Costco Wholesale Corporation (NASDAQ:COST) Q4 2017 Earnings Conference Call October 5, 2017 5:00 PM ET

Executives

Richard Galanti - CFO

Analysts

Simeon Gutman - Morgan Stanley

Michael Lasser - UBS

John Heinbockel - Guggenheim Securities

Chris Horvers - JP Morgan

Karen Short - Barclays

Matt Fassler - Goldman Sachs

Paul Trussell - Deutsche Bank

Charles Grom - Gordon Haskett

Oliver Chen - Cowen & Company

Peter Benedict - Robert Baird

Scott Mushkin - Wolfe Research

Dan Binder - Jefferies

Kelly Bania - BMO

Chuck Cerankosky - Northcoast Research

Rob Iannarone - RBC Capital Markets

Joe Feldman - Telsey Advisory Group

David Bellinger - Oppenheimer

Mark Astrachan - Stifel

Operator

Good afternoon. My name is Christie and I will be your conference operator today. At this time, I would like to welcome everyone to the Q4 Earnings Call and September sales. 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.

I will now turn the call over to CFO, Richard Galanti. You may begin sir.

Richard Galanti

Thank you, Christie and good afternoon to everyone.

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

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

In today's press release, we reported our fourth quarter and fiscal year end 2017 operating results for the 17-week and 53-week periods ended September 3 and our September sales results for the five week retail month ended this past Sunday, October 1. For the 17-week fiscal fourth quarter, reported earnings came in at $2.08 a share, up $0.31 over last year's fourth quarter earnings per share of $1.77.

In comparing our year-over-year fourth quarter operating results, several items to note. First, of course this year's fiscal fourth quarter was comprised of 17 weeks of operations. Last year's fourth quarter results covered 16 weeks. We just finished the year which had the extra weekend. Second, the improved results related to co-branded credit card, as we reported in each of our first three quarters of fiscal '17, as the Citi Visa co-branded credit card program again positively impacted our year-over-year gross margins by 14 basis points and SG&A expenses by 8 basis points and our overall bottom line in Q4, benefiting earnings year-over-year by an aggregate of 22 basis points or $0.13 a share over the 17-week fourth quarter. More detail to follow later in the call on this.

Gas profitability, the third item. Our profits from gas during the quarter as compared to last year's fourth quarter were higher by about 40 million pretax or $0.05 a share. Number four, gross margin, this year's fourth quarter margin, the gross margin included $20 million of pretax benefits from non-recurring legal items, which were partially offset by about a $10 million reserve charge for inventory losses attributable to Hurricane Harvey. Together, this net $10 million pretax benefit represented a benefit of 2 basis point improvement to gross margin or about a penny and a half share benefit to earnings per share.

Fifth item of note, SG&A. This year's fourth quarter SG&A expenses included an $11 million or about a penny and a half negative hit related to Hurricane Harvey. This represented about a 3 basis point detriment to our reported SG&A percentage in the quarter. Number six, modernization related IT, as a percent of sales, only slightly higher by a basis point year-over-year. Next, FX. There's two FX items to point out. On an operating basis compared to a year ago, foreign currencies had a very slight negative impact to earnings, less than $1 million pretax.

Also, in our interest income and other line, the year-over-year swing in gains and losses related to accounting for our FX exposures in the other countries where we operate. In Q4, the year-over-year swing was about a minus $12 million pretax or $0.02 a share hit, impact to EPS year-over-year. Last year, in Q4, we had a gain of 11 million in terms of these items. This year, we had a loss of about $1 million recorded in this year in the fourth quarter.

Number eight, income taxes. We had favorable discrete tax items in both fourth quarters, both this year and last. In last year's fourth quarter, discrete tax items benefited the last year's fourth quarter earnings by $0.05 a share. This year's fourth quarter discrete positive tax items benefited earnings per share by $0.03, so $0.02 lesser benefit this year over last year. And lastly, LIFO, there was no LIFO charge or credit in this year's fourth quarter results whereas last year's fourth quarter results had a LIFO credit of $31 million, reflecting deflation in our LIFO indices a year ago or a $0.04 per share benefit last year versus zero this year.

Turning to fourth quarter sales, reported sales were up 16% in the quarter, including the benefit from the extra week and reported comparable sales figure, which compares a like-for-like number of weeks year-over-year was up 6.1%. For the quarter, the plus 6.1% comp sales figure was helped by gasoline price inflation to the tune of about a half a percentage point and hurt slightly by a slight detriment from the FX impact.

In terms of new openings, in Q4, we opened 12 new locations, six in the US, two in Canada and one each in Australia, Japan, Iceland and France, the last two countries being new countries for us as well. As of our fiscal year end, we operated 741 locations worldwide, including 26 new buildings during the year. We opened 28, but two of them are relos.

This afternoon, I’ll also review with you membership trends and renewal rates and update on our co-branded Citi Visa card. I'll discuss a little bit further about margins and expenses, I’ll discuss e-commerce results and some recent initiatives, a couple of other new initiatives as well and lastly, I'll give you a recap of our September sales results for the five week period ended this past Sunday.

So on to the results. Sales for this year's fourth quarter, the 17 weeks ended September 3 were $41.36 billion, up 16% over last year's 35.73 billion. On a reported comp basis, Q4 comp sales were up 6.1% for the quarter on a reported basis, up 5.7% after accounting for fluctuations and gas prices and FX. For the quarter, our reported 6.1% comp sales results were a combination of an average transaction increase of 2.1% for the quarter, an average shopping frequency increase for the company worldwide 3.9% up and within that 3.9%, it's up 4.4% for the US.

In terms of sales comparisons by geography, for the fourth quarter, within the US, the Midwest, Southeast and Texas regions were the strongest, with other US regions not far behind. Internationally, in local currencies, better performing countries were Japan, Mexico and the UK. In terms of merchandise categories for the quarter, within that 6% reporting comp, food and sundries up about 4%, strong categories include spirits, deli and frozen, hardlines, up in the mid-single digits.

Overall, strongest department results were lawn and garden, tires, toys and consumer electronics itself were up in high singles. Softlines were up in the high singles overall with housewares, jewelry and home furnishings showing the best results and in fresh foods, comp sales were in the mid-single digits, relatively consistent across various departments of meat, bakery, deli and produce.

Within ancillary, gasoline had strong comps in the quarter aided by higher average sale price this year versus last as well as very strong gallon growth. In addition, hearing aids were up in the mid-teens, followed by optical and food court.

Moving to the line items of the income statement, I'll start with membership fees. Membership fees were up 13.4% or $111 million year-over-year. As a percent of sales, they were down 5 basis points, as we expect in part due to simply the strong sales results. Of the $111 million increase in fees year-over-year, about 15 million related to the membership fee increases we took, a little over half of that $15 million from the fee increases taken in our international operations last September 2016 and the balance from the June 1 increases taken in the US and Canada recently.

In terms of membership, our renewal rates are fine. There's still some slight negative renewal rate impact from the US credit card conversion last year and we expect that to continue for at least a quarter or two and we continue to see increased penetration of our executive membership. In terms of number of members at Q4 end, at year end, at Q3 end, we started with Gold Star of 37.8 million and at the end of the quarter, at the end of the year, we had 38.6. Business primary was 7.4 at each period; business add-on, 3.4; total member households, 48.6 at third quarter end and 17 weeks later at fiscal year-end, 49.4 million. All told, cardholders were 88.9 million a quarter ago. And fourth quarter year end was 90.3.

At year end, paid executive memberships totaled 18.5 million, an increase of 274,000 since third quarter end, which is about 16,000 per week increase in the quarter. Executive members are about 38% of our member base and about two-thirds of our sales. In terms of renewal rates, at year end, business members renewed at 94%, Gold Star members at 89.3%, these are numbers for the US and Canada combined, which is over 80% of our company and total US and Canada 90.0%, and worldwide, 87.2%, a slight tick down of a tenth or two from the last quarter.

A lot of that, as I mentioned earlier, we believe relates to -- in the US, the conversion last June to the new credit card program and with auto rebuild and again, we expect that to continue to downtrend a little bit in the next quarter or two. While I'm on the subject of membership, I’d like to spend a couple of minutes to respond to the many questions we get literally every day relating to concerns -- the following concerns.

One, the new member sign ups might be slowing. Two, that the average number of member households per location seems to be coming down a little. And three, that with the increasing overlap of people having both a

Costco membership and an Amazon Prime account and the fact that more and more people are having groceries delivered by everyone, is this the beginning of something that will impact Costco.

As to new memberships sign up slowing, we believe it's virtually all related to timing, the timing of openings and the timing of two online new membership initiatives we undertook, one each in the past two fiscal years. For example, in the first three fiscal quarters of 2017, fiscal 2017, in these 36 weeks, we opened 16 new warehouses, including two openings with outsized sign ups, both in Asia, a new unit in each of Korea and Taiwan. Those were done last January. Each of these locations added almost 60,000 new members to our base. In Q4, we opened -- in these 17 weeks, we opened 12 new locations, three were large sign ups in Japan, Iceland and France.

Again, these three locations, each opened for only 5 to 15 weeks in the fourth quarter added a total of 180,000 members to our base, again an average of about 60,000 new members per building. So timing of those certainly impact the numbers in terms of averages. Conversely, when we look at openings that cannibalize the existing nearby locations, you'll add maybe a few thousand at the most new members at that new location, the result will drive an expected $80 million to $100 million of new annual sales in that market, but lower the average number of members for each building in that market by 10,000 or more.

The other timing issue, in the last two fiscal years, we've done two online new membership drives, each which added an average of around 200,000 members, one a little less and one a little more. The fiscal 2016 event occurred in February of ’16, near the end of our second quarter. The fiscal 17 event occurred in August in the fourth quarter of this year. So again, timing played an issue with that.

One last data point, if I take all of the US and Canada locations and I exclude all the new openings and all locations that were being cannibalized, in many cases, by these new openings, the average number of members at these remaining locations grew year-over-year from the end of fiscal ’16 to the end of fiscal ’17 by approximately 4% year-over-year. So our view is that we're fine and hopefully that answers some of the many questions we've got on these questions.

As to the other question, as it relates to increased delivery options by everyone, is it impacting us and is it impacting our brick and mortar? A few comments. One, of course, our sales and our comps are strong and have even trended up. Two, our shopping frequency is strong and has also trended up. Three, our value proposition, we believe it's stronger than ever. Four, we're just getting started on some of the new delivery options of our own and I'll talk about that in a minute. And five, we're using online and the Internet to drive businesses both to e-commerce as well as in store. So stay tuned and we'll continue to discuss that in each quarter.

Before continuing down the income statement line items, a couple of updated stats on the Citi Visa card offering. Again, this began in Q4 of last year in June, about June 20 I believe. When the conversion to Citi Visa occurred in June of 16, there were 11.4 million co-branded cards or about 7.4 million accounts being transferred over to Citi. As of Q4 end, just over a year since the conversion, we now have 1.8 million new approved member accounts or about 2.4 million new cards, including about 270,000 new accounts during the past 17 weeks.

Overall, we're seeing the Citi Visa co-branded portfolio total spend higher year-over-year, both organically and from these new accounts. Despite the fact that we had a partial comparison to the conversion last year, since it was midway through Q4, it was still positive year-over-year to gross margin, SG&A and EPS as I mentioned that earlier. I should note though that we’d anticipate the year-over-year comparisons to moderate of course as it did actually in Q4 as well to moderate starting with the first quarter.

Lastly, we continue to enhance the value proposition, not only of being a Costco member, but then being a Costco executive member and then even better at Costco executive member using the Citi Visa Anywhere card. I'll share a couple of new examples of that during the remainder of this call. Overall, in terms of conversion, usage and sign-ups for the card, all good at this point.

Going down to the gross margin line, our reported gross margin the fourth quarter was lower year-over-year by 15 basis points. As I do always, I'll ask you to jot down a few numbers. We'll do four columns. The first two columns are year-over-year basis point changes for the third quarter. First column would be as reported and the second column would be without gas inflation. And then Q4 reported and Q4 without gas inflation. So those would be the four columns.

First line item would be core merchandising. In Q3, we reported improvement year-over-year of plus 7 basis points, without gas inflation, plus 20. This year, in Q4, minus 8 and minus 3. Ancillary in Q3 was plus 15 reported and plus 19 ex inflation in gas. In Q4, minus 1 and plus 1, 2% reward from executive membership, minus 2 and minus 4 in the third and fourth columns, plus 1 and zero. LIFO, minus 5 and minus 5 in Q3 and minus 9 and minus 9 in Q4.

Other, minus 7 and minus 7 in Q3 and the two columns for Q4, plus 2 and plus 2. So all told, on a reported basis, in Q3, 17 year-over-year, we were up 8 basis points, without gas inflation, up 23. And in Q4, on a reported basis, down 15 and without gas inflation, minus 9. Now, mind you, in these numbers, the Citi Visa impact, as I mentioned earlier, in Q4, was plus 14 on a reported basis and on -- without gas inflation. So if you look at that way, the minus 15 would be minus 29 ex that and the minus 9 would be minus 23 ex that.

Now, overall, as I mentioned, reported margins were 15 basis points down year-over-year and 9 ex gas and as I just mentioned, taking out the Citi Visa benefit, minus 29 and minus 23. Now, within that, the core merchandise component gross margin was lower by 8 reported, but 3 excluding gas. As I've shared before, the subcategories within our core gross margin, which is almost 80% of our sales within the warehouse, food and sundries, hardlines, softlines and fresh foods, as a percent of their own sales, they were essentially flat year-over-year, notwithstanding the investing in price that we have done during the course of this, with food and sundries and softlines being up a little bit year-over-year and hard lines and fresh being down a little bit again investing in price.

Ancillary and other business gross margin was down a basis point, up a basis point ex gas inflation. In the quarter, higher year-over-year margin contribution in gasoline, hearing aids, business centers and travel was offset by lower year-over-year margin contribution in e-commerce, again investing in price as well as pharmacy lower margins year-over-year. LIFO, I already shared with you, the fact that we had a LIFO credit last year to the tune of $31 million versus zero this year, so year-over-year, that was the 9 basis point delta. And Hurricane Harvey, well, that was the net of two items, so I won’t go through that one, but overall, margins were down relative to last year and we feel it's a function of our own initiatives to drive sales and enhance member loyalty and satisfaction.

Moving to reported SG&A, our reported SG&A year-over-year in Q4 was better or lower by 37 basis points and 31 without gas inflation, coming in at 9.97% for the year compared to 10.34% last year. Excluding the Citi Visa benefit, and again the Citi Visa benefit was 8 basis points benefit to SG&A year-over-year or lower. Again, I'll ask you to jot down those four columns, Q3 reported and Q3 without gas and then Q4 reported and Q4 without gas. In terms of core operations, in Q3, plus 21 basis points and plus means good or lower and plus 9 without gas in Q4, plus 32 and plus 27.

Central, minus 1 and minus 3 and in Q4, reported and adjusted for gas, plus 8 and plus 7. Stock compensation, minus 1 and minus 1 and then in Q4, zero and zero. Other, minus 5 and minus 5 and then in Q4, minus 3 and minus 3. So reported Q3 lower or plus 14 basis points, reported and flat without gas inflation. And reported, plus 37 or lower by 37 basis points year-over-year and plus 31 or lower by 31 basis points ex gas. And again, each of those numbers, at 37 and 31, you could adjust -- you could look at it from the standpoint that 8 basis points came from the improvement year-over-year related to the Citi Visa card. And while that's been a great improvement each of the last four quarters as it was to margin, we'll start to see that benefit -- we'll still expect to see some benefit, but it will be greatly reduced after the first full year.

In terms of our SG&A performance in Q4, the operations component again was quite good. Strong top line sales frankly led to year-over-year improvement in payroll benefits and other items, particularly bank fees. Central expense was lower year-over-year by 8 basis points and 7 without gas. Again, we saw a nice improvement in payroll and benefit expense percentages, again offset very slightly by a basis point from IT modernization. And lastly, other was worse by 3 basis points that impacted negatively and that was the 11 million I mentioned earlier related to Hurricane Harvey.

And next on the income statement is preopening expense. Last year, in Q4, we had 24 million. This year, it was 6 million higher at 30 million. Last year, we opened 11 new units, 11 units, 10 that of relos, 2 of those 11 were international. This year, while we opened up only 1 more, 12 total, 6 were in international, international tend to have higher preopening. Overall, higher year-over-year preopening costs is really a reflection of higher penetration from international. All told, operating income in Q4 came in at 1.450 billion, up 259 million or 22% higher year-over-year than last year's results.

Below the operating income line, reported net interest expense came in at 53 million as compared to 39 million last year, primarily a result of the incremental new debt offering we did this past May in conjunction with a special dividend, which was discussed in last quarter's earnings call, plus there's one extra week in Q4 this year than last year. Interest income and other was lower year-over-year by 7 million, coming in at $22 million this year compared to 29 million last year. Within that number, actual interest income for the quarter was better year-over-year by 5 million, however, it was more than offset by that minus 12 million of FX related items I discussed at the beginning of the call.

Overall, pretax income was higher by 20% or 238 million higher in Q4, coming in at $1.419 billion this year. In terms of income taxes, our tax rate in Q4 of 17 came in at 34.3% for the quarter compared to 33.6 last year. Again, as I mentioned during the call, we benefited from a few positive discrete items, tax items in both fourth quarters, but our -- but more last year than this year. Our effective rate for the entire fiscal year that we just ended came in at 35.36%. With that, reported net income was higher by 18%, coming in at $919 million this year compared to 779 million in net income reported last year in Q4.

Now, for a quick rundown of other topics. The balance sheet is included in today's press release. A couple of balance sheet info items. Depreciation and amortization in Q4 totaled $441 million. So for the entire year, depreciation of $1.370. Our accounts Payable ratio, if you recall last year, we were converting an ITR accounting system, so we paid an extra week of invoices early to make sure we wouldn't run into any snafus with that conversion on day 1 of the fiscal year that just ended.

But adjusting for that, last year, our accounts payable as a percent of inventories was 104%, reported was 85, but 104 taking the adjustment out. It came down to 98% at the end of this fiscal year. If you take construction payables out there and other types of payables that are not merchandise, last year's normalized number at year-end was 91, a little down at 89%, roughly 90% in both year-ends of last year on a merchandise only basis and normalized for that payables early.

In terms of average inventory per warehouse, this year fourth quarter end, it was about $12.28 million per location, last year, 11.85 million, so up about

$430,000 per location. There is -- that's at the warehouse level. We've broken out this time the increase in inventories elsewhere, because we have quite a bit of expanded inventory with our expansion of e-commerce fulfillment locations and activities as well as some of the vertical integration things we're doing in those businesses.

In terms of CapEx, in Q4, we expended $779 million, which for all of 2017 would put us right at $2.5 billion, which is about the same as fiscal ’16. We’d anticipate spending to be a little higher in fiscal ’18, not only as it relates to net increase -- relates to the sum of everything we do, not only openings, but also some manufacturing businesses that we’re expanding as well as e-commerce and some other things.

Next, in terms of e-commerce, of course in the US, Canada, UK, Mexico, Korea and Taiwan, you should expect additional countries to be open over the next year, year and a half. Total e-commerce sales in fiscal 2017 came in at 4.6 billion, up 15% from right at 4 billion at the end of our fiscal ‘16. For Q4, sales were -- profits were of course up. Total e-commerce sales were up 27% in the quarter. Of course, that includes an extra week, 17 versus 16 weeks and up 21% on a comp sales basis with a trending positive during the -- roughly four months of the quarter. As discussed over the past few quarters, much of our efforts over the past year focused on improving the functionality of our site.

We improved search, streamlined the checkout process, improved our members' ability to track their orders and automated much of the returns process and we also improved our online merchandising efforts by adding high end and well-known brand names, a few examples of late, Marmot, Spyder, ExOfficio, GE Appliances and Jiffy Lube Services. We've expanded our KS offerings. We're providing new hot buys, limited time offer with extra discounts.

We're also -- we’ve started doing what we called Buyer’s Picks and unique offerings to our partnership, Buyer’s Picks and lastly some unique offerings through partnerships with Citi Visa, where we're offering in the cases we've done it with Samsung Electronics, we've done it with tires and a few other things where you buy it at Costco and you use your Citi Visa card on top of all the other great savings, there's anywhere from a 10% to 15% cash offer. And leveraging as well, we're leveraging our global brick and mortar buying power to expand and improve our online value proposition by lowering prices even further.

Lastly, we continue to build awareness on our site with Costco members through warehouse signage, special offers and targeted emails and expect us to discuss some of those activities more in 2018. We feel that all these efforts, which are ongoing have resulted in increased traffic in sales, both online and in-store during the past couple of quarters in particular. Looking forward, we’ll continue to expand these types of activities to drive our businesses. You'll hear more from us in the coming quarters about driving online sales with ongoing site improvements, improved online marketing activities and of course along with great products and services at fantastic prices. That's what we do.

In terms of what's new, three days ago, we rolled out two new online delivery related offerings. The first, Costco grocery, which consists of nonperishable food and sundries items. This offers two day delivery on dry grocery and a second, an expanded white label same day grocery delivery offering through our partnership with Instacart that includes both dry and fresh grocery. You can find both sites by going to costco.com and then clicking on the Grocery tab. You'll then be taken to a page offering and explaining both of these new online delivery options.

A few details about each option. As it relates to Costco grocery, just under 500 dry grocery SKUs, again no fresh, free delivery with orders over $75, two day or less delivery throughout the continental United States, the boxes are up to 40 pounds shipment through UPS, orders are fulfilled at several of our business delivery centers. These offer very competitive pricing and value proposition, excuse me, in fact significantly better price than even we had at costco.com on many of these items. We'd expect to expand these offerings overtime.

The second option, I mentioned, Instacart white label. This is currently offered at 376 of our US locations are live with it and there will be a number of additional US locations planned, added between now and the end of calendar '18 as our partnership expands. There are approximately 1700 SKUs, both dry and fresh that are offered and can be fulfilled through the Instacart white label option. Again, I mention that same day delivery and same day delivery, it's also a very competitive pricing value proposition, better than before and again, Costco members will now have access to our promotional pricing like on MVMs as well. Costco executive members will also receive the 2% reward and members utilizing the co-branded Costco Visa card will now earn that 2% on these purchases similar to in-store purchases. It's just starting this weekend and stay tuned.

Next on the discussion list here, warehouse expansion. For fiscal '17, we opened 26 net new units, about 3.5% square footage growth. For fiscal '18, we'd expect to open about 25 net new warehouses, a little under two thirds of them in the US and about a third internationally as well we plan to relocate six warehouses to better located and larger facilities. That compares to two to three relos in each of the last several years. As of Q4 end, total warehouse square footage stood at 107.3 million square feet.

In terms of stock buybacks, in the first three fiscal quarters of 2017, over these 36 weeks, we expended $233 million to buy just under 1.5 million shares at an average price of $156.51, In Q4, these 17 weeks, we expended a little more than that 233, we expanded $240 million for about 1.5 million shares at an average price of 159.21 a share. So for the year, $473 million on stock repurchases, 2.998 million shares repurchased at an average price of $157.87.

In terms of dividends, our current dividend stands at $0.50 per share per quarter. That's up 11% from the previous quarterly amount. This yearly $2 per share annualized dividend represents a total payout from the company of approximately $880 million.

Finally, before I turn it back for Q&A, I'll discuss September sales results. For September, which is the five weeks ended this past Sunday, sales for the five week month were 12.4 billion, up 12.1% from the comparable five week period last year of 11.06 billion, they were up, sorry, yeah, they were up 12.1%. On a reported comp basis, September comp sales were up 8.9% and 6.2% after accounting for fluctuation in gas prices and FX. For September, our reported 8.9% comp was a combination of an average transaction increase of 4.1 and again that 4.1 of course includes the benefits from FX and gas at an average shopping frequency of 4.7% worldwide and within the 4.7%, a 5.4% in the US.

Gasoline price inflation and FX both contributed possibly in the month. Gas added 160 basis points while FX was favorable in the month by 110 basis points. Cannibalization impacted Canada in September by 325 basis points. As you know, we opened I believe 6 or 7 locations on a base of low-90s this year. So, a lot of cannibalization going on out there, while the US was negatively impacted by 60 basis points and other international by 155. So total company 110 basis points of impact in cannibalization. And as I -- not sure if I mentioned early, e-commerce, comp sales in the month were up 30%.

In terms of sales by geographic region, Texas and Midwest, both low double digits were strongest with California and the southeast regions being in the 7% range. Internationally, in local currencies, better performing countries were Japan, Mexico and the UK. In terms of merchandise categories for September, within food and sundries, tobacco, candy and cooler were the leaders. Tobacco of course, we've anniversaried back in June some of the big declines and we're seeing some strength since that point.

For hard lines, which was up low double digits, strongest department results were lawn and garden, automotive, tires, consumer electronics and toys.

Softlines, which were up in the mid-single digits, housewares, small appliance, domestics and apparel showed strong results, strongest results and in fresh foods, comp sales which were in the mid-single digits again consistent pretty much across most -- all four -- main categories.

Within ancillary, gasoline again had very strong comps in the month, driven by both high, both price inflation and the cost of a gallon of gas as well as strong comp gallon growth. In addition, hearing aids were up in the teens and optical was not far behind.

Lastly, before I turn it back for Q&A, our fiscal 18 first quarter scheduled earnings release date for the 12 weeks first quarter ending on November 26th, these will be reported after market close on Thursday, December 14 with the earnings call that afternoon at 2 o'clock Pacific time.

With that, I’ll be happy to answer questions and I'll turn it over back to Christie.

Question-and-Answer Session

Operator

[Operator Instructions] First question comes from the line of Simeon Gutman from Morgan Stanley.

Simeon Gutman

I wanted to ask one on membership and I want to ask another on gross margins. So first on membership. The renewal rates have been moderating a little bit and there’s been some explanation behind it, I think there was some credit card friction. And then regarding -- and I'm just curious if that's still the case or what's going on there. And as part of that, the membership growth, can you talk to the composition in the US versus international?

Richard Galanti

Yeah. Well, again, in terms of renewal rate, we believe the biggest issue is the auto bill. When we look back at Canada, which occurred a year and a half, two years prior the conversion up there, from its peak renewal rate, I think all the way back to early fiscal ’15, if I looked out six quarters, it came down about a full percentage point. It's now actually a tenth of a percent above where it was a year -- that year earlier at its peak. So -- and when I look at the -- we’re now 4.5 quarters into it, not 6 and it's down – again, it was down a full percentage point in the US and recognize it's a little bit different scenario with conversion, but it's down about seven-tenths of a percent.

So we believe that's what it is. We don't -- when we look at -- we talk to the members of marketing people and we ask them about what are the reasons when somebody doesn't renew, we get consistent answers of what they've heard for the last several years. So our view at this point is that we're not seeing, we're not concerned about it and want to see what happens over the next couple of quarters if after that it doesn't change. But we assume it will at this point.

And I'm sorry –

Simeon Gutman

If you just look at the overall membership, trying to dissect what the US run rate is or how is, I guess, same unit membership trends, I guess if you can try to take out cannibalization, just the direction and what the trend line has been in the US?

Richard Galanti

Well, in the US and Canada, which again is 80% of our company, 80 plus percent of our company, it was four. We just did that because we're getting the question every day. We can look at it. I don't have it off -- we didn't do that. We actually was -- we're trying to respond to some of the many questions. I think internationally, particularly since you've got newer units internationally, particularly in Asia and Australia, which is where your impact, less so in Mexico and UK where it's older, my sense is you'll see the same thing. It will be a positive, but greatly affected by cannibalization.

When you've got, in a city in Taiwan, where you've got two very high volume units, which with well over 60,000 members per warehouse and you open up a new one, you're still going to get a lot of new openings, not a lot of new members relative to what we see here, but my guess it's still -- that's going to cause it to come down. So again, it has more to do with timing than anything, cannibalization than anything. I just don't have beyond that. Canada and the US are pretty similar.

Simeon Gutman

Okay. And then my follow-up was on gross margin and I don't expect you to give a clear answer, because I don't think you give a lot on the outlook, but trying to think of price investment in particular, right, but there's been a pretty favorable trend up until this quarter and I think you said down 3 ex fuel. So I guess, how do you think of the price investment? I know, it's constant for the business, but you'll have some tough compares as you head into the next year, both on a gross margin and an overall EBIT growth perspective. So how do you think of that as the next several quarters play out?

Richard Galanti

Well, I mean, in a couple of words, we're fine. I think what we saw this fiscal quarter in terms of sales growth cures a lot of things and driving it with value, we've had the good fortune of having better than expected economics from our new credit card and we certainly -- we are just starting the benefit, if you will, to the membership fee line item, which will start -- continue over the next 20-ish quarters, 20-ish months as the fee increase in the US and Canada. That is again -- that's a fee increase that's about $240 million, peaking 12 months after we started. It takes 23 months because the deferred accounting get in there. So, there's plenty to go around and our view is that we can do both and we feel quite good.

Simeon Gutman

Thanks, Richard.

Richard Galanti

Let me add one last comment on that, I forgot to mention. The big chunk of it also is penetration of gas. Gas, while gas was great year-over-year, profitability is great. It's a much lower margin business, it's 9 plus percent of our total sales at 500 to 700 less margin -- basis points of margin. So when you've got huge increasing sales price per gallon and 10 plus percent sales growth on 10% of your business, and that aid into it as well. I'll take that lower margin percentage every day for 40-ish million of profits in the quarter.

Operator

Next question comes from the line of Michael Lasser from UBS.

Michael Lasser

Richard, on the metric you provided about 4% membership per club growth ex cannibalization in the US and Canada, is it just a coincidence that that's kind of in line with where your traffic has been trending over the last couple of quarters or should we think about it as your traffic growth is highly correlated to that membership growth ex-cannibalization?

Richard Galanti

I think they're separate. I mean, a lot of times, I'll give you a simple example. Here in the Seattle region, we have three locations on the east side of the lake, Issaquah, which is across the street from where I am; Kirkland, which is where we used to be and Woodinville, all three kind of aligned north to south on the east side of this Puget Sound. Last November, we opened Redmond, which is where of course Microsoft is headquartered and basically, I think we had as of opening, less than 1000 new sign ups at the Redmond location because we have close to 80% household penetration in the Puget Sound, which is extreme.

This is where we're headquartered and we've been forever. We’ve taken the average number of members per location, down from the mid-60s to the low-50s by just adding a new unit, but we’ll add 80 million to 100 million in sales in the first year in this market. So when you've got locations that are doing 250 to 300 plus per unit, you've got to cannibalize them. So, I mean that's an example of that. So I don't think the two are correlated.

Michael Lasser

Okay. Just thinking about the comp frequency or the frequency component of your comp, it would seem some of your most longstanding members are probably going to Costco about as much as they can, so is it that the newer members are building their frequency and that's where the bulk of the frequency across your population is growing? Are you seeing growth in frequency across your entire population of members?

Richard Galanti

I think it’s over the entire population. First of all, new members -- every new member is going to presumably be more frequent every year for several years. I believe that some of the things we're doing, I didn't give an example on the call here but we've done several e-mail initiatives to members to drive them in-store. We did it over the holidays with New York Strip Steaks at $6.99. We did it with Copper River salmon over just a very limited, I think a ten or so day period. These are little things that little anecdotal things, but we think that we keep doing things to drive even more frequently as well. So I would bet that most of it, since the bulk of our sales come from the numbers that are more than a year, more than two years and more than three years, we're getting them in as well.

Michael Lasser

My final question is on September's frequency growth of 5.4%. There's obviously a lot of moving pieces within landscape in September between the hurricanes, you also had Amazon closed on its acquisition of Whole Foods and there was a lot of noise around that. If you look at your clubs around Whole Foods, was there any impact and what do you think drove such strong frequency growth in September?

Richard Galanti

Mel Brooks once said it's merchandising. It's value and merchandising and some of the other little things we're doing here. As it relates to the tragic things of the hurricanes in Texas and Florida and Puerto Rico, frankly, you get a bill -- whenever there's a pending tragedy that's on the news every day, with this pending tragedy like a hurricane, you get a build-up in sales leading up to it. You're closed for a few days perhaps or more in a couple of locations, but when we look at it -- as I think I mentioned, the comp sales in Texas in September was one of the stronger regions. Now, that's partly because the entire state wasn't impacted by it. So we don't think that was a big impact at all. As it relates to the publicity and the news and the noise around Amazon Whole Foods, all we can do is perform. When we look at the value proposition, our view is our value proposition got better. You read about Whole Foods having giant increase in member shops or customer shops that first week. I would hope they do and I would expect them to.

There's a lot of news out there and there's a lot of things. When we've done our own, we've read about the price changes that the lowering of prices gives us more confidence that our value is even greater. So we'll have to wait and see and nobody can predict everything. All we know is that our brick and mortar is as strong as it's ever been and trending in the right direction from there.

And we know we've done a lot of, there's 100 different things you do every day. I gave you a couple of the sound bites, the example. So again at this point, we feel pretty good about what we're doing. We feel good that we've got a few delivery Options for our members that frankly are better than the ones they were doing the day before with us or with Instacart or with anybody else. So we feel that to the extent that somebody wants to choose -- to use that route, they'll be able to and we'll be able to generate the sales from it.

Operator

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

John Heinbockel

So Richard, I just want to start on SG&A leverage. Right. So both operations in Central, this was about I think as good a quarter as you've had in a long time. Extra week play any role in that? And maybe a little more detail on particularly operations because that you're down 27, you think about wages, benefits?

Richard Galanti

The only benefit is it's one-sixteenth more of our earnings number. I mean I guess you would have taken that 208 and divided by 17 weeks, but there's not a week with no rent expense in it, because we prorate that daily.

John Heinbockel

Yes. So I mean, if you think about it, you sort of -- you think about a sea change here, right, because you've typically been up in Central and now down and again, you were down quite a bit more than the third quarter. What is different -- what was different fourth quarter versus third? I'm just curious what was different, how sustainable that is?

Richard Galanti

Well, it’s sales. I mean, we hope it’s sustainable. We’ve got a lot of good things going on, but we’re only a little bit better predictor than you guys are at that. We feel good about the initiatives we got going on. We feel good about the monies we have to invest in price and to still drive the other line items of our income statement. And –

John Heinbockel

All right. Then just on the openings, right? So it sounds like maybe 8 or 9, 7 or 8 outside the US. Is that sort of 2 Canada and maybe 6 or 7 other international, and then where in other International?

Richard Galanti

I’ll tell you. Yeah. I mean basically, a couple in Canada, two or three, a couple, four or five between the three countries in Asia and another one probably in Australia. That's generally where they are.

John Heinbockel

Okay. And then just one last thing, when you think about your delivery options here, what's your sense as to how customers will use those and alter their behavior? Right? So you think about the non-perishable food and sundries on the 2-day, do people simply get, do you think they’ll get those delivered to the home and then come in to buy fresh and nonfood, some of the treasure hunt items and not to have their cards loaded with some of those sundries? How do you sort of get comfort about the impact on traffic to what you're doing?

Richard Galanti

Well, needless to say, we have to continue to watch that. We’ve had some limited experience with our relationship with Google starting a few years ago and with Instacart over the last couple of years. What we found so far is it's more fill-in than replacement of a shop and the key is, if you come down a couple or three shops a year, one way as you add several more shops as fill-in or alternative, that's what we saw, but we have very little time and data to feel comfortable about where it will go.

We had to keep getting you, we want to do both of course, but we have to keep getting you in store because you're going to buy more and you’re going to see more even if we had everything online, but we don't of course. And one of these I mentioned was, how do we get you in-store. We're just literally scratching the surface of any type of targeted Internet -- e-mail marketing initiatives. We have a very, as you know, a very loyal, hopefully you’re one of them, a loyal member. And we're just scratching the surface with thinking about how to get you in store as well more often. And on the few examples, and several examples that we tried, it's great and we’ll have to see how that goes.

I guess the one question that none of us know is [indiscernible] home and order stuff, recognizing you've got to pay for it and no matter who ultimately and there will be several of the lowest cost supplier provider delivering to you at home, there are people that actually want to go out, there are people that actually want to go touch their fresh foods and decide, pick it themselves and it's going to change over time. There's going to be an increasing percentage of online and online delivery and the question is, in brick and mortar, we even asked for years, well, how can you drive sales if you're not offering as many alternatives and whatever else. We've done it with value, in our case, value first and foremost is quality and low price. Over time, the percentage of delivery of fresh will change, how much so, we'll have to wait and see.

Operator

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

Chris Horvers

So first question just on the SG&A front. Can you talk about, the IT headwind was small from a basis point perspective, but of course, the overall top line has accelerated. So as you think about the IT modernization on that central expense line, the underlying dollars, is that dollar growth year-over-year decelerating at this point or when do you think that dollar growth actually decelerates?

Richard Galanti

Basically, I think we're in the middle of that. I think it was a quarter or two ago where we actually, it was lower year-over-year by a basis point, and I said, that's on an inflection point. Certainly, even this 1 or 0 basis point this quarter was helped greatly by sales growth. It's going to still increase. I think part of it is where -- we're right at or about to enter our fifth year of modernization. So, that line will start getting fuzzier and fuzzier. We certainly added things to what we are modernizing, taking major systems and doing that we had not contemplated at first.

And so my guess is in the next year, assuming regular decent sales, as a percent of sales, a lot of these systems, you spend $60 million or $100 million on one system, it’s kind of like building a building, you start appreciating the day open or the day you turn it on. And it was probably three to four years ago that we started turning a system on in that regard as we complete them.

So it will be another year before we've got, if you will, the plate full with these bigger expenses that then amortize over generally five to seven years. So but as sales grows, the denominator in this calculation grows, that will be an offset to it. So I'm shooting from the hip here and as a guest, but all things being equal, sometime in the next year, there is maybe an inflection point, but it's going to be in the one or two basis points either way hopefully and at some point here, we’ll stop talking about it.

Chris Horvers

Okay. And then you said on the Visa benefits, the gross margin, SG&A, you’ve said the word, used the term moderate, but not go away. So I think the last quarter, you talked about that sort of -- we're going to start to lap that guys and that's going to go away. So is it just moderation or does it go away and is that –

Richard Galanti

Well, it’s a moderation with a capital M. I think in the first three quarters this fiscal year, the sum of the benefit of improvement to SG&A and margin was 37 or 38 basis points. The aggregate in Q4 was 22. And mind you, a year ago, in Q4, you had a lot of things happening. You were getting off the old program and there was some detriment to that in those last several weeks anyway, the first five weeks of Q4. Then, you had it, but there was also some noise and friction around getting the conversion done for two or three weeks. So my guess is, it will be a much -- it should improve because we're seeing increased penetration of usage.

We're seeing increased revenue shift from people saying the value of this card and not only at Costco, but their top of wallet. I forgot if I mentioned it on my part of this call, but using travel as an example. We just added Costco travel to the executive member, first of all, effective September 1, so you get 2% on travel, which you hadn’t gotten before. On top of that, if you use your Costco co-branded Visa Anywhere card, Citi Visa card, you get another 3% by using that on travel. So there's a 5% off unbelievable prices.

Chris Horvers

Understood. And then last thing is, you did do -- you talked about the timing in the Groupon, January or earlier and then in August. Can you talk about what the rationale was to do in August? I think a lot of people look out there and say, hey, they see this growth in membership slowing, so sort of a desperation pass to the end zone to buffer the numbers and to the print. So maybe just talk about what the genesis of that was, does it make you -- is it an expression that you're concerned about millennial retention or millennial customer acquisition, just talk broadly about that.

Richard Galanti

No, I mean I think first of all, we did it because it works. We don't do it every month or every six months because we don't want to get people comfortable waiting for the next online offering with that added value, with added giftback, gifts in them. We want them to sign up as a member and pay for it. And so it works, the timing difference is simply, we have a lot going on. I believe if I recall, if I look back, we did the fee increase effective June 1 and we didn't want to do it over that month or two period of time. So we pushed it out a little bit.

Chris Horvers

And then just from what you've seen in terms of the millennial customer from a renewal rate perspective on these deals going back in time?

Richard Galanti

Yeah. Going back to your question though, you asked, do we do it because of concern about millennial, I don't think we're smart enough to understand that. The fact is we do it just to drive membership, we recognize that it has a good millennial benefit. I don't have the one on the one that we just did, but the one we did a year and a half ago and what we did like 2.5 and 3 ago, versus a walk-in, a higher percentage of people that sign up on these LivingSocial or Groupon offers are millennials, not as much as you'd expect and I think it's walking in if I recall correctly.

It is like mid – 39% of those that walk in this last one were millennials. I think I'll go back to the previous one, it was 36% were walk-ins or millennial, whereas millennials under this program, it was like in the mid to high-40s, so about 10 extra percentage points. So not a huge distortion or a difference between those two. But it helps.

Operator

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

Karen Short

Actually, just on the subject of millennials. Wondering, can you maybe just give us an update a little bit on the average age of your membership? I know, you kind of give that periodically. It seems to have been trending down, any color you can give on that.

Richard Galanti

I don't have anything in front of me. I know that what we did a couple of – not a couple of years, about a year ago, it was looking at US numbers, it was 52 years versus 54 years across the US, not the entire population of US adults, which was about, so we were two years older instead of a few years earlier than that, we were four years older. I have not seen anything since that. If I have a – you can ask me, I'll find out, but I don't recall.

Karen Short

Okay. And then one other question I think you were asked, and I didn't catch the answer, if you gave it. But do you have any color just specifically on the performance of your stores that are in close proximity to Whole Foods since the price reduction were -- took place at Whole Foods.

Richard Galanti

Yeah. We essentially overlap everywhere. And I'm not trying to be cute, but other than reading about it on the news and the paper on Wall Street, we have not seen -- we recognized – I read yesterday that there are some specialties brick and mortar retail stores that are impacted more than others. We don't believe we've seen an impact from it.

Karen Short

And then I guess on the online grocery, I just want to clarify. You gave 1700 SKUs and I think what you said was that possibly, the price points will possibly be cheaper than Costco, did I catch that right and then --?

Richard Galanti

No, no. It will be lowered. Currently, you could go to certain other parties, Google Express, Instacart as was before Octobe1, costco.com Costco Business Center and limited delivery within the 40 or 70 mile radius of those 15 locations, shipped down in the southeast, I believe, boxed. And I'm sure there are some others out there that I’m missing. When we look at the pricing that anybody, both a member and a non-member as the case may be depending on each one, how they price their goods, what they're ultimately have -- what their delivery prices, this is better, including on some of the items which you could buy at great value and better value than those areas on costco.com already.

Karen Short

Got it. Okay. And then just a last question, there seems to have been some rumblings that you’re looking to expand into China, I don’t know if you could comment on that a little bit.

Richard Galanti

It’s the 20-year discussion as we're looking. As a rule, until we have permits to do something, building permits to do something, we don’t announce whether it's in Alabama or China and, but we're looking and at some point, we'll announce something.

Operator

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

Matt Fassler

Richard, my first question relates to the line item that talks about core margin categories on their own sales and I guess that line item, this is inclusive of gas and I might not have caught the number ex-gas, have been up for the first –

Richard Galanti

It's exclusive of gas.

Matt Fassler

Okay. So only in core categories. That number had been up I think each quarter of the year and in fact, I think had been up something like 11 straight quarters. Last time it was down I think was in that -- 10 straight quarters -- second quarter of fiscal ’15 and I know it was flat this quarter and the differences are not very big, but it was a bit of a break in the pattern. So was there any particular area where you invested in price and was there a concerted effort to invest to a greater degree in price that would have led to the increases in that line item data here?

Richard Galanti

Yes. But again -- honestly, we don't sit down. We decide like here is a bucket of money, if you will, and how we're going to use it. We don't do a bunch of sensitivity analysis of it. We’re merchants and I’m not, but they are here and we look at what are the things that drive business in retail grocery, or retail non-food as a case maybe and certainly on key items, I think I used the example of New York Strip Steaks where we were $7.99 and $8.99, which – we went down to $6.99. And by the way, we did that and still made a decent margin because of how we bought it on, we're a giant buyer of this stuff. We've done it on several items and it works. So I think the point you made though is, while it's not a lot directionally, it's different. That's fine. We're really not concerned about that.

Matt Fassler

Fair enough. And then secondly, so Instacart, I know, is a prominent delivery partner. I know that prior to Amazon acquiring Whole Foods, Whole Foods had made an equity investment in Instacart, does that have any impact on that partnership on the future of -- and obviously you're not the only partner Instacart has and there is probably a question a lot of their business partners are having, is that a relevant consideration at all as we think about this forward for Instacart?

Richard Galanti

No. In fact, what we announced, when we initiated this week our discussions both before and after that, but both before and after June 15 or 16.

Matt Fassler

Great. And then finally, the e-commerce business, I know, has accelerated over the past few months and you spoke about the last couple of quarter about some of the changes that you made, re-platforming, et cetera and the capacity you have. Are there any particular categories where you're seeing that acceleration to the extent that you've kind of more than doubled the pace of growth in e-commerce, I know you're not doing fresh obviously and you're expanding your e-commerce efforts with some of these brand new initiatives, but anywhere in particular where the business is taking off.

Richard Galanti

Well, on the non-foods side, I think we mentioned a quarter or two ago, appliances is a big area. Apparel – on the non-foods area, [indiscernible] sundries. So we continue, I think, to do a better job on the things on the food and sundry side, on the dry food and sundry side and some big ticket items. And then, I look at some of the examples, again, it was only for what one or two week period, the Samsung deal with using the Citi Visa card on top of great pricing on the TV to start and white glove service if you want it, it was -- you got our great price and if you're an executive, remember, you got 2% and have used the Citi Visa card, you not only got a 2%, you got that 2% because you bought at Costco. On top of that, you got a 15% cash card. And that impacted sales, both in line -- in store as well as online. So, these are sound bites, but there's lots of them.

Operator

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

Paul Trussell

First on membership. I believe the last LivingSocial deal that you ran in 2016, you signed up approximately 250,000 new members through that program or so, could you discuss what the more recent program led to in terms of sign up and then also, the number you gave early on call in terms of the 4% growth in the US and Canada, ex-cannibalization, what would that number be all in, even if we included the club that did see some cannibalization or just kind of overall US maybe versus international growth in membership per club.

Richard Galanti

Yeah. I don't have it. I was trying to be helpful to the – one of the things I guess I want to warn, we're not going to start doing this new calculation every quarter. We try to be helpful here, but we know based on our discussions every day, we can, at the budget meeting, that we felt that we're fine when the question's been asked about the average number of members who are all seems to be going down. The new, total new member signups seems to be – the rate of growth seems a bit slow a little bit. Again hopefully, the data points I gave you lay those concerns. But I don't have the detail beyond that. What we did is we took, let’s take all the cannibalized units, we know that's a bigger impact and all the new units that many of them are in small markets. That's an impact. That’s going to impact it.

Paul Trussell

Understood. And on the LivingSocial sign ups?

Richard Galanti

It was a little better than the one 18 months earlier.

Paul Trussell

Fair enough. And then just on gross margins, you mentioned at the beginning of the call, the benefit, the pretax benefit had been netted out to about 10 million or so. What line item within gross margins did that impact and also just wanted to enquire what if any margin impact you are assuming from the new Costco grocery rollout?

Richard Galanti

Yeah. On the first one, I think it was a separate line item called other. That was the 2 basis points. And as it relates to the impact of the new thing, it’s going to be so small to start with, we don't even know yet.

Paul Trussell

Got it. And then just so, on that point, as we think about gross margins over the near term, is it fair that we should think that there could, maybe flat to slightly down would be kind of the near term run rate, just given investments in price that you've made and the moderating contribution from Visa.

Richard Galanti

Well, we don't guide. Visa will be moderating, but moderating still has a plus sign in front of us, even if it's small. I look back though as we still have a chunk of those monies, we still have -- we have the new membership fee increase that started in June, with -- again ultimately it's $240 million that increase in just the US and Canada that will hit the P&L, but the total benefit to the P&L line won’t be for 23 months from June. So that’s May of 19. So, but there is plenty of money out there to do both, to be able to – when the margins go up or down a little bit, again, I get back to it, it is merchandising. We feel we've got plenty of capacity. I think that the salient point is, is any of this related to competitive issues out there? For the most part, no. It's us.

Operator

Next question comes from the line of Charles Grom with Gordon Haskett.

Charles Grom

Could you just remind us the profitability of your digital business relative to the club segment and also the SKU overlap between both and what you think the long term opportunity is for the SKU count on the digital side?

Richard Galanti

E-commerce profitability is a higher percentage of pretax earnings as a percent of sales in the brick and mortar, but there are a lot of things like that. Some of the ancillary businesses are that way, but it has continued. If it's come down a little, it’s simply because we've invested in price and I would say whatever investment in price is, that number of basis points is less than the reduction in the profitability of e-commerce, because we've driven e-commerce profitability.

Charles Grom

Okay. And is that mostly on the merch margin side or has it been on the SG&A side?

Richard Galanti

A little of it is SG&A, little of it’s margins.

Charles Grom

Okay. And then just a follow-up on Chris’ question earlier about the millennials, could you speak to membership trends and renewal rates for that category or for that cohort of individuals?

Richard Galanti

I don't have any new data on that other than I think what I shared last quarter. Millennials, new members generally renew at a lower rate. Every year, you're stuck around, you're going to renew at a better higher rate until you're really old. And millennials linear renew at about the same rate, at least that’s always, it offers your members. Yeah. And in fact, I remember, I don’t have the detail on the one we just did, but the one we did 18 months ago versus walk-in, we saw those that signed up on LivingSocial renewed at like a percentage point higher rate in that first year of renewal. But again that's plus or minus a little.

Charles Grom

Okay. And then just my last question is obviously the compression in your renewal rates and the timing of the Amazon Whole Foods deal has sort of given a lot of people concern and there's obviously a focal point on the call and I wanted to circle back to Simeon’s question earlier, in your answer to his question with regards to Canada, because I think it gives you a good proxy for sort of a pathway for the renewal rate subsequent to the change in tender. So could you just remind us and just go over that again. You said that peak to trough was around 100 basis points from the time you rolled out that new credit card and what was the recovery time and therefore you think it's going to be another quarter or two before your renewal rates ticked up, can you just kind of discuss that because I think it’s pretty important?

Richard Galanti

Yes. And mind you, there's still some differences and nuance differences between Canada and the US, but notwithstanding those differences, Canada, I think we did the transition in early fiscal ’15, September of ’14, which was Q1 of ’15 and we were in Canada. And then if I look out six months later, it dropped -- it continue to drop for six quarters and it dropped exactly -- and I mean – but it dropped 1.0 percentage points.

The next couple of quarters, it ticked up half of the delta and it took another couple of quarters to pick up all of the delta. Another quarter plus to pick up the rest of the delta. This year, we did -- we converted in Q4 of ‘16. So we're now in the fourth quarter past that, whereas, I saw the trough in Canada, albeit some differences and nuances, six quarters out. So that would tell me, it's probably a couple of more quarters, but that’s about as much analysis as we've done.

Operator

Next question comes from the line of Oliver Chen with Cowen & Company.

Oliver Chen

Richard, as you do think about e-commerce and you become much more aggressive and considerate about what your strategies are, what are your thoughts about the framework for balancing e-commerce and the convenience factor against margins and cost control from a CapEx and expense perspective, what’s your framework for how you're thinking about evaluating where you should allocate ROIC for the long term.

And our second question was just about the value proposition story, which continues to be very compelling. How are you triangulating the value proposition against core merchandise margin and also working through with vendors in terms of maximizing it for the whole system and sharing and passing on some savings to customers. And that's also a little bit related to the multi-vendor Mailer and where you are with that project? Thank you.

Richard Galanti

It's all of the above. First of all, in terms of allocation, first of all, the base e-commerce as we’ve gone to more fulfillment centers, we frankly -- it’s been a net positive because we’ve driven down transportation costs, freight costs, we've driven down time to get it to you. The improvements, the costs of the improvements to the site are de minimis. It's just that perhaps we were a little stubborn for a long time and we hadn’t done it. It wasn’t our focus, but improving search, improving the site itself, expanding distribution points, those are small pieces of a $2.5 billion CapEx budget.

So I don't really see that, we've got more than enough money to do it. As it relates to driving business, some of these things are text clearly. Someone else earlier asked the question, what if this thing with grocery is really successful. Well, really successful is two things. It's really successful as a business and how does it impact the people coming into -- walking into Costco, because we know we're going to buy really a lot more stuff when they walk in. So we have to do that and we think we can manage that by using email to drive people in store as well and the couponing and things like that. So again, time will tell and we’ll have to see where it goes.

As it relates to working with vendors, it's pretty simple. Based to the volume and the efficiencies that we bring to purchasing a product from a vendor, we better get the best price and we all hear and sometimes we read and sometimes somebody accidentally sends us something, but we all hear about all the special deals out of one retailer, whether brick and mortar or someone else. I think like all of us out there, we have to keep our options open, but we feel pretty good about we’re getting money.

Some of the successes we've had, whether it's the special deals and the example of the special deals, working with vendors on hot items and the Buyer’s Picks, when I spoke about last February or early March in the second quarter earnings call about, in some cases, tweaking some types -- differently tweaking how we use the MVM and what I was doing with, how we drive greater value and sometimes partnering with the vendor to do that, all those things are part of the equation. I think it's a lot easier for us to do it when we're trying to manage a few thousand items at the enormity of purchasing power we have within those items and the availability of sourcing those items from many people.

So I think we feel pretty good about what we're doing and how we're getting the monies and how we’re spending them, and there's a lot going on. We’ll have to wait to see. We’re gratified that the things we're doing are driving brick and mortar traffic and comps and we're gratified by some of the things that we were telling you over the last few quarters of earnings calls about improving the site, adding a few things, have started coming to fruition on e-commerce. We think some of these new things, we're excited about it, but there's a lot of unknowns yet.

A comment from somebody in the room here mentioned, I think appliance is a great example. It used to be, we sold some appliances in-store and other big ticket items like furniture. And if you know we don't deliver and you'll get your U-Haul or your pickup -- your friend's pickup truck, well, that's not happening today. By displaying some items in store, we're driving more business, we're doing very well online with furniture, with patio furniture, with regular furniture, with lawn and garden type big ticket items, with electronics, including white glove service and now with appliances. We think appliances, part of it also is brands, having partnerships with GE and LG and Samsung among others, which are relatively new in the way we're doing it, we think in literally three or so years, we can add $1 billion of sales, which we've started doing about 8 months ago.

Operator

Next question comes from the line of Peter Benedict from Robert Baird.

Peter Benedict

You mentioned the manufacturing facilities during your prepared remarks. Can you talk a little bit more just about what you've done there and what kind of the strategy is and some of the benefits you see when you start to take some of that stuff in-house? Thank you.

Richard Galanti

Well that's a continuation of some things we've done. Years ago, we opened our first ground beef plant, I think it was originally in Tracy, California and the intention was -- is to one, assure supply and two, by definition have great quality, but in two, lower the price per pound of landed ground beef to our locations. We did that and more. We now have a plant in California that supplies us. It's our planet, 4 plus million pounds a week, over half a dozen SKUs. We're building a second plant on the East Coast right now because this one has been beyond capacity for a few years, but we now can accommodate one in the East Coast and by the way reduce some freight costs along the way, so we’ll get more efficiencies from that.

The $300 million we're spending on a chicken plant in Nebraska just broke ground a month or two ago. We need over 400 million birds in the US every year. This will be less than about 100 million, so just under a quarter of our need. More importantly, we've got two other plants run by other well-known suppliers where we, we call them dedicated facilities. We had to retrofit them, greatly reduce the number of SKUs they’re supplying and manufacturing to supermarkets, restaurants and us and other clubs and driving, guess what, if you are to greatly reduced the SKUs, you make the manufacturing more efficient, you can save, given the weak and given what happens with all the byproduct and the markets themselves, we can guarantee sourcing and lower our costs by anywhere from $0.10 to $0.35 a bird depending on what month and what's going on out there in the markets.

So it has worked well for us. We're looking to do that and other things and the fact that we source produce from 44 countries, it's what's make -- it is what makes us who we are, but we're sourcing 30 SKUs or so, not 150 SKUs. We’re building -- in Canada, we’ve built a commissary for baking these. We've got – so we’ll continue to do that, but I think the biggest single commitment we've made is this new chicken plant, but it's not likely gone from zero to 300 million in this example. We've done a lot of things.

Operator

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

Scott Mushkin

I know we're late, but I wanted to just kind of attack the elephant in the room. We’ve had a lot of questions on kind of memberships and I think the elephant in the room basically, it's the old Peter Lynch of investing, invest in what you know and I think a lot of people in the investment community have seen, if they’re Costco members, maybe have seen that their shopping frequency to Costco drop as Amazon's come in with things like subscribe and save and other programs that they've done.

So Richard, what I wanted to, I mean, clearly, your sales are just amazing, like they speed up and they speed up and they speed up in your frequency, what are we missing in the investment community, where again it's the old Peter Lynch thing kind of invest in what you know where our experiences, I think, collectively and I hear from a lot of investors, but I also have experienced myself in my own household, we're going to Costco less and yet, your sales are so darn strong, what are we missing and why do you think we're missing it.

Richard Galanti

I wish it was the easy explanation. We don’t see it and that's not a good -- it's a good answer from the standpoint that we don't see it and that's good, it’s in the numbers. To the extent, clearly, you've done some sampling yourself, Scott, others have as well. Some of that sampling shows what you just suggested that it appears that, including your family. Others, it doesn't show that. I don't know why. What we know is that we feel good, well, certainly, we feel good about comps and frequency and renewal rates, subject to the – to some of the credit card stuff. We feel good about some of the things we're getting ready to offer.

If this stuff is being sold out there at higher prices and now we're going to -- those prices are going to be even lowered further by us with one and two day delivery or with, the first, one day, same day delivery with fresh, we have to figure out how to communicate that to everybody. But that should continue to drive more business. We’ll see. I don't have a good answer for that one. I think part of it is, if you take, using the supermarket grocery industry, the roughly whatever it is, 900 billion or $1 trillion industry, everybody out there on this call and elsewhere will have their estimate of what delivery and online will be as a percentage of the total. If whatever it is today, it'll be more tomorrow and it will be more the next day.

I think everybody, even though has extreme assumption is it's not going to be 100% ever. The question is, is it going to go from and making these numbers up from 5 to 10 and then slow down, is it going to go to 20 or 25, is it going to go to 40, who the hell knows. Whatever it's going to be, we should have a piece of it, but clearly, whatever that brick and mortar and people actually drive somewhere and get in themselves, I think we're going to keep taking pieces of that. An extreme example is not even on grocery, it's on apparel.

We have a six plus billion dollar apparel business that's compounded for 3.5 years at 9 plus percent, while the brick and mortar apparel is down. I know why and we've explained why. So for every point, there seems to be a counter point. Within grocery itself, part of it's the unique items, whether it's Kirkland Signature items or some of the things we do uniquely ourselves, all those things hopefully will get in.

If we can't get you to come in for it, we will at least get you to come in occasionally, buy some of the things we do that drive you it like the strip stakes or like the Copper River salmon or like organics and to the extent if you want to pay a little more, that little more will be a lot less more than it was the day before, even through us. So that's what we're going to do.

Scott Mushkin

Yeah. I mean I think right now, it seems like with the strength of the business, our experience maybe on the investment community is a little different than what's going on for a lot of people. Hey, I had just one last one on the $75 free delivery, I've been on the site during the call. If you sell items and you deliver for free for over $75 of the order size, are the profits equivalent there with going to the store and then thanks for letting the call go so long.

Richard Galanti

Repeat the question, somebody was mentioning something.

Scott Mushkin

Yes. So I mean basically, if it's $75, the delivery is free. What -- is the profit equivalent if I go over $75 and I buy on this Costco grocery, is the profit equivalent there versus the store?

Richard Galanti

Yes.

Scott Mushkin

Yes. All right. Again thanks for taking my question. Thanks for letting the call go so long.

Richard Galanti

Yes. No worries. And part of that by the way is what we do. I mean it's a huge volume that we're doing, like any deliverer out there, including some of the ones that deliver our stuff and they're doing stuff third party with us, it's all about getting more things on the box. If we get you to maximize that shipment, that goes a big way. If we get the volume that we can bring to the table when third party shippers are also looking for more volume and to spread that volume, that's all good for us.

Operator

Next question comes from the line of Dan Binder with Jefferies.

Dan Binder

On the topic of e-commerce, you talked about the higher profitability of an online sale. I'm just curious if you were to take a dollar of sales out of the club and transfer it to online, does the better profit online completely offset the deleverage of pulling that dollar out of the club.

Richard Galanti

It took me a long time before we figure that out. At the end of the day, if all we’re doing is substituting and taking sales out of brick and mortar and doing it online, that's a loss and that's a money losing proposition. The fact of the matter is, if we're going to lose it, a, we should lose it to ourselves and b, can we drive more business anyway, both in-store and online. The fact that you can get under this Costco grocery dry items throughout the entire Continental United States within a year, 90% of it already, starting two days ago, that includes lots of geographies where there's not a Costco within 150, 200 miles.

So we think that we're going to drive some business outside of our existing members and by the way, they're going to come remember to do this. So they're really doing it despite ourselves online with a limited amount of things we had at a higher price. So we think that, will there be some, will somebody stop becoming a Costco member? Sure. There's going to be somebody. Will somebody shop less on in-store because they’re now infilling or fulfilling some of that with buying direct? Yes. But, will there be new people that do it before? Absolutely. And will we figure out how to get you in the store even if you don't want to drive to the store? Yes. And we've been pleasantly surprised by some little things we've done to do that. People like deals and we do deals better than anybody.

Dan Binder

Second question was around renewal rates. You talked about the next couple of quarters possibly before you see that inflection. If I go back far enough, I can recall cycles where you had membership fee increases, where the renewal rate would come off a little bit, not a lot. I think the last cycle, you didn't see that. I'm just curious as you look -- because you just raised membership fees, is it possible that that renewal rate takes a little bit longer than just a couple of quarters until you lap that fee increase next year?

Richard Galanti

I think it's possible. I think what you're talking about originally though is when we do an increase, you'd see almost an immediate drop in renewal rate for about a year that it gets backed up and it's continuing on. I think it's been like, at least two, if not three cycles of 10 to 15 years prior to that when we saw that. Recognizing, there's other things that have made you want to renew your membership, having gas stations, having fresh foods, becoming the executive member, all those things have helped that as well. So it's hard to dissect it in that regard. Anecdotally, what we hear from -- again from membership and from membership when they survey members that have dropped that it has nothing to -- virtually nothing to do with raising the fee.

Dan Binder

Okay. Just two other questions. On the promotional front, if I go back a couple of quarters ago, it looked like you were pulling back on the MVM, hit the sales a little bit, but over the years, it's gotten a little bit more business on promotion, maybe a little less on EDLP, there's been a little bit of a shift, and now I'm just listening to the call today, it sounds like you're going to be more active online. So I guess just in terms of how it fits into the message to the customer about everyday low price and whether they should wait for that promotion, do you feel like you're -- you have the right balance today or do you think there will be further tweaks as you do more online, take away some of the MVM in the club?

Richard Galanti

Well, first of all, the letter E means every day. What we talked about -- what we changed back in February-ish, we've continue. What I mentioned -- I gave a couple of examples what we've done online of late. So it's not substituting something else. The view is -- our collective view is that there's -- we have the ability to do all the above and we're doing it.

Dan Binder

Okay. And then my last question was just around traffic, both I think in September and the quarter and I think actually for quite a while, the US traffic, or at least a couple of quarters, the US traffic has been better than international. I was just curious with a younger international store base, why would that traffic be softer? Is it strictly cannibalization or is it something more than that as you compare it to the US traffic growth?

Richard Galanti

I think it’s two things. It’s cannibalization and the newness of the – it’s cannibalization and new members in any state or any country and that first renewal is less than the second year renewals, less than the third year’s. So every time they renew, they’re more likely to renew the next year at a higher rate than the previous year class if you will. And so we've got newer market units and we have cannibalization.

Operator

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

Kelly Bania

Just a couple more questions on the two new online initiatives. I guess, first, how will the prices compare for each of them to the stores in the club. I believe Instacart has two different models, one where the prices actually matched the in-store prices, but I believe there's a margin impact for that for the retailer. So just any comments on how we should expect or what the message to members will be on how prices will be on the online versus in the club? And then are there any plans in terms of testing some more auto replenishment type programs along with this and any plans to market or advertise this in a meaningful way.

Richard Galanti

On the latter part, I believe there's something already on the site in terms of auto replenishment. That's over there. I'm sorry, it does replenishment in terms of the list of based on you bought before. And again, yes, that will be tweaked, but that was first order business to get out there. First of all, in terms of Instacart having two different models, the same prices in store or not, I don't think they only have one model with us currently, prior to this week. And which included, however they charge for delivery or they markup our goods. So this will be lower when you go on to Instacart and even lower when you go on to Costco grocery or Costco e-commerce.

Did I answer that?

Operator

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

Chuck Cerankosky

When you're looking at the various reasons people shop at the Costco clubs, are you able to look at just how much they enjoy their shopping experience, you've got great sales numbers and there's a lot of reasons to be in the store, but is there just a factor that indicates people enjoy being in the club.

Richard Galanti

Well, I'm biased, but of course, we all enjoy being in a club. What was first part of your question?

Chuck Cerankosky

Well, you've got various reasons like saving money to go to a Costco club and high quality, but is there just flat out simply an experiential reason to be in the clubs that is driving traffic numbers that are better than a lot of other brick and mortar retail?

Richard Galanti

Well, I think it’s several, well, Chuck and again, I am biased, it’s several things. The gas station’s help to fresh foods is second to none. And in our view, that’s even got -- the amount around that has gotten bigger, not smaller since June. There's Kirkland Signature items, there's Treasure Hunt fresh. There's organics, I mean I think this is what we do. When I go to the budget meetings every four weeks and I look at even some of the things we've got coming in for the various holidays, whether it's outerwear, apparel for the winter or some of the holidays like Thanksgiving and Christmas, just, I think our members are -- should be as excited as ever about some of the exciting new things we have.

They keep driving that value proposition. And all the things that I mentioned earlier in the call, the tweaking of the MVM, the -- using the emails to get you into buy, when everybody out there was $8.99 to $10.99 on choice, New York Strip Steaks, we went from $7.99 to $6.99. That not only drives business and it takes it away from chicken and ground beef, it drives traffic. And we know how to do that kind of stuff pretty well.

Chuck Cerankosky

Going back to membership, our work has been showing that household formations are looking a little better than the census numbers, which are about 1 million new households per year right now. Are you seeing that in membership sign ups in the US?

Richard Galanti

New households? I don't know. If you want to me email me the question, I can find out.

Operator

Next question comes from the line of Scot Ciccarelli with RBC Capital Markets.

Rob Iannarone

Rob Iannarone on for Scot Ciccarelli. Just one housekeeping item. Organic sales, can you tell us how much that was for the year?

Richard Galanti

Organic? It was up a little over 20% and about 5.5 billion.

Rob Iannarone

Great. And one follow-up also food related here. Anything you're seeing changing in either inflation/deflation, has the preliminary conversation changed with any of the suppliers you talk to?

Richard Galanti

It's pretty stable. I mean, everybody's hoping for a little -- well, we're not hoping for inflation, everybody's hoping for inflation. Again, it doesn't hurt us, but it's been pretty stable. I mean if I look at LIFO indices or any type of those metrics, we've gone from deflation to flat or literally low single digit basis points up on a basket. Taking gas out of the equation, which is quite inflationary right now.

Operator

Next question comes from the line of Joe Feldman with Telsey Advisory Group.

Joe Feldman

Two quick ones. Pick up in store, I know we've talked about this before with you guys, but just curious if you’ve changed your thinking on it at all or if there's any potential to do a test like a bottom line pickup in store situation.

Richard Galanti

Yes. We look at it, but at this point, we’re not prepared to do it. We do with tires. You can order them online and schedule your appointment.

Joe Feldman

Got it. Is it a space issue or a labor issue you think?

Richard Galanti

Well, it's -- first of all, to tell you the truth, in our view and maybe we're stubborn, it's a common sense issue. You order and then you've gotten, we have separated, it's a dry refrigerated frozen wait for you and it's clearly a space issue. I mean, we're doing literally twice the volume of some others out there, two to three times the volume versus our two direct competitors and I'm sure at some point, we’ll try it, but it's not on the agenda in the next couple of months.

Joe Feldman

Got it. And then the other topic, I think you said the store mix for this year, new stores was two-thirds US, one-third International, I feel like that you were trying to push more towards 50-50 the past couple of years, just anything to do that you can mention there.

Richard Galanti

We’re still trying and just there's a longer pipeline and we’ve had a lot going on. So there's, we will get there and I look at it and I think the good news is, if you had asked me five, six, seven years ago, I don't think we'd have as many opportunities in the US as we still think we have. I mean saturation continues, but that the time with saturation ultimately occurs for new locations, keeps -- being pushed out a little bit further.

Why don’t we take two last questions?

Operator

Okay. We’ve got two more questions left. The next question comes from the line of Brian Nagel with Oppenheimer.

David Bellinger

Hi. This is David Bellinger on for Brian. So my first question is on the price investments you detailed earlier. Just to be clear, did those step up in Q4 versus the trend over the first three quarters of the year and if so, was that in some way a reaction to the Amazon Whole Foods deal.

Richard Galanti

No. They didn’t other than there’s more weeks, there's 17 weeks versus the first three quarters that had 12 weeks and it had absolutely nothing to do with that. I mean, we priced Whole Foods twice a week in many, many markets around the country and we're kind of scratching our head. And we did that before the announcement of the acquisition by the way. Have they come down in prices of some items? Sure. Overall, and some of you have done your own price baskets, while we read about up to 43%, it's a lot closer to 0 than it is 43%. And even with something dramatic, others out there will be impacted a lot more than we are. Other than people wanting to have stuff delivered and we're providing that option based on how we do stuff.

David Bellinger

Got it. And then as my follow up, can you just give us any comments around the recent trajectory of food price deflation and what your expectations are going into 2018?

Richard Galanti

It's pretty flat right now. Within fresh, you're going to see variations like meat has come down a little bit. It was way up for a year, but that's going to be seasonal. Produce depends on props, recent events, oil, gasoline depends on recent events, the hurricanes, but other than that, taking some of those things out, it's pretty flat.

Operator

The last question comes from the line of Mark Astrachan with Stifel.

Mark Astrachan

I wanted to ask, can you give the percentage of sales that Kirkland Signature represents and then just curious if you think about the margins relative to what else is in store, given increasing competition out there and obviously the favorability of the KS product, would you think about increasing the offering there going forward to help sort of fund offer uniqueness within the store?

Richard Galanti

Yeah. Well, percentage wise, ex gasoline, even though, it says Kirkland Signature gasoline is about 24%, 25% of our total sales are non-gas sales, we'll continue to add items as they make sense. We're not really working towards the number and we think the number will keep going up a little bit, because we do like it, but we've also -- we've tried -- we remind ourselves, our head of merchandising reminds our buyers every day, don't fall in love with it, because it has your name on it and each year, which items, even Kirkland Signature, we just continue because the brand does better, maybe ours is a better value in our minds and maybe it is a better value, but we're still not successful with it. And by the way, part of the focus of our buyers probably before that is to find more brands, we want more brands.

Mark Astrachan

Got it. And then just lastly, you had previously talked about e-commerce expansion being done organically, curious if that's still the case or would you potentially take a look at other things, whether it's national retailer or it's a logistics provider, something that can help sort of bridge what you're doing externally now with something internally and related to that sort of views on competitive dynamics, meaning you buy something that isn't necessarily something you want, but something that somebody else may want that ultimately could negatively impact your business?

Richard Galanti

I think on the latter part of that, no. That’s going to be the last thing. I always joke, we're not smart enough to figure that one out. I think that we're likely to first of all look for partnerships and ventures to jointly venture something rather than to buy something. As you might expect, we along with other large consumer retailers, get calls every day about everything, whether it's delivery services, food related meal stuff, all kinds of stuff and we're fortunate in the sense that one, we've got some good relationships like this recent expansion, what we're doing with Instacart. That helps.

So I don't see us doing that. That being said, we’ll be open minded to anything. But we'll have to wait and see on that one. We've gotten a lot going on right now with some of the things we're doing that we're excited about and every time, when we tried something, I keep bringing up the steak idea or the steak example or the Copper River salmon answer, then we figure out what else can we do. And there's a lot of those what elses. And so we've got our plate pretty full on those kind of things and we've got to, look, we just rolled this thing out, it’s -- what we rolled out three days ago is a soft opening if you will. There's no publicity out there for it. We have to see how it goes, what it does first.

Mark Astrachan

Thank you.

Thank you, everyone. Have a good day.

Operator

There are no more audio questions at this time. You may now disconnect