Costco Wholesale Corporation (NASDAQ:COST) Q3 2015 Earnings Conference Call May 28, 2015 11:00 AM ET

Executives

Richard Galanti - Executive Vice President and Chief Financial Officer

Analysts

John Heinbockel - Guggenheim

Simeon Gutman - Morgan Stanley

Meredith Adler - Barclays

John Parker - Sterne, Agee

Michael Lasser - UBS

Matthew Fassler - Goldman Sachs

Chris Horvers - JPMorgan

Paul Trussell - Deutsche Bank

Peter Benedict - Robert W. Baird

Kelly Bania - BMO Capital

Mark Miller - William Blair

Bob Drbul - Nomura

Michael Montani - Evercore ISI

Scott Mushkin - Wolfe Research

Joe Feldman - Telsey Advisory

Operator

Good morning. My name is Britney, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q3 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

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

Richard Galanti

Thank you, Britney. Good morning to everyone. Last night’s press release presented our third quarter operating results for the 12 weeks ended May 10, 2015.

Before I begin, please note that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results, and/or performance to differ materially from those indicated by such statements.

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

So to begin with, our 12-week third quarter fiscal 2015 operating results for the quarter, earnings per share came in at $1.17 a share, a 9% increase over last year’s third quarter earnings results of $1.07 a share.

Couple of factors that impacted our third quarter earnings comparison year-over-year. First, FX; as compared to a year ago, in the third quarter this year, the foreign currencies where we operate weakened versus the U.S. dollar, in fact in all countries, but primarily in Canada, Mexico, Korea and Japan, resulting in our foreign earnings in Q3 when converted into U.S. dollars being lower by about $33 million pre-tax or $0.06 a share than these earnings would have been had FX rates been flat year-over-year.

Second item of note, IT modernization. As with the past many quarter, our major IT modernization efforts are ongoing and will continue to negatively impact our SG&A expense percentages through this fiscal year and certainly into next year, especially as new major systems are placed into service and depreciation on those being. And in Q3, on an incremental year-over-year basis, these costs impacted SG&A by an estimated $19 million pre-tax or 5 basis points without gas deflation and FX.

A third note, LIFO. Last year in Q3, we recorded a $12 million pre-tax LIFO charge. This year in Q3, we had a $7 million pre-tax LIFO credit, which benefited Q3 this year by $0.01 a share. And last item of note, while we enjoyed the benefit of strong year-over-year gross [ph] profits in the first half of the fiscal year, both Q1 and Q2, in Q3 it was additive, but only by $0.01 a share, so pretty much back to normal this quarter although the next quarter will be a little bit of a tougher comparison.

In terms of sales for the third quarter, total sales were up 1% and our 12-week reported comparable sales figure came in at down 1%. For the quarter, sales were negatively impacted as you all know by gasoline price deflation. That represented about 350 basis point negative impact and by weaker foreign currencies relative to the U.S. dollar year-over-year. That impact was a little over 300 basis points.

So excluding gas, the reported plus 1% U.S. comp number increase in Q3 would have been a plus 5% and the reported minus 6% international comp figure excluding gas and FX impacts would have been plus 7%. Such that the total company comps reported at minus 1% for the quarter excluding gas and FX would have been plus 6% for the company.

One other item of note on sales, looking at some of the preliminary reports by analysts out there, it looks like the suggestion was that May might have gotten off to a weak start. That’s not the case. The first couple of weeks of May are just fine.

And in terms of new openings, after nine new locations in the first half of fiscal 2015, including the relocation of Wayne, New Jersey, we opened four locations in Q3, one in Québec, Canada, one in Merida, Mexico, which was a relocation, and one in Culiacán, Mexico. And we also converted our existing Bedford Park, Illinois warehouse into a business center. So a net of two additional locations in the third quarter.

All told, that puts our fiscal 2015 opening schedule so far through the third quarter at 10 net new locations. Next week kicks off a very buys fiscal fourth quarter expansion, which includes openings next week in Wichita, Kansas, Mobile, Alabama, and Rochester, New York. These are the first three of 14 planned new locations for the fourth quarter, including four additional new U.S. locations, one new location in each UK, Taiwan, Korea, and Mexico, and three new warehouses opening in Japan this August.

We will most likely end the fiscal year with 24 net new openings and 687 Costcos worldwide. We had originally planned to be closer to 30 for the fiscal year. However, several of these have been pushed into early fiscal 2016 due to timing and construction issues. In fact, between September 1 and the end of the calendar year 2015 or the first four months of fiscal 2016, we expect to open somewhere between 15 and 18 new warehouses. So a very busy seven-month period ahead for us.

Also this morning, I'll review with you our e-commerce activity, our membership trends and renewal rates, our recent common stock repurchase and dividend activities and of course additional discussion about margins, SG&A and other items in Q3.

So for our third quarter results, in terms of sales, sales for this year's third quarter for the 12 weeks ended May 10 were $25.52 billion, up 1% from last year's third quarter results of $25.23 billion. On a reported comp basis, Q3 comps were down 1%, but up 6% excluding gas deflation and FX.

For the quarter, our minus 1% reported comp was a combination of an average frequency increase of about 3.5% and an average transaction decrease of minus 4% for the quarter recognizing that that minus 4% is reported excluding FX and gas that 4% average transaction would have been plus 2.5%.

In terms of sales comparisons by geographic region – excuse me, in terms of sales by geographic region for the U.S., the Midwest and California were the strongest. Internationally in local currencies Australia, Mexico and Taiwan posted the strongest results.

In terms of merchandize categories sales performance for the quarter, in the third quarter, within food and sundries, overall low to mid singles, deli low reported, mid if you take the FX out. Deli and frozen were the relative standouts. For hardlines, the departments with the strongest results were hardware and garden. Consumer electronics comps were slightly positive, excluding FX. Within the low single-digit softlines comps men's apparel and housewares were the standouts, and in fresh foods meat and deli were the strongest.

Now moving to the line items of the income statement, membership fees we came in at $584 million or 2.29% that's a 4% increase and a 7 basis points increase and a $23 million increase versus last year's third quarter. Again these numbers are impacted of course by FX. The $584 million number FX has been flat year-over-year at 4% dollar increase would have been 7%, up instead of 4% reporting.

In terms of membership, we continue to enjoy strong renewal rates, 91% in the U.S. and Canada, and 88% worldwide and also continuing increased penetration of our executive membership. New member signups in the third quarter were slightly down year-over-year; this has to do essentially with timing of four openings in Asia last year, two in Japan, and two in Korea, which generate typically larger than normal sign-ups.

In terms of number of members at Q3 end, Gold Star 33.2 million at Q3 end, which is up from 32.7 million 12 weeks earlier at Q2 end; primary business, the same at 7.0 million; business add-ons, the same at 3.5 million. So all told, we ended the quarter with 43.7 million member households up from 43.2 million and including extra cards 79.6 million at Q3 end versus 78.7 million just 12 weeks earlier.

At May 10 Q3 end, paid executive members came in at 15.7 million, an increase of just about 250,000 since Q2 end or about 21,000 a week increase in the quarter. As I've stated before executive members continue to grow, they are currently approximately 36% of our member base and approximately two-thirds of our sales. In terms of renewal rates, as I mentioned business continues strong rounding up to 95%, Gold Star around 90% and so total within the 91% and Worldwide 88%.

Our reported gross margin for the quarter was up on a reported basis up 47 basis points from a 10.62% this last year up to 11.09% this year. And that 47 basis point increase is a plus 9 basis point increase without gas deflation. If you jot down a few numbers as I always ask you to do, we will have four columns. The first two columns will be first half of 2015 as reported. Second column will be first half of 2015 without gas deflation, and then Q3 2015 and Q3 2015 [ph] reported and without gas deflation for the third and fourth columns.

The line items, first one would be core merchandizing, the first half reported we were up 2 basis points and the first half without gas deflation it was down 17 basis points. For Q3 reported was plus 23 and without gas deflation minus 10. Ancillary businesses plus 34 and plus 29 for the first half, and for the third quarter plus 23 reported and plus 15 without gas, 2% reward minus 3 and minus 1 and for the quarter minus 6 and minus 3.

LIFO, plus 2 and plus 2 and for the quarter-on-quarter plus 7 and plus 7, other was plus 3 and plus 3 for the first half and zero and zero for the third quarter. Anyway for total, for the first half we were up 38 basis points and without gas deflation up 16 and reported for the third quarter we were up 47 and as I just mentioned plus 9 on a without gas deflation basis.

Now again as you can see when these numbers, core merchandising gross margin was up 23 basis points year-over-year and down 10 without gas deflation, this is primarily a function of improved year-over-year gross margins within our ancillary businesses. The core gross margins in food and sundries, hardlines, softlines and fresh foods as a percentage of their own sales were up 10 basis points year-over-year with food and sundries and softlines being up year-over-year and hardlines and fresh foods being down year-over-year, but the net of the four on their own sales was up 10 basis points, so a good margin performance in the quarter.

Ancillary and other business grows margins were up 23 and 15 without gas deflation in the third quarter. We basically enjoyed fairly broad based strength within all of our ancillary businesses with year-over-year gross margin improvements in gas optical hearing aids and food courts, as well as proved year-over-year sales penetration within pharmacy commerce and travel, which all contributed to the ancillary gross margin improvement.

The impact from sales to our executive membership represents a 6 basis point hit to the margin or 3 basis point hit without gas deflation. This is good, it is the 2% reward feature, which reduces sales and the fact is it is more members switched to executive member, we think that's good for us long term. LIFO as I mentioned $7 million pre-tax benefit this year, compared to $12 million pretax charge last year. For a $19 million or 7 basis point year-over-year positive earnings gross margin. As I've said many times whether these numbers are up or down on LIFO it is really part of the margin in my view. Overall, we think margins are in good shape.

Moving to reported SG&A, our SG&A percentages in Q3 year-over-year were higher by 25 basis points coming in at 10.1% of sales this year, compared to a 9.86% in last year's third quarter, but again better or lower by 10 basis points, excluding gas deflation. In terms of SG&A again, we will do the same four columns, first half 2015, both reported and without gas deflation and Q3 2015 both reported and without gas deflation.

First is operations, we were plus 6, and plus means good or lower, plus 6 reported and plus 23 without gas deflation in the first half year-over-year. We were minus 16 and plus 14 without gas deflation, the plus 14. Central minus 6 and minus 4 for the first half and minus 10 and minus 6 for the third quarter reported without gas deflation. Stock compensation minus 8 and minus 7 in the first half and plus 1 and plus 2 for the third quarter.

Quarterly adjustments were not an issue, it was zero all across the board. In total, we reported for the first half minus 8 basis points or higher by 8 basis points and when factor was better or lower by 12 basis points or plus 12, reported for the third quarter was minus 25 basis points or higher by 25, again lower or plus 10 basis point without gas deflation. The operations component again was a minus 16. Within operations, excluding gas deflation, pay roll and benefits represented 10 basis point of that year-over-year improvement.

So good expense control on payroll and stuff. The benefits, our central expense was higher year-over-year in the third quarter by 10, 6 without deflation. Again IT monetization represented about 7 of that or 5 without gas deflation in FX, so that's a big chunk of that. Equity compensation little bit of a benefit there. That fluctuate is based on when people high their 25, 30 or 35 year tenures where some of those are accelerated as well as of course every October we do the annual grant.

Next on the income statement line is pre-opening expense, no real big issues here. $16 million last year in the quarter $14 million this year. So, lower by – this expense item lower by $2 million. We had four openings in each of Q3 2014 and Q3 2015. All told, operating income for the third quarter came in at $821 million higher by $84 million or 11% from last year's operating income figure of $737 million.

Below the operating income line interest expense came in at $31 million this year versus $25 million during last year's fiscal quarter. This increase is a result of the billion dollars of senior notes issued during the second quarter in conjunction with the recent $5 per share special dividend. Interest income in other was lower year-over-year by about $3 million coming in at $9 million this year versus $12 million a year ago in the quarter.

Actual interest income for the quarter was lower by – a million of that $3 million was actual interest income. The other component is principally, which is about minus 2 million year-over-year, this principally relates to marking to market forward FX contracts used by our foreign operations, sometimes that's positive by a little, sometimes that's negative, pretty small negative this time. These swings are caused by the change in the U.S. dollar relative in those currencies.

Overall, pretax income was higher by little over 10% year-over-year or higher by $75 million in the third quarter coming in from last year's $724 million in the quarter to this year's $799 million. In terms of income taxes, our company tax rate this quarter came in right at 35.0%; that compares to 33.9% last year in the third quarter. Compared to last year our effective tax rate has gone up due to lower year-over-year percentages of earnings coming from our foreign operations. This lower penetration is primarily due to foreign exchange, as well as strong U.S. gas profits compared to last year although they are only slightly stronger. Overall, reported net income of $516 million this year in the third quarter represented a 9% increase as compared to the $473 million net income figure last year in Q3.

Now for a quick rundown of other usual topics. The balance sheet of course is included in this morning's press release, but a couple of balance sheet info items. Accounts payable as a percent of inventories reported was 100%, up from 99% a year ago. Payables of course in that number include construction payables, not just merchandize payables. If you look at just merchandize payables against inventories this year, it was also up 1%, a little better – at 90% this year versus 89% a year ago.

Average inventories per warehouse were up on a reported basis about $180,000, coming in at $13.2 million per location versus $13.0 million a year ago, up about 1%, but again FX – without FX, inventory levels per warehouse if FX had been flat year-over-year would have been up about $570,000 or up about 4% per warehouse. This increase was pretty much spread over many departments, some of which had resulted from the increased flow of backlogged inventories from the West Coast port slowdown. That's pretty much behind us and we should see some – a little of that burn off. Overall, our inventories are just fine as I mentioned in the second quarter earnings report, midyear fiscal inventories came in as good as they ever have.

In terms of CapEx, in the first quarter, we spent $555 million; in Q2, an additional $612 million; and in Q3, $421 million, so for a year-to-date total of CapEx of $1.6 billion. Given that a couple of units have been pushed into the fall, current estimate for CapEx this year is somewhere in the $2.4 billion to $2.5 billion. That compares to last year's fiscal 2014 expenditures for the whole fiscal year of right at $2.0 billion.

In terms of Costco Online, we continue to operate it in four countries – U.S., Canada, UK, and Mexico. For the third quarter, sales and profit were up nicely. Sales were up 18% in U.S. dollars for the quarter. And again excluding FX, our e-commerce business in local currencies, sales were up 21%.

Next on the discussion list, expansion. As I mentioned, in terms of net new openings, we opened eight in Q1, none in Q2, two in Q3, and 14 anticipated for Q4 net. So that would be 24 net increase for the year. And as I mentioned, somewhere in the 15 to 18 more in the first four months of – the last four months of calendar 2015, which will be the first four months of fiscal 2016. For fiscal 2015, again, these 24 will represent about a little over a 3.5% unit increase, so probably about a 4% square footage increase. And at Q3 end, we ended with total square footage of 96.7 million square feet.

In terms of common stock repurchases, in Q1, we started buying back a little again at $18 million in purchases in Q2, it was $92 million in purchase for that 12-week quarter and for the third quarter that 12-week quarter, we did $124 million in purchases having purchased about 839,000 shares. So, again, in terms of an annualized basis, we are doing more in Q3 than we had in the previous two quarters. Year-to-date, 234 million shares.

In terms of dividends, our quarterly dividend per share increased with the May dividend payment from 35.5% to $0.40 a share for the quarter, 12.7% increase. This $1.60 a share annualized dividend represents the total cost to the company right at $700 million a year. This regular dividend of course was an addition to the $5 a share special dividend, which totaled $2.2 billion to our shareholders that was paid on February 27. It was announced in Q2, but paid in the beginning of Q3.

Lastly, next week on Wednesday, June 3, after the market closes, we will announce our sales results for the month of May, the four weeks ending Sunday, May 31. As well, our fourth quarter scheduled earnings release will be Wednesday, September 30, after market close at 6 PM Pacific Time. The earnings conference call will occur the following morning.

And with that, Britney, I will turn it back over to you for Q&A. Thank you.

Question-and-Answer Session

Operator

You are welcome. [Operator Instructions] Your first question does come from the line of John Heinbockel with Guggenheim.

John Heinbockel

So, Richard, two questions about gross margin. Number one, so the guest benefit moderated, but you still had a pretty good performance out of ancillary, so were there some other non-gas ancillary departments that were particularly robust, really up quite a bit in gross? That is number one. And then two, if you look at sort of core merchandise right ex deflation, so you are still down there, I know you are making – I think you're making some investments. Can you talk about how you think about tying gasoline windfall or gasoline benefit or ancillary benefit to investments in price and is one of those the idea of pass along less meat inflation because you've got some gas wind at your back?

Richard Galanti

First of all, all the ancillary businesses were good this quarter. They generally have been good. I mean sometimes one is a little lower year-over-year but it hit all, we are up. Gas was a very small benefit year-over-year this quarter of gas profits versus the first two quarters as we mentioned in those first two quarters. And again that will cycle over the next three quarters when we had strong Q4 a year ago and strong Q1 and Q2 earlier this year, so those could be tougher comparisons.

In terms of investing in price, I mean that's what we do. It's not a scientific function here. It's an art form and we are always going to be competitive. Frankly I can remember over the past several years when we talked about just when poultry prices were skyrocketing there were some fiscal years when just that one item was $30 million or $40 million of margin reduction year-over-year – you know, $0.05 or $0.06 a share to the company, when we had no gas impact. So we do what we do when we do it when it is the right thing to do for our company from a competitive standpoint.

Certainly having strong gas profits makes it a little easier, but I wouldn't say – we don't use a certain percentage of – certainly don't use all of it, but certainly don't use some fixed percentage either. We do what we do each quarter in all of the competitive environment. I think I answered all your questions. Did I miss anything?

John Heinbockel

Well, just curious about meat, meat in particular has been very inflationary. It is a big category for you. That strikes me that that is one where you may have delayed putting some pricing through.

Richard Galanti

Yeah, well, but that's such a front and center category, when you see ads in the paper every week particularly holiday weekends for Memorial Day or July 4th or Christmas or Labor Day, you name it, and so we are always going to be tough on that. Historically when commodity prices are going up, we are the first to not have them go up as much and when they are coming down, we are going to go down as fast as we can.

I think one thing that has helped offset it a little bit over the last few years is in this tough economy, we are the ones – I remember right after the economy got hammered in late 2008, there were some fiscal quarters and calendar years 2009 and 2010 where we were upwards of a third of all the prime meat sold in the United States when usually that was nothing or very little because it all goes to restaurants and hotels. So we have a customer that when prices come down we can sell it and that kind of stuff. And on organic, we can protect our margin a little bit because everybody else is trying to make more and we try to make fair. So all those things.

By the way, the other comment – the question you asked earlier about the core being down 10, it is, recognizing core margin on core sales was up 10. The fact of the matter is all these things there is 12 buttons that you have to push in and this one pushes that one out as it relates to what is going on penetration wise, sales penetration wise. So again, we are never going to – we are going to do what we do competitively first and foremost and knock on wood at the end of the day, it comes out pretty good.

John Heinbockel

All right. And then just lastly again on the topic of mix here, so if you think about KS, just remind us the margin spread and I know it will vary by item, but margin spread KS versus a branded product, KS penetration and then is the KS margin itself staying pretty flat over time as you get a benefit you pass it along or is KS margin actually getting a little bit better?

Richard Galanti

Yeah, of core merchandise, Kirkland Signature is about a quarter of our sales and increasing. Hopefully it will continue to increase to some higher level. I would say again if I think back of some of the big volume items, paper goods, we have some KS on order, we have some KS items that are several hundred million dollars or more of sales a year. Some of the low hanging fruit originally was those are typically very competitive branded items where we can show a great savings and still make a better margin. It ranges all over the board. The difference between KS margin and branded margin could be sometimes as much as half a dozen percentage points and sometimes 1, 0 to 2.

So – and really again, and probably that's price point driven, you know if the if the right margin and something was, I mean to get to some margin percentage was right 11.39 you can well bet it's going to be 10.99, but when it goes the other way, we're not going to go up past some percentage point because we're pretty disciplined in that. So overall, I don't think – if it's changed, it's changed very little because most of those, the big wide ones have been done so many years ago. So, now the only extra of that is just a little extra penetration, but I would say that's a declining, probably a slightly declining penetration because new stuff is all over the board in different items.

John Heinbockel

Okay. Thank you.

Operator

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

Simeon Gutman

Thanks. Good morning Richard. One follow-up on gas, this quarter it looked like there was a slightly different dynamic at play where wholesale prices were rising different from the prior to, you got retail prices went up a bit – national prices, right I don't know how your prices trended, but you still eked out a little bit of a benefit, did you do anything different to manage it, did you typically lag, I guess the market, but where you more cognizant of the interplay between wholesale cost and retail prices this quarter?

Richard Galanti

Nothing out of the ordinary, no.

Simeon Gutman

Okay and then my follow-up is on investments in SG&A spending, I think we asked this once a quarter, regarding the timing in terms of when investments crest and when we should start to see those investments dwindle?

Richard Galanti

In terms of IT?

Simeon Gutman

Correct.

Richard Galanti

Yeah, I think if I go back two and a half years ago, we felt that probably sometime in early 2016, maybe I'm off by half a year or a year, so maybe still longer, but good news is the denominator in that calculation keeps getting higher to the sales denominator, but we're just starting to see some of those big projects and we've got several of them. The installed and that's when you start that amortization of those items. So we will still see it eke up a little bit over the next – certainly the next four quarters maybe six, it's hard to predict maybe it's seven, I don't know yet, but it's going as planned and part of the plan in a tongue-in-cheek way was whatever we think it's going to be, it's going to be a little more.

Simeon Gutman

And when you said 2016 are you referring to calendar or fiscal?

Richard Galanti

Well, I'm referring to fiscal, but it could be a little longer than that, but if it is, it's coming down as, these are smaller in my view, smaller, they're going to be smaller year-over-year higher SG&A basis points than they have been, but you will have to wait and see guys. Things are going along, knocked on with the things we have installed so far, each time we install something we're getting better than the last installation, but as with this IT stuff it takes a little longer than we originally planned.

Simeon Gutman

Okay thanks.

Operator

Your next question comes from the line of Meredith Adler with Barclays.

Meredith Adler

Hi Meredith Adler from Barclays. Hi Richard, I was wondering if you could talk a little bit about what you are seeing in terms of inflation in chicken and eggs because of avian flu?

Richard Galanti

No I don't know completely, I do know that there was requirement in California in terms of something related to eggs that caused egg prices to come up and if you want to follow-up with me, I am happy to find out, I just don't know on the top of my head.

Meredith Adler

Well then more theoretically, I do actually, it has to do with giving the birds, the hens bigger cages and that meant there was a shortage of supply, I learned that from another retailer yesterday, but what is your philosophy about chickens and rotisserie chicken pricing if you see a big increase are you going to do what you've done before, which is just maintain your retail price?

Richard Galanti

Well I'll proceed, I can only tell you what history has shown us, is that when others were raising their chicken prices from 4.99 to 5.99 we were willing to – if eat if you will $30 million, $40 million a year in gross margin by keeping it at 4.99 and that's what we do for a living.

Meredith Adler

Can you talk also just more generally about food inflation both in the U.S. and outside the U.S.?

Richard Galanti

On the protein site it's been involved for various reasons, pork was volatile because of a virus that reduced the supply. The beef was, as I understand in an 18 month transition where grain prices when feed prices skyrocketed, certain part of that 18 month cycle of growing cattle was reduced as people, as farmers sent them to process sooner because it was too much, it cost too much to feed them. And so we are going through that cycle of limited inventory there and then there is also higher demand overseas, which has been muted a little bit by the stronger dollar. So, again it is just like predicting anything you never know what it is going to be until it gets there.

When I look overall, looking just down the list of the most deflationary and inflationary items in the last month, you've got some beef items on there for sure and that's 8% to 20% range year-over-year.

On the deflationary side, again it is all over the board there is some – nothing that stands out in terms of big trends. So, I think overall proteins are up a little more than they have been three and six months ago in terms of that expectation and the expectation, the, I will pick up comment from one of our senior buyers on the fresh foods, on the pork, beef, and poultry sidewise as they come down a little bit you can be assured that they will go back up and as they go up a little bit you can be sure they will come back down.

So, again it is hit and missed, when I get back to my comment, I made earlier in this call, when prices are, when these types of prices are going up, we're going to try to hold off as long as we can and when they are going down, rest assured we are going to be the first out there lowering them, but it is a very competitive field out there. We are benefiting, I think a little bit with the increasing organic and fresh foods in general not necessarily protein, but I think that trend of benefiting from that will – should continue from the standpoint that there is more supply of organic out there.

Meredith Adler

Great, thank you very much.

Operator

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

Unidentified Analyst

Yeah, good morning. This is Stephen at Cowen on for Oliver today, thanks for taking our questions. Looking at international, can you provide an update where you guys are versus your long-term potential, you know currently international is about 30% of your star base, could that get to 50% over time and then we understand you know France is the next country you guys are going to enter, any other new markets you are looking to consider?

Richard Galanti

Well international is going to be most likely continue to grow if you think about it on a base of about 480 U.S. we are opening 12 or 14 year this year and about half in the US half International where that number of openings internationally on a smaller basis of total international right now is a lot bigger and that will continue and I think even the percentage of annual openings each year will continue to grow outside of the US as we, as that is limited. If anything I would probably was as our expectations five years ago that is probably more opening then we had anticipated so that is good news from the US but we will still but we will see still seeing more grow internationally, could it be 50-50 one day, probably, I'm not sure when but it will keep growing.

Unidentified Analyst

Okay and then just and then I guess like specific we would like to get your views on the competitive environment, you know some of your traditional warehouse competitors are struggling and then conversely there is a lot of new grocery concepts that are emerging, how do you guys see the environment changing and then do you think there's an opportunity for Costco to eventually have a, you know like a new store concept or a modified store concept, thanks very much.

Richard Galanti

Well it’s always a competitive field, I mean there is some great supermarket changes out there both nationally and regionally, we still respect our direct competitors. I think, one of the good things about our concept from my view is that I look at organic, it started off small, it is still small relative by growing faster and there is certainly more supply of that out there and it’s where we shine in terms of quality and value and I think that’s nothing but a positive for us going forward at this point. I don't see us doing, you know many years ago we tried a smaller box size concept in the 72,000 foot range compared to the – probably back then the average Costco was in the 135, 140, we are building Costco’s in the 155 range now, in terms of thousand square feet.

I don't see us trying a smaller box anytime in the near future because we got plenty going on with the regular sized box. I mentioned on the call earlier we converted the Bedford, Illinois unit from a warehouse club to a business center, that’s our 10th business center. I think the last five of those 10 business centers over the last four or so year – five years, we will probably open a couple of three of those a year going forward as they have started to perform better, but again we will see. That is pretty much what we have going on at this point and so far so good.

Unidentified Analyst

Okay. Thanks.

Operator

Your next question comes from the line of Charles Grom with Sterne, Agee.

John Parker

Good morning. This is actually John Parker on for Chuck. I guess can we dig into the core margins by category a little bit and I mean it seems like the 10 basis point improvement as a percentage of owned sales is the best in a few quarters. So kind of what drove that performance I guess in the food and sundries and softlines categories?

Richard Galanti

Yes, well, again food and sundries, softlines was bigger improvement year-over-year than food and sundries. In fact, I don't remember if it is because it was a weak comparison to last year. Foods has a much bigger penetration mind you. Food and sundries is our biggest core category. And there is nothing specific. Again I think that we feel that we are able to make a little more margin mostly by buying better and keeping a little of it but passing more of it on. When we look at our competitive [indiscernible] versus our direct competitors if anything the gap is improving, it is getting bigger a little bit, not a lot.

So it is not like – and so in our view we are as if not more competitive while still showing some improvement in the core. But as many of you know who have known us for a long time, we could make a little more if we wanted to and sometimes if we need to and sometimes if we need to we don't because it’s the right thing to do. So I think we feel at this point quite comfortable with where our margins have been and hopefully that will continue.

John Parker

Got it. Thanks. And then just switching gears a little bit, can you provide an update on some of the digital initiatives you guys are doing like e-commerce, Tmall with Alibaba, Google Express and Instacart?

Richard Galanti

Sure. Well, pretty much the same as a quarter ago. We are certainly testing in six markets with Google and probably a few other merchants with Google, the Google Express Shopping. Instacart has expanded to more cities with their announced capital raise a few months ago. And there's a couple of other smaller ones in some regional markets and so that is good. We are agnostic. We are working with all of them. We like to sell merchandize and we will see where it goes.

In terms of Tmall, I think we've got about 160 items on there and it’s doing quite well. We don't disclose numbers on it, it’s still small of course. But I would say certainly significantly better than we expected to start with. And the good news is it’s getting our name known over there and as more stuff is shipped in, and more to Kirkland Signature name than the Costco name frankly and that’s good too.

In terms of other digital initiatives, I know we did one thing in one of our smaller regional markets with Groupon, but relatively small, good results, but small impact, a small geographic impact and that is pretty much it at this point. We plan an e-commerce – again, we are currently in three – in four countries. In the next 12 months we will be in two more and probably a seventh, if you will, the third of three more will be probably a year and a half, two years out and so that is a business that is more profitable as a percent of sales than the core business and still relatively small. It’s big, it’s $3 billion plus, but I'm happy to say over the last probably 10 or so 2.5, 2.75 years, we’ve seen year-over-year increases right around 20%, 18% to 20%, which is both – mostly comp, and so that’s been pretty good for us.

John Parker

Great. Thanks a lot.

Operator

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

Michael Lasser

Good morning, Richard. Thanks a lot for taking my question. You have been putting up such great traffic trends for so long, I think some of it has been due to the improvement in your fresh, rolling out more gas stations. How long can that continue? What is your expectation on the sustainability of the recent traffic performance?

Richard Galanti

Well, you know, we cross our fingers and hope it will continue. I mean we are out there every day trying to get new items and new exciting stuff and lower some of our prices. And organics has helped, gas helps. We are still certainly as many new locations that can get gas gets it which is more than the company average and there is still several out there that existing locations that we are fighting hard to get gas stations or buying land next door or appealing the 12th appeal out there ourselves in one city I can think of. But at the end of the day, that is what we do. So fresh – in my view, fresh foods, gas, executive membership, opening in new geographic markets outside of United States, all those things are net positives.

I remember when the economy kind of crashed in late 2008, I remember at the end of calendar 2009 when we had a full year of right around 4% maybe 4.1% or 4.2% frequency increases, I remember warning everybody that if it's zero in calendar 2010, that's a 2% compounded, which is better than our historical average so how can we sustain that? We are now six years of a little over 4% compounded. In my view, anything in and around that range we will continue to try to do, but there is no predicting it.

Michael Lasser

And you are not – are you seeing any differences in the month-to-month like more variability…?

Richard Galanti

Where the variability has been of late is Easter fell two or three weeks different year-over-year so it is kind of like you need to look at an eight week average, the two-month average or eight- or nine-week average, not just a given week because the numbers are a little screwy trying to compare them when there's things like that. Same thing with Memorial Day, which is I think a week different.

Michael Lasser

Okay. And then on the return of cash, you have been stepping up activity [indiscernible] in the market over the last couple of quarters. Should we expect that to continue? It sounds like you also like the special dividend, so how are you going to balance out the activity? Thank you so much.

Richard Galanti

Well, I think what we've said in the past is, is that, generally speaking, we generate more cash than we spend on ramped up CapEx, although ramped up CapEx will be our first and foremost directive. We do have a little debt to pay down. We are cognizant of the fact that I think as a board to be pro-shareholder and having done now, we have two data points for special dividends, but two points does not a trend make, but it worked pretty well and we will see what the future brings.

I think in terms of stock buybacks, I think as I mentioned in the past, we will continue to buy sometimes on a regular basis, sometimes periodically, but we don't know – as long as we feel good about the long-term of our company, we don't know when we are going to be complete right or a little wrong and so if we buy over a longer period of time on a regular basis, we generally like that way to do it. And we certainly picked up in the last couple of quarters and there is no reason to change that. But let’s see what tomorrow brings.

Michael Lasser

Okay, great. Thank you so much.

Operator

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

Matthew Fassler

Thanks a lot. Good morning to you. First of all, any initial thoughts on the transition process as you move away from AmEx to your new credit card deal whether there is any friction in the process? And when do you think you will get visibility or maybe will get visibility on how the economics impact the offer in your financials?

Richard Galanti

Right. Well, there is not a lot we could say at this point. Needless to say we are excited about it. I’m not excited about the transition because there is work to be done, but we are getting through that. And there is really not a lot that we could be able to say about the new program other than needless to say we wouldn’t have done this unless we found it was better for our members. And just like when we price goods, the old adage was for every dollar we save, we give $0.90 to the customer, that’s not a fixed formula needless to say, but we are going to give most of it to the member and it’s a lot and we will let you know next March or April.

Matthew Fassler

That’s very helpful. Second question, just thinking about the U.S. comp ex-gas that you reported and trying to square it with the monthly data that comes out, I know that the months don't align with the quarters necessarily. But I think you had two 7s and a 4 and the straight average of that would be around a 6 and you printed a 5. So what would account for the variability in the U.S. comp ex-gas that we saw for the quarter and the months that comprised most of it?

Richard Galanti

Well, without even looking at it, it's two things. It’s going to be rounding and it’s going to be the months don’t align with the quarters. Part of February was the end of Q2 and part of it was the beginning of Q3, the same thing with May. The first week of May was part of Q3 and the next three weeks are going to be part of Q4. I did mention earlier in the call because we did see a comment or two, I don’t know if one of those was from you that there was some that suggested perhaps May was getting off to a weak start and that’s not the case.

Matthew Fassler

Got it. That is helpful. Finally, Spain, if you just give us some early thoughts on what you are seeing and just kind of lessons learned if you will going forward as you think about Europe more broadly?

Richard Galanti

Well, basically as I’ve said, but people have asked sales were a little less than we have planned, but growing nicely and membership sign-ups are just fine, probably a little stronger than our original plan and the renewals so far are good. So, recognizing, our first opening there was where we could open first in terms of timing that’s Seville and we are excited about being there. Our next two openings which would be later this calendar year and early next calendar year will be two units in Madrid, which is a bigger market and so we are – it is again a little lower sales than originally planned, but membership sign-ups are good and actually a little better than planned, so we will be fine.

Matthew Fassler

And cost of doing business and the whole cultural dynamic you are finding is in sync with what you expected?

Richard Galanti

Yeah it is as expected. The good news is whatever the labor issues or policies we know that we have got great product and services and the best prices and people seem to like it and as it relates to any restrictions on labor or whatever or closing in some countries, in one country in Asia we have to close two Sundays a month as to other big boxes. So, the good news is it rains on everybody and we think all things being equal we’ve got a good competitive stance.

Matthew Fassler

Thank you so much.

Operator

Your next question comes from the line of Chris Horvers with JPMorgan.

Chris Horvers

Thanks. Good morning, guys. So, I wanted to follow up on the traffic question a little differently. So if I look at the trend, so last August traffic inflected by about 100 basis points to 150 basis points from the prior rolling average. If I look at the March, April period together, it looks like it decelerated back down to 3.5. So, I guess what do you attribute the acceleration and then recent deceleration to? And does it line up at all with sort of how your gallonage comps changed over that period as you had widened the gap out versus the market bringing price down more slowly?

Richard Galanti

Yeah. If I knew the exact answer I would retire and just give that out on a consulting basis. A lot of – some of it I think has to do with gas when the prices fall dramatically, we get a lot more press, but then I remember when prices were very low we were getting bumps in gallonage like we had never seen before in the low double digits on a gallonage comp basis. So, there is no, nothing is that predictive. I think the last couple of months, I remember several weeks ago we were looking at a several week period and again frequency had come down like you say to the – from something above a 4 to something below, you know in the mid-to-high 3's and we say is this the beginning of that then the next week it was back up

So, it is really not predictable, if you ask me six years ago and today is 4% sustainable, no, but we are going to keep working at it, one of the things that could help it go in positive directions adding gas stations to existing units not just in the U.S. and Canada, but elsewhere. We have a couple, two or three in Australia, one or two. I think three and a couple more coming. We are going to open about in a couple of other countries. Again it's a little relative to the whole pie, but its lots of little things, that's one of them. Fresh foods, I'm convinced there is still going to be a driver going forward.

Opening new warehouses and new markets that are much less saturated markets will help that number. So, I think all the executive membership penetration increasing will help that number. What won't help the number is that there is, you know it is a hard number to sustain and I am pleased to say that for six and a half years we have and we will see what tomorrow brings again and we feel pretty good about what we're doing and all those things would help.

Chris Horvers

Absolutely, and I think we all agree like that 3.5% to 4% is sustainable. Did you see, what were gallonage comps? I think if you look back to past gas price drop, they are running sort of mid-single digits. They had I think revved up to about 15%. Had they come back down to closer to 5% in this most recent quarter?

Richard Galanti

I honestly don't have that in front of me. We generally don't give that out we probably – it comes out occasionally when it went above 10, I don't think it's above 10, but it's certainly positive. I just don't know on the top of my head.

Chris Horvers

Understood, understood. And then as you think about lapping the gas margin benefit in the upcoming quarters, I guess you don't guide, but you have a lot of positive things going on underneath in the margin structure, core margins. You are getting better payroll leverage than you had prior. So, I guess what's the degree of difficulty in terms of actually seeing margin expansion as you lap those, I guess two big quarters where you had 10s of basis points of gas benefit?

Richard Galanti

You are talking about operating margins?

Chris Horvers

Yes.

Richard Galanti

Look we are up against – Q4 of last year was the first in a while outsized gasoline profitability, should be pretty good this quarter, but I don't know if we get all the way, I don't think we get all the way where we were last quarter and then as I mentioned in Q1 and Q2, they were outsized to some extent. Again Q3 it is not even a factor other than the factor is it is virtually nothing versus it was bigger in those three fiscal quarters. So that will be a tougher comparison. Mind you we've also got hit by it seems like $0.04, $0.05, $0.06 a quarter on FX.

At some point the dollar is going to slow down and shrink and maybe even reverse a little bit, I don't know when and if and when, maybe it's another year of FX weakness for us first and but at some point I think that impact will mitigate. So, the good news is that some of these outside gas quarters have been equally hit by outsize FX hits just because of the strong U.S. dollar, maybe there is a couple of quarters in there where you get both hits, but as long as we are – we are really worried about driving frequency, driving sales, the unit sales as well and having mid strong membership sign-ups in renewal rates and all those things are good. Again, we recognize that looking at some metrics there maybe a couple of tough comparisons in the next several quarters, but that's what we do.

Chris Horvers

And then just one last follow-up. You have had 10 basis points to 20 basis points of payroll leverage these past couple of quarters despite a total reported comp that was hit 600 basis points, 700 basis points by FX and gas., so your leverage point seems a lot lower now, so should we expect that to continue as you go against the tougher gas margin comparisons? Thanks.

Richard Galanti

By the way that 10 plus basis point has payroll end benefits and chunk of it has also been healthcare not this quarter, but in couple of recent quarters before this quarter with a little bit of workers comp benefit too. By the way what helps those numbers also has increased foreign expansion. There is a – just on benefits, which is primarily healthcare medical, dental, and vision in a large extent. They are U.S. versus other countries. In some countries there is 40 basis points to 60 basis points of delta just on that SG&A item because healthcare cost in the U.S. are so much higher than everywhere else.

And then payroll, our 22 or just under 22 on an hour average in the U.S. we have comparable premiums above other retail in each country, but in some countries that comparable is $11 or $12 not $22. So, increasing penetrations of some of those countries help. So, we've got some of those things helping us irrespective of everything else. I think, we focus on payroll and benefits, which is whatever 70% of SG&A, 60% plus of SG&A more than anything and if we can drive sales that helps a lot. And what also helps those numbers fortunately is increased penetration outside the United States. But in the last couple of quarters, we also benefited on healthcare in the United States as we started to see a few things we've changed like preferred provider networks, but still giving great coverage to our members – to our employees.

Chris Horvers

Very helpful, thanks.

Operator

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

Paul Trussell

Good morning and thank you for, first of all, taking all those questions. I want to just follow up on comments you are making around international margin. We will find out more details in the 10-Q around the specific performance of Canada and international margins in this period versus the U.S. But just speaking broadly and historically, you've had 150-basis point to 200-basis point favorable gap in your international markets versus the U.S. As we think about your continued expansion where there may be some impact with cannibalization as we think about your move into Europe, the relationship that you have with Alibaba, with Tmall or any other external factors regarding competitive changes or labor costs in some of these markets outside the U.S., how do you feel about the sustainability of these high 3% to 4.5% margins in those markets? Is that sustainable or do you think that will over time contract closer to the U.S.?

Richard Galanti

You know, if I were a betting person, it's going to be higher than the U.S. I think what I have said in the past is, is that ultimately some of the highest profitable countries will come down a little, but still going to be higher than the U.S. There is just so many moving parts to that question in terms of what. I think when we go into a new country by definition we lose money for the first few years as we did in Japan many years ago. And then when we went from nine to 20 units in about a two-year period in Japan, we cannibalized the hell out of the existing units. We have now started to see that improve and we are going – the rest of this calendar year we will open four more in Japan and several more in the future.

So I think that at least for the foreseeable future, we will see stronger profitability percentages outside of the U.S., but hopefully we can see the U.S. number improve a little too. But having an increased sales penetration outside the U.S., which has a higher than U.S. profitability should help a little. And again, that is why we say that statement at the beginning of this thing, whatever we say today we don't have to update tomorrow until we talk to you again in a quarter. But overall I think that those trends will continue but when we open a new country by definition, we get hit a little bit but it is a little bit on a much bigger company today too.

Paul Trussell

Understood. And just regarding the store count and growth, I missed some of your comments and I apologize, but I know that – I think the new forecast for 24 – is for 24 store openings this year with some slipping into the first quarter. What was that – at this point in time, what would your crystal ball say around fiscal 2016 openings given this slippage? Would it still be around 30 store openings as you think about next year?

Richard Galanti

I would say 30 or low 30s. What's going to happen just like this year, I think if I go back to the beginning of time, we are going to be in the 30 or the low 30s, inevitably 10 or 12 of those are in the last six weeks of the fiscal year. We are pushing for it, we are trying. Inevitably things happen whether it's cold weather or you have to wait for the ground to thaw out or some other roadblock with one of the permits to get open. And so there are lots of different reasons.

But when we started, this was kind of our best guess stretch effort and inevitably a few fall out. I think a few more than we had planned fell out into next quarter, but it is a matter of months, it is not a matter of reducing something that fell out of bed completely. That happens less frequently. So I think the 30+ number this year came down to an actual 24 gives me a lot more confidence next year's 30, low 30 number is much more achievable. But if we do 15 to 18, if we only do 15 in the first four months that gives me pretty good confidence we can get to 30 for sure. But for sure is a guess until we get there next year.

Paul Trussell

Understood. Thank you. Good luck.

Operator

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

Peter Benedict

Hey, Richard, a couple of things. Just back to the sales to make sure I'm thinking about this correctly, your April sales release allows you to kind of calculate the 11 week sales growth number for the quarter was like up 0.8% and then the quarter full 12 weeks was up 1.1% so it seems pretty clear that that May started off at least on a pretty healthy note relative to how trends had been for the rest of the quarter. Is that the right way to look at it?

Richard Galanti

Well, it’s consistent with what I said at the beginning of the call about the first couple of weeks of May are just fine.

Peter Benedict

Okay, good. The other – executive membership rollout, you are currently I think in four countries. Can you remind us how you are thinking about that, what would it take for you to kind of start introducing that into some other countries?

Richard Galanti

We like the executive membership program. In our view, we need at least a core base of units to do it because you want to go out there and not – and while the 2% reward is certainly an important part of the executive membership program, so are many of the executive member services and other benefits. And we need more than a few units to do that. But we like it and if we could have it everywhere, one day we will. We want to be able a bit more true with more locations in a market.

Certainly in the UK with something in the mid-20s and Mexico in the low to mid-30s number of units and certainly Canada and the U.S. With Japan, 20 going to 24, that – just looked at how many units we have and I'm not suggesting – I don't know if we have any plans currently to do it. Right now our plans are to get a bunch more openings in these countries and the country past those four with the most units right now is Japan and that trend will continue. So we will see.

Peter Benedict

Okay. And then lastly, just the gas mix in the third quarter, what was it as a percentage of sales and what was it a year ago? Thank you.

Richard Galanti

I believe it was about somewhere between 9and 10 for this quarter and I am guessing we are looking it up as we speak, but I'm guessing it’s somewhere in the 11 range, maybe 12. 9 this year, 11 last year rounding.

Peter Benedict

Okay, great. Thanks, guys.

Operator

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

Kelly Bania

Hi, good morning. Thanks for taking my question. First just housekeeping, I don't know if I missed this, but can you talk about your membership fee income growth excluding the impact from FX?

Richard Galanti

Sure. I think, again, dollars assuming flat FX was up 7% for the quarter, which is I think ends up 7 basis points, so overall a good number. I think again that's partly the fact that sign-ups are doing pretty good and partly rental rates continue to be good and partly conversions to executive member. When I look at all of those components, the one thing that continues to surprise me from a number of years ago, the number of new executive members, which is a combination of sign-ups and higher percentage of new sign-ups being to the executive member in those countries than it had been historically and conversions. So that's continuing to be probably a little bit number than I would have guessed. Anybody who has wanted it, already has it, but I think we are doing a better job of communicating to the member why it is a good deal.

Kelly Bania

Got it. That is helpful. And then Richard, you mentioned organics a couple of times already. Just curious if you could talk about what the run rate is for that business at this point in terms of dollars that you are doing in organic foods and what the opportunity is? Really you mentioned supply maybe a little bit challenging, what are you doing to work around that?

Richard Galanti

Well, first of all, I think it was about six or nine months ago I had mentioned that, it was about $3 billion, up kind of a double in the past two years. I guess that at least it has a 4 in front of it now given just extrapolating that and probably the challenges are still out there although they are becoming less formidable because we like everybody else – there is more organic supply and producers doing it. And we are pretty good at getting out there and working with suppliers, both here and around the world to commit more to it, whether it's raising eggs or ground beef processing or produce, and so it is going to still – it should still drive sales and drive incremental sales. I have given a couple of anecdotal examples over the last couple of years, one of that was when we introduced organic fresh ground beef 80% of it was to existing members that like us, but never bought ground beef from us because they are organic ground beef buyers and so it had the benefit of incremental, mostly incremental business to us at a little better margin at a greater savings versus our competitors because it is organic. And so that will continue to be nice, but it is, I put it under that category of – the good news is it is a lot of different things and certainly that's one of them.

Kelly Bania

Great, that is helpful. If I could just also ask about produce supply in the quarter. Some complaining about a tough growing season, maybe a little bit of impact from the ports, did you see any impact from that and if so, is it getting better now or just any color there?

Richard Galanti

The remarks I always get from our fresh foods buyers are as soon as something good happens and something doesn't – something bad happens. The only impact in terms of sales from the port issue was exporting. We do a great business and Asia is an example and Australia, and while a lot of that fresh stuff is sent on – is air freighted anyway, whatever incremental was required was air freighted as well, so probably impacted margin a little bit to the negative and supply a little bit to the negative overseas. Other than that I know berries which is a big business for us, is very depended on what's going on with weather and crop and that was hit a little bit in the last couple of months, but notwithstanding that, our fresh margins were actually quite good in the last month or two.

Kelly Bania

Okay, thanks. That is helpful.

Operator

Your next question comes from the line of Mark Miller with William Blair.

Mark Miller

Hi, Richard. I know the new member sign-ups were impacted by the club openings in Asia last year, but I guess a little bit bigger question, a bigger picture question, could you give us some insight into the portion of new member sign-ups that are coming from the younger demographic versus the long-term historical mix at Costco?

Richard Galanti

I know it is more, I don't have the numbers completely in front of me and in our view it's two reasons it's organic and it's a couple of the things we did like living social, which was a lot more than that, but actually the gap between our average age members and the U.S. average age has actually been reduced a little bit. I think we've historically been a couple of years older than the average U.S. and now it's a little bit less than that. So, all I can tell you is it's trending in the right direction. We are not terribly concerned about at this point, we are seeing younger people join us and certainly we know that some of the things that we are not doing like organic is a part of that.

Mark Miller

Oh that's great because clearly Costco is getting business from other retailers that are hurt by e-commerce, but you would think that younger demographic, the millennial might be converting to e-commerce at a faster rate – so…

Richard Galanti

They maybe, but not everybody is going to sit at home and do everything. I maybe in a small group here, but I actually enjoy going to Costco and I know a lot of people too. And it's kind of hard to get gas delivered to you. And if we can get you in the parking lot that helps. So, ultimately it's value. We recognize that convenience is value and we are not the best at some convenient side, so we're not going to the be company that delivers two different cereals to your doorstep at 7 AM, as long as you order by 10 PM the night before, soon by 3 AM in the morning probably. But we will sell to some of those people and more importantly there is a lot of reasons to come into Costco.

So, we have a unique value proposition. I think we benefit while all – first of all we will get some of the e-commerce business in addition to the extent that all of us, every brick and mortar loses something to e-commerce incrementally, we probably will lose at least so far a little less incrementally, but we are also gaining incrementally on market share of other things. So, all those things help us, but I can tell you, we don't have our head in the sand, but we're not going to – we know there is certain things we can't do as well. But what we can do really well is value in terms of quality and the things that we saw and we will keep doing that.

Mark Miller

Yeah, it's clearly working. Other question is the 2% reward impact in the fiscal third quarter, minus 3 basis points versus minus 1 basis point in the first half all ex-gas, I'm assuming that FX may be partly contributing to that because of smaller penetration outside the US. But is there anything else that is causing that?

Richard Galanti

That’s it. No, mind you any basis point or two hit to that number means an increasing penetration to that group. Not only new executive members, but executive members shot more frequently and buy more.

Mark Miller

Exactly. All right, thanks.

Operator

Your next question comes from the line of Bob Drbul with Nomura.

Bob Drbul

Hi Richard, I just have one question. I think you said you are launching two new e-commerce sites in new countries in the next 12 months and one more the year after. Can you tell us what those countries are?

Richard Galanti

I think they are two of the three Asia countries and – Korea and Taiwan I believe.

Bob Drbul

And so where does that put you overall in terms of the total number of countries that you will be operating in on e-commerce?

Richard Galanti

We are in nine countries, mind you one location in Spain and seven in Australia. So, we are nine countries, we currently are in four, so put us at six of nine, but a higher percentage that’s six ninths of number of warehouses needless to say.

Bob Drbul

Great. Thank you, Richard.

Operator

Your next question comes from the line of Michael Montani with Evercore ISI.

Michael Montani

Hey guys good morning. I wanted to ask about IT modernization. You obviously mentioned some of the costs that are involved. Can you just update us on the benefits that you are seeing now and where we are at in the process and timeline of the rollout?

Richard Galanti

A little tongue in cheek, the biggest benefit is, is we haven't screwed it up. We probably felt that we should have been modernizing for a number of years. We were really good at keeping stuff cheap and band-aided and we also recognized that if we are going to trying to try to double our business in the next ten years and that's around, it is not a plan, it's just 7% compounded for 10 years is a double. But going into more countries and doing more things than we need better systems and because first of all we are going to outgrow, we were starting to see the seams of some of the existing systems.

So, first and foremost it was a necessity. Secondly, as a very simple example, our membership system. There is two ways you can change your mailing address or your phone number or anything else or add-on or take of a business add-on member. You call it 800 number or you come into the membership desk. Soon you will be able to do that online, but I recognize we're not the first to do that, but there is still lot of things like that. We think that there is big savings in transportation management and a lot of little things like that membership thing, if you think about, if we've got 40 plus million member households only a small percentage of us have to want to change their address or move or change of members on it or change of phone number and you can think about how many millions fewer of these can be done online instead of talking to somebody at Costco.

We are seeing some benefits in the membership desk, but we are just rolling it out. So, I'd say there is still more cost to benefit. The big benefits are to come when we get like the depot and transportation management systems, when we get the buyers on the new system, after I'm sure a little bit of indigestion that's still a year and a half out that's kind of the culmination of other modules that are going into place soon. Let me just look here one other thing. You know in service so far, a new payroll system, which is not a big benefit, but it was a big necessity. The members in point of sales systems are new and there is some efficiencies in the point of sale.

Both inefficiencies and enhancements to be able to do all the things we are doing with – we and other retailers are doing with security and things like that, data security. Pending again the big ones, the main accounting system will go in next, merchandising will shortly follow, and again the depot management system will be a little earlier than that I believe. But any big benefits from it will be at least a year out, maybe more. We are starting to see some little benefits from some of the things that we have done, but the big news is that it is working so far, costing more than we expected, taking a little longer than we expected, but it's working.

Michael Montani

Great, thanks. And then to follow up on categories just for a minute in consumer electronics, you guys I think were up a little bit there, which is impressive given the West Coast port. So can you just give us some color on kind of TV units and ASP and just what is driving the strength?

Richard Galanti

I don't have that in front of me. I think for the last few months, I mean TV sales have been up slightly on average in terms of dollars. My guess is – again, I don't have the numbers in front of me, but ASPs have probably come down a few percentage points. We tend to sell bigger ticket TVs and the newer ones, the bigger screens as an example. But if anything I'd guess that the dollar number is in the low single digits, low to mid single digits and the ASP represents a low single to maybe upper middle-digit number and it fluctuates a little every month. I'm sorry, that's what I can recall.

Michael Montani

Got it. Thanks. And the last question I had was just more conceptual, which is if you think about some of the competitive set and what they have been doing, one change that a competitor has done recently is rolling out by online, pickup in club and it seems to have made a material impact on their business. Can you just talk a little bit about the puts and takes that you guys would have from a labor model standpoint as well as cross-shop treasure hunt standpoint of potentially doing something like that? And the follow-up to that is another competitor has got a beta test this summer with $50 shipping. I understand there is Google Express and so forth, but should we expect any direct response to that or is it kind of wait and see and how you think through those two things?

Richard Galanti

There is no current plan for any direct response to it. We do at our business centers deliver to businesses, not to homes. But again, what we are doing so far is working pretty well for us. Your one comment or suggestion about that the incremental buying when somebody is actually in-store, it is huge. We want them in store and when you order online, there is a cost and a convenience in terms of just ordering and picking up. We would like not to have to do that and so there are no plans right now given how we are performing. We always monitor what others are doing. There is a lot of things that others do from giving away memberships more freely or more discounted to advertising in newspapers. I am sure they work, but it is nothing that we want to do at this point.

Michael Montani

Got it. Thank you.

Operator

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

Scott Mushkin

Hi, guys. Thanks and thanks for letting it go so long. I will be quick. I just wanted a housekeeping item. I know you said the renewal rate was 91% in the U.S., Richard. Do you actually have the exact number? Do you know the exact number? I know, I think, it was like 90.7% last time; I was just trying to understand what the exact number is.

Richard Galanti

It still rounds up to 91%. We try to just keep – it is about the same, maybe [indiscernible] – it is about the same.

Scott Mushkin

Okay. Second question, when you do the tech and some of the updates, I know you said the membership desk and whatnot and obviously the ancillary businesses are going well, but the constant feedback we get from people, members, is, gosh, I didn't really realize Costco did travel or car buying programs or garage doors or some of the other stuff you guys do. I mean, is there – how do you envision maybe getting the word out better to the membership base over time? And then – that is my last question.

Richard Galanti

I think that's a good point. Word of mouth is certainly something that we rely on a lot. I think we do a better job today even in the Costco Connection and again, our membership marketing department is starting to test a few things whether it's on different internet sites and what have you. But don't expect us to be paying to go advertise or market it anywhere. It's working fine for us. Clearly travel is one of the best-kept secrets out there. It is huge savings, incredible positive feedback from our members and I personally hear both from people like yourselves to friends where they say they had no idea and they couldn't believe how much they saved. So we are getting better at letting people know about that stuff, but we are not going to go crazy. It works for us the way we do it and the goal is to try to keep getting you in the door because when you are in the door you are going to buy a bunch of stuff and see those garage doors and air-conditioning units as well.

Scott Mushkin

All right, perfect. Thanks for taking my question.

Operator

Your final question comes from the line of Cristina Fernandez with Telsey Advisory.

Joe Feldman

Hey, guys, it's Joe Feldman on. Thanks for taking our question. I just wanted to follow up again on the inventory. I know you commented that you did the physical inventory and everything was pretty clean. But again, this was the first quarter in like the past three or four where inventory growth did outpace sales growth and presumably some of that is the FX. But I guess I was wondering if you could talk about that a little bit, if there is any driver there, if there is any one area of the inventory that may be a little heavy?

Richard Galanti

It really is across categories, maybe a little higher in some of those categories that come by boat, shipped from Asia. By the way when the slowdown was solved, that was just the beginning of a two or three month period of catching up backlog and so bringing in some seasonal items, not having some patio furniture as an example right after – we were fine through Christmas because we like other retailers were able to get some of that stuff in a little earlier than planned.

So the good news is I think because we are in seasons early and out seasons early, we were all a little later, but we were just fine. I think – I am guessing again – we will wait and see until the fourth quarter end, but I am guessing you will see that trend reverse a little given ex-FX given that some of it had to do with that. We haven't seen any change in markdowns at all related to having a little extra inventory as these containers were catching up.

Joe Feldman

Got it. Okay. Thanks, guys, and good luck with this quarter.

Richard Galanti

Thanks, everyone, and have a good morning or afternoon.

Operator

Ladies and gentlemen, this does conclude today’s conference. You may now disconnect your line.