Costco Wholesale Corporation (NASDAQ:COST) Q2 2015 Earnings Conference Call March 5, 2015 11:00 AM ET

Executives

Richard Galanti - Chief Financial Officer

Analysts

Charles Grom - Sterne, Agee

John Heinbockel - Guggenheim Securities

Dan Binder - Jefferies

Mark Becks - JPMorgan

Simeon Gutman - Morgan Stanley

Paul Trussell - Deutsche Bank

Matthew Fassler - Goldman Sachs

Kelly Bania - BMO Capital Markets

Scott Mushkin - Wolfe Research

Oliver Chen - Cowen and Company

Michael Lasser - UBS

Bob Drbul - Nomura Securities

Gregory Melich - Evercore ISI

Joe Feldman - Telsey Advisory Group

Operator

Good morning. My name is Brandy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter Earnings 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, Chief Financial Officer. Sir, you may begin your conference.

Richard Galanti

Thank you, Brandy. Good morning to everyone. This morning’s release we’ll review our second quarter and first half fiscal 2015 operating results for the 12 and 24 week periods ended February 15th and our monthly four week sales results for the four week period ending this past Sunday, March 1st.

The discussions we well be having 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.

To begin with, our 12 week second quarter fiscal ’15 operating results, as you saw this morning for the quarter reported earnings per share came in at a $1.35, up 29% from last year’s $1.05. As noted in this morning’s release this year’s net income was positively impacted by a $57 million or $0.13 a share income tax benefit. This was in connection with a portion of the $5 per share special cash dividend paid by the Company last month to Company’s 401(k) plan participants. Partially offsetting this reduction to the income tax line was a $14 million or $0.03 a share income tax charge related to an ongoing overseas income tax letter. And the net impact of these two discrete tax items to our reported second quarter earnings $1.35 earnings per share was $43 million or $0.10 a share to the positive. So excluding these two items EPS for the second quarter would have been a $1.25 or up 19%.

Other factors that have impacted our second quarter when you're comparing year-over-year results, gasoline operations as results of the case in Q1 ’15, we benefitted from strong margins and profits in our gas business, I’ll speak to this a little bit more, when I discuss our gross margin. FX as compared to year ago, in Q2 this year, the foreign currencies where we operate weaken versus the U.S. dollar in all countries but primarily in Canada, Mexico and Japan, this resulted in our foreign earnings in Q2 when converted into U.S. dollars being lower by about 32 million pre-tax or $0.05 a share and those earnings would have been had FX exchange rates been flat year-over-year, so again another -- a relative weakening of these foreign currencies relative to the U.S. dollar.

Third, IT modernization cost, as discussed in each of the past eight or 10 or so fiscal quarters, our major IT modernization efforts will continue to negatively impact our SG&A expenses through this year and into next year and possibly well beyond especially as new systems are placed into service and depreciation begins. In Q2 on an incremental year-over-year basis, these costs impacted SG&A by an estimated $22 million or about $0.03 a share. Fourth, stock compensation expense, this was higher year-over-year in the quarter by $14 million or $0.02 a share, while this charge was about a 4 basis point hit to SG&A it was much smaller year-over-year impact to SG&A this quarter than it was in Q1 when the year-over-year delta was $38 million or $0.06 a share to the negative.

Lastly interest income and other, this number was lower year-over-year in Q2 by 10 million in pre-tax or $0.02 a share. The decrease primarily related to the revaluation and settlement of U.S. dollar payables, primarily in our Mexico operations. As you know this line item if you will it goes back and forth sometimes it helps us a little sometimes it hurts us a little. Under GAAP these adjustments are recording to the interest income and other line.

Now in terms of sales for the quarter reported sales were up 4.3% and our 12 week reported comp sales for the year was up 2%. For the quarter sales were negatively impacted by significant year-over-year gas price deflation and this had about a 323 basis point impact to the number to the negative and by weakening FX foreign currencies relative to U.S. dollar. This was just under 250 basis points to the negative. So excluding gas our reported 4% U.S. comp sales increase in Q2 would have been plus 8, our reported minus 2 international comp assuming flat year-over-year FX rates would have been plus 8% as well. As for the total comps again reported 2% for the quarter plus 2% excluding gas and FX was plus 8% for the quarter on a more normalized basis. For our four week month of February which includes the last two weeks of the fiscal second quarter reported comps came in at plus one consisting of a plus two comp in the U.S., flat international. Sales again were negatively impacted by gas price deflation almost 400 basis points for the month to the negative and weakening FX just under 300 basis points to the negative. So excluding gas the plus 2% reported comp for February would have been a plus 7 the reported flat international comp would have been actually been a plus 12. And there is a little benefit in there from the switch in the Lunar New Year I believe that impacted a couple of the Asian countries for us and so as to the total comps the reported plus one for the month would have been a plus 8 excluding gas inflation and FX.

In terms of new openings after will be 9 new locations in Q1 including one reload we opened no new locations in Q2 all-to-all that puts our fiscal 2015 openings to the same quarter store as eight net new locations and we now operate 671 locations around the world. Which we now and the end of fiscal 2015 we expect to open an additional 20 new locations. And just a couple in Q3 which will end in early to mid May and then 18 planned for Q4 of these 20 additional openings before our August 30th fiscal year-end 10 are in the U.S. and 10 will be international. So it should most likely end the fiscal year with 691 total locations. Now a few of those near the very end of the fiscal year could slip into Q1 of ’16. So my guess is that that additional 20 may be ’17, ’18 to those.

Also this morning I'll review to you our e-commerce activities, our membership trends and renewal rates a little more discussion on margins and SG&A in the quarter. Our recent $5 a share special cash dividend in the related billion dollar debt offering and our recent announcement related to the planned changes for our U.S. co-branded credit card offering. For our second quarter results, sales for the quarter for the 12 weeks ended February 15th were 26.87 billion up 4% from last year's 25.76 billion. On a reported comp basis as I mentioned Q2 comps were up 2 but up 8 excluding gas and FX.

Now for the quarter that reported plus two was a combination of an average transaction decrease of a little over minus 3%. But again taking gas out of that number the average transaction increase would have been plus taking gas and FX out of that number the average normalized transaction increase would have been a little over 2% to the positive. And average frequency increased a little over five and a half. So year-to-date shopping frequency is up a little over 5%.

In terms of sales comparisons by geographic region for the quarter in terms of geography Midwest, Southeast and Northeast regions were the strongest. Internationally local currencies Japan was the weakest still impacted by cannibalization of two units we opened in the last 12 months on a total base of only 20 over there. And with Taiwan, Korea and Mexico being strongest in local currency comps. In terms of merchandize categories for the quarter for the second quarter within Food and Sundries overall in the mid single-digits Candy, meat, daily, beer and wine were the relative standouts. Within hardlines overall in the low single-digits, departments were the strongest retires in electronics and consumer electronics was up in the mid single-digits.

Within mid single-digit softlines comps domestics and apparel were standouts and in fresh foods where comps were in the high singles meat showed the best results although impacted by inflation there. For February traffic was up again 5% well average transaction on a reported basis was down 3.5% but again getting really impacted by FX and even weaker gas year-over-year. Gas prices during the month before we left the February year-over-year the average pricing of gas was almost down to 31.5%.

In terms of geography Midwest, Southeast and Bay Area regions were the strongest during February and internationally in local currencies Taiwan and Korea were the strongest as I mentioned previously the shift in the New Year holiday from January to February negatively impact January comps and positively impact February comps for the company probably about 50 basis points each way. From a merchandize category standpoint ex-FX food and sundries overall for the month was in the mid single-digit range hardlines overall came in to the mid single-digits which was consist with what electronics did, during February softlines was up in the mid single-digit range and finally fresh foods up nicely in the low-teens overall with meat being the strongest and again as I mentioned this thing was quite a bit of replenishment in that area.

Moving on the line items down the income statement, membership fees we're up 4 basis points and up 6% from $550 million a year ago in the quarter to 582 or up $32 million, take out FX up 6% in dollars would have been up 9%. In terms of membership, we continue to enjoy strong renewal rates, our U.S. and Canada renewal rates still is at 91, I think just a shade under that but averaging up to 91 and for the first time our fully captured worldwide rate is rounding up to 88 and sets us down to 87. Continue to increasing penetration of as you would actually remember of course helps us as well as those members tend to be the most loyal.

New membership signups in Q2 companywide were up 9%. In terms of members in Q2 end, in terms of Gold Star, we ended Q2 with 32.7 million members, up from 32.0 million up about a little under 700,000 from the end of the first quarter 12 weeks earlier. Primary business it's jumped from 6.9 million to 7.0 million add-on remained at 3.5 million, so the total numbered households 42.5 million at the end of Q1 at 43.2 million at the end of Q2 and representing total card holders going from 77.5 to 78.7 over the 12 weeks fiscal quarter at Q2 end on February 15th, paid executive memberships were a shade over 15.4 million, which is an increase of 188,000 during the quarter of about 15,000 a week and that's both new member signups as well as conversions.

Executive members as I mentioned before a little over two-thirds of our -- about two-thirds of our membership base a little over two-thirds of our membership base and just about two-thirds of our sales -- I am sorry about one-third of our membership base and about two-thirds of our sales. In terms of renewal rates, they continue strong again from business member renewal rates and Q1 end was 94.5, it tweaked up to 94.6 at the end of Q2, Gold Star was 89.8 that pinched up to 89.9 and total was -- remained at a 90.7 and worldwide the 87.3 went to an 87.9. You'll see a little bit bigger increase there because when you start at a lower base that tends to improve a little bit faster in those first few years.

Now I'll comment on this past Monday's press release regarding Costco entering into long-term co-branded credit card agreement with Citi and our acceptance and co-brand agreement with Visa. Yes, the press release stated we've entered into a new co-branded credit card agreement with Citi and an acceptance and co-branded incentive agreement with Visa these agreements are subject to purchase from American Express of the existing co-branded credit card portfolio by Citi and would be implemented until next April 1, 2016 at the end of our current co-brand arrangement. While there is not a lot of specifics I can give you at this point, but I can tell you the following, once issued the new co-brand cost of Visa credit card will be accepted throughout United States and Puerto Rico, the new rewards based card will be fee free. The new card will needless to say provide generous rewards to Costco members utilizing the new card and again I can't tell you a lot of specifics about that, but we certainly look forward to telling you and our members more about it, but it probably is not going to be until several months down the road this calendar year. The new card of course will also service the members Costco membership card, again there is not a lot detail we can give you at this point needless to say what we do is ultimately for the long-term benefit for our Company and our members in this case the co-branded credit card holders as well.

Pulling down the gross margin line, gross margins were up 54 basis points on a reported basis from 10.53 to 11.07. As I always ask you to do I will ask you to notch out four columns and six line items the columns of course will be Q1 '15 both reported or without gas deflation and then the columns three and four would be Q2 '15 reported and without gas deflation. And going across those lone items, the first one is co-merchandize and reported in Q1 was minus 6 basis points year-over-year without gas deflation was minus 13. In Q2 reported was plus 10, without gas deflation was minus 20, ancillary plus 22 and plus 20 in Q1 and plus 46 and plus 49 in Q2, 2% reward minus 1 and minus 1 and then minus 5 and minus 2, LIFO plus one and plus one, and then in Q2 plus three and plus three, and then other plus six and plus seven in Q1 and zero and zero in Q2 all totaled in Q1 '15 year-over-year to Q1 '14 we had a reported gross margin improvement of 22, which is the sum of those line items from column one on a gas neutral basis it was plus 14.

Again reported for this quarter it was plus 54 and on a gas neutral basis excluding gas deflation was a plus 20. And now as you can see again our overall gross margin was outside plus 54 and even at plus 20 without gas deflation. Again a lot of this has to do with gas sales penetration, which were up as well even though at the lower price per gallon. Our core merchandise drove margin was up 10 basis points year-over-year, but again excluding as you can see in this chart it was down 20, again this is a function of both increased sales penetration and strong gross margins with our gas business. If you look at the core gross margins as a percent of the various departments of their own sales and then when I talk about core, I am talking about food and sundries, hardlines, and softlines and fresh foods which account for about 80 plus percent of our total sales. On their own sales they were down year-over-year by 3 basis points in the second quarter with food and sundries and hardlines being up year-over-year a little and softlines and fresh foods being down a little frankly margins are fine we're driving sales and certainly gas prices give us probably room to be to continue to be aggressive. Although the gas prices going up the other way right now we’re -- don’t expect to see those kinds of outsized gas profits in the next quarter.

Ancillary and other business gross margin was up 46 on a reported basis 39 without gas deflation again our gas business accounted for nearly two-thirds of this Q2 year-over-year increase. But we also showed higher year-over-year margins in optical, hearing aids and pharmacy. The impact of the increasing executive membership was good is hit margins by 5 basis points or 2 basis points without gas deflation and again that’s 2% reward feature this just generally reflects to continue to increase sales penetration from the executive remembers which again as I mentioned buy more and are more royal and shop more frequently.

LIFO in the second quarter we recorded a $4 million credit pre-tax compared to a $5 million pre-tax charge last year so about a penny a share or 3 basis points benefits year-over-year for 9 million to the gross margin. Moving on to SG&A our SG&A percentage Q2-over-Q2 was higher or worst by 11 basis points come in at 994 this year versus a 983 last year again we'll do the same four columns reported and without gas impact Q1 '15 then columns three and four Q2 '15 both reported and without gas. Five line items first one is core operations or just operations plus 8 basis points was reported in Q1 I mean and plus year is a positive mean lower year-over-year plus 15 without gas deflation and Q2 was a plus three and a plus 29 central minus and minus one and in Q2 minus 10 and minus 7 so higher year-over-year on that note. Stock compensation minus 11 and minus 11 and the minus 4 and minus 3 they are no quarterly adjustments so the last line item will be total again we reported a minus 4 or year-over-year SG&A higher by 4 basis points in Q1 both on a reported basis plus 4 or lower by 4 basis points in Q1 without gas deflation.

Again in Q2 higher or minus 11 basis points and then better or lower by 19 basis points. So plus 19 basis points without gas deflation another editorial on SG&A here again the operations component of SG&A was better by three in Q2 on a reported basis and better by 29 year-over-year excluding gas deflation. Again gasoline sales penetration and very low SG&A in the gas business certainly helps that number. Within operations excluding gas and other warehouse businesses and so taking all that out payroll benefits represented an improvement of 16 points of this 29 basis point improvement. So again strong sales overall certainly helped us improve payroll and benefits as well and get some leverage there.

Central expense was higher year-over-year by 10 or 7 without gas inflation as I mentioned earlier increased IT spending for monetization this was a 7 basis points on a reported basis 5 basis points without deflation in FX and lastly in both years we had a few discreet items to the tune of about minus 5 basis points but that is what it is. Finally with SG&A our stock compensation expenses I mentioned was higher or worst by 4 basis points on a reported basis three without gas deflation.

Next on the income statement line pre-opening expense, 8 million last year and 9 million this year. Last year we had three opening this year we had no opening but we got plenty of opening coming up so you have got quite of a bit of pre-opening expense rates starting in this also the little things that goes with that number no real surprises. Our total operating income for Q2 came in at 877 million 21% higher year-over-year or higher by 153 million compared to last year’s 724 million in the quarter. Below the operating income line reported interest expense was essentially the same year-over-year coming at 26 million last year and 27 million this year. As I mentioned earlier interesting income and other was lower by 10 million coming in last year in the quarter of 30 million to the positive this year only 20 million to the positive. Actual interest income for the quarter was higher by three the other swing was a minus 13 and again most of that relates to year-over-year swings and various FX things in this case I think the biggest piece was the revolution settlement of dollar payables U.S. dollar payables primarily in our Mexico operations I think that was a small positive in the last quarter.

Overall pre-tax income was higher by 20 or up 142 million from 728 million last year in the quarter to 870 million this year. In terms of income taxes our company tax rate this quarter came in at a needless to say on a reported basis at a very low 30.2% versus 35 over last year again the income tax line benefited primarily from a $57 million tax benefit in connection with the special cash dividend. Dividends paid on cost per share has helped by our employees in our foreign K plan which totaled about 29 million shares are deductable for U.S. income tax purposes and we recognized a one-time income tax benefit of approximately $57 million related to that as I mentioned there was an offset to that benefit of about 14 million after tax charge in the income tax line related to an outgoing income tax matter. Excluding these two items our Q2 tax rate this year was actually up would have been up a 10% to 35.1 just slightly higher compared to last year's 35.0 on a normal basis.

Overall reported net income was 463 last year compared to a reported 598 in net income this year again this year's net income on a reported basis was up 28%-29% taking out those two tax items up about 19%. For a quick rundown of other topics with a lot of the balance sheet as included in the morning's press release, a couple of balance sheet information items, depreciation and amortization for Q2 totaled 260 million in the quarter and 514 million year-to-date, accounts payable ratio, accounts payable as a percent of inventories on a reported basis has shown improvement year-over-year from a 93% figure to a 97. There is a lot of construction payables in that it's showed a comparable improvement from an 83 if you just to merchandise -- accounts payable as a percent of merchandise inventories, merchandise accounts payable as a percent of merchandise inventories 83% last year up to 87% this year in the quarter.

Average inventory per warehouse was during the year flat coming in at 12.8 million this year on average per warehouse about $20,000 compared to a year ago so pretty much flat. FX year-over-year inventory levels were up -- would have been up about $350,000 or about 2.7% of sales on again an 8% sales increase. So, I think this control of our inventories and inventory is in good shape mid-year fiscals came in just fine because of the inventories.

I'll respond at this point to questions received in the past few months about the work slowdowns as you know on the West Coast ports. There is a week and a half ago I guess there was a new agreement, so things are getting back to order although the view is it will take four to eight weeks if not a little longer to get through the backup there, we like I am sure every other importer of containers, I try to identify which ones have priority where we can and really there is some pretty much the impact of that's over when we talk to our heads of merchandising in the different areas maybe using the tool we might probably got hit by $100 million-$200 million nothing to really speak off in terms of sales and there is probably a little worse for some others out there.

In terms of CapEx, in Q1 we spent $555 million on CapEx, in Q2 we spend 619 million, so quarter-to-date just under a $1.2 billion. For the year, we still expect to be somewhere in the $2.5 billion to $2.7 billion range, which is up from $2.0 billion last year. In terms of Costco Online, we continue to operate it into four countries, U.S., Canada, UK and Mexico. We're also doing things not really online, but through Alibaba Tmall in Asia, but in terms of the four countries online there is costco.com, sales and profits needless to say were up during the quarter, sales were up 23% in the quarter, comp sales in the U.S. were similarly up right around 23%, foreign sales in the other three countries were up on a local currency basis 20 and more percent as well, but again with currencies being down there is some impact there, but overall continued good results of sales strength on our .com efforts.

In terms of expansion as I mentioned, we planned in Q3, to open three units including one relocation so a net of two and have current plans for 19 which includes one reload, so a net of 18 new in Q4. Assuming we opened those, we'll be at 28 net new units for the year or about 4.5% square footage growth and by country assuming we get to 28 it would be 17 in the U.S. so a little under two-thirds there, one in Canada, one in the UK, five in Asia, one in Korea, one in Taiwan and three in Japan, as well as one in Australia and three new in Mexico. As of Q2 end total square footage stood at 96.4 million square feet.

In terms of stock buybacks, in Q1 as you know we started the process about a little bit, we brought $18 million worth or 139,000 shares at an average price of a little over $126 a share. In Q2, we spended $92 million to buy 642,000 shares at an average price of 143.21, now a bunch of that was done before the dividend date for the $5 ex-dividend date.

In terms of dividends, our first quarterly dividend stands at $0.355 a share or at a $1.42 per share annualized that leaves as total cost to company and about $630 million. This regular dividend of course was an addition to $5 per share dividend which amounted to $2.2 billion that we paid out last on February 27th and in fact both dividends were paid to shareholders on February 27th. As I mentioned, we also completed a one -- to pay impart for the $2.2 billion special dividend, we did a $1 billion debt offering a few weeks back that 500 million of five-year fixed and 500 million of seven-year fixed at attractive market rates.

Lastly just a couple of other items to note, the March comp sales reporting period for this year will include 34 selling days versus which is a day less than the 35 days last year, reflecting the calendar shift of the Easter holiday. And in addition beginning next month we will start reporting comp sales one day earlier than we have historically done so March comp sales will be announced on Wednesday, April 8th after the market close around 6 PM Pacific Time and 9 PM Eastern Time, hopefully that will help our East Coast friends and similarly our Q3 scheduled earnings release date will be Wednesday, May 27th for the 12 week third quarter ending May 10th. Again the release will occur at 6 PM Pacific Time, 9 PM Eastern Time that Wednesday with the earnings conference call still occurring the following morning.

Before I turn the call back to Brandy for Q&A, hopefully I have helped everyone understand some of the factors impacting the number. Overall, I think we had certainly the outsized gas profits helped, but there were lots of other little things that went the other way so overall still we felt pretty good a quarter and certainly strong sales membership renewal rates and alike.

With that, I'll turn it back to Brandy for any Q&A. Thank you. Hello.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question is from Charles Grom with Sterne, Agee.

Charles Grom

I guess my first question is when you look at your gas business today clearly it's a bucket for you guys to pull funds and invest back in pricing for you guys to kind of be like Costco if you will. Is there a way to quantify that this quarter I mean clearly the core margins within the [indiscernible] of the business being down 3 basis points, was there some impact for you guys being more aggressive on price or if you can maybe just speak to arithmetically?

Richard Galanti

I think qualitatively it allowed us to be a little more aggressive we didn’t just say, hey take this extra money and put it all there we didn’t. We certainly benefited from in the quarter. And again it's not like we looked at this as that will be an offset to FX as an example because we know that FX has still got even if FX rates continue to stay where they are right now and don’t get any relatively weaker it's still on a relative basis in Q3 and 4 maybe relatively weaker so yes we've recognized it Q3 and 4 will be a little more challenge in that regard but certainly food margins have been up a few instead of down a few probably but who knows.

Charles Grom

And then when you look to March of next year and then change in tenders because my understanding is roughly 750 million U.S. visa card holders today and there's roughly 50 million AMX holders today in the U.S. How bigger opportunity this could be for you guys to expand your membership base when you move into next year?

Richard Galanti

Well we'll see I mean there's a lot of unknowns, the first order business is for Citi to work with American Express and figure out the account portfolio a lot hinges on that we expect that to happen but there's no guarantees and there'll be -- and again there's a lot I'd like to tell you there's a lot we'll figure it out now. We know the bucket of dollars if you will in our mind of what we can use to drive usage of that kind of card to recognizing there'll be some cannibalization somebody that has a visa mileage card in their wallet. They may want to use that instead. Just like there is cannibalization now there's people who use a non-cobranded AMX card. Similarly there'll be other places where there's outside spend increase because your neighborhood drycleaner one card is accepted and another card is not, so there's lots -- I think there's lots of opportunities we have to get there first and first order business is the transition itself and there'll be a lot more to say once we get there.

Charles Grom

And then just last question on e-commerce up 23% in the quarter, can you just remind us number of skews online today relative to a year ago? And where you think that can go? How much is costing through your depots versus not and then just margins on e-commerce relative to the clubs? Thanks.

Richard Galanti

That is probably approaching 8,000 regular skews and excluding from that that we have a lot of tyre skews based on all the sizes we've got a lot of office product skews through a third-party but core skews on our side is 8,000 probably 1,500 plus more than a year ago and I'm guessing there but that's probably a big number. And then those increases are a lot of sundries items, some apparel items things like that probably gets you to come back on a more frequent basis and smaller ticket items a lot of the items a lot of the items we have added are items like I've mentioned versus $300 to $2,000 televisions and furniture sets.

Charles Grom

Any color on profitability?

Richard Galanti

Excuse me?

Charles Grom

Just as margins in the e-commerce business?

Richard Galanti

Margins overall are probably are a shade lower SG&A is a lot lower so profitability wise e-commerce is a very profitable operation relative to the company as a whole.

Operator

Your next question is from John Heinbockel with Guggenheim Securities.

John Heinbockel

So Richard two part question to get kind of the same thing you've got some very busy clubs and you keep increasing traffic mid single-digit every year and you guys spend a lot of time looking at kind of quality of experience in the club in maybe different parts of the club right like fresh and with that in mind is there an opportunity to open more clubs in the U.S. than you might have thought before maybe cannibalize yourselves gain share improve the experience if some of them are too crowded have you guys done work on that?

Richard Galanti

Well yes in a lot of different ways but not in terms of let's sit down and do that today at one-time I mean first of all quality of experience as you I think know I'm sure you know our operators and our merchants are in the warehouses a lot create and a random set of merchandising and operating victims just spend two days shopping around part of the country visiting warehouses both us in competition and other things and looking in the sites, so I think certainly the member responses that we get every day the types of throughput for hours and front end registers all those things go into that and I got to tell when a member writes a little complaint then that could be nasty just a complaint it just hurt and recognizing we’re always been have some challenges. So we're constantly looking for that experience and we're constantly looking for that to get you out of there faster and to make it a better experience.

I got to tell you we still get probably more positive than negatives in terms of e-mails that are sent in to senior management about positive experience as with a member with a particular employee who they have helped in a warehouse something like that and beyond so we have no illusion that we do everything right but we're pretty steadfast of looking all those things in terms of really deliverable units absolutely I mean if you would have ask me five years ago when we're opening about 20 units a year and probably I don’t have the numbers in front of me we're probably it is 70-30 U.S. and you said Richard five year heads where you are going be and I'd say well we're going to be about 30 and we actually got there pretty close. And if it's 70-30 U.S. backed then it's probably 50-50 heading into 30-70 over the next five years and here we are almost 50-40 still in U.S. I think that’s a reflection of we're finding probably more opportunities that we thought possible some of it's what you mentioned openly up in busy that quality of experience the units that are 250 and 300 and even the 300 plus trying to get those in trying to balance that because cannibalization does cause a little heartburn per year. But a lot of it also is as I think surprising how many units we can put in some of the newer markets so that newer is a relative term newer markets over the last -- in markets that we've been in for the last five or 10 years. So I think it's a combination of all that again last year I think of the 20 in fact I have it here hold on, of the, here it is of the 20 -- in fiscal ’13 I am sorry last year of the 29 net openings we had I think 16 were in the U.S. and this year of the 29 or 16 or 17 were in the U.S. a little over half and this year it's what did I say 17 out of 28 so almost two-thirds and so I think you'll probably five years from now as we go from let’s say 30 to 35 probably still half are in the U.S and then we are finding more opportunities.

John Heinbockel

Do you think you can get to a 1,000 there ultimately or have you gone out that far?

Richard Galanti

Well we haven’t gone out that far as yet yes if we added 30 year for 10 years around a sense there so yes I think so but certainly not out of the relm.

John Heinbockel

And then secondly what the though at least it seems like anecdotally maybe in certain items or categories there may be Kirkland introduced maybe the brand or a brand is no longer carried. I don’t think there is a conscious effort to although the quality and value Kirkland certainly outstrips a lot of the brands. A conscious effort to get more Kirkland items in the store more space to them is there a conscious effort or that’s just kind of it happens you put in it is where the demand is and so maybe it squeezes out some brands along the way?

Richard Galanti

Well I think there is an ongoing conscious effort to there are people that are in charge of coming up with new Kirkland stuff in each merchandize category and their job is to try to find new things just like any buyers job is to find good exciting branded items. And ultimately an item it is our cousin it has got the name on it but it has to live and die like any other item I think if we've added 30 or 40 items in the past 12 or 18 months that should we subtracted 20 or 30 that ultimately did work out when though we bring back some a few years later that worked better I remember years ago we had a organic peanut butter Kirkland team ensured that didn’t set the world on fire. I think we're now testing again and it's a pretty good item. But we'll see how long pretty good means. So it has to -- we recognize the strength of our concept is both KS and brand and I don’t think we if you said Richard you are in the mid 20s now in terms of KS do you ever see going to 50 I’d have to stretch I mean even our own members internally will say how can we get it from 25 to 30 there is no formal game plan how many years is that going to take what items work and certainly there is a not a lot of low hanging fruit there is lots of $20 million and $30 million and $50 million overtime. Not a lot of 300 million and 400 million items like paper goods or water and things like that or K stuffs.

John Heinbockel

Okay thank you.

Richard Galanti

And last comment before getting to the next question out there in terms of cannibalization even if that’s ramped up a little bit. I was just looking over the last few years if you go back to fiscal '13 what we called cannibalization that’s just not just here that’s opening three units in Japan and that affects three or five other Japanese units. Total cannibalization in fiscal '13 was 65 basis points and ’14, 58 and for the first half of this year it looks like it's about something in the low 40s so it’s going to fluctuate between 35 and 75 depending on what we do and where we do it, but my guess is something in the 40 to 50 range is kind of -- we’ll have to be able to move that number overall a lot.

Operator

Your next question is from Dan Binder with Jefferies.

Dan Binder

My first question is related to the gas business, can you just give us an update on where the comp gallons were in the quarter, where gas is as a percentage of total sales? And then you mentioned that the gas margin would start to be little bit less favorable given where price is, what prices is doing. Can you help us just to understand kind of what the excess margin may have been in EPS this quarter?

Richard Galanti

Yes, look it was just on that line item it was two-thirds of the margin improvement of all ancillary businesses. It could be 200 plus basis points of extra margin, I mean our margin in gas on a daily basis over the years could be anywhere from a zero to a five or six and it's all over the Board might even be a little bit higher sometimes, but it really ranges and frankly when it's a little higher, we're saving the customer more money. In terms of gallon it comes I remember for a couple of years when the U.S. overall not Costco, but all U.S. vehicle gallons consumption was in the low single-digits and maybe in the -- when the bad economy hit and went to the low negative single-digits and we went from, we remained at four, five, six, seven. Right now we're in the mid-teens. So, we're getting a lot of people coming into Costco to buy gas and that certainly drives them into the warehouse as well.

Dan Binder

And then on the IT spend, you mentioned I think you said it was $0.02 this quarter as you look at Q3 and Q4, what do you expect that in fact look like?

Richard Galanti

It's hard to guess completely, I know we've had a couple of some of the original modules and modules makes it sound like it's a small number, these are big numbers but then you have projects that are $50 million-$60 million projects that the day you are put into service they then over the next in our case 55 four week periods over the next five years generally you take a little under a $1 million a month hit and so some of those are starting to hit so my guess is that much it will is it that much is a little less a little more it is hard to say but still over a several year period incrementally recognizing your denominator sales keep getting bigger too, but with that bigger sales we had indicated something in low to mid-teens of basis points I could be off by a couple of basis points but and they achieve.

Dan Binder

And then my last question is related to organics, can you just give us an update on how many that skews are on in the club at this point and what the mix is of sales and how that performed in the quarter, how are you thinking about that business going forward?

Richard Galanti

Yes, it's still a small percentage of Costco, it's a rising but it's a fast growing area as it is with a lot of other retailers as well. You're are going to see more and more of it a part of that is availability there is -- we could sell -- we and everybody else can sell a lot more if there was more out there. I think we're doing a pretty good job of winding up our sourcing and I think I mentioned last quarter that for all of '14 organic was like approaching 3 billion which was more than twice when it was two years earlier or a year and a half earlier. It's growing fast, I don't know if it is 50% a year, but it is certainly growing at a high and a low mid or mid double-digit number and it's great for us because we show even a better value on that stuff than some of the things that it replaces when we can do organic ground beef I mean for everybody football is regular ground beef and everybody makes lower than average margin this is the item that everybody tries to make more on, and so we can make a little more not a lot more and show a greater value to our member. So it will keep growing, I am sorry I can't be more specific.

Operator

Your next question is from Christopher Horvers with JPMorgan.

Mark Becks

Hi, it's Mark Becks on for Chris. Congrats on the fantastic quarter. Just a follow-up on a couple of Chuck's questions, actually, so it doesn't look like you are getting into too much specifics about the change in the credit card to AMEX, et cetera. Just curious what has been the response that you've seen from our friends up north? I knew that changed over in January -- maybe what the reception has been there?

Richard Galanti

Well it's been good so far, I mean we're getting a lot of people to switch, recognizing it's peoples membership card as well and if anything our view of the U.S. should be -- I guess I can't get into a lot of it right now. We wouldn't have done this if we thought there was a lot of risk associated with it, we think it's a big positive over a long period of time, but recognize big positive to us means giving most of it back to the customer in this case most of it back to the co-branded user of a credit card and that's going to happen -- we're really not going to be able to tell you a lot about it for a number of months.

Mark Becks

Okay. I guess I'll switch back to the gas prices then. Historically, the adage has been you guys benefit when prices go up, but it looks like just based on gallonages and miles driven, which has only been up a couple percent, so you guys are actually capturing a lot more share now then in history period. Is that something you would agree with?

Richard Galanti

Yes there is two places to that just so everybody understands. When prices go up, we make less and save the customer we still save them but save them less. When prices go down, we save them more and we make more. Certainly price is going down, we save the customer more and that's positive and we make a little more or a lot more right that's changed in the last few weeks, but we made a lot more in the last few quarters. If you go -- the other thing the thing I think you're talking about is when it was in the press everyday as prices went from $3 to $4 to $4 plus a gallon it was on the news every night in every city, that helped us I think. The offset to that would be as prices are less important, how can that help you? I don't know other than it is and it is a lot because our gallon is quite a bit up.

Mark Becks

Did you see what the volume and gallonage was/ I think it was, call it, up 11% last quarter?

Richard Galanti

It was in the mid-teens I think we mentioned.

Mark Becks

So pretty big acceleration there and just finally on geography -- go ahead, sorry.

Richard Galanti

Just getting back to that comment I think people ask us why I think it's because we do a good job of being the most competitively priced and there's that third-party as gasbuddy.com that 40 whatever million people and put their price on what they bought gas for. For three years in a row since they started announcing best overall low price out there by $0.14 a gallon or $0.16 a gallon across the country, now you're going to and that's not every station every day everywhere but on average with all those data points we're it and I think that kind of publicity helps us as well.

Mark Becks

And then just the last question on geographical differences, it looks like you called out the Midwest and the South areas as the strongest obviously, a lot of moving pieces there, with the Chinese New Year as a help, but then the port shutdowns, which on our math comes out to 60 basis points roughly. Maybe just what you are seeing, elaborate a little bit geography, and then maybe the Northeast? I know we have seen some pretty severe weather here as of late? Thanks.

Richard Galanti

Well look I think you summed up or re-summed up on the port strike in the Lunar New Year switch -- I think the big deal is weather has played a role although it did last year as well, but relative to New York, the Northeast as an example the four weeks that complies February the first two weeks were mid positive say normal after weeks were mid negative single-digit that's a huge swing but other areas did just fine and the Texas region got hammered in the last week with weather but overall we're -- it's been, we've done okay.

Operator

Your next question is from Simeon Gutman with Morgan Stanley.

Simeon Gutman

A couple quick ones, on the credit card, I know you not going to share a lot of details. Is there -- besides probably some savings just from some slower interchange fees or credit card fees, is there any elevators, such that if there are certain volumes met, you could see further benefits down the road? Or is this the lower fees, you will see a benefit upfront? And then from there, just how much business you do?

Richard Galanti

As you're asking I'm looking at my wall behind me and there's a handwritten note from many years ago when our securities counsel is sitting here and quickly somebody's asking a question he wrote we have no comment beyond the release and then the reality is that there's lots of buttons that you push on these agreements there's all aspects of it at the end of the day whatever our current arrangement as we look at it whatever our current arrangement is with our current provider both what we pay what we receive to offset some of that what our member using that co-brand cardholder is rewarded with a premise of how much is that to start with where we think it can go to at the end of the day we can whatever that bucket of money is it can go towards lowering merchant fees raising rewards or using some other place in our company and we'll figure it out there's we think that's it's an exciting bucket and we'll do a lot with it but just like I've told people in the past if we can save the dollar on buying a product better whether it's detergent or coffee or anything or due to packaging or raw materials cost or energy cost we're going to give $0.80-$0.90 back to the customer and rest assured there'll be whenever benefit x is a little bit of will accrue to our P&L and a lot of it will accrue to the member in some way shape or form but none of that can really be -- we can’t really tell you until next year.

Simeon Gutman

On membership, I know you don't say a lot on international versus U.S., but can you just speak directionally to whatever growth rate you are seeing in membership, whatever trend line has been occurring, how has that -- has it changed much? Is it the same in the U.S. versus international?

Richard Galanti

It's higher international because we're newer we didn’t save -- and I think I've shared in the past I mean if you take the total number of members divided by our total number of warehouses you've got roughly 59,000 to 60,000 member households per warehouse in Japan you've got a number that has it's a three digit number it's in the low hundreds you also have a lower renewal rate in those first few years so it tends to bounce out overtime but we operate overall in other countries on a membership fee as a higher percent of sales particularly in Asia.

Simeon Gutman

But whatever prevailing growth rate there has been in membership in the U.S., up until second quarter or up until the first -- meaning, has that run rate stayed the same in the U.S.?

Richard Galanti

Yes and a lot of it is dictated by new openings and again it's going to be dictated more by what I said in new member signups in the quarter were up 9%. There have been times when it’s been almost flat but prior are down a little bit because a year earlier in that quarter you opened three units in Asia where you might have and again I talked about an average of roughly 60,000 member households per location. We had locations that will have new member signups as of opening day and that as of day mean during the 8 or 10 or 12 weeks prior to opening when their parking lot is kind of set and we have the flags and the tabling activities out front side you could have anywhere from 25,000 to 40,000 members signed up now 40% of them renew a year later but in terms of new members coming in and buying a membership and that really distorts that number. So I don’t know how much meaning is that plus 9 is a function that as well but we always point that out.

Simeon Gutman

And then just very quickly, can you just remind us of the e-commerce business, is there other member-only items or is there items someone can just -- who is not a member can just come on the website and purchase as well?

Richard Galanti

In this crazy world there are some items that we have online where we've agreed not to show the price unless you are a member.

Simeon Gutman

Not to show the price but the only person who is buying on your Web site is a member?

Richard Galanti

Yes.

Operator

And your next question is from Paul Trussell with Deutsche Bank.

Paul Trussell

I wanted to just touch on membership as well. Certainly, with consistent and strong traffic and you certainly are saving people money at the pump, how are you thinking about the value proposition of your membership currently in the U.S. and international? What may be the timeline in terms of you kind of reassessing what you think the value of the membership should be?

Richard Galanti

I think round about what you're asking about when do we see this I think the possibility of our fee change historically that’s really we think about last. We drive prices and value everyday in everything we do and I mean it you go to our budget meetings every four weeks you got a day and a half of that time or a third of time is merchants and we’re figuring out how to improve the value and lower the price and raise the quality. And historically using U.S. and Canada as 80% of our business first of all and probably 80ish and a little different than that number pretty close in terms of percent of members you have -- we have done a fee increase about every five or six years the last time we did was very late '11 very early '12. So most of the calendar year of '12 those renewals been a first time in five or six years saw the increase from 50 to 55 and from 100 to 110 on the executive in the U.S. and Canada if history repeats itself five to six years from January of '12 will be January of '17 into January of '18. So that again based on history it doesn’t mean we are going to do it or not going to do it. We've chosen generally the whole membership fees at whatever their prices are mostly of the countries impart because it's so darn strong to start with and why not continue to drive the business. And so again I think it's generally the last thing we look at but something we've looked at regularly over 30 years and I'm sure we'll look at it again at and when time tends right.

Paul Trussell

And then just circling back to gas profitability and I know you have addressed this a few times on the call, but given the spread between the Street's forecast and the actual for 2Q, I just wanted to touch back on your comments around the third quarter. You mentioned that gas prices have started to trickle back up, but frankly, can you help us just kind of think about our expectations for the back half of the year? Should it be closer to a more normalized cadence around gasoline profitability or do you continue to see a little bit of tailwind, given the favorable mix?

Richard Galanti

Well if you look at history when we each quarter for the last several years we'll share with people that gas helped us a little hurt us a little helped us a lot hurt us a lot. It's virtually all -- it's pretty much in proportion with the trend of gas prices per gallon. And so as you know in the constant to drive down has stopped and went up a little bit. So a lot of that party is now behind us for right now and but I can't really tell you what is going to be other than historically that's what it's been.

Operator

Your next question is line Matthew Fassler with Goldman Sachs.

Matthew Fassler

First question relates to the special dividend. I guess this is our first conference call since you announced the last one. What the prior special dividend that was around the time of tax policy change and many companies pursued that tack. As you take a bigger picture look now at capital allocation, understanding that you did accelerate the stock buyback a bit, how are you thinking about special dividends, perhaps as a recurring element of capital allocation? And any other light you want to shed on your decision to issue that one last week?

Richard Galanti

Well, I mean we now have two data points instead of one we did it and you're right the motivation or one of the motivations could be really the one we did it was reading about in the Wall Street Journal everyday and just before people expected a dividend tax rates is automatically, so it make sense to be not only shareholder friendly but shareholder friendly a way that might help people as well if tax rates were going to change and we feel active about that. I think we appreciated the fact that it was perceived as being shareholder friendly, as you might expect both management and the Board wanted to be in that regard and it's not like we sat down and did this giant study exactly when how much and what should we do, I think we liked it the first time and it seems like our shareholders liked it the second time. And that's how we clearly worry about it and there a little on dependent of each other.

I think that when we did the first one which was a little over $3 billion worth it was quite sizeable it was a time when I guess in retrospect we could have bought some more stock back it have been a smart thing to do given where it's at now. We want to -- we tend to do both and we tend to look at all things, first and foremost CapEx, how through we ramp-up CapEx and we've done that. Second would be our regular dividend, what are we going to do with that every year again there is no guarantees, but in each of the last spring periods over the last nine years I think we've raised it on average around 13.5%. We looked as you know premiere models and our models we are generating more cash than we can use in CapEx and so we'll continue to look at ways to the shareholders run rate. But there is no reason of thinking that will be two year sense we'll do another one, there is always a thing we will mostly.

Matthew Fassler

It's interesting even though you're running with several billion dollars of cash on the balance sheet, you haven't gotten to the debt markets, which I understand is opportunistic. Should we think about the cash balance that you have today as something that you feel you need to be comfortable with or is that a number that you could whittle down over time?

Richard Galanti

I think it is a number that you wrote down mind you, I am looking at quarter end and this number might be a shade different than the balance sheet number, but I think we had cash and short-term investments was across this number there, hold on a second, cash in short-term investments at the end of the quarter of 7.4 billion roughly and add a number that wasn't completely consolidated of like 7.2, but if you look at that roughly 7.4 number about 2.5 is really cash in the U.S. another 2.5-3 is real cash outside the U.S. where we're spending it frankly. In addition we announced last year that we brought back some of the cash in Canada. So, I think we can withheld the number down but some of its cash equivalent, if you think about from the time base close on Friday night, so the time they open on Monday morning all those debit and credit card receivables which could be upwards of a $1 billion, $1.5 billion, 1 billion plus that is cash equivalent, but is not cash.

Matthew Fassler

And then just a very quick follow-up, we are seeing the LIFO creep up. I know it's only a couple basis points, but it's a nice change from year ago, when, I guess, you peaked out at around 8 basis points hit. Could you just talk about what the moving pieces are in driving that? And I know you feel like you are fully marked at the end of any given quarter, but if you had to place bets on which direction it would go for the rest of the year, it would be very helpful?

Richard Galanti

I don't know, gas has come up a little bit, although it's still below where it was at the beginning of the year, so that is still probably LIFO as of today it is LIFO creditable, I don't think it's going to be a big giant number either way, but it's a little bit of attraction at this point. Yes, you were right about it Matt, a point of that is some proteins are inflationary right now for not always is related and some other things we're just starting to see what beginnings of some deflationary pressure on items manufactured in the oil, plastic bags and alike, so some of that is starting to finally flow through so there will be some things that are inflationary and some that are deflationary.

Operator

Your next question is line Kelly Bania with BMO Capital Market.

Kelly Bania

I am not sure if it's too early to ask this, but just curious about the members that you brought in via the Living Social promotion several months ago just curious if you are tracking them? Are they following that typical spending pattern of a new member in terms of spending and frequency?

Richard Galanti

I'm going to plead because I don't know the answer to that, but we hold that question for next quarter I promise we'll have some numbers. I know that we're tracking it and I just don't have the detail on it. I know that on average, they're a little younger. I don't know spend habits.

Kelly Bania

Then just another one, you mentioned the Bay Area as I think a strong region either in the quarter or for the month. I know that's an area where you have more robust offering in organics and I was just curious if that's part of it? And maybe how plans are to kind of bring that more robust organic offering to some more clubs in the rest of the country?

Richard Galanti

Well and that's probably a little piece of it. I think weather overall has helped. The West Coast is as bad as it's been in Texas and the Midwest and the East Coast it's been offsettingly good over on our side of the country. And I'm sure that's helped some. Clearly I think some of the merchandising efforts we've done on organic have helped. Part of that, we are doing it more in other parts of the country. Part of it is supply issues and it will still take time for that to grow.

Operator

Your next question is from Scott Mushkin with Wolfe Research.

Scott Mushkin

I want to get back to e-commerce and maybe the ancillary services ex-gas and just explore I know I think you said that the margins are great. Did you give us a number on how big e-commerce is?

Richard Galanti

No, it's -- do you mean total size of e-commerce?

Scott Mushkin

Yes.

Richard Galanti

It's about 3% of our total.

Scott Mushkin

3% of your total sales?

Richard Galanti

Yes on an annualized basis, I think last year was like 2.9 or something, 3 billion and growing at 20%.

Scott Mushkin

3 billion growing 20%-25%. And then from a gross margin perspective, I mean that how do we think about SG&A associated with that business? Is there much of it? I mean is it like fractional a couple percent? I mean how do we think of SG&A when you look -- I know a lot of the stuff just goes directly to the consumer about 60% of it. Is there really a lot of SG&A associated?

Richard Galanti

No there's -- margins are let me just look here, margins are a shade lower not a lot and SG&A is a lot lower.

Scott Mushkin

And then from a philosophical perspective -- everyone has always ragged on or not ragged on that's a bad way to say it, everyone's always -- some people have criticized Costco because they don't let enough flow through to shareholders. How do we think about that? I think the gross margins are what you are saying are a little bit lower. SG&A is a lot lower, so net-net we got much better operating profit in the e-commerce business. Is that okay with the Company or is that something that you would try to make look like the rest of the business?

Richard Galanti

No I mean we're a retailer, there's different part of it. No, we're happy to make a little more there. We're still making first and foremost are we as competitive as we can be relative to others and we feel that we are very competitive. We are also recognizing that e-commerce is supported by the buying sites of the warehouses as we brought in line electronics and furniture and some of those bigger ticket categories that buying strength, how do you compensate -- how does e-commerce if you will compensate to that so it's all part of the same thing. The fact it's margins overall are a little lower than the warehouses I think it's indicative -- it's a function of that and we'll continue to do that. We work on strong profits in some of the other ancillary businesses but they also have different either cost associated with it or purchasing powers. Pharmacies of course you got pharmacist and pharmacy techs that make more than average hourly employees, so you got a higher cost structure there as well as all the regulatory and billing stuff going on in that business so we work on a higher margin to offset some of that and but we also work on a profitability number that's good so it's all part of the equation if you will.

Scott Mushkin

So then just one last one. So I think you said you are up to 8,000 SKUs. One of the things we think benefits Costco hugely on the e-commerce is that you are basically letting me use your people to do the shopping for me. In other words like the fact that there isn't 2 million skews like there is on Walmart's site I think is a great attribute. So what's your thought about where the SKU count goes, kind of balancing Costco being a personal shopper versus wanting more maybe more SKUs? Where do you think it goes?

Richard Galanti

I think it probably goes up a little bit but not a lot, the fact that it went from 4,000 to 8,000 or something in the last few years is a lot, but part of that was just trying to drive business adding some categories to get people -- for people to think of it as top of mind or near top of mind instead of not at all. If I have to think about and comment from very loyal shareholder and somebody who loves Costco with three kids at home three teenagers and said look I love Costco and I know when I go into a warehouse I know I'm going to get the 10 items I planned to get in the food and sundries area and the other 10 that I didn’t plan to get but I know I'm going to come out with 20 I'm going to be sated I know I'm going to have great food samples I know we have three other things in nonfood area that I have no plan to get and I'm excited about that but I knew going in I was going to get three items or four items that I didn’t plan on getting.

So I don’t know why when do I go to costco.com so part of our challenge in the last year on costco.com is not only driving sales of those bigger physical ticket bigger dollar ticket and physical ticket items that not everybody wants to shop home like furniture and big screen TVs and had a great price and in many cases write about service delivery and we're driving that business. But also how we just did it more regularly and whether it's take ups in other items for your office or home or some apparel items. As you know the 5.5 million KS restaurants that we sell every year which is a great value if you always joked if you really tall with short runs we can assort you because we don’t sell all the sizes and collar combinations online we do. So trying to get different reasons to get you under the state more often is part of the equation here and nothing we're doing pretty job of doing that. I don’t see and you said Richard you're taking again 15,000 one day I don’t see it in my near future.

Operator

Your next question comes from the line of Oliver Chen with Cowen and Company.

Oliver Chen

I just had a bigger picture question about holiday. Did you have -- would you prioritize any major learnings from holiday in terms of where you might look to do things differently next year? And then on the core merchandising margins number, what should we look at as helpful drivers for that positively going forward? Or what kind of run rate might we expect there? Thank you.

Richard Galanti

What's the second part of that question?

Oliver Chen

The core merchandise margins. What are some of the positive drivers we should look for in terms of optimism on the core merchandise margins, whether it be inventory control. Or is the run rate at a slight negative kind of realistic for us to model?

Richard Galanti

We didn’t say we don’t provide on the latter part we don’t provide specific direction on that area. I remember several years ago when our margins were just down year-over-year every quarter for a couple of years and every quarter we'd say margins are fine. We can tweak them a little bit if we want and where we want to I think that sentence and that response is still there I think we continue to get excited by strong sales and strong loyalty and strong conversion to executive member. And all those things will continue to take front seat to a little margin improvement. But if we want to get a little bit we think we can while still being very competitive. In terms of what do we learn or not learn during the holiday.

I think when we look back I think we did a pretty good job of planning for the port slowdowns and arguably it's probably easier to do a better job when you're managing fewer items. And so while we felt that we got hurt by a little bit I think we probably mitigated that hurt. Beyond that again I think we are comfortable when raw materials, prices, and bakery and food court and the alike go up that we're not going to change our prices and if it hurt our margin a little bit it hurts it we can get elsewhere. So I don’t think this was given our strength we didn’t they weren’t a lot of things to necessary learn as it relates to did sales soften and we drive more sales by more mark down just something I think we thought we had came out of this season pretty good. And if anything continues to be aggressive in terms of price of the products the price points of products that our member wants great value or great items and we'll continue to drive the value proposition in upscale items.

Oliver Chen

And inventories were nicely growing versus the sales, like underpinning sales. Is that a trend we should also model going forward in terms of the spread being neutral?

Richard Galanti

Probably a little bit again I wouldn’t read too much into one quarter. For a number of years here we've generally again taking FX gas out of it the four walls of warehouse inventories that on a non-FX diluted or increased basis. Generally speaking we've had sales greater than inventory per warehouse increases if sales were up 8 or 9 inventories were up five or six. I think my guess is Q2 was a little better than we thought but it not's going to drive a little bit but still trending in a positive ratio there.

Oliver Chen

In our last question, you gave a lot of great details on the e-commerce and the evolution there. What about flexible store fulfillment and reserve and pick up and ship from store. Is that on the horizon? Is it something your customer appreciates and will that be a material driver of traffic? At some competitors, e-com contributes 100 basis points or more to comp.

Richard Galanti

Well 23% of growth on 3 billion is like 60 or whatever 500 million. So that’s like little under half a percent of comp to the company. First of all we don’t do it right now with the exception of the 8 or 9 Costco business centers that we have that we both to delivered and order for pick up several things we’re testing like Google and the cart are something enhancement, it's not like you can’t call Costco, or online Costco and say I want to order this stuff and I’ll come and pick it up. So, I don’t know if our member appreciates it, I know there is a lot of effort out they are doing it, our first order business is get -- we just are installing the membership module which includes a lot of hooks to things, but I don’t see us doing that certainly in the next year.

Operator

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

Michael Lasser

One, have you seen any evidence that gas prices correlate either to customers' willingness to spend more on food, sundries, and hardlines in your stores or your ability to sign up more members at your Clubs when gas prices are either moving up or moving down?

Richard Galanti

Well, it used to be when prices were moving up and it was the topic du jour every night on the -- from the consumer product and the consumer activist on the local news station, when were prices were skyrocketing is when we saw some real signups related to in that market. Conversely you see less of that right now, certainly we're seeing and the answer is I don't know completely, but certainly we're seeing more traffic to the gas stations, more and continued strong shopping frequency in the four walls of the warehouse and some of that's got to be related that but I couldn't tell you how much.

Michael Lasser

And my second question is on the credit card. Can you give us a sense of what the private-label credit card penetration is in your Clubs?

Richard Galanti

I don't think we disclosed that, total credit card, in U.S. total credit card is about 40, debit is about 40, cash, check and other is about 20.

Michael Lasser

But presumably a big portion is private label?

Richard Galanti

Probably and certainly more than half but there are people that choose even using our credit thing, there are people that choose to get star reward points or drop the points on a different AMEX card than the Costco one. Our goal though is to certainly drive more of it and we have successfully historically and hope we can do that in the future to drive more of it to this top of the wallet card.

Operator

Your next question comes from the line of Meredith Adler with Barclays. There is no response form that line, we'll move to the next question. Your next question comes from the line of Bob Drbul with Nomura.

Bob Drbul

Just have two questions for you. The first one is when you look at the impact of FX this quarter throughout the P&L, can you just help us understand a little better, like what we should expect both on MFI and on SG&A over the coming quarters as we look at the foreign exchange where we are today? And the second question is, with gas prices rising a bit over the past few weeks, are you adjusting the merchandise pricing that quickly to reflect the movement in gas, as you were opportunistic this quarter. With gas prices going up, will you change things as we go into the next few weeks, given the rising prices?

Richard Galanti

The answer to last one is no and again I am not -- I can't tell you how exactly what, when, where and how, but did it give us a little bit of cover to be aggressive? Yes. Did it give us a lot? No, it gave us a lot of cover, but we choose not use it. So, I mean it's not like we're going to say, hey, let's take all this and go use it. So yes, as gas profits come down that was probably our improvement, it so happen in this quarter where is that pointed out all those other things, some of which we will continue doing it, you guys can figure out FX based on where the currencies of each country are. If it weakens a little bit relative to dollar from a year ago, it is a little more impactful, if it weakens little less, it's a less gradual but still with a negative front of it. Yes, interest income and others that little bit of a crapshoot. It goes both ways. Gas now is going to be less outsize profitable in the coming quarters and there is another reason hopefully that sales will continue to drive in the right direction. I think overall, I look at Q2 and taking all the good of gas out and the negatives and sort of other things some of that will go away in Q3, but if we can drive sales frequently we'll be fine. I am going to take two more calls.

Operator

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

Gregory Melich

Two questions, one is -- and I realize there's a lot of moving pieces, but if you were to look at gas and how much that helps EPS this quarter, could you give a range or if it was $0.10. And then sort of think about it going forward, if gas was steady, is that something you have to cycle, it comes back, or is it something that is a new plan? And then my other question was on gross margin. I think I heard you say that in ancillary, there was pharmacy and maybe something else where there was some margin expansion. Could you help explain that, if I heard that right? Thanks.

Richard Galanti

Sure we're not going give specifics on gas it was very profitable a little bit of it could be an offset to other margins a lot of it is just outsized but then we also had a few other things that went the other way and so that outsize this was a little less outside. In terms of gross margin optical and hearing aids again just looking just like I say in the core gas was the big one but several other key businesses, ancillary businesses also had slightly improving margins year-over-year pharmacy optical and hearing aid.

Gregory Melich

And what drove that? Was there a mix issue or --?

Richard Galanti

I think some of it is driving sales a big chunk of it driving sales I think on hearing aids and I'm guess here because I don't know our success of purple signature which is a incredible value and quality I am told that the penetration that's huge generally we make more margin and save the customer more money on our private label. But I'm guessing it that way.

Gregory Melich

And I guess just because it is linked a little bit, where are we now with inflation for the whole store? If you were to roll it together? Does it meet enough in electronics now and all that kind of stuff?

Richard Galanti

Year-to-date we're about a 0.5% deflationary and that's a LIFO index for U.S. inventory, so what we're all like items cost update one of the fiscal year and one of these same items cost us on day 180 or so whatever this year and if day one it was 100.00 at the end of 24 weeks it was 0.995 so literally 0.5% you had a little bit of inflation in for sundries and apparel and domestics. You had deflation as you expect in majors you had deflation in gas and you had deflation in foods a little bit sundries are up a little food was down a little.

Gregory Melich

That's tough.

Richard Galanti

Not a lot of deflation.

Operator

And your final question comes from line of Joe Feldman with Telsey Advisory.

Joe Feldman

Wanted to just ask about international for a moment, I think you have been in Spain now for about a year. Just was curious for a little update there, update on what you are thinking about new countries. I believe France was going to be next. And also just more generally, just store productivity. When you are opening internationally, are you still kind of achieving and exceeding the targets that you have set out?

Richard Galanti

In Asia and Australia historically achieved and exceeded recognizing whenever you are in a new country. And as go back I use to depend as an example 15, 18 years ago 15 years. Our original plan there was over a unit a year for five years and just achieved breakeven at the end of your five I think we ended up opening six in five years and we achieved breakeven at the end of year four roughly. And a lot of that has do with you have got a 5 plus million plus a year net on central expense, buyers, and carry department. Small IT department you name it and then of course all the efficiencies are starting up memberships wide were doing great in Spain. We have one unit mind you sales wise we're under our plan but it's starting to finally grow nicely. I think now that we're here to say we've got two openings planned for the rent remaining part of this calendar year both of them are in the mid grid area and one in September and one is later that year. I think that both in the fall and again what we find even if it's a different city once we're there you start getting more local vendors willing to sell you because we're going be around and you get a little more play in the press. Yes we'll see but we feel good about going so far, France we’re still at least a year away for opening I think when we first set down four or so years ago the view was is that Spain would take three to five years and France would take three to eight years and it is. So it is a long run out process of permitting and the whole appeals process over there by third-parties.

Richard Galanti

Well thank you and I thank you for listening for an hour and a half. And have a good day.

Operator

Thank you. This does conclude today’s conference call. You may now disconnect.