Costco Wholesale Corporation (NASDAQ:COST) Q2 2017 Earnings Conference Call March 2, 2017 5:00 PM ET

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Peter Benedict - Robert W. Baird

Edward Kelly - Credit Suisse

Greg Melich - Evercore ISI

Molly Smith - Bloomberg

Joe Feldman - Telsey Advisory Group

Operator

Good afternoon. My name is Frederica and I will be your conference operator today. At this time, I would like to welcome everyone to the Costco Q2

Earnings Call and February Sales 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.

Mr. Richard Galanti, CFO, sir you may begin your conference.

Richard Galanti

Thank you, Frederica and good afternoon to everyone. I'll start by saying 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 we do not undertake to update these statements except as required by law.

In today's press release, we reported - three things to discuss. We reported our second quarter and fiscal first half 2017 operating results for the 12-week and 24-week periods ended February 12. We also reported our monthly sales results for the four-week reporting month of February, which ended this past Sunday, February 26. And we announced our plans for membership fee increase in the US and Canada effective this coming June 1.

For the 12-week fiscal second quarter, earnings came in at a $1.17 a share or $0.07 below last year's earnings results of $1.24. Some items of note, first, our co-branded credit card and how it impacts our results. Similar to what we reported in our first quarter results, the Citi Visa co-branded credit card program, which went live last June 20, partially impact our margins by 16 basis points, our SG&A expenses by 24 basis points as compared to a year earlier, and our overall bottom line in Q2, benefiting earnings by $0.16 a share. A more detail on that, later in the call.

Second, gas profitability, our profits from gasoline during the quarter as compared to last year's second quarter were lower by 42 million pre-tax or $0.06 a share. This primarily a function of last year's very strong second quarter gas profit results and is consistent with the impact of the gas profitability that rises in gas prices will cause on our earnings of gas.

Number three, IT expenses, our IT activities impacted SG&A in Q2, on an incremental year-over-year basis by $26 million pre-tax or 7 basis points or - SG&A of $0.04 a share compared to last year. This reflects both the direct expenses for the quarter, as well as increasing levels of depreciation and amortization on major completed projects that are now in service.

Number four, stock compensation expense, this one is getting less of a negative impact each year, so it is a little smaller than spend. It was 10% higher year-over-year. So $10 million higher or about $0.015 impact to the P&L. FX, number five, there are two FX items to point out. The first one which I typically point out is the - how the impact is to changes in foreign currencies relative to the US dollar year-over-year.

As compared to your ago during the second quarter, many of the foreign countries and locations where we operate began to strengthen during the quarter versus the US dollar, most notably in Canada, resulting in our foreign earnings in Q2 when converted into US dollars being slightly higher by about 4 million pre-tax or a about $0.01 a share, then if the exchange rates have been flat year-over-year.

Number two, as it relates to FX is a much bigger impact to this quarters P&L had to do with FX losses related to forward contracts and US dollar holdings by our international subsidiaries, these are used to pay US dollar denominated merchandise payables in those countries. Losses on those exceeded the gains on the related US dollar denominated payables. This year in the second quarter, it was roughly $20 million pre-tax hit.

Last year in Q2, the gains on those payables exceeded the net losses on forward contracts at US dollar holdings by plus $6 million. So year-over-year $26 million year-over-year swing or an impact - negative impacted P&L by $0.04 a share. I might add that this year-over-year swing, it generally runs in the plus or minus $0.00 to $0.02 a share range, with all the volatility out there it was a little bigger this quarter.

Number six, LIFO, there was no LIFO charge or credit in this year's second quarter results. Whereas in last year's Q2 results it had a LIFO credit $15 million, reflecting deflation in our LIFO indices and so positively impacted last year's Q2 by $0.02 a share. While we did have some deflation in the quarter, as we did in Q1 with the switch over to a new accounting system and platform in the beginning of the fiscal year.

Basically even though, we’ve had deflation, we have no associated previous inflation or LIFO charges historically taken and so if you will, there is a buildup of credit that will offset future LIFO charges to the extent that there is inflation in the future, but again year-over-year that’s a $0.02 hit to the quarter, year-over-year swing.

Number seven income taxes, last year in Q2, our effective income taxes tax rate was right at 34%. Due to a discrete tax item this year in Q2, as well as small changes in the profitability mix by country. Our effective rate this year came rather at - instead of the 34.0 came in at 35.6, effectively impacting our Q2 EPS by about $0.03 a share.

Turning to our second quarter sales, reported sales were up 6% and our 12-week reported comparable sales figure came in at up 3%. For the quarter, the 3% plus comparable sales figure was helped by gasoline price inflation to the tune of about 84 basis points, while the impact from FX was a very slight detriment, again, well currency strengthened during the quarter, the net over the quarter was still a slight detriment of about minus 9 basis points, so together about three-quarts of a percent hit.

Excluding gas price inflation the reported plus 3% US comp remained at 3%. Our reported Canadian comp of plus 8% was actually a plus 2%, excluding gas and inflation and FX, mind you that we get Canadian dollar strengthening quite a bit, and the reported minus 2 other international comp, excluding gas and FX would have been a plus.

Also total comps reported for the quarter at 3% plus for the quarter, excluding gas and FX with the pluses and the minus still remained at plus 3% ex gas and FX. For our four-week month of February, which included the last two weeks of the fiscal second quarter and the first two weeks of February did, comps came in at plus 4.

On a reported basis, this consisted of a plus 5 reported in Canada - a plus 5 reported in the US, a plus 10 reported in Canada, and a minus 2 reported for other international. As I discussed last month, or actually as we discussed on a monthly sales call last month, the calendar shift of the Chinese lunar New Year, that was 11 days earlier versus last year, that positively benefited the January reporting period this year and negatively impacted February.

We estimate that this shift was a detriment to February comps of about three quarters of a percent on the total company and 6.5 percentage points or 650 basis points to the other international segment. Sales in February were positively impacted by both gasoline inflation to the tune of a little over 200 basis points, and by overall strengthening in foreign currencies relative to the dollar to the tune of about plus 60 basis points.

Ex-gas inflation in FX, in Canada, the reported plus 10 would have been also a plus 2, and the minus 2 reported further in international would have been a minus 1 ex gas impacts and a plus 5 excluding the lunar New Year shift. Total company comps for the month reported a plus 4, would have been a plus 2, excluding gas deflation and FX.

I also point out cannibalization, you know we do that every quarter and typically it’s somewhere in the 0.5% range or a little less. Cannibalization has become a little bigger of a factor to our comp sales results in the last couple of months. The cannibalization impact on February was approximately 90 basis points negative for the total company and it was actually is minus 75 in January.

For February, it was minus 300 basis points in Canada, mind you this year we are opening seven - I believe seven new warehouses on a base of 91 up there. So, a lot of relative cannibalization in Canada, and minus 180 basis points on the other international segments in February. I mentioned that the minus 90 basis points in February for the total company by comparison for all of fiscal years 2015 and 2016, total company cannibalization to average a little under 40 basis points to the negative.

So again it’s picked up of late with some of the openings. We estimate weather had a negative impact on February comps as we had snow in the east and heavy rains in the west. The estimated impact in that was about 50 basis points in the US, about 75 in Canada, and to the total company also about 50.

Regarding deflation, overall, primarily in the US, we have seen deflation in the 1%, 1.5% range in February. Departments such as foods, sundries, frozen foods, liquor meat, dairy showed the most deflation on the foods and sundries side. On the non-food side consumer electronics continue to be deflationary, primarily in the TV category. In terms of new openings, our opening activities, we planned, we opened a net of a 8 new locations during the first quarter, nine less were re-low.

In Q2, we opened four new locations. Those included our 13th unit in each of Korea and Taiwan, as well as two new locations in Florida in the Tampa Florida area. For all of fiscal 2017, we have current plans of 29 net new locations, so 17 additional openings during the third and fourth quarters of 2017 are planned.

Of the 29 for the year, 14 in the US, 8 in Canada, I mention seven earlier, it’s actually eight on a base of 91 in Canada and one each in Japan, Korea, Taiwan, Mexico, and Australia, as well as our first openings in France and Iceland, most likely in mid-to-late May. This afternoon, I’ll also review with you membership trends and renewal rates. Our membership fleet plans in terms of increases in June, and update on the Citi Visa Anywhere card, an update on our multi-vendor mailer promotional activities, additional discussion of course on margins and SG&A and a little bit about e-commerce results and some initiatives there as well.

In terms of second quarter results, quickly on the sales, for the quarter sales were up 6% to $29.13 billion. On a reported comp basis, they were up 3%

and again ex gas and FX, they still remained at 3%. For the quarter, the plus 3 reported comp was a combination of an average transaction increase of a little over 1%, and an average shopping frequency increase of 2% for the quarter. That is the company-wide frequency in the quarter for the US was a 3%.

In terms of geographic sales by geographic regions, the Midwest, Texas, and Northwest regions were strongest, with California not far behind. Internationally, in local currencies, better performing countries were Mexico, UK and Korea. In terms of merchandise category sales for the quarter, for the second quarter within food and sundries, overall flattish year-over-year, liquor or spirits, and foods were the leaders.

Tobacco continues to be a negative, and actually in the high teens, as we've mentioned, that we look to cycle the majority of that tobacco sales losses by the end of June. For hardlines, overall in the low-to-mid single-digits. The strongest department results were tires, hardware, and seasonal, with consumer electronics down in the low singles. Softlines were also up in the low to mid single-digit range, with apparel and home furnishings showing the strongest results.

In fresh foods, comp sales were also in the low to mid single-digits. And lastly, in the second quarter overall, again in terms of deflation, for the second quarter was in the 1.5% to 2% range. Similar departments on the foods and sundries side, non-foods again, saw a little deflation in consumer electronics, primarily TVs.

For February, traffic was up approximately 2% and 3% in the US - including 3% in the US. While average transaction was up a little under 2.5%, most of this was due to gas inflation and FX. In terms of geography, for February, Midwest, Texas, San Diego region, which also in our case includes Arizona and Colorado and New Mexico, were the strongest, as well as the Bay Area.

Internationally, in local currencies, UK, Mexico, and Canada were at the top of the list. From a merchandise category standpoint, excluding FX, food and sundries and hardlines, including the consumer electronics were up low single-digits, softlines up mid single, and fresh foods slightly negative for the February reporting period. Again, a little deflation is impacting these numbers.

Before moving to the income statement, a few comments about our multi-vendor mailer, the coupon booklets that we send out and have online, what we call the MVMs, these promotional activities, and a few changes we've recently implemented.

As most of you know for many, many years ago, the MVMs have grown and evolved over 22 years, from one six week summer coupon booklet back in 1995, to generally year-around promotional price pieces with great values on items being offered in each mailer. Over the years, we've expanded the mailers, and have continued to tweak them.

More recently, we've revamped the MVM program, creating it some newness, enhancing values - member values on some of the items - many of the items, and created a little bit more merchandising excitement. We've eliminated a few of the MVMs over the course of the year, and also there will be fewer days.

We've reduced the number of items per mailer, but we've overall increased the offering in terms of total savings of those items. And we're also moving in some cases, to everyday low pricing, EDLP, where we can drive higher over sales, and show better every day pricing and value. In terms of second quarter of 2017, it was really the transition to fiscal quarter for these MVM changes, if you will. The first revamped MVM ran in December, and which is near the beginning of Q2.

Overall, in the second quarter, we had 17 fewer MVM promotional days. Mind you, the quarter itself is 12 weeks times 7 is 84, a couple days closed for the holidays, but basically 17 out of those 84. 71 fewer items offered in those MVMs, but again, higher overall sales compared to last year in the MVMs.

Overall, so far, we like what we see. We continue to tweak it a little, but remember, we're still in the early stages of this. We know that 17 fewer MVM days in our 84 day second quarter, and 10 fewer MVM days in our 28 day month of February, probably hurt traffic a little. But we shouldn't see that latter aspect in Q3, as there are the same number of MVM days year-over-year in the third quarter. So again, Q2 is really the transition of that.

Now moving on to the line items in the income statement, in terms of membership fees, coming in at $636 million, up 5% or $33 million versus last year or down 1 basis point. Minimal impact from FX, because, again, while they were increasing over the course of the year, they started off lower in the beginning of the second quarter.

In terms of membership, we continue to enjoy strong renewal rates, coming in a little over 90% in the US and Canada, and 87.7% worldwide on a fully captured basis. And we continue to see increasing penetration of the Executive Membership program in the countries where we offer it.

In terms of number of members at Q2 end, at Q2 end, primary Gold Star came in at 37.5 million, up from 12 weeks earlier at 37.1 million. Primary business, 7.4 million, up from 7.3 million 12 weeks earlier. Business add-on, 3.4 million, down from 3.5 million. That has to do with some of those people converting into their own membership, as generally as they become Executive Members. So total accounts, 48.3 million compared to 47.9 million, a fiscal quarter earlier.

Total card holders, 88.1 million at second quarter end, up from 87.3 million 12-weeks earlier. As of Q2 end, our paid Executive Memberships stood at 17.9 million, which is an increase of about 200,000 from 12-weeks earlier, or about 17,000 additional per week. Executive Members represented a little over one-third of our member base, and about two-thirds of our sales.

In terms of renewal rates, again, overall, in the US and Canada 90.2, down 1/10 from 90.3 at the end of the quarter, which was also 90.3 at the end of the fiscal year back in late August. Business within that remained at 94.3, in both fiscal one and two quarters end. And Gold Star, primary Gold Star at 89.5. Again, it probably a little rounding, just pushed it down, instead of up, that tenth of a percentage point. Worldwide, it actually picked up a little. At Q2 end, it was 87.7 up from 87.5% at Q2 end, and 87.6 at fiscal year end.

We feel these are pretty good numbers, and don't really see a lot of impact. We believe a lot of it has to do with the conversions in credit cards. If you'll recall, me talking, probably a year, a year and a half ago, about some of this stuff we saw in Canada as we transitioned the Canadian credit card program, a year and a half or so earlier, than we did in last June here in the US. And if I look back, as an example, just a year ago in Q3, the Canadian renewal rate was 90.6 for this quarter, as a 91.6, so it started to come back as we would expect.

Again, in the US, we're still seeing some of that auto bill impact that we believe has a big piece of it. Back in Q3, a year ago, we were 90.3, and actually 90.4 the prior quarter, down to 90.1 at the end of the year. And we're 89.9 at Q2 2017 end. So again, pretty much the kind of impact that we would have expected to see, and I'm not really terribly concerned about that at all.

I want to spend a minute, regarding our announcement on the increases of fees this morning, which will be effective June 1. First, the planned increases relate to our US and Canadian operations. Recall that fee increases, membership fee increases took place in several other countries effective this past September 1 at the beginning of the fiscal year.

In both, the US and Canada, which by the way, represents just under 90% of our Company's fees, about 87% or 88%, the current annual fee for our individual Gold Star business and business add-on memberships, what we refer to as our primary memberships is currently $55 a year, and has been at that level since November of 2011, about 5.5 years ago. The annual fees for these memberships will go to $60 effective June 1.

Also in the US and Canada, our $110 per year Executive Membership fee, which has been at that level also since November of 2011 is being increased by $10 to $120. Also with regard to Executive Membership, the 2% reward associated with the Executive Membership will increase. Currently, the annual reward is capped at $750. That will be increased to $1,000.

So while there is an increase in the annual fee, the reward goes up to $1,000, and that's based on eligible purchases. That, of course, is in addition to the 2% reward that one gets, if they use the Citi Visa Anywhere card at Costco, or the 4% when they buy gas at Costco. In all, approximately 35 million member households will be impacted by this increase, approximately half of whom are Executive Members, and half of whom are primary Gold Star business and business add-on members. Note that the membership fees are accounted for on a deferred basis.

So in terms of how it hits our P&L, our membership income line, approximately one-twelfth if you will, or one month worth of the increase in fees from the June renewers, that will be the first group that gets this fee increase, approximately 1/12 of the increase will be booked to the income statement in that first month of June, with an additional 1/12 being booked in each of the succeeding 11 months.

Next, the increased fees from our July renewals, those will be booked starting in July, one-twelfth and following through to the following June, and so on. So the full P&L impact of these increases will be over a 23 month time line, such that the last group of members to be billed at these new levels will be next May of 2018, with a booking if you will, of those $5 and $10 increases being recorded over that month, and its succeeding 11 months, i.e. 23 months out.

Before continuing down the income statement line items, a quick update, and a few updated stats on the Citi Visa card offering. Again, this began last June 20, early in our fourth quarter of 2016. Recall that we began last June 20, with approximately 11.4 million co-branded cards, or about 7.4 million accounts being transferred to Citi for a conversion to the new Citi Visa Anywhere card.

As of Q2 end, just under 90% of these accounts transferred have been activated, recognizing all accounts transferred to begin with, were not activated. And I think, it was down in the low 80s at the time - low to mid 80s. And in fact, that just under 90% activated as of Q2 end. That's up a few percentage points from Q1 end, 12 weeks earlier. Also we now have about 1.2 million new approved member accounts, representing about 1.6 million new Citi Visa cards out there, since the June 20 conversion. Again, this is also up about 200,000 accounts, over the past 12 weeks during fiscal second quarter.

Lastly, we are seeing Citi Visa co-brand portfolio total spend higher year-over-year, both organically from the cards converted last June, as well as from these new accounts. We'll see what the next few quarters bring. Overall, in terms of conversion, usage, and new sign-ups for the card, we feel it's going pretty well so far.

Going down to the gross margin line, our gross margin in second quarter was lower on a reported basis, was lower year-over-year by 24 basis points, coming in at 11.00, compared to last year's 11.24. Now as usual, there's a lot of moving parts here, gas inflation and the impact of the credit card, some of that benefit goes to the sales line, which therefore improves the reported margin.

I'll let your do - I'll ask you to do my little matrix here. We'll do it for first and second quarters. There will be four columns, reported Q1 2017, without gas deflation in Q1 2017 is the second column, third column is reported Q2 2017, and the last column would be without gas inflation in Q2 2017.

The first line item would be core merchandise. In Q1, reported, plus 19 basis points year-over-year, without gas deflation, plus 16 basis points. For Q2, reported plus 1 basis point, and without gas inflation, plus 9 basis points. Ancillary businesses, minus 5 and minus 6 in the two Q1 columns.

In Q2 2017, in the two columns, minus 20 basis points and minus 18 basis points, again, reflecting lower margins in gas year-over-year, while increasing the penetration of gas sales. 2% reward, minus 2 basis points and minus 1 in columns one and two, and in columns three and four, 0 and minus 1.

LIFO, minus 2 and minus 2 in Q1, and minus 5 and minus 5 in Q2. Again, recognizing that the year ago, we had deflation and therefore LIFO credits. This year, while we had deflation, we can't take them, since there's nothing to take them from prior offsetting LIFO charges.

Other, last year there was, I believe, a one-time legal settlement that added 19 basis points to the first two columns here, and 0 and 0 in columns three and four. You add all that up, last year in the first quarter, year-over-year margins were up 29 basis points on a reported basis, and up 26 basis points ex gas deflation. I also mentioned last year, that within those numbers, the Citi Visa impact to margins within that 29 and 26, was plus 13.

In the next two columns, the reported Q2 2017. Again, margins on a reported basis came in 24 basis points lower year-over-year, and ex gas and FX came in 15 basis points lower than last year. Now mind you, both of those numbers still include, do include the benefit from the Citi Visa program, to the tune of about 16 basis points to the positive. So again, taking those out, the reported minus 24, adding the 16 in, that would be a minus 40. And adding 16 to the minus 15, it would be a minus 31 on an adjusted basis, if you will using Citi Visa.

Now the core merchandise component of gross margin was higher by 1, as you see in the chart, and plus 9, excluding gas. Excluding the benefits of Citi Visa, it was minus 15, and minus 7, excluding gas inflation. As I always mention, sub categories within the margin, our core sub categories, food and sundries, hardlines, softlines and fresh foods, as a percent of their own sales were positive year-over-year by 7 basis points. But with the declining sales penetration of that, given the inflation in gas, the contribution is a minus 7.

Food and sundries and hardlines were both slightly higher year-over-year on their own sales, softlines was up about 60 basis points, and fresh foods was lower year-over-year by about 10 basis points. Ancillary and other business gross margin, I mentioned was down 20 in the quarter. Most of the year-over-year decrease was due to lower gas profits, as I mentioned earlier in the call. 2% reward, 1 basis point of negative impact to ex gas, just implying a slightly higher sales penetration, ex gas inflation on a year-over-year basis. And I already mentioned LIFO that was about $0.02 a share as well.

Overall, our margins ex the Citi Visa Credit Card benefit, were most negatively impacted by lower gas margins. Somewhat negatively impacted by 5 basis points from LIFO year-over-year, with slightly lower year-over-year sales penetration in the quarter also hurting it a little bit, even though core margins on the core sales were up 7 basis points. I might also mention that the plus 7 basis points core margin improvement year-over-year, this is notwithstanding some of the pricing initiatives that I mentioned earlier like EDLP that we've been taking these last couple months.

Moving to reported SG&A, our SG&A percentage in second quarter year-over-year was lower or better by 5 basis points, but higher or worse by 4 ex gas inflation, coming in at 10.23% this year, compared to 10.28% last year, on a reported basis. Again, excluding the benefits of the Citi Visa Program, which clearly helped SG&A by lowering merchant charges that was a 19 basis - excluding benefits from that, year-over-year SG&A was higher by 19 basis points, and 28 basis points ex gas inflation.

In terms of the performance year-over-year, and SG&A operations component, as I mentioned was lower or better by 8 basis points year-over-year, and plus 1, excluding the impact of gas. You see that in the chart we just drew. The plus 8 basis point improvement consists again, of much lower Citi Visa merchant fees and related fees, somewhat offset primarily by higher payroll and employee benefits costs.

And again, that has to do with the underlying sales being a little lower, and a few other things. Central expense was higher year-over-year in Q2 by 2 basis points, 3 without gas. Again, IT was a 7 or 8 without gas of that, and offset by a couple things that went our other way. Stock compensation expense, again 1 to 2 basis points, not a big amount.

Moving down to pre-opening expense. Pre-opening expense was higher by $5 million, coming in at $15 million in Q2 of 2017, versus $10 million a year earlier. Pre-opening relates, not only to the actual openings in that quarter, but also some of the ones leading up to it, or getting ready to be open rather. That was four openings in Q2 this year, only one opening last year. There's also higher year-over-year pre-opening expenses related to our entrance into two new countries, France and Iceland, as we already have people on the ground.

Operating income in Q2, all told, came in at $840 million - $844 million, 1% lower or $12 million lower from last year's $856 million. Below operating income line, reported interest expense, came in at $31 million, in both this and last year's fiscal second quarters.

Interest expense - I might mention that interest expense, beginning part way through Q3 - I believe the middle of March, will improve quite a bit, with the scheduled March 15, $1.1 billion debt repayment. This is a 10-year fixed rate debt instrument, I believe, at 5.5% - about 5.5% fixed rate interest. Net, we'll save about $50 million a year pre-tax, about $60 million of reduced interest expense on that pre-tax, offset by cutting a check for the $1.1 billion if you will, and losing some interest income on that, to the tune of roughly $10 million. And that's just a simple guesstimate.

Interest income and other was lower year-over-year by $20 million in the quarter. I was just informed that I skipped the SG&A chart. So, why don't we go back and write that, just so it's easier for those of you that put it down. Thank you.

Again, four columns for SG&A, reported, and without gas deflation Q1 2017 and Q1 2017, and reported or without gas inflation Q2 2017 and Q2 2017. I think these numbers that I just read, will make a little more sense. Operations, Q1 2017 reported minus 8 basis points or higher by 8 basis points, and minus 6 without gas deflation, plus 8 and plus 1 in columns three and four, central, minus 9 and minus 9. And in Q3 and Q2, those columns three and four, minus 2 and minus 3. Stock compensation, minus 7 and minus 6, and then minus 1 and minus 2 in Q2.

Mind you, it's always higher in Q1, because we do our big total company, total employee, those that get RSUs grant in October. Other, plus 8 and plus 8 last year, again, that was a year-over-year unusual item, I believe, and 0 and 0 in columns three and four. You add it all up, on a reported basis in Q1 2017 it was higher year-over-year on a reported basis by 16 basis points, and without gas deflation by 13. On a reported basis, in Q2 2017, we were lower or better by 5, and higher or slightly worse by 4 basis points, without gas inflation.

As I mentioned the Citi Visa impact to SG&A in Q1 was 25 basis points - that's in those numbers, and 24 basis points in Q2. I won't go through the numbers, I just mentioned. My apology for doing that in reverse order. Below the operating income line, reported interest expense came in, I mentioned at $31 million. And I also mentioned that, come March 15, we're going to save about $0.08 a share or $50 million pre-tax net, $60 million reduced interest expense, and roughly about $10 million pre-tax reduced interest income.

I was just getting ready to talk about the next line item on the income statement, the interest income and other, it was lower year-over-year by $20 million in the quarter. This year in the quarter, it was a minus $4 million number. Needless to say, it's the other, not the interest income, and last year, it was plus $16 million.

Actual interest income and other, other than the FX that I talked about earlier for the quarter, were better year-over-year by $6 million. Offsetting this, of course, was that $26 million in charges related to various FX items that I discussed at the beginning of the call. Overall pre-tax income was lower by 4% or $32 million in the quarter, coming in at $809 million, versus $840 million - $841 million a year ago.

I mentioned earlier in the call, income taxes, a little higher rate, coming in at 35.6% this fiscal quarter, versus 34% last year. We think for the year, our current best guess or effective rate for the year is actually lower than that - a little lower than that 35.6% that we recorded in Q2, probably somewhere more likely in the 35.3% or 35.4%. That's our best guess.

Overall, reported net income came in at $515 million, compared to $546 million net income last year in the same quarter. A quick rundown of other topics. The balance sheet is included in the morning's press - in this afternoon's press release, and a couple of balance sheet items that we try to give out.

Depreciation and amortization for Q2 totaled $312 million for the quarter, and $609 million for the first half of the fiscal year. In terms of AP ratio, accounts payable as a percent of merchandise - as a percent of inventories, 92% reported, both this year and last year.

If you take out non-merchandise payables for construction and other things, this year it came in at 82 AP ratio, and last year it was 83, I was just rounding down a little there. Average inventory per warehouse came in at $13.1 million, compared to $12.8 million a year ago, or up about $350,000.

Variances, about a little over $100,000 of it's health and beauty aids and the like, over-the-counter items. And some of that has to do with the timing of our MVM build up in February. Others are mostly non-foods, majors about $100,000, small electrics about $75,000, and hardware about $50,000 to $60,000, so nothing terribly out of pocket there.

In terms of CapEx, first quarter, we spent $670 million. In the second - I'm sorry, in the second quarter, we spent $515 million. In the first quarter, we spent $670 million, so total year-to-date, $1.185 billion. We estimate for the year, CapEx will still be in the range of $2.7 billion to $2.8 billion. So $1.5 billion to go if you will - a $1.5 billion-plus to go.

Next, Costco online, we're in the US, Canada, UK, Mexico, Korea and Taiwan, Korea and Taiwan being the most recent additions, about a year ago. For Q2, sales and profits were up, of course. Total online sales were up 12%, and up 11% on a comp basis. As I spoken about a little bit, probably in Q4 last year, in October, and then in - a fiscal quarter ago, back in early December, we continue to improve our offerings, merchandise offerings, and enhance our member experience online.

In terms of improving merchandise, we continue to add new and exciting merchandise, and we continue to improve in-stocks on high velocity items. In terms of recent initiatives, and recent online additions include Samsung appliances, and a variety of added apparel brands, both direct and indirectly purchased, with additional offerings in various non-food categories in the coming months. These would include Kohler bath and kitchen, Reebok mens and women's active wear and footwear, and Spyder Ski and outerwear, to name a few.

We've also continued to add various health and beauty aids, both regular ones and upscale ones, and sundries items to our online offerings, increasing both online page viewing, and member shopping frequency as well. One recent fun item to note, leading up to Valentine's Day, we offered online 50 long stem roses for $49.99, and that included delivery.

We had sales in those three days of over $2 million, represented over two cargo planes, and most important, that $49.99 price point for 50 long stem roses is $30 less than what we sold the same item for just a year ago. And if you're late to getting those roses, we are now offering them at $39.99 including shipping.

In terms of improving experience and functionality of the site, we've improved search, we've shortened the check-out process, and we've improved our member's ability to track their orders, and we'll continue to do some more of that. Just recently, we automated much of our returns process, not only providing members a much better quality of service, but also reducing by more than 20%, in just the first couple of months, our call center volume related to returns. There will be more to come, over this coming calendar year in several of these things, and we're finally getting around to doing some of those.

Lastly, we continue to improve our distribution logistics. For example, in the US and Canada, we now fulfill online orders from 11 depot distribution points, which, of course, allows for closer and fast delivery of online orders. Overall, as I mentioned, we have plenty of online initiatives going on, both in terms of member experience and service, expanded products, and services offerings, and a greater value to the member.

Finally, a quick update on other home and office delivery sales channels. As you know, we partner with Google Express in five cities, operating out of 15 of our Costco US warehouses. In addition, we're working with Google Express on a new service offering one to three day shipping of products throughout the Continental United States. We also continue to work with Instacart. Instacart currently operates in 26 US cities, in our case utilizing 132 of our US locations, and we are either testing or getting ready to test two other third-party delivery services within the next month or so.

In terms of expansion, in Fiscal 2016, last year, we opened 29 net units, about 4.5% square footage growth. This year, it looks like it's going be also 29 net new units, so about 4.25% square footage growth. The planned Fiscal 2017 locations, these 29 locations by country, would be 14 in the US, 8 in Canada, and 1 each in Taiwan, Korea, Japan, Australia, Mexico, and then the new ones in France and Iceland.

As of Q2 end, total warehouse square footage stood at 105.1 million square feet. Next in terms of stock buybacks, as you recall, in Q1 we repurchased $122 million or 809,000 shares of Costco stock for an average price of right around $151 a share. In Q2, we repurchased $66 million or 411,000 shares at an average price of just under $160, $159.86, I believe. In terms of dividends, our current quarterly dividend continues to stand at $0.45 a share. And on a quarterly basis, this $1.80 per share annualized, represents a total cost to the company of right at $800 million.

Lastly, I want, before I turn it back to Frederica, our Fiscal 2017 third quarter scheduled earnings release date for the 12_week period ending - our third quarter ending May 7, will be - we'll do that after the market close on Thursday, May 25, with the earnings call that afternoon at 2 PM again. With that, I'll be happy to open it up to Q&A. And Frederica, I'll turn it back over to you for that process.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Simeon Gutman with Morgan Stanley.

Simeon Gutman

Hi Guys, it’s Simeon. So Richard, I think the big question that will come up a lot, it looks like - I'm not in front of all of the numbers - but margins in this quarter sequentially versus Q1 seemed like they got a little bit weaker? And I'm excluding some of the gasoline impact, which granted, I don't think was fully captured. Is there anything changing as far as investment back in the business, SG&A dollars, eCommerce, or just reinvesting back into price, that we aren't seeing?

Richard Galanti

Well certainly, the gas inflation does have an impact, as well as the increasing sales penetration of gas. That's probably as much of an impact. Certainly, as some of the more promotional stuff we did with everyday low pricing, had an impact. I didn't bother to try to quantify it because it's lots of different items and that's what we do. If anything, we did it a little more because we wanted to. There's been some other things going on, nothing major though.

We really - I look at the numbers and I don't see a big change other than the things I mentioned, and perhaps what I mentioned about that. As Bob is reminding me, and getting back to the gasoline comment, a lot of it has to do with the contribution penetration of these areas. With gas inflation - I think gas prices are up 29% over the year, and gallon comps were up higher as well because of that.

We're higher because of what we do, we have good prices, that had probably a bigger impact. Gas is typically, these are rough numbers, 800 or

900 basis points lower than the rest of the merchandise that we sell. It could be 700,000, but it's big and you have increasing penetration of that.

So not only were gas margins down with rising gas prices within the gasoline business, but the impact that it has - and again if you get back to what I mentioned on the core margins, on their own sales, which is roughly 80% of our sales - food and sundries hard lines, soft lines, and fresh foods. On core margins year over year in Q2, they were up seven basis points, but the contribution, if you will, to the total here was minus seven.

Simeon Gutman

Got it. Okay. That's helpful. I guess my follow-up - just thinking about reinvestment rates in the business, you have a membership fee increase coming down the pike at some point, and now we know when and there's a lot of debate on how much flow through or not. I guess, maybe the way to ask it is, is there a natural run rate of reinvestment that you as managers of this business try to put back in? And where are we running relative to that? I'm trying to gauge when we get the membership fee increase, are we going to see that getting pushed back into price as well? Or some of that will come through to the bottom line?

Richard Galanti

My view is - I'm speaking historically here, that roughly we've done increases about every five years. And we're certainly not smart enough to figure out how to put it in over the five years. We know it hits the membership fee income line over about two years. We also know it hits very little in the first month, one-twelfth of the one-twelfth of the renewals, if you will.

Historically, we've generally taken - we've invested in a lot of things, including continuing to invest in price, which might even be a slight negative then. Arguably, we've chosen, with some of the revamping of the MVM and some other things we're doing with everyday low pricing to, if you will, do some of that now. And that really is, in my view, not directly related to if, when, and now - when not if - a fee increase.

But I would argue we probably did a little more now. Certainly the reduced number of MVM days. Even in the MVM what we've done is basically gone out to vendors and worked with them. The goal for us, and them, is to drive sales. Basically, it's a better value to the member, which means it's a little more expensive both for the vendor and us.

So, I would say in some ways we've started that process, or we always do that process, and you'll see when you see. But generally speaking, in my view it historically goes in over a longer period of time, not just those two years - the net of everything.

Simeon Gutman

Okay thanks, Richard, good luck.

Operator

Your next question comes from the line of Michael Lasser with UBS.

Michael Lasser

Good evening, thanks a lot for taking my question. Richard, presumably you're investing in price because you're seeing a more competitive environment? Can you quantify or at least qualitatively comment on how much more promotionally and competitively intense it is now than when you've seen it in the past, particularly around the time when you've raised your fees?

Richard Galanti

Well, do you know what? We have a couple of senior merchants in the room with me shaking their head, and I concur. This is really not terribly related to that, to the fact that there's increased levels of competition. When we look at our direct competitors - notably direct warehouse clubs and certainly supermarkets on certain key fresh foods and sundries items - a lot of what you read about were some of the big box discounters and their investment in price which is formidable. Our view is that impacts and the competitors have to deal with that more directly, or supermarkets in the case of Wal-Mart, or Target, or whatever else.

We really haven't seen a big change there and certainly this was not motivated by that. I think it more has to do with is over the last few years, you'll see some of the sales lift in some of the things that the MVM has been great for us for so many years, changing and this is an iterative process. If anything, just like we are ultimately, we are going to do the right thing for the long term irrespective of how it impacts now.

We knew and we chose, but we don't give direction, we knew this was going to have some impact. Not a big impact frankly, but with having less days by going to some EDLP, it's what it does to drive sales. I don't know where else you can get in the country a 40-pack of half-liter water bottles for $2.99, down from $3.49.

And we're driving units and we're driving a little traffic. And that's what we do and it's not because somebody else went down to that price. We look at some key items and how do we do this. And it has very little to do with either different - a change in the level of competition, or the fact we're getting ready to do a fee increase. We do that really somewhat independently.

Michael Lasser

And just to quantify the impact of pricing, you've got a 16 basis point benefit to your gross margin from the credit card transition? It sounds like you invested all of that and more back in the everyday low price?

Richard Galanti

Again, I think the same comment. We didn't say, hey, we've got this much back let's use it all, or let's use any of it. We really look at those independently. I think one of the comments I made on a Q1 call, which is the First Quarter that there was really some transparency of how big an impact and successful the new credit card has been, both in terms of improving, adding to our gross margin percentage and to reducing our SG&A percentage in terms of lower fees. We really didn't say, wow, that's so big, let's use it.

We do what we are going to do on pricing and this is where the chips fell on that. I think one of the comments we made on the first quarter conference call is we're clearly - we were more lucky than smart that, that helped to offset some of the reductions in things and this is what we do.

Michael Lasser

My follow-up question is, the assumption is because you tend to skew higher on the socioeconomic demographic, or your membership base does, that you were not impacted by the delayed tax refunds in February? Do you think that's right? Or do you think there was some impact, and if so could you quantify it?

Richard Galanti

Well, I can't quantify it, certainly. Historically, when we've been asked a similar questions about when there was issues with food stamp-it programs or things like that, or this, we generally don't feel we're impacted a lot at all. It certainly is not a positive but my guess is it's not very much of a negative either. I would lean towards saying not really a big impact at all.

Michael Lasser

Okay, thank you.

Operator

And your next question comes from the line of Christopher Horvers with JP Morgan Chase. Christopher, you line open. If your phone is one mute, please unmute.

Richard Galanti

We can move on.

Operator

And your next question comes from the line of John Heinbockel.

John Heinbockel

So Richard, when you think about the executive increase in particular, how much discussion was there? What you should do with that, in light of where your club competitors are, where prime is? And then, when you think about where that goes over time, what kind of things can you add, and obviously the 2% is a big benefit, what can you add to the executive that might, people might want, that could allow that to continue to go up over time?

Richard Galanti

Again, first of all, what we do best is value to the member on products and services, and certainly that's going to be part of it. As it relates to enhancing both the primary membership, and more importantly the Executive Membership, I will say - and not being cute - stay tuned. We've got other things we're planning to do, nothing's Earth-shattering, but several things we'll do, including, I'm sure one late summer or early fall. But so we'll continue to do that, and we'll continue to look at the value proposition on the credit card.

As I mentioned - I'm sure a year ago when it first transitioned to it - whatever we do, and certainly the credit card profitability and success has been better than we and our partners have felt and originally planned, we'll look to enhance that value over time. But that's not something you do until you're a couple years out to see where things trend out. We'll continue to be very good at driving value and getting you to say, wow.

John Heinbockel

Was there, again, when you think about what you could have done with Executive, was there any serious consideration to leave it alone, enhance the value proposition, and push more people toward Executive? Or you pretty much knew you wanted to do the $10 from the beginning?

Richard Galanti

Well, I think we always start with the premise that we pretty much knew that. We look at other things as well, and we'll see what happens in the future. Nothing will happen in the next year or so I'm sure, but there are some other reasons in the state of California that it makes sense as it relates to sales taxability. We're pretty simple and it works for us. We're pretty simple and pretty extreme in terms of value. And we always look at, we always talk about, what about another level of membership above that.

If we ever figure out how to just offer only Executive, we aren't there yet. But rest assured there will be more value-oriented things coming to the Executive for sure over time, and more value to all members and general pricing and things.

John Heinbockel

Just one last thing. When you look at KS, assortment over time here, so it's clearly grown, looks like maybe up 50% over the past five years or so? That's imperfect, because there's stuff that cycles in and out. But when you think about where that ends up, three years from now, five years from now, obviously your total assortment is staying somewhat the same - are we going to get a higher percentage of KS items, just continuously, almost forever?

Richard Galanti

Sure. I think yes, but we also, our success has been based first by selling branded goods at the best value out there. Two reasons, one such sharp savings relative to everybody else and two, our KS - if it's as good as, if not better quality, which is our starting point and even a greater savings versus what we sell the brand for, that's even better. And it keeps our members happy and it keeps us and our vendors honest.

We'll continue to drive it. Recognizing there aren't a lot of $300 million and $500 million items out there, like the waters and the paper goods, and the K cups and whatever. But there's lots of $20 million and $30 million and $50 million items - we get surprised every day. So yes, there will be a continued push for that, but there's also a continued push to add brands that historically haven't been prepared to sell us.

John Heinbockel

Okay, thank you.

Operator

Your next question comes from the line of Matt Fassler with Goldman Sachs.

Matt Fassler

Hello Richard and good afternoon. A couple questions. First of all, just to make sure we understand the magnitude of the impact of the change in the MVM and the move to EDLP - when you talk about EDLP, are you solely talking about stepping in and displacing the MVM? And is there a way to estimate the impact that might have had on margin? And does that impact get - grow or dissipate next quarter as the disparity for the MVM comes down?

Richard Galanti

It really, yes and no to each of those parts of those questions. We've tried some items using the MVM as example. Some with vendors we've chosen to go to EDLP and get out of the item, get out of the MVM. Others we go the other way. Sometimes it works one way and sometimes it works the other way and that's how you figure that out. Again, not to be smug, but we really don't see it as, yes small basis points impact $25 billion, $29 billion quarterly sales figures by a lot. But we really - as probably, we knew it was going to impact us this quarter.

We don't provide direction, so we really can't say anything. It should improve a little in the next quarter, but it's not that's not based on, oh, my God let's change it. It's just that's what happens.

Matt Fassler

And is the improvement based on the better sales that you're likely to get from the MVMs year-over-year or some other element related to the change you're making?

Richard Galanti

It's all of the above. Including - as we've only done this for a couple of MVMs here - so a subset of all of the vendors over the years that have participated in this with us. Some that participated with us all the time for 22 years, and some are in and out and seasonal and some are new. And as we see the things that work, we certainly don't keep that a secret, and we go to our vendors.

And we have vendors in some examples that are wanting to do more for us, wanting to get those prices even lower because they see the lift impact on it. It really is all of the above, and I joke and use the word a little it's a little strategy, because we are merchants and we try a lot of different things, and we're pretty good at figuring out what works and what doesn't and working with our vendors to do that.

Matt Fassler

And one quick follow-up. Where are we right now in the credit card benefit cycle for you, are there elements associated with Citi Visa? Whether it's sign-ups, whether it's outside sales, and the financial benefits they have to you - that would lead to the financial benefit to you to ramp up? Or are we kind of leveling off at what's likely to be sustainable?

Richard Galanti

Well, I think there was some benefit in Q4, but not big enough to actually separate out. The Big Kahuna was in Q1, where we reported it, and now it's Q2. So again, very simply, my guess is sometime you'll get some benefit, incremental benefit in Q4 to get the other half, if you will - it's not exactly half of that.

In addition though, there's probably a little more in Q4 because of some of the challenges of the conversion itself. And then beyond that, I think I've said occasionally, that it should and hopefully will be the gift that keeps on giving a little, as we drive more penetration both in Costco with the 2% component reward on that, along with the 2% Executive Member reward. And it will drive outside spend because of the fact the card is accepted at so many places.

And if we can get you to use it everywhere or most everywhere, particularly those small merchants that generally pay higher fees to everyone, there's a component of that we benefit from. There's no way to predict what's going to happen.

On a year-over-year comparison the biggest bang for this buck is over the first 12, maybe first 15 months, because the first 8 or 10 weeks had the challenges of the conversion. Beyond that there should be incremental benefits, but certainly not as big as the first year.

Matt Fassler

Alright, thank you so much.

Richard Galanti

By the way, at some point two or three years out, I'm guessing you're going to see - when we get comfortable and see where it goes - you're going to see enhanced improvement, because that's what we do, on even the reward proposition.

Matt Fassler

Thank you.

Richard Galanti

Both ours and our cards.

Matt Fassler

Thanks.

Operator

And your next question comes from the line of Paul Trussell with Deutsche Bank.

Tiffany Kanaga

Hi, this is Tiffany Kanaga on for Paul. Thanks for taking our questions. I know you've gone through all of the numbers in quite some detail, but can you help us understand a little better as we're lapping quite a significant deleverage in core SG&A, excluding gas, so we didn't see the leverage this quarter that we hoped for, can you walk us through what might have held back the core SG&A line, ex-gas this quarter? And how to think about it going forward as we continue to lap even greater deleverage?

Richard Galanti

Well, I mean, at the end of the day it's mostly, as it always is, payroll and benefits. Healthcare is inflationary. We still have bottom-of-scale increases that we've done. That was actually in March of last year, when that will anniversary, mid-March. So that hurt us a little bit. Again, we look to the numbers. I think, we always look in the mirror at each monthly budget meeting and say, could we have done a little better on controlling labor in the warehouses, controlling overtime hours - sure. And there's probably a few basis points that we could do better on. But for the most part I think it's the underlying comp.

And mind you, using that, again, some of the example of the water going from $3.49 to $2.99 and sell a lot more units. The margin dollars are plus or minus the same, but there's more labor involved. Not a lot more but again all these things are incremental - add a few basis points. So other than that, the big one of course is all of the modernization-related stuff as we've had these big systems come on - it's like building a building.

You build it and then you wait until you open it, if you will, or turn it on. And that's when you start to amortize it. In our case, typically over five and seven years. Sometimes three on a few things. And some of those big nuts, if you will, have occurred in the last year.

Tiffany Kanaga

Thank you so much.

Operator

Your next question comes from the line of Brian Nagel with Oppenheimer.

Brian Nagel

Hi, good afternoon. I too, wanted to drill further into the margin. So just to be clear, and I know you discussed this a lot today, Richard. If I'm looking at my model, year on year gross margins were down, ex-membership fees down by 24 basis points. So that's the first time in a while, at least in several quarters, that it’s been down. So the shift from MVM to EDLPs is a significant portion of that?

Richard Galanti

I'm sorry, ask the last part of the question - somebody was saying something here.

Brian Nagel

The question is, and I know this is a bit of a [indiscernible] because others asked more questions. But if I look at - the gross margin, ex-membership fees, here in the fiscal Q2 were down 24 basis points. And that's the first time, as I look back sequentially, I'm not saying now, but they were down. And so how much of that, we look at the break in trend then, how much of that can be explained by this shift from the MVM to EDLP?

Richard Galanti

I would say if there were five factors, I'm making this up, it's probably the third or fourth most impactful. And the biggest single factor, which is well more than half of the factors in total, is gasoline. Gasoline impacts it two ways. One, you have potentially lower margin on gasoline profits - or gasoline sales, and two, you have increasing penetration of gas because of a 29% higher price per gallon.

And this is a business. I don't know the exact number in my head, but roughly 10% of our total company sales. It's ranged from 9% to 12% or 13%. So that alone, again, if I go back to Q2, if we look again on a reported basis, lower by 24 basis points, ex gas inflation minus 15, but that minus 15 includes minus 18 - most of ancillary, most of which is gas. And so that's where a lot of it is.

Brian Nagel

Okay, and then just on the ship and EDLP, is it fair to assume that when this is implemented, it could have more of a near-term impact by margins than maybe, say it takes awhile for sales to catch up - and I'm thinking because the MVM to a certain extent [indiscernible] so if you shift to an EDLP, maybe you lose that caller to action over time that figures it out?

Richard Galanti

Couple of things here. First of all, it's not like we've changed this thing from - it's not binary, we aren't going from all this way to all another way. It is the transition quarter, and we did a bunch of stuff in that transition quarter. Again, that's in my view, one of the smallest factors relating to this decline in margins year-over-year. And the comment I made earlier to one of the questions on the call about what do we see going forward? I think Matt asked it, is that it should not be an issue. Yes, we'll see. But we don't believe it will be an issue in Q3 like it was in Q2.

So, I wouldn't lose a lot of sleep at this juncture over that, and certainly not lose any sleep over the fact that we've made this major change. The major change is, we've changed it. And we're seeing the things and components of it that work and seeing some of the things we're tweaking. I think one of the reports out there that I saw couple days ago, talked about adding some days into the thing. No doubt have some friends in the vendor business.

The comment I made earlier about Q3, whereas in Q2, on an 84-day quarter, there was 17 less MVM days. In the four-week month of February, 28 days, there were 11, 10 or 11 less MVM days. In Q3, and that 84-day month less a day or two for holidays, they are the same number of MVM days year over year. So again, I can't overemphasize that this is - EDLP is not a word we use a lot historically. We're trying a lot of different things and again, we think we feel pretty good about what we've got going forward here.

Brian Nagel

Got it. Thank you.

Operator

And your next question comes from the line of Oliver Chen with Cowen & Company.

Oliver Chen

Hi, Richard. Thanks for the details on the roses too, I like that. Regarding the mailer and the changes historically, what were you seeing with the consumer in terms of the consumer insights that kind of drove you to engage in testing and reacting on the changes to the MVM program? And what are you looking for as it gets tested? As we model the membership fee increases, how do you think that will interplay with store traffic? Do you feel like store traffic will continue in the nicely positive range? Or will there be some volatility and risk we should think about going forward?

Richard Galanti

First of all, as it relates to how and when we decide to change the MVM stuff. Not that we talk about this all the time, but for those who have known us, we talked for the last few years about how we tweak it a little bit. Ultimately over time, there's items that don't get these same annual - not only the same annual sales lift they historically have gotten, but also the additional incremental new potential customers to that given item, from the vendors perspective. It's not just getting somebody to buy more of something and consume more of something. It's getting new members to do it.

So over time, some of those things, not all of them, some of them get stale. And we've done some tweaking over the last few years. Probably six months ago, three months ago, the merchants sat down with the operators and senior people there and made a choice to do what we're doing now. We knew, and we know it's the most painful in the first, in that transition quarter. Again, it's not in our view, and not to be cavalier about it, but it's not that big of a deal other than it did impact some things this way.

And again, we continue to tweak it and so we're - unfortunately because small basis points make changes on EPS numbers and we sell it at a nice multiple, I recognize the concern. But we feel we've got a lot of good things going on and we're pretty optimistic about what's going to go on here in the upcoming quarters as it relates to driving sales and improving earnings. I can't give you specifics about how and why, but we're pretty, also good, as you know, laying out all of the stuff here, good and bad and so you can take a look at it.

We don't look at this and see it as that big of a deal, and we have tweaked it a little bit and we have added a few more days back to some things. We knew also that again, Q3 was going to be a lot less of any of the negative impacts as it relates specifically to MVM days.

Oliver Chen

And on the membership?

Richard Galanti

I wanted to get back to the EDLP question, because again it's not an acronym in our vernacular, even though that's what we do, since the beginning of time. When we looked at these items and worked with different vendors on different items, sometimes it's, let's put a little more emphasis on MVM, change the pack size and do a greater value.

Sometimes it's, get out of the MVM and do EDLP, and really come to the table with something that is a wow, on an ongoing basis. We've not just the last couple months but over the last few years, we've seen as we’ve tried this occasionally, we've seen different things. And again, we feel good about what we feel that we are going to see going forward.

We feel good about the lifts we've seen in many of the things. But we are by no means going to change everything to go to EDLP, which used to be MVM, by any stretch. We think the MVM has a lot of continued potential for us and by the way, there's some added benefits to it.

Historically, in the last few years our MVM’s - I believe there was three days between the MVMs and the warehouse. When you're talking about lots - one of the things that take up the most room and require the most operating issues in the warehouse. It's big bulk items like detergents and paper goods and water and the like.

And logistically, we pushed that pretty hard over the years to three days. One, this gives them a little bit more efficiency in the warehouse. That's not the reason we did it, but that's an added benefit. Two, we've actually put some time in there to do a few other things in the warehouse. Whether it's road shows or some other things we've got going on with merchandise presentations. So, all of this relates only to what we do every day. We keep trying new stuff. It's not like, oh, my God something's changed.

Oliver Chen

Okay, Richard, thank you. And what about your digital infrastructure, in terms of - is car pick-up and pick-up and buy online, reserve in store, as well as your mobile app, as well as thinking about the bricks and quick supply chain, what factors will be important over the next few years in terms of making sure you're driving ease, value, convenience as well as being superior merchants?

Richard Galanti

Well, first of all - in terms of pick-and-click, no. Ask me next quarter, but I think the answer will be no for a while. You want to go see it in some of the other places, by the way. It ain't all that good. And we don't have the room for it anyway. As it relates - we are doing some unique things with business delivery, and we now have, whatever 15 or 16 business delivery sites around the US, just opening our first one in Canada. Probably the single biggest thing is what items we're offering online and how quickly we can get them to you. And I mentioned maybe a little bit of a teaser, but I talked about it online, you'll see more things coming this calendar year.

Probably not until summer, that both what we're doing ourselves, as well as what we're doing with a couple third parties. Not only in our markets, but outside of our markets in the continental United States. One of the things we all know, we have the best prices on great quality items. And we've never been too good about worrying about how to get it to that end customer a day earlier. We're doing - it's the 80/20 with us. We've done just in the last six or eight months, a lot of improvement online in that customer experience, with the smallest amount of effort. The low hanging fruit.

We've got good things working on, but we're doing these things, honestly, from our offensive standpoint not a defensive standpoint. And I'm not trying to be cute. Clearly we want to do it for competitive reasons, too, but it's not like we looked at this and we lost. We see our renewal rates, ex-some of that auto bill stuff that we believe. We see our traffic going up still, and we see online, we see our page views and the like going up as well. With some of the additional items and the types of items we put on and better communication to our members of what that is.

I think again, sometimes we're viewed as the tortoise, not the hare. Certainly, over time we're viewed as being stubborn. I think in my view, we're a lot less stubborn and - but we're still a little bit of a tortoise sometimes and we got a lot of good things going on. We'll see, but stay tuned.

Oliver Chen

And the last question, Richard, is on stores. A big topic is the physical stores. You obviously have really superior traffic and a great assortment, so what is your maximum store opportunity in the United States versus where you are currently? And are there any potential edits to the format or is it status quo in terms of what we should think about over the longer term?

Richard Galanti

Well, first of all, every year seems to occur that we think there becomes a few more locations than we thought were possible. Certainly in the last three fiscal years, in 2015 I think, we opened 21 in the US as an example. And 16 or 17 last year, and I think 17, I said this year. If you asked me five or seven years ago, I'd guess we would be down to 10 to 12 a year. Clearly we've gone to several new markets, new for us, not new for the warehouse club industry, where we've done well. Some of them are smaller and take a little longer but we're doing just fine there.

I think we'll continue to add - the line will keep getting a little bit more towards that saturation, but a little slower than some might think. I mean, we don't know in terms of our basic 155,000-160,000 square foot format Costco warehouse in the United States, I think it's a good guess to assume that it will be somewhere in the mid teens for the next 10 years, per year.

I don't know, three years from now I might be wrong, but at this juncture we doing a little higher than that which is a surprise to me. Canada, this year's an anomaly, opening 8 on a base of 91. But I can remember five or eight years ago, I don't remember how many we had, maybe 70. We felt one day the market potential for all of Canada could be 90. Now it's probably in the 110-120 range, but not 7 or 8 a year. This is unusual, but it's good for us. The opportunities present itself.

I don't see us necessarily any time soon doing a unit half the size. We tried that a while back, not to say we won't try something. We began this year with 14 business centers all in the US. I believe we plan to end this year with 18, 1 of which is our first 1 in Canada. Could you have 40 or 50 in the US one day? We'll see. We had 8 for the first 10 or 20 years, for 10 or 15 years, before we opened a 9th a few years back. And so I don't know if the 2018 or the 2017 in the US, by fiscal year end will be 25 one day or 50 one day. But it's working and we'll see where it goes. And then the second and last thing -

Oliver Chen

Thank you. Best of luck.

Richard Galanti

Lastly, leg is international.

Oliver Chen

Thank you very much, Richard.

Operator

Your next question comes from the line of Scott Mushkin from Wolfe Research.

Ben Shim

Hi. This is Ben Shim, in for Scott. Thanks for taking my question. Just a couple of questions. Can you give us an idea at this point what your expectations are for inflation? Are you inflating across some of your consumables categories, such as food and personal care products?

Richard Galanti

The collective view is inflationary, or less deflationary, for the next few months and maybe a little inflationary, but it's a crap shoot.

Ben Shim

Okay.

Richard Galanti

I mean, it's based on SER buyers in different departments. There's nothing widespread at this juncture.

Ben Shim

Okay, going to your historical experience with respect to membership fee increases, has 10% been the norm over the last several increases as far as attrition goes?

Richard Galanti

I'm sorry what was the 10% related to?

Ben Shim

I think you mentioned something like a 90% renewal rate over the last membership fee increase and I'm just wondering -

Richard Galanti

Our renewal rate over the last many years has tweaked up from the high 80s to low 90s in the US and Canada. I mean there was a period of time for two or three years, that let's say three years over 12 quarters, it seemed like every quarter, year-over-year was up another tenth for a lot of reasons. Executive Members, as we convert them, they renew at a higher rate. Needless to say on a co-branded credit card, there is the benefit of auto billing for those that opt into that. You'll get a little higher rate there and hopefully we keep doing things to make you want to renew more.

Ben Shim

Okay. Relative to five years ago when you had your last fee increase, can you describe what the competitive environment was back then if you remember and how it might be different now? Does it give you pause or concern?

Richard Galanti

Absolutely no concern.

Ben Shim

Okay. Alright, thank you very much.

Richard Galanti

Sure.

Operator

Your next question comes from Robby Ohmes from Banc of America Merrill Lynch.

Robby Ohmes

Hi, Richard, I just quickly, was curious on an update of your business in China - what you're seeing on TMOL and if you're any closer to maybe opening a store over there? Thanks.

Richard Galanti

We continue to - I think there was an issue with taxes that negatively impacted not only us but anybody selling, importing into China. There's a 10% increase in taxes. Boy, maybe somebody else shouldn’t do that. But there's a 10% increase in taxes and that impacted again, negatively some of the imports into there. It's still relatively small. It's good, but it’s relatively small. In terms of us opening in a location over there, you should expect something in the next couple years.

Robby Ohmes

Got it, thanks.

Operator

Your next question comes from Karen Short from Barclays.

Karen Short

Hi, thanks for taking my question. I just want to go to the fee increase. I'm asking this because I'm wondering if you can give a little color on where your average ticket is with your Executive Members now, say versus 2012? Because when I calculate with the breakeven spending is off with this new fee, and when I try to kind of back into how many trips per week your Executive Member needs to be making, you're almost up to once per week to break, for that member to breakeven. I may be wrong on the math on the average ticket, so just wondering if you could give a little color on that?

Richard Galanti

We don't give out those numbers, but directionally, I think one of your assumptions is, the average Executive Member spends a lot more per visit as well. And an Executive and a Business member, and more - relatively speaking, more of our Business Members or Executive Members, as a percent of total business members versus Goldstar, I'm guessing - I don't have the numbers in front of me - so all those things play. I want to also add a comment to a question a few questions ago about renewal rates, about how they've changed over time.

I have a simple summary sheet here that shows what our renewal rates were. I only have US and Canada combined, which is again more than 80% of our company. At the end of 2005, it was 85.9%, at 2010 it was 87.7%, and at 2015 it was 90.6%, and at the end of 2016 it was 90.3%. That little delta downward has to do, in our view, with the conversion to the new Citi Visa card and some of the changes with automatic auto billing had to be redone. So sequentially its continuing to go in that direction. Recognizing it can't go above a hundred - and jokes aside it won't get that close, but we think that it’s been consistently improving at a level that's consistently good for us.

Karen Short

Okay and then just on eCommerce, you know I'm wondering if you could maybe give a little color on eCommerce growth rate by categories? And obviously your growth rate overall trails some of the mass competitors, so wondering, A, did it come in kind of in line with where you expected for the holidays? Or what do you think you could continue to do to drive that strength?

Richard Galanti

I've shared I think a little bit of the kinds of things we're doing, from member experience, to faster delivery, to expanding items, and arguably, letting our members know that we have it. Again, it started off years ago as limited big ticket items, hard to carry, hard to deliver, hard to install items, and we've added to that. We feel again, fine with where we are.

Yes, there are bigger increases out there, but I would bet that the investment per dollar of increase is dwarfed everywhere else. I'm not trying to be cute about that because we are investing more in it, but doing it in an offensive rather than a defensive way. We still are a brick and mortar entity and we want to get you into the store because you're going to buy more in the warehouse.

You're going to buy more when that happens, and we've got a lot of reasons for you to do that. We also recognize we don't want to lose the sale to somebody else because they only buy online. I think, I feel you're going to see good things continue over the next few years. It's a small, online is a small percentage of our Company, 4%, $4.5 billion or so. Still a $4.5 billion business growing in the low, well, 11% or 12% this past fiscal quarter, and the mid-teens over the last few years in general, and I'm betting that will go up some from that level, but we have to see.

Karen Short

Great, thanks.

Operator

Your next question comes from Sean Naughton from Piper Jaffrey.

Sean Naughton

Hi, good afternoon. Just wanted to go back to the merchandise margin, the core merchandise margin, up 7 basis points in the quarter, just on a rate basis, just - this has been going on for a couple years now, and is it really driven by mix or is it some of the fewer promotions you were kind of describing or better deals from your vendors - just trying to understand how this line item has just been a very consistent march higher and is that intentional by Costco?

Richard Galanti

First of all, it is intentional by us. My guess is that most of it is related to mix. I mean this quarter a little bit is related to the EDLP and MVM shift or whatever, but generally speaking, and certainly over the years, increasing penetration of gas. I mean you've got a total company gross margin last year of approaching 12%. If roughly 10% of that's gas at, quarter-over-quarter.

Oh, that's right. I think that's just the nature of the draw that quarter. Fresh foods tends to be a little higher margin, and I think it was down a little bit this quarter. Some of that has to do with holding prices on some deflationary items. A couple months ago, there was a bad berry crop. Literally, these are the kind of things that will impact us when we are such a big player in this stuff. I don't think any big difference here.

Sean Naughton

Because it seems to me, and I'd have to look at the model again, this has been a number that's been very consistently going up between 5 to 15 basis points almost every quarter for the last probably 10 quarters? But maybe just mix related?

Richard Galanti

Well no, quarter-on-quarter is not mix related. It's quarter-on-quarter.

Sean Naughton

I'm just saying like it was in the core. Yes.

Richard Galanti

Okay, I'm sorry I misunderstood part of the question. I think part of that is some of the aspects of the components of that. Some of the higher margin categories would be some of the non-food categories like apparel. For those who have known us for awhile, the last three years we've enjoyed probably an annual compound growth rate in our apparel sales in certainly the high singles, maybe 10%.

So that's a category that's a higher margin to start with. I think we've done a little better job in some of the other areas of non foods, but apparel is the one that stands out in my mind as a big example. Fresh foods overall has a higher margin and even though it fluctuates up and down quarter over quarter of its own accord, if you will, it's a higher average margin department and penetration overall.

Sean Naughton

Okay got it. And then just on new sign ups and renewal rates, I know Millennials are becoming a bigger piece of the store, and I think Craig mentioned something like 44% of new sign ups are actually Millennials now? Can you talk about how the Millennials are doing in terms of their renewal rates, just overall? And then I guess as an add-on there, is any color on the renewal rates for some of the promos that you've experienced or experimented with over the last couple of years on Living Social, or in social media, how the renewal rates from those programs have gone?

Richard Galanti

Yes, I can't tell you how, like the age-group called Millennials today and how they renew and spend versus 5 years ago - whatever they were called, or 10 years ago in Gen Y or Z whatever it was back then. We didn't look at that kind of data back then. We have for the last couple of years, so ask me in three years and I'll have good information for you on that. What we see though, in terms of that age-group now called Millennials, it's not that different relative to the other age-groups today than it was two or three, and four years ago, when they signed up. What we see is - we only have two good data points on the two Living Social things we did about two and a half years ago, and a little over a year ago.

We compared them to everybody else that signed up that month by just walking in or going online to sign up. What we found is due to Living Social, and I could be off a few percentage points here, on Living Social, it was about in the mid 40% range of those that signed up on the Living Social promotional effort that were Millennials. And that compared to the walk-ins that was in the mid 30%, maybe 9 or 10 percentage points difference. What we saw in terms of how much they spend over the course of the year, the Living Social - or the Millennials spent a little less each time and actually shopped a little more frequently, which is counterintuitive to me.

And in terms of renewal, they renewed about a percentage point or two higher than the walk-ins in that first year that they had to renew. Again, a little counterintuitive to me. Maybe it is not statistically meaningful because again, this is its first year, it's one or two percentage points. But at least it gave me comfort personally, that we're not losing them and they are coming in. What we've also seen, and what we believe, when I look at the curve of who spends the most at Costco, it's the - they start spending - the peak is, if I separate people from 25 to 80 years old in 11 age-groups, the peak is the fifth and sixth age-groups, which are 45-49 and 50-54, and a nice increase going from 35-39 up to 40 and 44 before that.

Well, might be that makes sense. Maybe they are getting married, maybe having kids, maybe getting married later having one less kid, who knows. But once they do that, then they start making more money, they spend more. They have more mouths to feed and they are making more so it's again, this is looking at a chart, not doing a lot of statistically significant analysis.

Sean Naughton

That's helpful. Last quick question from me. When should we expect the golf ball back in stock?

Richard Galanti

The golf ball back in stock? Stay tuned, when we have it, if and when we have it back, we'll let you know.

Sean Naughton

Thank you.

Operator

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

Chuck Cerankosky

Good afternoon, got a question because what you said about the MVM is counterintuitive. You're very focused, Richard, always on growing frequency of visit, and it sounds like by reducing the days there is the opposite? How do you communicate the other factors you don't advertise to the member about road shows and new excitement or lower prices on certain key items you're trying to feature?

Richard Galanti

First of all, how we do it, it's the Costco Connection, or magazine. E-mail and in-store sites but I've got to tell you we started this during the, Heard First, if you will. This goes back over a year ago when you start talking to vendors and our key merchandise partners and figure out what we can do and how we're going to do it. It wasn't like we need to get every reduced day filled with something else.

Giving a little breathing room to the warehouses has been a big positive from our operator standpoint, and again, we'll see how that goes. I don't think it was a big surprise. We knew we would get impacted on the traffic side. And we know - one of the comments, I mentioned, and one of the comments some of you guys have mentioned or heard through others, is there have been a few extra days added to the starting point. Well, that's correct.

If we look back out in the next three or six or nine months, the big extreme transition was this quarter, and in particular February, and you won't see that in Q3 as the same number of days. We'll stay more fluid in the next two to three quarters. And then it's just anniversarying stuff.

Q - Sean Naughton

Thank you.

Operator

Your next question comes from the line of Kelly Bania with BMO Capital Markets.

Kelly Bania

Hi, thanks for fitting me in. Just wanted to ask about the decision to raise the dollar impact for the 2% reward? I was just curious if you tested that, that increase to a thousand? Or if you have any thoughts on what kind of impact you think that could have on traffic or ticket from that Executive Member? And then also, I guess associated with that, how we think about just the impact to gross margin as that flows through over the next several years? Thank you.

Richard Galanti

Well first of all, there's a lot of Executive Members. In theory, even assuming the new fee structure of $60 and $120, that $60 means you've got to spend what, $3,000 more a year to be breakeven on it on eligible purchases. That's not a big hurdle, but there's plenty of Executive Members that don't get near the $750. So there's some that won't be impacted at all and others, a nice impact.

How we came to $750 to $1,000 is not unlike how we decided to do $5 and $10 each five or six years and how we went from $500 to $750 last time. I think again you'll see other things that will add to the benefit, we continue to have added things to the Executive benefit. Our family bought a Yukon Denali a couple years ago. If you were a regular member, on top of getting incredible pricing on the car, a regular primary member we got, I think $200 or $300 cash card, and Executive Member got a $600 or $700 cash card.

Needless to say, that incentives people to become an Executive Member. Once they are, they look at other rewards and there's plenty of things out there we'll continue to add to that. How it impacts margin - the extra $250 is relatively small, very small, relative to the 35 million people paying $5 and $10 each. Mind you, some of those are Canadian dollars, that's lower relative to the US dollar but nonetheless a very small piece of it.

Kelly Bania

Thanks.

Operator

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

Peter Benedict

Hi Richard, quickly, when you pay down the debt later this month, your leverage ratios drops pretty dramatically, just what are your latest thoughts around leverage? And if you care to comment on the circus in Washington and what's going on there, is that impacting your decision on when you might do something around leverage? Thank you.

Richard Galanti

Clearly, as it relates to all of the proposed tax things, one of which is the ability to not write-off interest expense, that is not one of the ones we're worried about. We don't have a lot of interest expense. As it relates to our balance sheet leverage, we like to think of ourselves as well capitalized, not over capitalized. We're cognizant of it and I'm again, not trying to be cute. We look at all of the components of it - regular dividend growth, special dividend stuff, stock buybacks, first and foremost ramping up expansion. We're cognizant of it, but again we aren't going to just do something because this is March 15, and we got to do something.

Again, stay tuned we'll - our Board meeting meets regularly every quarter, and we just had a Board meeting a few weeks ago and didn't do anything different. We're constantly asking questions about, are you going to increase the regular dividend, do another special. Stay tuned. We look at it every quarter and we decide what we want to do. But at this juncture, we basically use cash to pay off that debt, and I'm happy it's the most expensive piece of debt that we have.

Peter Benedict

Sounds good, thanks, Richard.

Operator

Your next question comes from the line of Edward Kelly with Credit Suisse.

Edward Kelly

Hi, thanks for taking my question. Richard, just looking at gross profit dollar growth, I know there's been a lot of talk about margins, but gross profit dollar growth this quarter slowed relative to where you were last quarter? Is that primarily fuel? Asking another way, did you make less in profit per gallon in fuel this year than - or less in gross profit dollars in fuel this year than what you did last year?

Richard Galanti

I'm guessing we did, because when prices go up, we make less per gallon, period. And I don't have the exact numbers in front of me, but let's face it, what was it, $0.06 a share of 42 million pretax in the quarter year-over-year. That ain't all gallons. It's mostly profit per gallon. The vast majority is profit per gallon.

Edward Kelly

Okay, so as we think about - obviously the Street wasn't really modeling the quarter the way that it came out. And it's not as much about the gross margin, but it seems like it may be around this fuel side, with a bit of price investment on top of that? I guess, is that fair? And my question to you beyond that as we look out into Q3 as long as fuel prices are stable, does this headwind go away a bit?

Richard Galanti

Bob, what did we do last year in Q3 on gas, was it still big? I think it won't be, all things be equal, in terms of the comparison year over year Q1 and Q2 profitability in gas a year ago was outsized big. We were profitable in Q1 through this year, but again, comparison was a huge difference. Some of that outsized big became less outsized big in Q3. It was less in Q3, but we don't know what Q3 this year brings. My guess is it certainly won't - well there's no certainty to anything in life - but my guess is it will be a little less negative all things being equal. And the other?

Edward Kelly

Thank you.

Operator

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

Greg Melich

Hi, thanks, I have a quick follow-up to that and another question. If you're thinking about penny profit, Richard, are we back in gasoline to where we were a few years ago? Or could there still be room to go down there? And then my other questions were on deflation. I think you mentioned in February it was about 50 bips less than in the second quarter? I'd love to know what drove that. And maybe a longer term question, if you just look at membership growth numbers, we had been running close to 7% and it's decelerated to about 5.5% the last few quarters. Could you help us understand why that is, and if it's just timing of clubs or what's at work there? Thanks.

Richard Galanti

Greg, I hope you wrote down the numbers because a few people were whispering to me as you were talking - what was the first question?

Greg Melich

First question was a follow-up on the gas profit, so basically are we -

Richard Galanti

Yes, we've had about, I don't know if it's a year and a half or two years of outsized gas profits. Is it back to where it was before - two years of outsized gas profits. I believe so, I don't know if it's a little worse or better than the two and a half years ago, but certainly these last two years have been fun.

Greg Melich

Got it. And then the other questions were deflation in February looked like it was not quite as bad, it was 50 bips less deflation than in the second quarter?

Richard Galanti

Yes, that's year-over-year, so part of that is just when the relative timing of inflation was a year earlier in those respective quarters and probably a little of it is some lower pricing on some stuff. I use the water example. See, that item is a $300 million item and we did more sales. Bob is mentioning in terms of deflation, it was a little better in the quarter in Q2 versus Q1, but February was more deflationary than the whole quarter, relatively speaking, than the whole Q2 overall.

Greg Melich

Okay.

Richard Galanti

It is eventually going down, but I think again some of that has to do with pricing on our side. It's not just what the economists are telling us.

Greg Melich

Lastly, on the membership growth, I know it can move around quarter to quarter, but if you look a few years ago, it seemed to run 7%-ish, give or take? And now it's more like 5.5% the last couple quarters, is that because we have more in fills, or how should we think about less membership growth, the same sort of club openings?

Richard Galanti

Some of it's related to the cannibalization I mentioned earlier. When you open eight units in Canada this year, there aren't a lot of new markets. We have openings, we've had openings in the US where in a small new market - well, Tulsa was my extreme example, where through opening day we had 20,000 plus sign-ups.

I remember in Tennessee in a new market we had 10,000 or 12,000, which is great. We could open a new unit in LA and have 3,000 sign ups and it's an awesome location because it's existing members shopping a lot more frequently because it's a lot closer unit to the members. They have always been members. The other thing that will affect that is international openings, particularly in Asia where we could have, during those 8 or 10 weeks, up through opening day where we do tabling activities, we've had openings of 20,000 to 50,000 - 20,000 to 40,000 sign ups in those several weeks.

So having a few of those change and I don't know if that helps or hurts us, those are the things that are generally impacted. Overall, we feel we're still adding members. Some of the new markets we've gone into, Tulsa again was an extreme one, but we tend to do well in those.

Greg Melich

Okay, great, thanks.

Operator

Your next question comes from the line of Molly Smith with Bloomberg.

Molly Smith

Hi yes, Molly Smith here from Bloomberg News, thanks for taking my question. Richard, I wanted to ask you about the prospect of the border adjustment tax and given that your cost of goods sold, about half of that comes from imports - so what have your thoughts been as these discussions continue? Have you tried to lobby with any of these other retailers against the tax? And as well as other changes potentially coming out of the new administration with healthcare, how that may impact your business as well, if at all?

Richard Galanti

Sure. Before I answer that, just one final comment in response to Greg's question about the increased growth in new members - or actually, not members, but new members, but revenue. A little of that probably was negatively impacted by the auto billing comment I made about the credit card transition. A little bit, I don't know how much but that's probably a little bit of that offset too.

As it relates to the border adjustment tax, there's clearly the people out there that want it and manufacturers that export a bunch of stuff and don't import a lot of stuff and at the very other extreme retailers. Recognizing border adjustment tax is just one element of one version of the tax reform plan that's been put forward out there. The probability of what's going to happen and when it's going to happen and how much of it's going to happen, we don't know.

We don't believe it's good for consumers - it's going to raise prices and ultimately, I read articles where some retailers, particularly apparel retailers, were 90%-plus of their merchandise is sourced overseas, well a 20% tax is a 20% tax. While retailers generally tend to historically be full corporate taxpayers, us in the mid-30s in the US probably a little higher than that, the total company effective rate. It's going to hit it and so to go through, we personally don't buy into the fact that it will be offset by a big rising dollar.

We don't know what's going to happen with the retaliation out there by other countries, and we'll see. But as a retailer, we definitely think that it's bad, and we're against it. We, in terms of lobbying, we aren't big on lobbying. We're doing a little bit of that area, certainly RILA, Retail Industry Association, is very involved in it. There's an offshoot organization forum which RILA is a big part of, and we become part of - the Americans for Affordable Products.

We’ve joined that along with many, hundreds of retailers including some very large retailers. And through those lobbying efforts, we certainly support what they are saying and hopefully, those out there that will make these decisions are listening. We've spent our whole lives driving down prices, and recognizing also that so many items - it's not a question of - let's buy them here instead of outside of the US. They don't exist here and that's not going to happen overnight. So it will be a tax, ultimately in our view, and prices will ultimately have to rise.

Molly Smith

Thanks so much, and anything on the Affordable Care Act either, or no?

Richard Galanti

I'm sorry?

Molly Smith

Anything else on prospects of change to ACA, if that impacts your healthcare at all?

Richard Galanti

It really doesn't. We have a very good quality, rich, Medical/Dental/Vision and Other plan where our employees only pay about 10% of the total cost. It's one of the things that sometimes impacts our P&L a little bit, but something that we're very proud of, and so we really don't have a lot to say about that.

Molly Smith

Thanks so much.

Operator

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

Joe Feldman

Hi, guys. Joe Feldman from Telsey Advisory Group as you know. Sorry to prolong the call, but just wanted to ask, could you share any thoughts on the service element of your offering? I'm thinking about like travel, and maybe like payroll tax, or doing different things, auto sales, and maybe how data mining could play into that?

Richard Galanti

Well all those services, we tried to not talk about them a lot because we've got a lot of good things going on. They are profitable, they are growing, so many of you have heard me talk to you about, challenge you to go next time you rent a car, go to www.Costco.com and no matter how smart you think you are, and you'll see what a great value it is.

We're doing better in getting that word out and you'll see additional services. As it relates to data mining, we're starting to take some baby steps in that area, but again our first and foremost is - we're pretty good at getting on the phone and calling third party people that we think can be a good partner to us.

And we continue to look at other things, but those are all things that will continue to drive our business in a positive way, but I don't want to suggest we're hiring somebody to do big data mining at this point. We're doing more data analytics that we've ever done and there's plenty of low hanging fruit to start.

Joe Feldman

Thanks, and one other question. Just on IT expenses, I know it’s been a drag much of this year and presumably it never goes away given where we are headed with technology in general - but is that the right way should it annualize at some point and level off? Or should we think about incremental expense going forward?

Richard Galanti

You know, about three and a half years ago when we embarked on this dark journey, recognizing we probably had the lowest cost IT out there. And I always joke we were in the greatest MASH unit. It was always up and running, but band-aided to death, and we made a big investment. We also during the process found out what we don't know, and what we need to do and again it's gone up. I think best guess four years ago was incrementally, it might cost in the low double digit basis points to SG&A. Mind you, every year, the denominator of that calculation, sales, keeps going up so it's rising.

It's I think historically today it's probably in the mid- to high teens. It has gotten a little more outsized this year because some of the big programs have now been installed. Notably, the beginning of this first fiscal year as an example, our major accounting platform, which is the crux of a lot of things, we'll do on it now. That was $150 million that will then be amortized over seven years. We'll keep it longer than that but that's what we amortize over, so that's added to that thing. I think you'll still have incremental costs and the definition of modernization will evolve also, and we keep adding new things to it, rewriting the pharmacy system.

There's additional things that we'll do, so I think it's going to be less painful going forward. This year is a double whammy, because you also have some things that impact sales downward. So that denominator hasn't grown as fast in that regard. I think it's still going to be a drag for a few years. Much less of a drag than it has been.

Joe Feldman

Got it, thanks and good luck.

Richard Galanti

Why don't we take two more questions. I think this is our longest call ever, and we're all, David, and Bob, and I are here to answer them outside of this conference.

Operator

[Operator Instructions] There are no questions in queue.

Richard Galanti

Well thank you very much, have a good afternoon.

Operator

This concludes today's conference call, you may now disconnect.