capital T called Tariff there's questions out there that we read about every day and we'll see.

Again we feel whatever the impact is, we feel that in the earlier tariffs last year, recognizing many of them were in the 10% range not a 25% range, we actually felt we picked up a little market share in some cases. We don't know what will happen tomorrow, but we feel we're in a good position from a buying power standpoint and certainly have the ability to drive sales the way we know how to do it with good value.

Michael Lasser

My follow-up question is your core-on-core gross margin expanded rate that accelerate quite a bit from the last couple of quarters. Is that because of what you are doing proactively? Or is it just that the market becoming a little less competitive and as a result you're able to earn a little bit more in your sales?

Richard Galanti

I think it's a little of everything. I think some of its internal controls. We still manage the basics, managing spoilage and D&D, and negotiating with vendors. It's a lot easier to do that. Our buying power, and our strength per item is enormous given our $150 billion is over 4,000 given items at a given time.

Certainly I get back to some of those other buckets we've had available. We're able to use those and we're able to -- we've also been able to show that we drive even greater value. We -- the vendor sees a big increase in pick up in the unit sales and I think that's worked in our benefit.

Michael Lasser

Okay. Thank you very much.

Operator

Your next question comes from the line of Edward Kelly from Wells Fargo. Edward, you are now live.

Edward Kelly

Yeah, hi Richard. I wanted to ask you about margins. Just the performance on the core margin and then the core-on-core, which obviously was even better. Any additional color on the puts and takes there? And then how we should maybe be thinking about that for the remainder of the year particularly as tariff starts to accelerate?

Richard Galanti

Well, I mean, look when – we've obviously been asked when prices are going up, when cost are going up we want to be the last to raise them. And when prices are going down we want to be the first to lower them. We're not afraid to use some of those monies to again drive business. I think a lot of things worked in our favor this quarter. Just when you get comfortable with us we'll do something else, right?

But there's -- again we don't really give -- provide direction or guidance on where it will go in the future. We feel pretty good right now about our competitive position relative to both in line and online and the value proposition that we bring. In fact, some of the weakness whether it's tariff related or whatever it's related, in some cases, we feel that it gives us a leg up as it relates to we can go in there and buy large quantities of something at great value. And these are all anecdotal comments though. Overall, we feel again good about our competitive position and the things that we have in the pipeline as it relates to having good - great merchandise and great prices.

Edward Kelly

And just maybe a follow-up on the tariff side. As we think about this three and we think about 25% your philosophy I guess generally you've always been a bit more of a customer-first organization. Is there a margin risk associated with that? And then as we think about any potential for list four, how strategically would you think about that?

Richard Galanti

Well, there's always risk. At some point, you can't [indiscernible] all these tariffs. We work with vendors. There's been some switching a small amount of switching to other countries of origin where we can, although we're not the only one in town trying to do that.

At the end of the day prices will go up on things. What's interesting is that it's hard to predict what the impact is. We've seen strengthened patio furniture even with certain tariff price increases although part of that is because there was a little bit of slowdown in patio furniture because of the bad weather in January, February and we get into seasons early. So, again, it's hard to analyze each one. I think what we're most cognizant of is a key price point. If you're something at $9.99, you hate to go to a new calculation that was at $10.49. But if it's 25% on $9.99, needless to say you're not worried about $10.49 you've got to figure out where it is above that.

And again I think we've done everything we can and we'll see where it goes from here. And then the real unknown is how long it's going to last. And to the extent it gets into list four, that's a whole new ballgame as well. That's the rest of everything, if you will, including electronics and apparel and the phones and televisions.

And so the more discretionary item is we were -- again I think a little conservatively surprised on the patio side, although we also have to recognize there were some build up because the weather. It took a little bit while for the weather to turn. And -- but if you start getting 25% tariffs on that list four, the list four is not here yet. And we're hopeful that the ebbs and flows of the relations between our countries improves in that regard.

Operator

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

Josh Kamboj

Hi, this is Josh Kamboj joined for Simeon. Thank you for taking our question. The expense leverage that you saw in the quarter was encouraging especially against the wage headwinds that you're facing. Can you maybe go into a little bit more detail about what's driving those specifically? And then ignoring the benefit from lapping that wage increase next year, can you continue to drive expense leverage in the same areas for the foreseeable future to offset tariffs?

Richard Galanti

Look the biggest – depending on the level of tariffs, if it's lot, no. But as we've always said, we're – the biggest thing is driving sales. If we can drive sales, we're not very good at leveraging expenses of sales or weakening relative to others perhaps because there are things we're not going to do. We're not going to postpone a wage increase and things like that.

And we work on expenses every day and every week and every month at our budget meetings literally, and I think we – again, there will be a little reduced headwind in each of the next few quarters with the big increase as we saw an hourly wages both in June of 2017 and now in March – sorry in June of 2018 and now in March of 2019 as those – that 10 to 12 negative goes to six or seven goes to four or five or whatever I said earlier.

Beyond that, there's also – I mean, there is basis points here and there that go both ways. A lot of the things we're doing like this – the new fulfillment centers, the automation, none of this stuff goes completely smoothly. And we don't point out each one of these things, but I'm sure there's some extra hits of half basis points here and half points there and there is other things that improve. At the end of the day sales is paramount.

The other thing is that as – I think not over this next year, but over the next several years to the extent that we have a higher increase of openings outside the United States that tends to help the overall percentages on things like health care. Health care is 30 to 70 basis points higher in every other country than in the U.S. things like that. And so – I'm sorry, lower, health care expense as a percent of sales is lower in every other country outside the United States.

So there is – we've been fortunate that our comps [after works] [ph] and virtually every other country we've gone to take some time, it takes a few years to get there, when we first opened in a country. But at the end of the day that will help. And that's not going to help tomorrow. That's over the next 5 and 10 years.

Josh Kamboj

Okay. Thank you. And Just as a quick follow-up following up on some of the other questions a little bit more directly. Do you think over the next few quarters your merch margin can continue to expand if it's the core-on-core one as tariffs have greater impact on your business?

Richard Galanti

Well, first of all, we don't guide. That's why – I should say stop. But look tariffs to the extent that we want to be the last to raise prices, it doesn't mean we're going to wait and not do it at all. We've had to be pragmatic about it, but net-net those that would be a drag a little bit of a drag. Now hopefully, it's a grab from a plus – a drag from a plus 20 not a minus 5.

Josh Kamboj

Appreciate it. Thank you.

Operator

Your next question comes from the line of Scot Ciccarelli from RBC market. Scot, you are now live.

Scot Ciccarelli

Good afternoon, guys. Scot Ciccarelli. I was curious, if you guys have considered providing a quick-and-collect kind of process for your grocery offering given the success that Walmart had with their grocery pickup?

Richard Galanti

Not at this juncture. I mean, the click and collect that we're doing is simply – as more for small size big-ticket items like electronics and jewelry and handbags. We continue to look at it. We continue to scratch our heads about it. We recognize that they and some others are putting in a lot of financial commitment to doing this. I think what you're going to find is like everything else in life at Costco over time we figure out how to do it our way that makes sense for us that still works.

One of the reasons that whether it's Instacart or a smaller scale shipped in the Southeast, which is growing its geographic footprint as well as Google, all those things are ways to do that without us having to get into that business in a big way. And that's on two-day. And recognizing if somebody wants something in an hour, they're probably not going to get it from us.

But what we see is – the other thing is we still want to drive into the warehouse, and so far what we see in small bite-size this year and some of the things we've done, the net of having that one-day grocery with third parties or two-day drag grocery through us, it has been slightly additive. So it's not cannibalizing -- well it cannibalizes the number of business to our warehouse a little, some of the -- still is an increase in sales. These are small data points over a short period of time, so we have to see it. But we'll figure out how to keep doing it our way and hopefully that will work.

Scot Ciccarelli

Got it. So, really nothing in the near future. Okay. Thanks guys.

Operator

Your next question comes from the line of Chuck Grom from Gordon Haskett. Chuck, you are now live.

Chuck Grom

Hi, good afternoon. Thanks. Richard, just in light of the trade war, rhetoric and market volatility and some of the concerns, I'm just wondering if you've seen any change in the consumer behavior particularly in some of your more important market such as California. PVH was out saying some things last night. Curious if you're seeing anything on your consumer?

Richard Galanti

No. We really haven't.

Chuck Grom

No? Okay, great. And just thinking on Ed's question about operating margins, they are much stronger than a decade ago. And frankly not many in retail can say that. I’m just curious when you look ahead, you think bigger picture about some of the puts and takes what do you think about operating margin dollar growth in the future?

Richard Galanti

I guess, more, more. The slides that has been shown at our international managers meeting every year for that three or four-day event from the beginning of time and through Craig Jelinek's tenure over the last eight years, we're a top line company. And as long as we can keep driving sales all those other things fall into place.

The fact that we have been successful longer than I thought and continuing to get more people to convert to Executive Membership, the benefit that we have with great value on a credit card, all those things drive loyalty and will drive sales and everything else will take care of itself. And we feel pretty comfortable right now with the recognizing the value is not just price, the price is still the biggest piece of value on what we do.

Operator

Your next question comes from the line of Christopher Mandeville from Jefferies. Christopher, you are now live.

Christopher Mandeville

Hi, good evening. Can I just ask in terms of competition on the consumable side, are you seeing anything notable in terms of change on pricing, whether it be greater aggression or maybe a greater willingness to pass on overall cost inflation? And I guess I am definitely curious about categories like eggs and pork where we've seen some significant deviations on pricing?

Richard Galanti

I mean, pork has been over the board as I understand. But overall – the answer to your overall question is not really. If anything, I mean using gasoline as an extreme example, I think the fact that our -- most gasoline retailers have been willing to make more on gas and has enabled us to have a bigger value GAAP and make a little more. And so that suited us well.

Again I think we're fortunate that many of the price wars are out there, the traditional retailers at any given category are impacting a lot more than we are on those things. So that's -- I think we've been fortunate. And on basics, what I call the supermarket ads of yesteryears, we've been watching those every week since the beginning of time and continue to do so.

And where we helped ourselves is in areas of private label and areas of organic and specialty items. I mean you go into even something as basic as cheeses. We're not just selling to basics cheeses anymore. We're selling premium cheeses. And I think in everything we do and packaged food items, we stepped up the quality and whether it's organic or antibiotic free or you name it. And those things we're able to show a to show a great savings and still maintain a decent margin.

Christopher Mandeville

Okay. And you brought up fuel. I guess I'm curious that the comments on being able to capture maybe a little bit more margin all while expanding the gap relative to competition. Is that broad-based across the country? Or is it more so confined to areas like state of California? And then can you just speak to growth on gallons in the quarter?

Richard Galanti

As I understand it the only geographic region in the U.S. where that's not the case is parts of the Midwest and it ebbs and flows there. Everywhere else it's been pretty healthy for us. And I think the gas -- the value gas when you look at some of these third-party websites that collect from millions of people across the country on pricing, we continue to be shown as the best value out there.

Christopher Mandeville

And anything on the comps for gallon growth?

Richard Galanti

They continue to be in the -- I believe they're still in the high single digits in gallons. Yes, they continue in this quarter to be in the high single digits, whereas I think U.S. gallon consumption is in the low single digits. We're driving people into the parking lot.

Operator

Your next question comes from the line of Karen Short from Barclays. Karen you are now live.

Karen Short

I'm wondering -- on core growth margin is there any benefit to core-on-core maybe from timing in terms of accelerating delivery of items that may be passing on some price increases because -- I mean it sounds like it could be a little more structural in nature although, I know you don't really want to commit to that? And then I had another question.

Richard Galanti

Not really because in our mobility we kept of the cost down. Even as costs went up and we had it sooner we held it off. We held off raising price until we were into a higher cost unit or product.

Karen Short

Okay. And then I guess then that would lead us to think that there may be something more structural in terms of what we saw on core-on-core? Or are you reluctant to go down that path?

Richard Galanti

Look. Again I guess, I choose to use the world that we try to be pragmatic about it. We didn't look back two quarters ago and say core-on-core was down five or six basis points year-over-year and then last quarter it was up seven or eight or whatever we reported and now it's up 20. We didn't strategically plan to do with like that. It's our buying power.

I think in some of these weak times in certain categories, apparel is an example. We can go in and buy huge quantities of something where the manufacturer's volumes have been cut by other merchants and really drive great value and people love it and even give even a greater value to the customer. The private label is a little bit -- product mix is a little bit. Certainly private label is a little of it.

Karen Short

Okay. And then if we get -- if list four does get implemented, what percent is actually imported from China in totality? Or what will be the increase on what's imported directly from China? Or do you just have no way of calculating that really?

Richard Galanti

There's really not an easy way to calculate it. First of all, list four is somewhat titled everything else, but who knows what everything else is once it goes through that few months' process of exceptions and people appealing the process.

And look it's more significant in the sense that there's some categories that are arguably discretionary in nature. Apparel to some extent, electronics certainly, and more people put that off. Again getting back to patio furniture, we didn't see it, although, we believe part of that is related to just the season starting a little later this year.

Karen Short

Okay. And then just last question from me. I think testing self-check-out in some stores, maybe can you just give an update on how many stores that's been? And then any color on what you're seeing with respect to traffic in those stores where that's been rolled out?

Richard Galanti

Of the 540-ish locations in the U. S. it's in about 125, we're going to move to 250 in rapid order over the next several months. It works -- by the way for us it works best in high-volume locations where it's got a lot easier, particularly if you have a credit card now where you can just contactless.

And it's very fast and customers are using it. Our members are using it. And it's saving some labor at the front end. As important, on the highest volume units, it's getting people through the front end faster which we recognize when you get -- if our average unit is in the 180, 190 range they get a lot of units in the 250 to 350 range that helps.

Karen Short

Great. Thanks very much.

Operator

Your next question comes from the line of Gregory Melich from Evercore ISI. Gregory, you're now live.

Gregory Melich

Hi thanks. Richard can you give us a little more on the e-commerce front? Specifically, is it still more profitable from a margin standpoint than retail globally? And how could that change as you know roll out into Japan and Australia, how should we think about that?

Richard Galanti

Well, keep in mind U.S. doors everybody else Canada doors everybody else to some extent portion to the size of our company. Overall, it's more profitable recognizing we don't charge back every item. There's a charge that the warehouse gets for accepting merchandise and things like that.

At the end of the day, it's -- we think it's slightly more profitable at a lower gross margin. And there's certain categories like -- I mean the most notable one is white goods. Four years ago in the U.S., we did maybe 50 million in limited amount of white good sales, meaning refrigerators, washers, and dryers and the like. Now, we display a few items in-store in three – go out three fiscal years, which was last year's fiscal 2018, we did 50 something, 500-plus, a little over $500 million, and that should be – we should be able to double that to go over $700 million this year.

So double that in a few years. So that's a category that by necessity nobody was going to go pick it up buy in and pick it up anywhere else anymore. And this has enabled us to have – so there is those kinds of things that have helped as well, where we would have lost some of that business, I think over time in the warehouse anyway.

Patio Furniture or -- Patio Furniture during the 12 weeks to 16 weeks in the January through April period, predominantly and regular furniture during the kind of after Memorial Day and before back-to-school during the 10 or so weeks in the middle of summer, that's when we sold that stuff. Now, we sell some of that stuff year-round online most notably Patio Furniture that we sell year-round in decent amount in geographies where the sun actually shines more often.

Gregory Melich

Got it. And so is it fair to say that still that e-commerce business is very general merchandise-heavy? And can you update us on what vendor direct is as a percentage of that business or just – and how big it is as a percent of sales?

Richard Galanti

Well, vendor direct, yeah. When we first started years ago, it was mostly all vendor direct, because it was big ticket. It was solely big-ticket items being shipped – drop shipped. That's a lot of smaller percentage today than it's ever been. First of all, in addition over the last few years, where we have gone as to, one, improve the site greatly itself, whether its search, returns, you name it. But we've added categories to create more velocity and more reasons for you some of you to think about the going to costco.com, whether its health and beauty aids or food and sundries and things like that.

And so I think you'll see that continue, one of the reasons that we're doing some of these automation fulfillment for small packages. If you will and that's the natural progression of how we do things. And I was reading an article just this morning about – the writer was suggesting a small percentage of our members shop online at Costco. That's in this small relative to others, but it's increased each year and has increasing at a greater level now. And we're getting better at it. But again, we still want to use the Internet to get to the end of the store as well, and we think we done a pretty good job of both of those.

Gregory Melich

Great. And just a clarification on the tariffs, it sounds like – if just pick a number let's say 15% a year COGS came from China. List three would be less than half of that and list four theoretically would be bigger if it went on everything it. Is that fair?

Richard Galanti

List four would be -- yes absolutely.

Gregory Melich

Yeah. Okay. Great. Thank you, guys. Good luck.

Richard Galanti

Yeah.

Operator

Your next question comes from the line of John Heinbockel from Guggenheim Securities. John, you are now live.

John Heinbockel

So Richard, let me start with the sequential improvement in core-on-core, I'll beat that horse again. Is that fairly broad based right the 8 to the 21? And then secondly, I don't think you guys don't spend a lot of time thinking about item-by-item elasticity or do you? And a real good sense where – where the – where some of that can be given back productively?

Richard Galanti

Right. It is broad-based and we certainly do not think a lot about price elasticity. Are there – well, we think about price elasticity in one direction, if we lower the price where we sell more, and you know, if you think back John a couple – two or three years ago when we restructured the MVM, which had worked well in group sequentially over 15 years -- plus years and it was a little stale. And so we changed it up a few items of greater values each. And what we found is on some cases it worked, and on some cases it didn't. But I don't think we ever think about what if we raised the price and sell 2% less units.

John Heinbockel

Yeah, I'm thinking more on the -- if we cut the price, if we were invest some of our core-on-core benefit, can we get more share or we're just pushing on the strengths?

Richard Galanti

We do that. And I think we tried the most extreme example of saying can we drive more value out of more volume. And if we can't, we don't stubbornly push on a string in every case.

John Heinbockel

All right. And then secondly, where do you think we stand gross and net openings for next year right? So I know you probably have wanted to get up both of those right. Gross openings probably in the high 20s and maybe a you get a bit higher than it's been. And obviously you open Shanghai, but what's going on with China? Does that give you any pause for additional openings beyond Shanghai? Or no you're still looking for real estate?

Richard Galanti

Well, at this juncture we have two locations, one we're opening this late summer, and one that we will -- if all things go well about a year almost two years from now. So I should say 1.5 years plus after the first one opens. That's not that different than what we've done in other countries.

I think in Australia we opened three over the first four years. I think in Japan we opened five. We opened actually six over five years, in Spain we open two over four years. So that's not inconsistent. We'll continue; when they're there, Craig and real estate guys and Jim Murphy, the Head of International and the local country managers, they're looking at other sites. But right now we want to get to -- look China's a little unique in many ways aside from any issues right now with tariffs. That's not hopefully a long-term issue. Each item has to be registered separately.

We're fortunate in the sense that we have a successful operation in Taiwan, which we were able to bring some key people. But we want to hire from within and like we do in other countries start with a very small core group of people that are expats but really growing internally. And if it's also -- what we said is if new country's very successful, we're perfectly happy to have a couple of units over the first two or three years and four or five total units, four or five years after we opened our first, we'll go from there.

John Heinbockel

And your thoughts on opening this coming year?

Richard Galanti

Excuse me?

John Heinbockel

This coming year, 2019 or August of 2020, early thoughts on gross and net? Where would that goes to this year?

Richard Galanti

Yeah, I think the next year we'll look about the same amount as this year.

John Heinbockel

All right. So like mid-20s growth and low 20s net?

Richard Galanti

Yes.

John Heinbockel

Okay. All right, thank you.

Operator

Your next question comes from the line of Scott Mushkin from Wolfe Research. Scott. You are now live.

Scott Mushkin

Hey, guys thanks for taking my question. I got two questions. Richard, you talked about driving top line sales and that's the key – the company everything else takes care of itself. And if you look back over the last I guess five years did a huge expansion, even blew out a number of centers to add to the fresh, so I think that helped a lot. The credit card helped a lot. When you look out over the next year or two or three, what do you see pretty substantial? What do you see as similar type of sales drivers potential?

Richard Galanti

Well I think we continue to see - first of all I think fresh foods is -- continues to evolve and grow. Specialty items within both food and nonfood; organic, both fresh and shelf stable one of the think that's again -- the good news in my view is a lot of these -- there's lots of different things not one giant thing.

We continue to add gas stations in other countries besides U.S. and Canada. It works. E-commerce as I mentioned, we added to two more countries this year. All those things add on each other. One of the things that we historically have not done a lot and again this is not a game changer overnight in terms of our performance is, we're very -- we've been very good at taking items in the U.S. and bringing them elsewhere and maybe to a small extent some Canadian items because of the size that were up there.

We've been bringing and continuing to test items that we find in other countries that are high end specialty unique items and we're getting some success with that. It's a small thing right now, but we're very good at figuring out how to do that and taking it to the next step.

So I think you and I continue to -- we're merchants and we're the best price. And I think that's more than anything what you'll see with us. I think we're doing a better job on the membership site in terms of converting people to executive. We're still seeing good sign-ups with the credit card. And as those rewards get bigger we believe that number becomes even more loyal.

So I think we continue to see -- the good news is that concerns that many of you have had over the years and we haven't moved fast enough in certain areas whether it's internet or e-commerce there's a lot of low-hanging fruit out there and we're benefiting from some of that.

So I got to tell you I come to every -- I go to every budget meeting and you hear the merchants or the merchants from some of the other countries talk about some of the things that we're doing. I think that's exciting. We're now in a size from a value proposition, there's certain both high-volume Kirkland items and paper goods and the like order where we're now in the size where we can produce them in another country at the same quality level and dramatically lower in freight cost.

Now this is not across the board on everything, but there's lots of those types of opportunities that we continue to do. There's not a shortage of things to stay busy trying to drive our business around here that we feel pretty good about.

Scott Mushkin

Perfect. And then my follow-up question really goes to the competitive climate. And we're seeing that may be one of your competitors -- biggest competitors is kind of tacked a little bit differently. Maybe they were investing a lot in price a year ago and not so much now. Is that part of what's going on with the core-on-core gross margins? Is it the competitive climate is just a little bit easier?

Richard Galanti

It's really across the board with traditional retailer as well. One of the things that I mentioned on the last few quarters because on this side -- on the fresh side they become and continue to be more competitive than they have been historically. That's the nature of the beast. But I think again we're not competing with just one direct competitor. We're competing with traditional merchandise retailers and supermarkets. And on an overall basis, we haven't seen any dramatic change.

Scott Mushkin

So you see the competitive climate is stable, not worsening not getting better?

Richard Galanti

I think that's fair.

Scott Mushkin

All right. Thanks for taking my question. Appreciate it.

Operator

Your next question comes from the line of Rupesh Parikh from Oppenheimer. Rupesh, you are now live.

Erica Eiler

Good afternoon. This is actually Erica Eiler on for Rupesh. Thanks for taking our question. So, I was actually hoping to dive a little bit deeper into your online grocery efforts. Can you maybe talk a little bit more about how the Instacart and dry grocery ramps are going so far and what you're seeing with these offerings? And then any metrics you can provide such as type of basket you're seeing into how you're viewing the incrementality of the purchase, et cetera, would be helpful.

Richard Galanti

Yes. Look today -- first of all the 2-day drive which we do with UPS primarily is now the entire Continental United States. Much of it arrives in one day, but we guarantee two-day. And it's expanding and we're obviously getting small number of sign-ups where that member is signing up just to receive online because they're too far away from driving.

On Instacart they to ask you I'm sure you know have dramatically increased and their geographic footprint over the last two or three years. I think the thing that's most notable is that the value proposition to someone buying either directly from Instacart going into their site or go into our same-day grocery site -- one-day -- one day, sorry one-day grocery site which is the Instacart engine for fresh, we dramatically improve the value proposition over the last two years.

And I think that's reflective of the fact that they've grown and have their own structure in place. And if we believe we can do that anchor tag customer anchor-type tenant in terms of driving value. And so we have sequentially I think now four times brought down pricing over the last two years of what the ultimate markup on goods is above what you can walk into a customer --. And so we're doing more business. It's growing at big numbers high double-digit numbers, but it's on a small base.

Erica Eiler

Okay, great. Thank you.

Operator

Your last question comes from the line of Simeon Siegel from Nomura. Simeon, your line is now live.

Conference Call Participant

Hey guys, this is Steve [ph] on for Simeon. Thanks for taking our questions. So, apparel has obviously been a huge call out for you guys, but it looks like the soft line comps have been trending a little bit lower over the last couple of months kind of towards the mid-single-digit range. Can you just give us some color on what you're seeing within the category, any notable call out there?

Richard Galanti

Hold on. Within soft lines and jewelry, that's been a little soft. Household furniture although some of that had to do with -- I don't know it's been a little soft.

Conference Call Participant

All right. If I can sneak a little more in. On the MSI growth, did you guys call out what exactly was the fee high contribution for the quarter?

Richard Galanti

$10 million.

Conference Call Participant

$10 million. All right, great. Thanks guys.

Richard Galanti

Thank you very much. Have a great afternoon everyone.

Operator

Thank you. And that concludes Costco's third quarter earnings conference call. Thank you for joining. You may now disconnect.