Costco Wholesale Corporation (NASDAQ:COST) Q1 2018 Earnings Conference Call December 14, 2017 5:00 PM ET

Executives

Richard Galanti - EVP & CFO

Analysts

Michael Lasser - UBS

Charles Grom - Gordon Haskett

John Heinbockel - Guggenheim Securities

Karen Short - Barclays

Simeon Gutman - Morgan Stanley

Daniel Binder - Jefferies

Christopher Horvers - JP Morgan

Edward Kelly - Wells Fargo

Matthew Fassler - Goldman Sachs

Paul Trussell - Deutsche Bank

Kelly Bania - BMO Capital Markets

Scott Mushkin - Wolfe Research

Charles Cerankosky - Northcoast Research

Operator

Good afternoon, everyone. My name is Christy, and I will be your conference operator today. At this time, I would like to welcome everyone to Costco Wholesale Corporation First Quarter Earnings Call. [Operator Instructions] Thank you.

I would now like to turn the conference over to CFO, Richard Galanti. You may begin.

Richard Galanti

Thank you, Christy, and good afternoon to everyone. I'll start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements. The risks and uncertainties include, but are not limited to those outlined in today's call as well as other risks identified from time to time in the company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made, and the company does not undertake to update these statements except as required by law.

In today's press release, we reported operating results for the first quarter of fiscal '18, the 12 weeks ended November 26. Reported net income for the quarter came in at $640 million or $1.455 a share. That's a 17% increase compared to last year's first quarter results of $545 million or $1.24 a share. In comparing the year-over-year results, there were two items noted in today's release. First one, this year's first quarter had benefited from a $41 million or $0.09 a share income tax benefit related to a change in accounting rules for stock-based compensation.

And secondly, last year's first quarter results benefited from a non-recurring $51 million legal settlement. This $51 million figure represented a 19-basis point benefits in gross margin and a benefit to the first quarter 2017 earnings per share of $0.07 a share. So excluding those two items, the reported 17% integration earnings would have been up 16%. A variety of other items impacted the year-over-year comparison. To the positive, gasoline profitability was higher year-over-year as was, to a lesser extent, incremental events, incremental benefit from our co-branded credit card program metrics. Offsetting these year-over-year positives were costs related to Hurricanes Irma and Maria and the slightly higher year-over-year normalized income tax rate, about 70 basis points.

Now turning to the income statement I'll start with a sales. Net sales for the first quarter were $31.12 billion, a 13.3% increase from last year's $27.47 billion, while this year's 12-week quarter included one less sales day in the United States than the first quarter of last year due to the calendar shift for Thanksgiving. Our pre-thanksgiving and Black Friday holiday weekend sales fell into the first quarter this year compared to a fall into the second quarter last year. Combined, these two factors produced an estimated net benefit to this year's first quarter sales results by an estimated 1.5% in the U.S. and about 1.3% worldwide.

As you saw on the released today, reported U.S. comparable sales increase was 10.3. Ex-gas and FX, the 10.3 was an 8.7. Canada was reported at 11.3, ex-gas and FX was a 4.3; Other International, a plus 10.1 reported, and ex-gas and FX, 8.2. All told, the total company was a 10.5 reported and a 7.9 after taking on the effects of gas inflation and FX. E-commerce, which we several months ago started reporting each month. For the 12 weeks, e-commerce comp sales were 43.5% up. And ex-gas inflation -- I'm sorry, ex-FX, it was a 42.1%. Now this number includes the holiday shift of Thanksgiving, but it's a little different than in-store because of Cyber Monday and we estimate that somewhere north of 5% and perhaps up to 10% of benefit and that number; so that 42 would come down a little bit if you'd normalized it. Still a very strong number.

In terms of Q1 sales metric, first quarter traffic was up 5.9% worldwide and 6.6% in the U.S. Again, these two figures positively impacted by the Thanksgiving holiday shift as just discussed. FX impacted total sales by about 110 basis points and gasoline inflation contributed another 142 basis points. So gas and FX together for the entire company was about 2.5 percentage points, 250 basis points. As well, cannibalization weighed in on comps to the tune of minus 105 basis points. For the last several quarters, we've had more impact from that as we -- in several more reloads than we had done in the past. Average running transaction or ticket was 4.3%, and again, a little over half of that, which was the gas and FX benefit; so about a little over 2% normalized transaction figure.

Next to the income statement, membership fees; Reported in Q1, $692 million, that's up $62 million or 9.8% year-over-year and seven basis points. Now that $62 million increase in fees, about $24 million of the $62 million increase related to membership fee increases. About 3/4 of that $24 million membership fee increase benefit came from the fee increases we took in the U.S. and Canada effective June 1, 2017. And the balance from the fee increases taken in September of '16 or at the beginning of Q1 '17 and our other international operations, that is just back again to September of '16; but all told, that plus $24 million is in that plus $62 million. So ex that $24 million, we were still -- have been up 6% and up in the low-to-mid 5% range if you take out the FX benefit. We would expect, by the way, to see the impact of the fee increase based on how it impacts the income statement overtime with deferred accounting to continue to be even more positive year-over-year delta in the upcoming three or so quarters.

Our membership renewal rates were -- came in at 90.0% in the U.S. and Canada and 87.2% worldwide. These are the same renewal percentage figures we had at the end of the previous fiscal quarter at Q4 of '17. In terms of number of membership Q1 end -- in terms of total households, at Q4 end, we had 49.4 million. We ended Q1 in 12 weeks later with 49.9 million, up a little over -- up right at 1% during the 12 weeks. And total cardholders at Q4 end 12 weeks ago, we had 90.3 million cardholders, now 91.5 million. In terms of paid Executive Members, they stand at 18.8 million and that's an increase of about 246,000 over the past 12 weeks here. We are still being able to convert and add new Executive Members at the rate of about 21,000 a week in the quarter. In terms of -- and mentioned earlier, terms of membership portion release related to the recent annual increase, that year-over-year number will continue to increase and we'll share that with you in each quarter going forward.

Going down to the gross margin line. Our reported gross margin first quarter was lower year-over-year by 33 basis points. I'll ask you to just jot down two columns of numbers, not 4, just for first quarter and basically what we reported for Q1 '18, and the second column would be without gas inflation because that was impactful to understanding the numbers. The first line item is merchandise core. Year-over-year and on a reported basis, it was down 12 basis points. Ex-gas inflation, it was flat or 0. Ancillary businesses, plus 600 on a reported basis and plus 9, ex-gas inflation. 2% Reward, minus one basis point and minus two basis points. Other, minus 26 and minus 26. So all told in total on a reported basis, that was a minus three if you add up those numbers. And ex-gas inflation, it was minus 19.

Now overall, again, it was 33 excluding the 19 -- excluding the benefit from the non-recurring $51 million legal settlement last year, that was 19 basis points. Again, the total gross margin was lower year-over-year by 14 and was flat excluding gas deflation -- gas inflation. The core merchandise component margin was lower by 12, as you can see on the chart, but again, flat excluding gas price inflation for the quarter. And within the subcategories within core, food, sundries and soft lines merchandise departments, year-over-year in Q1 were up, and hard lines and fresh foods year-over-year were down.

The ancillary and other business gross margins, again, on the chart I just shared with you, plus 6 basis points and plus nine ex-gas inflation. Higher year-over-year margin contribution came from gas, hearing aids and hearing aids mostly, offset by lower year-over-year margin contributions and pharmacy, e-commerce and food court. In terms of the 2% Reward and the fact that, that hits margin by a little bit indicates the fact that we're still getting higher penetration of sales from members -- increasing penetration of sales from members that opted to become an Executive Member.

Lastly, in others, we had the positive non-recurring legal year-over-year settlement that was a 19 basis point number. Most of the rest is some incremental costs of this year primarily related to a new centralized return facilities. Going back two or three years ago, we tested this in one region, and in the last several months, we rolled out two the entire United States. And so there'll be some small incremental costs related to that, that hits the margin in each of the next couple of quarters.

Moving to reported SG&A; our SG&A percentage in Q1 year-over-year was lower or better by 34 basis points. More importantly, I think, ex-gas inflation, it was still better or lower by 20 basis points. Again, on a reported basis, it came in at 10.3 -- 10.36%. Doing the little chart again, the two columns reported and without gas inflation, core operations, lower or better by 24 basis points. Put a plus sign in front of that. And ex-gas inflation, plus 12. Central, plus 8, and ex-gas, plus 7; stock compensation, plus two and plus 1; total reported, lower or better, plus 34 basis points, and ex-gas, plus 20 basis points or lower by 20 basis points.

Now looking again at the chart, the operations component was lower or better by 24 basis points and better by 12 ex-gas inflation. This basically is a function of strong top line sales. As you know, we've reported in each of the last several months today in the quarter very strong sales, both in-store and online. Central expense also, lower by 8 basis points or seven without gas. Again, when we looked through all the detail, first and foremost, it is a strong sales results. No real surprises here. As we've been told, higher sales drive slower SG&A.

Next, for the income statement. Preopening, $5 million lower this year in Q1 coming in at $17 million compared to $22 million, really a function of opening schedule. This year in Q1, we opened seven openings, five net new openings plus two relows, all in North America. And last year in Q1, we opened 9, 8 of which were net new but nine openings, again, all in North America. All told, reported operating income in Q1 came in at $951 million, up $102 million or 12% higher year-over-year. And excluding the legal settlement, basically it was up -- would have been up $153 million from an adjusted $849 million last year, we are up 19% without that legal settlement. Below the operating income line, reported interest expense was up $8 million year-over-year at $37 million this year in Q1 compared to $29 million a year earlier. Higher year-over-year basically because of the result of the dead offering we did this past May in conjunction with our special dividend.

Interest in income and other was lower year-over-year by $4 million. Actual interest income in the quarter was better by $5 million; however, it was more than offset by about a $9 million impact, negative impact from FX contracts, FX-related items, not just contracts. Those fluctuate plus or minus that amount, it seems, each quarter based on how we manage foreign currency payables in to the countries around the world. Overall, pretax income was higher by 11% or $90 million in the quarter, coming in at $936 million, up $141 million or up 18% excluding the $51 million onetime legal settlement benefit last year in Q1. In terms of income taxes, our tax rate in Q1 '18 came in at 30.4% for the quarter, last year was 34.4%.

On a normalized basis, again, taking out that usual item that we've mentioned in the press today, last year's tax rate would have come in -- last year, there was a small incremental difference. Last year without normalized tax rate would have been a 34.1%, which would again have been lower by about 70 basis points than this year's normalized tax rate of 34.8%, taking that out item that we mentioned in the press release.

As I mentioned earlier in the call, again, we mentioned that positive discrete tax items this year. Overall, reported net income was higher by 17% coming in at $640 million compared to last $545 million. And again, excluding the two items, that's the one on the tax side, excluding the two items on the press release, net income would have been higher by 16 percentage points. A few other items of note before we turn it over to Q&A. Capital expenditures were $820 million and we would expect for the year for it to still be in the mid-to-high 2s, and depreciation at $335 million.

Warehouse expansion; so I think we've talked about somewhere between 20 and 25 openings. Over half of them will be in the U.S. We expect three in Canada, two in Korea and one each in Australia and Mexico. As well, we plan to relocate six warehouses this year, four in the U.S. and two in Canada. And that, again, compares to two or three a year in recent years. We will procure a few extra in fiscal '16 as well -- fiscal '17 as well. As of Q1 end, total warehouse square footage stood at 108 million square feet. In terms of stock buybacks, in all fiscal '17, we spent $473 million for just under 3 million shares at an average price of $157.87. In the first quarter, we repurchased 734,000 shares for $119 million or an average price of $162.51, and we will say we purchase more stock earlier in the fiscal quarter.

Now before I turn it back to Chrissie for Q&A, a quick update on e-commerce and our credit card relationship with Citi Visa. Worldwide, e-commerce sales for the first quarter of '18 were $1.3 billion, up 40% year-over-year. Again, somewhere between 5% and 10% benefit in the holiday shift. We continue to improve our offerings and we continue to improve our member experience with better sales, checkouts and returns processes. In the quarter, our site traffic conversion rates and traffic were up nicely year-over-year and we enjoyed basically stronger metrics for both the Thanksgiving, Black Friday week as well as Cyber Monday, which falls into Q2 this year versus -- falls in Q2 this year and last year.

Warehouses are supporting costco.com with signage used in search and purchase, and people can purchase for dot com items via members warehouses, selected items. Online grocery, as you know, at the call fiscal quarter ago, we talked about that week in first week of October, we introduced two new delivery options at Costco.com; a dry grocery two-day delivery and our same-day fresh -- the latter -- and also same-day fresh delivery through Instacart. Both of those rolled out early October. They've been positive to date while still in the soft openings/limited marketing mode. We rolled out in Q1 '18. We added -- enhanced the value excited membership. Q1 '18, we have now members who are Executive Members purchasing from Costco travel who also received a 2% reward on all their travel purchases. And of course, with travel and the like on -- using their Citi Visa card, they get an additional 3%, so 5% between the 2.

We're also now offering a buy online, pickup in store in selected items, including jewelry and some laptop computers. We're seeing proper coming into pick them up and over half of them were shopping while they're there. Overall, all these efforts are having a positive impact on our business, both online and in the warehouse, and it results in greater sales momentum that increased awareness of our digital presence. As well as we've done quite a few things online to increase traffic in our warehouses. I think I shared a few of those with you the last time, whether it's hot price on USDA choice prime steak to the back-to-school Labor Day weekend. And so we think that we can use the Internet and online and e-mails to drive traffic both ways.

In terms of Citi Visa Anywhere card; when the conversion to Citi Visa occurred back in June of '16, there were 11.4 million co-branded cards or 7.4 million accounts. Those were transferred over to Citi for the conversion. As of Q1 end, we now have 2.1 million new approved member accounts or 2.8 million new cards of there. And that includes about 263,000 new accounts opened during the 12-week first quarter. We continue to be pleased with the adoption utilization of the card to date and it's been overall very good for us and our partners.

Lastly, our fiscal '18 second quarter scheduled earnings release date for the 12-week second quarter ending February 18, this again will be after the market close on Wednesday, March 7. However, earnings call that afternoon at two P.M. so we'll release the earnings shortly after the market closes and at the top of the next hour do the call.

With that, I'd like to open it up for questions with Christy. Back to you.

Question-and-Answer Session

Operator

[Operator Instructions] The first question comes from Michael Lasser from UBS.

Michael Lasser

Richard, are you now at -- is membership for club now at a growth level that can be sustained from here? And whether any unit promotions that contributed to the growth in that method that you experienced during the quarter?

Richard Galanti

I think the biggest thing, if you go back a few quarters ago where it was that average came down a little bit, it's composed of two primary things, well, 3: Number of openings, and certainly they fluctuate quarter-to-quarter and year-over-year; two, we have huge memberships sign-ups in certain new markets, particularly Australia, Asia, Iceland was off the charts, great, and so when those compared to in the U.S. and Canada where we have been forever; and so those time, as you may get. And then when we add new unit to an existing market, and I gave a couple of example of that last time, that will tend -- you know, we might have 65,000 members per warehouse in three locations in the east side of Seattle here or in the San Jose area; I think those are two examples I gave you. We opened up a new unit, which adds $120 million, $130 million of incremental sales, but only adds literally a few thousand additional members because you now have members that are shopping more frequently because we're closer to them; and so that will continue to happen.

The timing of openings, as I've said, that will be up and down. I think overall, the number -- the metric did come up both last quarter and this quarter year-over-year for the first time and we're adding some new markets as well. That will help us. My guess is the average, if you take the total number of warehouse at quarter end and divided by the total number of locations, I mean, this is in the low 60s, it will probably remain plus or minus that a little bit. To the extent it was a little less, we'll look at it and say, well, usually the reason is there were less year-over-year openings in a few of these international markets. We feel very good about our renewal rates and so far so good on what we've felt the impact of the credit cards switch and the auto bill, and so, so far so good.

Michael Lasser

In the past, you've given a little bit more detail on renewal rate by Gold Star Primary Business that was your cohort. Is there any reason why you decided not to give that detail?

Richard Galanti

I think the biggest reason, over the years for some of you on this call noticed for 20 or 25 years doing this, and we've gotten so granular, it almost has become a distraction. Rest assured, anything that is impactful, we're going to make sure that you know about. But at the end of the day, what's important is total number of members and growth, existing renewal rates, of course. And part of the other challenges is for years, we've had -- early on in our career, wholesale member, you have to have a bona fide business license and truly was a small business owner. And then that evolved into a business mentorship where you have business add-ons, and many of those were not for business purposes but small business with 10 members, with 10 employees and the employer bought the membership for his or her employees.

And then after that, with the Executive Membership coming on, those people would get off of that primary membership and have their own membership. So we know more about our business member versus not based on what they're buying than anything else.

Michael Lasser

And then my follow-up question this on the potential for tax reform. Would you treat any savings that you might get from potential tax reform as any other windfall that you get and reinvest that back in the business in the form of price, lower prices?

Richard Galanti

Well, first, we have to wait and see what actually happens. I know in the first year, what we're reading about today, there's still some onetime offset to that for earnings overseas, historical earning overseas to the extent of that cash hasn't come back. That will be a partial offset, I believe, to what we currently read today. Look, going forward, we're going to do what's long term right for our stockholder's quarter's valuation. And for us, that includes all of the things you've heard about historically. But we'll have to wait and see and talk about it more when you get there.

Operator

Next question comes from the line of Chuck Grom from Gordon Haskett.

Charles Grom

Just on the gross margins, I think you said the quarter-on-quarter was flat. I was wondering if you could shed some color there on the Visa benefit? And then also what the total core was as a percentage of their own sales? If you could just amplify on any of the category color on direction that you gave earlier.

Richard Galanti

Yes. Getting back to the previous person's question about why respond with a granularity, the big benefits were in the first year. There was some incremental benefit, but going forward, we're really not going to specify the detail. Needless to say, incrementally, it was a lot lower than going from nothing to the big benefit that we got in the first 12 months and that we'll continue to get and the good news is it's growing us percent of sales. In terms of core encore, I think it was down few basis points. I don't have that detail in front of me.

And again, I know that was a big question last -- I was about to say last semester, last quarter, compared to prior quarters. There's so many moving parts. What I can tell you is we feel very good about our margins. There are a lot of the stuff that we have done and we'll continue to is offensive and not defensive and we are probably the biggest prize that's worth as good if not better than we thought it was going to work.

Charles Grom

Okay, great. And then just any early readings with Instacart? I know when you did Google Express that most of the purchases were falling trips and were therefore complimentary. I was just curious what your early takes are with that effort.

Richard Galanti

Look, all the members are great partly because they expanded themselves in terms of the number of locations over the last 12 months. Two, its front and center now on our website. But one of the things I mentioned here, we both have chosen for the first two-three months for this thing to basically have a soft opening, if you will, to make sure that we don't screw it up. And when I say we don't screw it up, it's growing very nicely. But clearly, when we market it, we think it will take off even more. But so far, so good.

Charles Grom

Okay. So then when you look at the acceleration in digital sales in November, that was really just your core Costco.com business?

Richard Galanti

Yes.

Operator

Next question comes from the line of John Heinbockel from Guggenheim.

John Heinbockel

The thought of starting with jewelry and PCs, what sort of drove that? How far can you take that operationally? Right, if you think about other products like big bulky stuff, papers and beverage, can you do that operationally? And then is that what your customers want? Are you hearing from numbers that they want more bulk items?

Richard Galanti

Well, first of all, we haven't heard from a lot of members. I'm not so sure that -- we have not asked them either, by the way, but we do see the strength in our numbers particularly in store. I mean, the online is fantastic, but in-store is maybe 5% of our business. When we look at doing it our way, we still scratch our head about doing what -- even consider doing what some of the others are doing, not just other warehouse clubs, but other retailers. There's a lot of cost to that. So far, we haven't seen a reason to do that. In the case of these couple of categories, what we found is that there are people that won't buy it because they don't want -- they can't have it shipped to their office or their place of work and they don't want it left at their doorstep. And so here's a way for them to buy it and we saw a nice piece of business being done that way.

And as you might expect, since we're not going to be over to pick up the groceries that we bought and put for the refrigerated stuff in the refrigerator and the frozen stuff in the freezer, they just go up to the cage and get this. Over half of them went in at shopped before they pick up their laptop or their jewelry. So that's what we like and we'll keep evolving it and we'll see, it's just the start.

John Heinbockel

And then the -- when you think about tenure of openings here, right, so do you think we are more at the low end of that 20 to 25? And obviously we have sort of haven't done many in Asia of late. Is that just the way the real estate timing folds and we're going to get a surge in overseas openings on the next 18 months? And then I think you're doing just one business center this year, is that right?

Richard Galanti

Only one business center this year?

Unidentified Company Representative

We've already opened up San Francisco, so we have one at Minnesota, maybe...

Richard Galanti

We'll have at least two this year, having open one already and maybe a third. That's just a matter of timing. I think it's clearly in the list right after the fiscal year. A lot of that has to do with timing. In terms of the 20 to 25, history would suggest we are at the lower end versus the higher end. There were a couple -- and the real difference is that things that don't have on the plate already, it's -- can we push them, can we move, do we get lucky with the weather if we push a couple of days on different hurdles like with permits or whatever.

John Heinbockel

And then just lastly, are you also -- you talked about the gas benefit. Was that de minimis or how big was that?

Richard Galanti

Well, we're trying to -- there's no good time to get a less granular, but when you add them all up, it was the biggest line to the bottom line but at the end of the day, gas is good, there have been some quarters. If you looked at the last 8 or 12 quarters which I haven't looked at, it's probably more than a $0.01 and there have been quarters when it was $0.05; and it could be anything whether there or little on either side of that. Needless to say, they were good.

Operator

Next question comes from the line of Karen Short from Barclays.

Karen Short

First, just a housekeeping question. What was inflation in the quarter? Could you give that?

Richard Galanti

No, we didn't. Overall, ex-gas and maybe the best was up a couple of percentage points. We don't really look at LIFO anymore. We had it, but we don't look at it. Our guests -- I think, if there was anything that's maybe ex-gas, there was a tiny amount of inflation. But that was on the cost side. Investing on price and given the competition that you see from other retailers out there, my guess is there is probably little if any inflation.

Karen Short

Okay, so that was [indiscernible], it's done a lot of -- I mean, PPI has clearly been high, I mean up and elevated, while TTI has been a lot more muted. So I guess, that's -- I'm wondering how much that impacted your margins? Or how do we think about that in terms of…

Richard Galanti

I really don't think that impacted it, Karen. It's really us looking at what happens when we get hot on pricing or hotter and recognizing we have these benefits from credit card and from membership. And that's what we do.

Karen Short

Okay. And then I guess, in terms of grocery delivery and then Instacart, I guess, you didn't give an update. Are you still at the 500 SKUs for grocery delivery and 1.700 on Instacart? And then anything to indicate on that component of the business, whether or not this is drawing a customer who has kind of been dormant? Now you're seeing incremental trips; anything it could point to because obviously the concern is that there will be cannibalization with this offering.

Richard Galanti

We really haven't. I mean, it's still -- even though they are big increases in what they're doing today before the day after with us going back to in early October, it was miniscule relative to our company size. We'll wait six months and then take a look at it.

Karen Short

Okay. And then lastly, how many units on focus right now?

Richard Galanti

I'm sorry, how many units?

Karen Short

Are on the buy online, pick up in store for those smaller items?

Richard Galanti

Very limited. Hold on, hold on. All warehouses are doing jewelry and laptops in U.S.

Operator

Our next question comes from the line of Simeon Gutman from Morgan Stanley.

Simeon Gutman

Richard, first on membership, could you talk about how successful the couple of promotions that you ran in the quarter and how it performed relative to other ones you've done in the past? And just generally, is the environment -- the competitive environment for club membership any different than it's been in the past?

Richard Galanti

Well, first of all, I'm not sure what we did this first quarter. During Q4, we did the Groupon/mini social. That went fine but I'm not sure of anything we did this quarter.

Simeon Gutman

Okay, what about the environment? Is it any different as far as competitors being promotional for new members? Is there anything to call out versus what it was like in the past?

Richard Galanti

I don't think they're more promotional, but our direct competitors have been very promotional one more than the other. But whether it's a monthly one or a certain amount of dollars off to try it out, and so we haven't really seen any dramatic differences to that. It's been that way for a while.

Simeon Gutman

Okay. My follow-up is on the online sale. You gave it a bit of color, I don't know if you talked about categories that are out comping the house average. Are there any gross margin implication of the categories? I realize there is still a range even within a pretty tight band, but curious, just thinking about the products that are growing faster than the house online versus others, if that's doing anything for the gross margin?

Richard Galanti

Well, yes. But keep in mind, with all these wonderful growth, it is still very smart -- it's less than 5% of our company so it doesn't have that big impact to the overall company. Electronics, it probably does because we've been very successful online with electronics. And given the white club service, hopefully, members understanding that if they are an executive member and may have the flow brand card, they'll get an extra 5% off and they get a four-year warranty that includes using the co-brand card. So all those things will help drive the business notwithstanding we have to let everybody know. And I think apparel has been good, but part of that so that we are doing more apparel online. And I think we're also getting better with a small B on targeting certain types of e-mails to members to do some of these things.

Operator

Next question comes from the line of Dan Binder from Jeffrey's.

Daniel Binder

So first question was on the Visa cardholder. I was just curious, you're over a year and now. Do you have any comparative data on how that cardholder spending in the club versus the MX holder previously?

Richard Galanti

The only thing I'd look at -- I don't know that. The only thing -- in many cases, it is the same number. We believe you have a higher spend because of a better rewards, better promotions. The fact that Visa is accepted in more places, if it is your top of wallet, old reward card, co-branded card, it was my top of wallet and now the new Citi Visa is. There are many more places I can use my new one, and so that's driven more outside spend. And the beauty of co-branded programs with big companies, whether it's airline, retail, hotel, travel, is that there's some revenue share there. So those are the metrics we look at.

We also, of course, double the reward on Costco purchases, gas more, not a double, but everything else used to be one and now it's two. So all of those things are helping us trend in the right direction there.

Daniel Binder

And then with regard to renewal rates, you highlighted of the renewal rate was same as where we were at the end of the fourth quarter. I know last quarter, you're talking about the trajectory and how you think it will follow your experience in Canada. Do think that next quarter, we could see the first tick up in renewal rates?

Richard Galanti

I think a quarter ago, we said one or two quarters. And so we have one more quarter of flat to -- we're talking about tenths of a percentage point, half a tenth is what we'll average it up or down. We want to hedge our bets here a little bit. But we believe this in the case, but we've got one more quarter of free pass here but we were pleased with what we saw in Q1 compared to Q4 end.

Daniel Binder

And then lastly, do you have any numbers around membership growth in comp stores?

Richard Galanti

No, we don't. Only because we did that last quarter because we know there was a lot of concerns around it, we thought that was a data point. And I'm sorry, we just don't have that.

Operator

Next question comes from the line of Chris Horvers from JP Morgan.

Christopher Horvers

So on the core margin being flat ex-gas, usually when you're going to these periods of intimate piece of the renewal, the membership fee increase. It tension investing gross margin and I think most expected it to be down. So going back to a prior question, is mix helping you? The price environment is pretty promotional out there solid just trying to understand why that came in flat versus through the historical experience of how you would invest and to the fee increase period.

Richard Galanti

Look, our philosophy is we invest in this stuff. We are also pragmatic. There's a lot out there, but I think we have a benefit also. We could take -- given our limited nature, limited number of items, we could just do some hot buys on a limited number of items that are truly wow, and drive sales and item at extra $10 million or $20 million in a week or a few weeks. And so it seems to work for us, we feel good that we've got -- we're looking at this stuff offensively and we'll see how we use it.

Christopher Horvers

And then in terms of the following up on the tax question, you talked about doing what's right for the shareholders, the valuation of the stock, and historically, I think your motto is customer employee vendor shareholder. So is that the way how we should think about that potential tax flow through?

Richard Galanti

We got crazy a little bit, sure, I mean, yes, we're going to keep doing what's right. And again, I'm noting try to be cute. First of all, we don't know what the tax plan is going to do and we don't know the impact on first year of it based on some offsets. But you can rest assure that we'll do the right thing and we'll drive the business the way we do it that helps of those stakeholders.

Christopher Horvers

And then lastly, just a couple of quick follow-ups. This in the calendar, this the 53rd-week end up being a point on headwind for this upcoming quarter? And the other line, we think, gross margins, I think you said 26 basis points. When you say some of that is going to stick around for the next three quarters, is that 26 basis points or something like that?

Richard Galanti

No, no. Within the 26 is 19 of that 26 was that $51 million legal settlement benefit to gross margin in Q1 of '17 a year ago. So year-over-year was minus 19 basis points. So we're talking about is the other 7, and the other seven has primary do with a major switch we did and how we hand over, return and dispose of salvaged merchandise. And we tested it for a couple of years in one of two regions, one region than another. And then just the last six or seven months we rolled it out through the United States to selling all 12 depots that do this for us that can handle the entire United States. And needless to say, we did because it works, since it's positive.

There's the start-up cost if you will of getting it rolled out and done in the efficiencies that we look for overtime. That seven hopefully will be 6, 5, 4, 3; but a year from now it will be zero in theory and then go the other way a little bit. But at the end of the day, we wanted to point it out because it is a little unusual and we recognize that you guys are very sensitive to these basis points of margin.

Christopher Horvers

And then 1.5 point sale shift?

Richard Galanti

That's for Q2.

Christopher Horvers

That is a headwind?

Richard Galanti

Yes, that will be a headwind, yes. And it will be a bigger headwind for e-commerce because we don't know if it's 5% or 10% probably in the high singles; that's a guess.

Operator

Next question comes from the line of Edward Kelly from Wells Fargo.

Edward Kelly

Can I just ask about traffic; it wasn't that long ago, I guess, that traffic slipped to kind of 2% or so and we were also thinking maybe this is the new norm. Obviously, you have seen dramatically better traffic growth this year. I guess, like just thinking about things in hindsight, was there something unusual about that period of 2016? And then as we think about things going forward, is there anything really that would cause things to set to that kind of level again given the levers you now have to pull in this business, whether it's the fee increase or tax or whatever it might be?

Richard Galanti

I think a little of it has to do with credit cards switch leading up to June of '16 for about nine months, prior from June 16 backwards. We didn't sign up any new members, but we had American Express agreed, there's no sense signing up selling for a card that's going to go away in June of 2016. And so there's probably some negative impact and confusion, and the confusion probably into the first few weeks of the new card given it was a overnight transition which was faded in behind. And -- so I think that probably had -- it certainly wasn't a positive impact, my guess is it was a little bit of a smaller impact. I think, it's -- I remember when those numbers were coming down, we were asked, and like you just said, we said maybe it's just normal, we don't know; we felt good about our business and one of the things we did is how should we get it more excited out there and part of that was the pricing and the like.

So I -- we also had a little bit of hiccup from a traffic standpoint with the multi-vendor mailers. If you recall, the good thing is it's pure items with greater values and more sales than an MBM. However, the offset to that was we probably dug a little bit deeper than we should have in terms of fewer MVM days and during the course of the year. And we saw that impact basically December of '16 to February or March of '17, so pretty much Q2 of fiscal '17. And then as we said on that Q2 call, which was a disappointing quarter, we said it's easy, we'll change it back, we'll add some more days. We kept the lower fewer items and the greater values and that's working nicely, but we have more days and so we had less and where we had tweaked a little bit too much, we've had fewer MVM days or higher traffic helping days. We were back to pretty much normal in that, maybe a few less, but nothing that really impacts us.

Edward Kelly

Just a follow-up on tax format. I know it is a difficult question to ask, but maybe we think about it in like bigger picture sense of investment and how you think about driving sales. And as you think about sort of like where you'd like to spend money particularly if you were to potentially get some windfall, everyone sort of thinks about price, but are there other things that sort of like would really like to have but are expensive? Or an earnings headwind currently that makes the return calculation a little different, whether it's the enhanced digital or fulfillment or something on labor.

Just figure out, are there other areas of business besides just price you should be thinking about that you would like to invest if you had the opportunity?

Richard Galanti

First of all, I would like to think we would be doing those anyway. We have strong cash flow. As you know, we generate cash flow well in excess of our CapEx and keep increasing the regular dividend, have done the specials a few times and brought back stuff to at least cover more than, frankly, cover that, which over 5,000 employees get as part of the compensation. And so I'd like to think that -- I don't think we're going to sit around the table and say we have this big box of money and what would we do we are not prepared to do yesterday.

I know -- now as we said, I think you'll see us do what we do well. It's merchandising and driving business and taking care of our employees and also taking care of our shareholders. I'm not trying to be cute. We don't know what we're going to do yet because we first we have to figure out what can actually happen.

Operator

Next question comes from the line of Matt Fassler from Goldman Sachs.

Matthew Fassler

Couple of follow-ups; one on the calendar shift, can you talk about whether it was a particularly profitable 1.5 of sales? Clearly, you're going to do a lot more sales per day and probably per employee hour. I'm not sure what the margin profile that you generate on that week so any impact on operating margin rate from that shift and presumably whatever it was would reverse in the following quarter.

Richard Galanti

This is -- I'm shooting from the hip on this one. Look, having extra strong sales in a warehouse on that day, they are more profitable as a percentage of pretax because you already budgeted your labor and is busier. We kind of know on the other end, hopefully we budget properly there so maybe it won't dramatically offset. But I don't -- We're talking about a few weeks here and there, I don't think it is a big deal either way.

Matthew Fassler

Okay. And then another question, you asked on e-commerce about profitability related to category shift. If you think about the growth of the business, you think about some of the accommodations you're making and the incremental offers that you are providing, can you talk a bit about the gross margin profile of e-commerce in total? I think you addressed them briefly, I think, as part of the gross margin discussion. Any sense as to the direction and they also know it's small, you made that point as well. Just as it gets bigger, is the direction you're taking it in and moving to gross margin category with the other through that channel, just, is what I should say?

Richard Galanti

First of all, gross margins in e-commerce even two years ago was a little lower than the warehouse, but yesterday was a lot lower than warehouse. So the bottom line was a lot higher than the warehouse, recognizing it wouldn't exist if it's in another warehouse. So it's all one big happy family there. At the end of the day, what we have found and what everybody else found before us probably is if we can figure out and we have, we think, figure out how to communicate effectively with our members on some particularly hot buys, it really drives business, and not just online. And so I think there is enough -- we have so much, in my view, flexibility and comfort in our margin. And because we're not being -- our views is our margin, whether it's a basis point lower or basis point higher is because of what we wanted to do, not because we're impacted by losing something to someone else. I think we're fortunate in that regard.

And even with very competitive products, hydraulics is very competitive, we over-indexed to higher end stuff. It's all competitive everywhere, but within the electronics here, it is probably a little better, a little less competitive, which makes us look better. So there's so many -- we have, in my view, there's so many buckets we can pull from. I don't see that as a big thing to worry about analyzing the structure.

Operator

Next question comes from the line of Paul Trussell from Deutsche Bank.

Paul Trussell

Just to follow-up on the e-commerce conversation. You had a series of announcements on the last few calls, including partnerships in the buy online, pick up on store Costco grocery. I just want to take a step back real quick, Richard, and if you could just talk overall kind of your mindset and approach to e-commerce and kind of omnichannel and what's kind of led to -- I think, a lot of us view this as a bit of a term in the narrative in the way that you all have kind of approached the business historically.

Richard Galanti

I think we still done things our way and we continue to evolve. Needless to say, there's a lot of views out there, like several people on the phone here, and there's a range of views. I think what we've hopefully communicated is that in our own way, there's lots of little buckets out there and low-hanging fruit that we haven't touched. Perhaps we should've touched some of them earlier, who knows. But we seem to be running on many cylinders here and the things we're doing our work in. Importantly, not only through e-commerce or omnichannel, but for in-store and driving business that way as well. We feel fortunate in that regard. It was funny, I remember on the last earnings call three months ago when we talked for the first time about the two new delivery options on grocery, on Costco.com site, these two links.

And on the one hand, there's some out there that viewed this, yes, they cleared it out. There's others saying they had to do this because somebody else is wrong. Our view is we are kind of doing it pretty well first and foremost with driving our brick-and-mortar business, understanding that some of it was going to evolve in respect of this. We believe we were very successful with big-ticket items, furniture, big-ticket like electronics. What was evolving already 10 years ago online even with us was light club service on things you had to install or build like a patio set or swing set or a big thing television.

One of the things we talked about last quarter was white goods. Over the last several months, we've improved our direct relationships with LG and Samsung rather than trying to -- rather historically when we were doing white goods not terribly well with just a little bit of a couple of item, not with the highest end stuff that we could sell in store. All of a sudden, we have great value, incredible value plus extra award, all that stuff if you use your Visa card. And we think we can take an item that was well under $100 million sales in a matter of few years be $1 billion. Now $1 billion is still just under a percent of sales, but it's $1 billion.

There is a lot of things we're able to do in this tough new world. I'd mentioned before apparel, where brick-and-mortar apparel is flat or down. And total apparel, including online, is up a few percentage points. We've got worldwide $7 billion -- close to $7 billion apparel business that's compounded in the last three-plus years over 9%. Two reasons, growth in signature and weakness in brick-and-mortar, and some manufacturer willing to sell to us for the first time, so suppliers. And amazing pricing; so we'll keep doing that.

Paul Trussell

That makes sense. And also in looking at your strong top line over the last few months, it's occurred globally. You spoke a bit about kind of the investments in price on some of the product on the U.S. front. Is that the same story in what's happening in Canada and other places around the world? Or other any kind of unique factors that we would attribute some of these in those regions, too?

Richard Galanti

It's everywhere. The fact that the warehouse club concept is newer in some of those countries, the fact that we're opening more new units, we opened one unit in Sylvia, it's in Seville, Spain. Smaller market than Madrid, but you had vendors, even international vendors and certainly local vendors, that would not -- were a little crazy, they knew how big we are, and if we comment, it would be great; but they have a lot of customers that weren't drilled. Once we get that second one opened, it helps in the first one as well. We see the same thing happen in Australia in the first few years and again it gets back to we are in sourcing and global supply company.

And clearly, with eight or so locations in Australia, we bring the purchasing power of $130 billion retailer to that market and that helps us as well. And I think the fact that our first signature items have become a high end, and incredibly low priced brand, incredibly high-value brand, that helps us as well.

Paul Trussell

And lastly, for me quickly, I might have missed it, but from the Visa card, did you outline any particular benefit to gross margins or SG&A in this quarter?

Richard Galanti

Well, for the first four quarters since it was so large going from the prior program to what this great new program has done for us, we did. And going forward, we aren't. We did say that incrementally, it was a little benefit percentage-wise.

Operator

Next questions comes from the line of Kelly Bania of BMO.

Kelly Bania

Just curious on the SG&A line, you mentioned some incremental cost to think about over the next few quarters. Can you quantify that at all for us? And in terms of the shift, was there an impact, the calendar shift, to SG&A or membership or any other line items in the quarter?

Richard Galanti

There's about little things. I mean, first of all, in terms of the shift, to help you -- as Matt asked early about the extra percentage half, it helps a little bit, but it's hard to quantify. This a little bit of shift with some holiday pay issues, but you're talking about, my guess is a small amount of basis points. The thing is the first part of the question you asked was about this thing and it will continue for the next few quarters; that's a margin item. That had to do with us changing the way to make it, frankly, more efficient and less costly for handling returns. And doing it centrally, if you will, at each of 12 depots across the country in the United States. Talking about U.S., we started -- we tested this for the first time probably three years ago; and over the last six months we went from two to 12 depots, added 10 of them.

And so there was about -- that was much of that extra, that line item that was 26 basis points of which 19 was the one-time thing from last year. Those other seven basis points, much of that is that, but that's a margin hit; and so that will be a little bit of a margin hit in the upcoming, probably two or three quarters. I'm hoping it will dwindle a little bit, but that would be what it will be.

Kelly Bania

Great. And then just on online with the acceleration online of grocery, just curious if you have any -- based on what you've seen so far, it's been very successful with just even a soft launch. So you mentioned getting deeper into using some e-mail and some targeted e-mail. Just curious, what else can we expect to come from online? Do you have any plans for adding an auto replenishment feature? Anything you can share with us on that would be great.

Richard Galanti

First of all, with regard to like -- delivery, we have done no marketing effort per say, so it truly has been a soft opening, both on our part and in the case of same-day grocery, on Instacart's part, we want to get it right. Percentage-wise, it's going crazy but it's very small, small amount of business relative to our company. Well, even with the comments I made about the laptops and the jewelry, that's the test. We looked at it and of course, we've been asked a hundred times, what about order online pick-up in store, we scratched our head in recognizing our places are a lot busier than others. We don't see how that makes sense and we don't hear a lot of members asking about it but we look at it and said where are some areas where it makes some sense and so we're trying.

Tires that make sense and that's been very successful over the last year, year and a half where you can order the tires online to go to the location that you want them installed at, your traditional warehouse that you shop at; and that's driven -- in our view, that's driven volume to the tire business for us.

Kelly Bania

Any from the auto replenishment?

Richard Galanti

No comment at this point. We'll let you know if and when we decide. We're looking at that and some other things.

Operator

Next question comes from the line of David Schick [ph] from Consumer Edge.

Unidentified Analyst

We talked a lot about digital and what you're trying digitally. My question is what you're seeing digitally in e-commerce, is that causing any merchandising decisions, pushed anything back to the club? Are you noticing anything in those trends that could change your merchandising? Thank you.

Richard Galanti

Yes, I mean, one thing that we've done is we've done a better job of e-mailing people to get them into the warehouse; I mentioned the New York strip steaks [ph]. We've also done some items that -- if you bought in-store a baby seat, car seat, the banner that's at the top of your e-mail includes some hot items or if you bought tires, the banner includes some automotive or garage items. Some of those are online and some of them are in-store; the tires, I just mentioned. And in terms of -- right now, what we're doing is high-fiving each other, it's working to drive business in-store and drive business online.

Unidentified Analyst

Just -- any update on the wage outlook, you guys have stayed ahead of it and been very transparent with it. But just talking about the wage outlook now, 90 days since your last quarter.

Richard Galanti

No, we feel good about that. We've taken -- of course, we took up wages throughout using the U.S. as a base here. We took about year and a half ago, March of '16 and in several markets we started people a little higher than that where we have to. Some parts of the Bay Area, some parts of New York, and there are only a couple of cities, Seattle and San Francisco, where there's a minimum of 15, but rest assured we'll stay ahead of the game a little bit.

Operator

Next question comes from the line of Scott Mushkin from Wolfe Research.

Scott Mushkin

So a couple housekeeping items and then a question. I don't think we've talked about much about inflation, or if we did, I missed it, and I wonder what the inflation would look like in the quarter, what's your outlook?

Richard Galanti

Yes, we did talk briefly about it. Look, we think it's up a little, but it's muted by the fact that driving better value. And so really not a big issue either way. Next question.

Scott Mushkin

The cost of hurricanes, that's the other -- there was a cost, I didn't hear what you said what the cost was.

Richard Galanti

We try to be a little less granular because if there are some offsetting things of there. The two together were a couple of $0.03 in total, but that's the difference. I'm learning not to tell you stuff.

Scott Mushkin

My last -- my real question is, when you take a step back and we talked about e-commerce forever, the Amazon impact that concerns about it, you historically, said we want people in our stores, we don't believe in a lot of this stuff, particularly the buy online and the Quicken collect types of businesses. The -- you want people in your stores or your warehouses. I guess, just from a philosophical perspective since your sales are so darn strong, why are you guys moving aggressively with some of the e-commerce, these e-commerce trials or you're just rolling it out? It seems that if I look at it over time, it could be harmful to keeping people in your warehouses.

And I just wanted to know philosophically what made you guys changed your mind and why you're doing it?

Richard Galanti

Well, first of all, I think, well, we want to be responsive and we want to make sure that we're not being stubborn about things but we also want to do it our way. I think we've gotten comfortable, there are some things we can do that we think can drive our total company sales and profitability without impacting and also recognize that if we have 3,800 -- an average about 3,800 items in-store, maybe we have twice that online, this is a rounding year for everybody else in terms of what they offer to customers in terms of items. And so we have to see or how to do it and still have the value of what we do. And so I think -- we've also figured out how to do it without spending hundreds of millions of dollars.

We are -- the two-day drive grocery -- up to two-day drive grocery that we're doing to a handful of our depots which covers essentially the entire United States, we're able to do that pretty cheaply because we are already allowing business members to run the business and not depots but the business centers, because you can already buy it online and have it delivered. But we brought in about -- just under 500 items that were more retail consumable type items. So our view is these are relatively inexpensive ways to try things and they're working, we do have to kind of first -- we have to measure how we do going forward if we love for orders -- on grocery orders online to be filled in, not stop you from coming; we've recognized it you may come a few less times during the year. How do we change that?

And we also recognized there is people that live 30 to 60 minutes away from us, sometimes that's 10 miles, sometimes that's 40 miles and that's been a big move for us where we see this could help. So again, life has changed on big-ticket, big sized items and items that you've got to install, and in many cases items that you want somebody else to take the old mattress or the old refrigerator away. So we can show -- we've got nothing, some confidence in those areas that we can show the best value on the high-end stuff in those areas as well.

So I think it's all working probably a little better than we thought it would.

Scott Mushkin

Alright, I appreciate the answer and I'd give a shot out to that tire program, it's actually -- it's pretty good. Anyway, have a good holiday.

Operator

Next question comes from the line of Chuck Cerankosky from Northcoast Research.

Charles Cerankosky

I just wanted to see if you could take sort of a 30,000-foot view and talk about how the mix is different and changing as these economies improve, not only in the U.S. but maybe also on Canada and the rest of your operations?

Richard Galanti

Bigger ticket items, jewelry I think, has improved. Electronics, expanded electronics, not just computers or laptops or iPads, tablets and televisions but the whole audio side. Audio is everything from these boxes that you put outside, telephones and jewelry. So I think from a -- is the economy getting better? Who knows; certainly, there is money out there to be spent on the stuff and we have seen some pickup in those areas, and the Internet helped out a little bit.

Charles Cerankosky

By Internet, you mean e-commerce?

Richard Galanti

Yes.

Charles Cerankosky

Great, thank you.

Richard Galanti

Well, thank you, everyone, and we'll be around. Happy holidays.

Operator

Thank you for your participation. That concludes today's conference call. You all may now disconnect.