Costco Wholesale Corporation (NASDAQ:COST) Q4 2016 Earnings Conference Call September 29, 2016 5:00 PM ET

Executives

Richard Galanti - Executive Vice President and Chief Financial Officer

Analysts

John Heinbockel - Guggenheim Securities

Simeon Gutman - Morgan Stanley

Matt Fassler - Goldman Sachs

Michael Lasser - UBS

Dan Binder - Jefferies

Karen Short - Barclays

Paul Trussell - Deutsche Bank

Sean Naughton - Piper Jaffray

Greg Melich - Evercore ISI

Oliver Chen - Cowen

Dan Farrell - Oppenheimer

Operator

Good afternoon. My name is Amanda and I will be your conference operator today. At this time, I would like to welcome everyone to the Q4 Earnings Call. [Operator Instructions] Thank you. I would now like to turn the conference over to Mr. Richard Galanti. Please go ahead.

Richard Galanti

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

Today, we reported our fourth quarter and year-to-date fiscal '16 operating results for the 16 and 52-week periods ended this past August 28. For the quarter, earnings came in at $1.77 a share, up 2% or $0.04 over last year's fourth quarter earnings of $1.73 a share. In comparing the year-over-year fourth quarter earnings results a couple of items of note in looking at the comparison. FX as compared to a year ago during the fourth quarter, foreign currencies in the countries and other areas where we operate were weaker overall versus the U.S. dollar, primarily in Mexico, Canada, UK and Korea, this resulting in foreign – in our foreign earnings in Q4 when converted into U.S. dollars being lower by about $13 million after tax or $0.03 a share and exchange rates been flat year-over-year.

Gasoline profitability. Our profits from gasoline during the quarter as compared to last year's fourth quarter were lower by about $27 million pre-tax or $0.04 a share, primarily a function of last year's very strong profit results in the fourth quarter. Our numbers were fine this quarter, but we did pretty well last year as well. IT modernization, that was about a $0.02 year-over-year impact. I can go for the detail on that, but that was about $60 million pre-tax or 4 basis points to the – primarily to the SG&A line.

Income taxes. Both this year and last year's fourth quarter results had several positive – net positive tax benefits that in the aggregate benefited each of the fourth quarter's earnings per share figures by $0.05. Excluding those positive tax items, this year's underlying Q4 tax rate was about 0.06% of a percentage point higher than last year's. That would have been about $0.02 a share, but again, year-over-year in the quarter, each of those fiscal quarters benefited by about $0.05 a share from positive items.

LIFO, this year in the fourth quarter, we reported pre-tax LIFO credit of $31 million. That compares to last year in the fourth quarter of $14 million, so both deflationary, although we have all talked about the increased levels of deflation of recent time. So at year-over-year delta $17 million or about $0.02 a share related to a higher deflation in the LIFO credit in the quarter up by – higher by that amount.

In terms of sales for the fourth quarter, total reported sales were up 2%. Our 16-week reported comparable sales figures were flat year-over-year. Comparable sales were negatively impacted by gas price deflation. That was a little over 200 basis points of impact to the company and by weaker foreign currencies relative to the U.S. dollar, the latter about 1 percentage point of impact to sales. Excluding deflation, the flat U.S. comp sales figure for the fourth quarter would have been plus 2%. The reported Canadian comp figure of plus 2% would have been plus 5% ex-gas and FX and the reported minus 2% other international comp figure, ex these two factors, would have been plus 1%. Total comps were reported as zero for the quarter and again, excluding gas and FX, would have been plus 3%. And of course, the plus 3% adjusted figure is still being impacted by a bit of an increased general merchandise deflation outside of gasoline.

Openings in Q4, we opened 10 new locations and also completed 1 relo. And for the fiscal year, we opened 29 net new locations. On top of that of 4 relocations I believe 2 of them which were relocated in the old units converted into new business centers. Of the 29 locations, 21 were in the U.S., 2 are in Canada, 2 are in Japan, and 1 each were in UK, Taiwan, Australia and Spain.

This afternoon, I will also review with you our membership trends and renewal rates, additional discussion about margin and SG&A, talk about e-commerce and a few other items of note, including an update on our recent switch over to the new Citi Visa Anywhere card. This occurred on June 20 after 6 weeks into the fourth quarter.

So, on to the fourth quarter results. Quickly, sales for the fourth quarter were $35.7 billion, up 2% from last year's fourth quarter sales of $35 billion, again, a flat comp on a reported basis plus 3% excluding gas deflation and FX. The flat comp sales results on a reported basis that consisted of an average transaction decrease of 2.8%. Again, excluding gas and FX deflation – gas deflation and FX, the average transaction was slightly positive year-over-year and an average shopping frequency increase of right around 2.5%.

In terms of sales comparisons by geography, Texas, Bay Area and the Midwest regions within the United States showed the best results. Internationally in local currencies, better performing countries were Canada, Mexico, Spain and the UK. In terms of merchandise categories for the quarter, sales for that within food and sundries, overall slightly negative year-over-year in the fourth quarter.

Within that though, spirits, sundries and deli came in best. Tobacco was the big negative, of course, as we have talked about that and that was down 21% year-over-year as we continue to see lower sales in that category. If I look at the food and sundries category, that again on a comp basis was slightly negative year-over-year for the quarter. Ex the tobacco department, it was plus 3. And you can see – continue to see tobacco impacting us into the early spring.

Hardlines, overall up mid single-digit. The departments with the strong results were majors, electronics, sporting goods, health and beauty aids, hardware and tires. Within softlines, which was up in the low single-digits, apparel, small electrics and home furnishings were the standouts. Within fresh foods, produce and deli were the strongest of the four departments. Of course, meat has had a lot – meat and other types of protein had a weakness relative to deflation. In ancillary businesses, hearing aids, pharmacy and optical showed the best results. I had mentioned earlier we have recently seen a little pickup in the level of deflation overall. Some categories in the low to mid single-digits – in the low to mid single-digit range and several fresh food categories, notably meat and pork and things like that in the 5% to 10% range in some cases. Overall though, we are seeing net increasing deflation, but not in those levels and some non-food levels as well – non-foods as well.

Moving to the line items on the income statement, membership fees, we saw good results for the quarter. Reported were $832 million, up 9 basis points and $47 million or up 6% in dollars versus last year's fourth quarter. It would – the $47 million would have been up $50 million if you would adjust it for FX. In terms of membership, we continue to enjoy strong renewal rates, 90% in the U.S. and Canada and 88% worldwide, continuing increasing penetration of executive memberships as well. In terms of number of members at fourth quarter and year end, at year end, we had 36.8 million Gold Star members, up from 36.2 million 16 weeks earlier at the end of the third quarter. Primary Business ticked up to 7.3 million from 7.2 million. Business add-on remained at 3.5 million for a total of 47.6 million member households at Q4 end compared to 16 weeks earlier when it was 46.9 million and including add-on cards in terms of you walking around with a Costco membership card in their wallet, 86.7 million at year end, up from 85.5 million just 16 weeks earlier.

In terms of Executive Member sign-ups – Executive Members, we have of the 47.6 million member households, we have 17.4 million. That was an increase of 370,000 during the 16-week fourth quarter or about 23,000 a week increase. And that's a combination, of course, of new members signing up as an Executive Member as well as members converting to it. Executive Members now account for a little over a third of our base and a little more than two-thirds of our sales, where Executive Members are offered.

In terms of membership renewal rates, we ended the year at 90.3% in the U.S. and Canada. That's ticked down from 90.4% at the end of Q3. In the first half, it was 90.5%; worldwide, 87.6%, which was the same at Q3 end, ticking down from 87.7% in the previous quarter, again, the second quarter. As I have talked about in the last few quarters, in Canada, we finally, in Q4, saw a reversal of some reductions in renewal rates, which we had anticipated when we converted 1.5 year or so ago to a new program card up there. In that case, the portfolio from American Express wasn't purchased. So it was really had to start all over and you don't have as many auto renewals to start with. But that's quickly changed and we have – again in Q4, we saw a slight increase in the renewal rate there. A little different reason but the same thing a little bit in the U.S. with having no new sign-ups for the last nine months prior to June 20 as we were switching over on June 20. So overall, pretty much the same and we will see where that goes from here.

Regarding membership fees, effective the beginning of this month, we increased membership fee – annual membership fees by about 10% in three Asia locations Taiwan, Korea and Japan, as well as in Mexico and the UK. On an annual basis and as you know, fee increases hit the membership fee income line over about 23 months based on deferred accounting. For example, the first month, people that are seeing this in September, those are people that originally signed up presumably in September and this is when they renew. People that don't – didn't sign up or aren't renewing until next March, they will be in March and for 12 months end. So that ends the 23 months overall. That will be about $50 million pretax to the membership income line. I am sure there will be some offset in terms of what we do in terms of competitive pricing and everything.

Before continuing down the income statement line items, let me spend a minute updating you on our transition from American Express to Citi Visa in the U.S. and Puerto Rico. As I mentioned this took place on June 20, the beginning of the seventh week into the fiscal fourth quarter. Beginning June 20, we stopped accepting American Express at all U.S. and Puerto Rico

Costcos and on costco.com and began accepting all Visa cards, including of course, the new Citi Visa Anywhere card. There was a lot of effort and as you know, there were a few operations glitches during the first few weeks after the cutover. We are now past that and more importantly, the new card is fantastic for our members. In terms of increased cash back rewards, the estimate is about a 40% to 50% improvement in the reward program, which is already previously a very good reward program to the members using the Citi Visa Anywhere card. And it’s also great for us in terms of driving member value and sales over the next years and of course lowering our effective costs of accepting credit and debit cards.

In terms of improved cash back member rewards, our former card provided a 3% cash back on gas, 2% on restaurant and travel, and 1% everywhere else, including everywhere at Costco other than the gas. With the new CV’s Anywhere card 3% on gas now is 4%, 2% on restaurant and travel is now at 3% and probably the most significant rewards improvement in terms of the total bucket here is the previous 1% reward on all other Costco purchases doubled from the previous 1% cash back rewards now to 2%. We think this is big and it’s even bigger for our executive members who also are in the 2% reward from us on most Costco purchases. So combined, an executive member using the new card with just a few exceptions will earn 4% back at Costco. We think this is exciting, and we think it will be good for our business over the next several years. Now lastly for all other purchases outside of Costco on the card, it will be – it will remain at 1% cash back reward.

A few basic stats on the new card, approximately 11.4 million American Express co-branded cards, representing about just under 7.5 million accounts were transferred over to Citi during the conversion. Nearly 85% of those cards what we considered active, that is the card had been used for purchases over the previous 60 days. Currently, over 85% of the accounts transferred over have now been activated with Costco. And since June 20 and just the past many weeks, 1.1 million members have applied for the new card and over 730,000 new accounts have been activated or a little over 1 million additional Citi Visa cards in circulation. It's still early. We launched only 14 weeks ago, but so far, we are beating our initial expectations in terms of conversion, usage and new sign-ups to the card. In terms of gross margin, our reported gross margin was higher year-over-year in the fourth quarter by 28 basis points from – up from 11.14% a year ago to 11.42%. Let you jot down the normal numbers that I asked you to jot down. With our [ph] four columns, reported and without gas deflation Q3 '16 – in Q3 '16 would be the first two columns. The third and fourth columns would both be Q4 '16 but then also reported without gas depreciation.

The core merchandise in Q3 on a reported basis was higher year-over-year by 16 basis points, but without gas deflation, down 2 basis points year-over-year. In the fourth quarter, up 29 basis points of this '16 and again ex gas deflation, up 9 basis points. Ancillary businesses in Q3, plus 9 and plus 4 reported in the gas deflation. And in Q4 '16, ancillary businesses reported minus 4 and minus 9 without gas deflation. 2% reward, zero and a plus 2 in Q3 and a minus 2 and a zero in Q4. LIFO, plus 2 and plus 2 and in Q4 '16, plus 4 and – I am sorry, plus 5 and plus 4. Other, in Q3 '16, both columns had a plus 7 and Q4, no issue, a zero and zero. So, all told in reporting on a year-over-year basis in Q3 of '16 compared to the prior Q3, up 34 basis points on a reported basis and up 13 on ex-gas deflation basis. This year in the fourth quarter of course, you saw the 28 basis point up, that would have been plus 4 ex-gas deflation. I might add that the plus 7 a year ago, that was – I am sorry in Q3 that was simply a one-time legal settlement that benefited margin [ph].

As you can see overall, again our margin was higher by 28, but without gas, plus 4. The core merchandise component that you see – that I have just mentioned, the plus 29 or the plus 9 ex-gas deflation, that's the thing our folks want to start with. Our core gross margins, which is fresh foods – food, sundries, hardlines, softlines and fresh foods, as a percentage of their own sales were higher year-over-year in the quarter by 12 basis points with food and sundries and hardlines showing higher year-over-year gross margins slightly, softlines being about flat year-over-year and fresh foods being ever so slightly down year-over-year. Ancillary and other business gross margins were down 4 basis points, ex-gas deflation, down 9, all a function of lower year-over-year gas prices – gas profits. And as discussed earlier in the call – but excluding gas, all other ancillary and other businesses gross margins as a percent of their own sales were up 6 basis points. So margins were fine in the quarter overall. And again, LIFO added 4 basis points to the equation.

In terms of SG&A expenses, for the quarter year-over-year, we were up 34 basis points, coming in at 10.34 versus a 10.00 a year ago. And again that 34 – I will have you jot down a couple of numbers, that 34 ex-gas deflation is a minus 13 or higher by 13, not higher by 84. Again the same four columns, Q3 '16 for reported and Q3 '16 for without gas and the same two column headings for Q4 '16 – in Q4 '16. Operation, core operations, minus 24 basis points and a minus means higher, higher by 28 and 4 basis points in Q3 '16 on a reported basis, higher by 8 ex-gas deflation. In the fourth quarter, higher by 24 and higher by 6, central, higher by 6 and higher by 4 in Q3 and then Q4, higher by 9 and higher by 7 ex-gas deflation. Stock compensation, higher by 3 and higher by 2 in the third quarter and higher by 1 and flat in the Q4 columns. Then total, reported in Q3 '16 compared to Q3 '15 on a reported basis, SG&A was higher by 33, but really higher by 14 ex-gas deflation and the higher by 34 this time was higher by 13 so not that different on looking at it that way.

The operations component, the minus 6 core operations ex-gas deflation, that consisted of higher payroll and benefits partly due to the slightly weaker sales and the deflation and particularly in fresh that impacts that number, somewhat offset by a variety of other controls and expense improvements, in particular lower year-over-year bank fees as a result of the Amex Citi Visa switch during the quarter. Central expense was higher year-over-year by 9, 7 ex-gas. Increased IT spending related to modernization that was 4 of those 7 and a couple other basis points higher from a few small legal settlements in the quarter. And again, stock compensation was really not an issue year-over-year.

Next on the income statement pre-opening, pretty much in line with openings themselves. Last year, we had $27 million pre-opening expense. This year, it's $3 million lower or $24 million. Last year in the quarter, we had 13 openings. This year in the quarter, we had 11 and which includes that relo, pretty much in line again with what we had expected – would expect. All told, operating income in the fourth quarter came in at $1.191 billion which was $35 million higher or 3% higher year-over-year than last year's $1.156 billion. Below the operating income line, interest expense in the fourth quarter came in at $39 million this year versus $40 million last year, essentially flat year-over-year, essentially the same amount of debt outstanding at the various interest rates. Interest income and other was lower year-over-year by $11 million in the quarter, coming in at $29 million versus $40 million a year ago. Actual interest income was higher year-over-year – I am sorry, was a little lower year-over-year. The big difference was the other category, which was $16 million, primarily various FX transactions. This year in the fourth quarter, if I added up all the various FX, which is marking to market items and FX from foreign exchange contracts, we made about $11 million pre-tax a year ago. It was a little outsized. We made $26 million. That generally fluctuates. Usually, it's plus or minus $5 million. Sometimes it's a little more or less.

Overall, pre-tax income was higher by 2% or $25 million higher, coming in at $1.181 billion. In terms of taxes, I mentioned that earlier, both fiscal fourth quarters this year and last year each benefited by about $0.05 a share from various positive items. And excluding these items, the normalized rate this year was still up about 0.06% from the year earlier. And again, net income coming in at $779 million for the fiscal quarter was up 2% from a year ago.

A quick rundown of some other topics in this afternoon's release, we have provided you balance sheet information. One thing that is not on the balance sheet that I am always asked about is depreciation and amortization. For the fourth quarter that came in at $408 million and for the entire fiscal year, D&A came in at $1.255 billion. One thing that I will look perhaps a little out on the balance sheet was cash levels and accounts payable and the like. That has to do with modernization and switching our basic accounting platform over and this has been a 2 plus year effort. It was installed and it's really the platform that allowed the legacy systems will now sit on as we continue to develop them over the next couple of years. Not only was a big effort, it was an expensive effort. But nonetheless, to make sure that we had an extra week at the beginning since this system went in on day 1, we – anything that was set up in the system, any merchandise or other payables that were set up in our system would be paid in – during week 1 of the new fiscal year. We prepaid a week early the prior – up to a week early the prior Friday I believe. And so we paid about $1.7 billion extra in week 52 of this past fiscal year and that's why you see – you will see the cash levels down and the payables levels down associated with that.

So again, one of the statistics we always share with you is accounts payable as a percent of inventory. Last year, fourth quarter end on a reported basis was 101%. What you will see now it's 85%, but again, taking out that $1.7 billion, it's 104%, actually a slight improvement in our payables ratio. And excluding construction payables and other types of non-merchandise payables, last year was an 89%, again on – what I will call a normalized basis. Assuming we hadn't prepaid $1.7 billion of payables, the 89% would have been up a couple of percentage points to 91%, so manage – seem to be managing that okay.

In terms of average inventory per warehouse, last year fourth quarter end, it stood at exactly $13 million per warehouse. This year, it came in at just slightly over $12.5 million or about $460,000 lower or 3% lower. And really lower warehouse inventory is pretty much spread across many categories, including the impact of deflation in many of the food and fresh departments as well as electronics. A little bit of it has to do with FX, but most of it is just coming down a little bit on inventory levels.

In terms of CapEx, in Q4, we spent approximately $850 million. And for all of fiscal '16, we came in right at $2.6 billion. That $2.6 billion by the way compares to $2.4 billion for the prior year fiscal year in ‵15. Our estimate for fiscal ‵17 CapEx is in the range of $2.6 billion to $2.8 billion, so about the same level as compared to last year perhaps a little bit higher depends on timing. Next, Costco in line, we are currently in the United States, Canada, UK, Mexico and recently – more recently launched in three in Taiwan. For the fourth quarter, sales and profits were up year-over-year. Total sales were up 12% in the quarter, 13% ex-FX. And for all of ‵16, 15% reported plus 17% ex-FX. On a comp basis, for the quarter, we were up 10% reported and 11% FX – 11% excluding FX and for the year are 14% and 17%.

Next discussion in terms of expansion, as I mentioned, in terms of net new locations this year, we opened 29, that's up from 23 openings in all of ‵15. This current year we have got in our budget 31 net openings, 34, but 3 of them are relos and so something certainly in the high 20s, but I think something our current best guess is the 31. If you look back over the last couple of years, the 23 we opened in ‵15 that represented about 3.5% square footage growth. In fiscal ‵16, the 29 units, recognizing they tend to be a little bigger and we have also expand a few units, it's about 4.5% square footage growth. And in ‵17, as soon as we got to 31, that would be in the low to mid-4s as well in terms of percentage of square footage growth.

Our planned fiscal ‵17 locations assuming the 31 number would be 17 in the U.S., 7 in Canada and 1 each in Taiwan, Korea, Japan, Australia, Mexico, France, our first in France and also a unit in Iceland. And both France and Iceland are currently targeted for mid-to-late spring – late spring this calendar ‵17. And as we know sometimes they may slip, but that's our best guess at this point. Note again, these are first locations in France and Iceland and we look forward to seeing some of you over there. As of fourth quarter end, total square footage stood at 103.2 million square feet. In terms of common stock repurchases for the fourth quarter, we purchased $131 million worth of stock or 856,000 shares at an average price just over $153 a share. For all of fiscal ‵16, we purchased $477 million of stock. That compares to $493 million in 2015 and $333 million in 2014.

In terms of dividends, our current quarterly dividend stands at $0.45 a share. We increased that this past spring a few months ago. That was 12.5% increase from the prior quarterly and annual rate. So, this year at $0.45 a quarter, this yearly $1.80 a share dividend represents an annual cost to the company of just under $800 million. Next Wednesday, October 5, at 6:00 p.m. Pacific Time, we will announce our September sales results for the 5-week period ending Sunday, October 2, this coming Sunday. This 5-week period will include 34 selling days in the U.S. and Canada recognizing the closing of your business in the observance of Labor Day in those two countries. Lastly, our fiscal ‘17 first quarter results, for the 12 weeks ending November 20, we will do it as we have done this time, we will report after shortly after the market close on Wednesday, December 7 with the earnings call that afternoon at 2:00.

With that, Amanda, I will turn it back to you for Q&A.

Question-and-Answer Session

Operator

My pleasure. [Operator Instructions] And your first question comes from John Heinbockel.

John Heinbockel

Richard, so let me start with expansion. I think you said 7% in Canada, was that right?

Richard Galanti

Yes.

John Heinbockel

So, kind of – which I don’t none in recent years have you opened that many in Canada, so what sort of drove that some unique real estate opportunities? Does cannibalization pick up over the next year in Canada? And then sort of tying it back to the U.S., when you think about where you sit today, have you really done any deeper thinking about what the saturation level in the U.S. could be beyond where we sit today?

Richard Galanti

Well, first of all, in Canada, I think it's a couple of reasons. If you think back 5 or so years ago or even 10 years ago when we had probably 65, 70 units, we thought the market might be 91 day and today we have 90 or 91 and we think that they will certainly be over 100 and we keep adding a few to that concept. I think the fact that we are opening so many right now has to do with as much with very strong sales over the last few years. We have been enjoying 5% to 9% comps in local currency in each of the last few years up there and so it keeps getting stronger. And just like in the U.S. and even in mature markets, we find that we can – while there will be some cannibalization, the net business that's added when we opened a unit even though it's cannibalizing, net of cannibalization will find that existing members will then be shopping more frequently, because they are closer. And so I think it's a combination of those things. And I don't know what the new 5 or 10-year guesstimate is in Canada. I don't think we can open 7 a year, but once we decided to go to look and see where we are going and how strong we have been, we have been – this is the result of probably an effort that started over a year ago to put a few more in the pipeline up there.

In terms of the U.S., I think the same story holds true If you had ask us 5 years or so years ago, by now how many would be in the U.S. versus outside the U.S. and we would have said probably we would be down from 75% or 80% in the U.S. to 50% and heading south of there is we saturate. We found in the U.S. that we can put more units in existing markets. I think we are getting, in a couple of months, we are getting ready to open our 17th or so unit in the Puget Sound, having opened our 16 or unit just less than a year ago. And the other thing of course, in the U.S. that we have perhaps up to our expectation is markets that 5 years or so years ago we didn't think we would have any near-term interest in considering medium sized markets where our direct competition was there. And what we have found is we have done pretty well when we go to these markets. Now some of these markets are smaller, it takes a little longer, but there is clearly an opportunity for us there and as we have gone into Tulsa and New Orleans and Birmingham and Rochester and lots of – and Toledo, these are markets that again, were higher on the radar 7 years or 8 years ago. And what we have seen is that our deal works. The last thing of course, includes adding to some of the business centers. For many years we only had six or eight or so business centers. We opened four last year to be at 11 and we are planning to open four this year to be at 15 including our first business center in Canada. And so again, that just adds a few in both the Canada question and the U.S. question. It includes that opportunity on a small basis. And a side on that is, I think as I have mentioned, I think two of the four relos this year were – two of the four business center openings this year were relos. One in back in many of your [indiscernible] when we took an older, smaller parking lot, no gas station, Hackensack Costco and relocated it to Teterboro nearby with the big sized unit with lots of great parking, great ingress in the U.S. and a gas station and converted the Hackensack unit into the business center, so just a small additional benefit in terms of having a use for units as we moved some of those to bigger locations. So all that's I think been part of it.

John Heinbockel

Alright. And then just lastly, have you sort of finalized or thought about the percentage of the Amex to Visa benefit that you are going to get, how much you keep versus providing that back to members, when you think about putting it back to members, when you think about price, labor and/or service and then maybe product development, where is the most lucrative place to reinvest and I am not – I don't know if it would be price, but is it something like product development and pushing the envelope outlook more in Kirkland?

Richard Galanti

Well, some of those things that you threw out is possible ways to use that parts of this bucket of money. We do all of those anyway. And I think probably the best, simplest answer is that just like when we buy a physical product better lower we can buy whether it's lower freight, greater purchasing power or greater production efficiencies or whatever we figure out with our supplier, we generally wanted 80% or 90% of that, the vast majority of it given back to the customer in terms of lower price because that's what drives us and drives our business. And if we do it more next year, we will give 80% or 90% of that back. It's not an exact number, but it's well closer to 80% or 90%. That same MO and philosophy occurred here. So when we sat down and negotiated all the various levers that relate what I call this bucket of money, there is a lot of ways one can use it, most importantly by improving the reward on the cards to the member that's going to utilize it. That will drive value to that member and loyalty to us and also more business to us. And secondly, what's left over and when we originally did it, we did it such that we are going to keep a small amount of it. Now, to the extent – we are not going to change the rewards program every afternoon if we see that there is more money in the bucket. So that will additionally accrue to us, but it's not changing what you are doing with it. We are going to still do those other things. So again I think over time, you look at it and you can rest assured in a few years if the success of the card and the economics of the card to us, we are not going to allow ourselves to keep a lot of that extra, but we started with a small amount and the big bucket is good and it is a little better because the card is working in direction that we expected, that's good. And we are still going to do those other things anyway.

John Heinbockel

Okay, thank you.

Operator

And your next question comes from Simeon Gutman. Morgan Stanley

Simeon Gutman

Thanks guys. Simeon Gutman. Richard, thinking about the top line, we are on the verge of cycling, I would say some of the worst of food deflation, I know you mentioned it's picking up a little and then some of the traffic that the business got on the gas side and I think the tobacco headwinds you mentioned is still a little more to go and first, is that fair that we are on the verge of cycling that. And then if we are, should we expect to pickup in the business from a top line, are expecting a pickup, I am just curious how you are thinking about that?

Richard Galanti

What was the last part of the question, Simeon?

Simeon Gutman

I mean, should we see the business in flat from the top line as some of these, I guess deflation top line headwind debate?

Richard Galanti

Yes. Well I think first of all, I think first of all there is – first one, when I asked different buyers and different merchandise categories, their view is it's going to be three months to six more months. Recognizing these are also gasses, I mean they are perhaps educated, unless you know there is something specifically happening like you are anniversary-ing the bird flu or your anniversary-ing really high feed prices on the commodity side. Sometimes there is a little more predictability on that side. But beyond that, I would say probably best guess is five months or six months of continued deflation at these newer levels in some cases. Gas, who the heck knows.

Simeon Gutman

Are there any changes there?

Richard Galanti

Yes. Bob is here. Barring any major changes out there, you would see an inflection point probably in. More neutralism.

Simeon Gutman

Late fall.

Richard Galanti

Late fall, so it’s a few months. That sounds like a definite maybe.

Simeon Gutman

If you – I guess if you take the deflation in the food categories, if you take some of the deflation, maybe in electronics or do this analysis of looking at the units versus the sales, I guess what is that delta if you put it altogether, like your best guess at that?

Richard Galanti

I have to get back to you on that and I will give you some sound points, if you will. Some of it, I mean there are so many examples particularly like in meat. You have seen every month at the budget meeting where we will have literally a 10 or so percentage point dropped in the price per pound and a 4 or 5 – 3% or 4% or 5% increase in labor productivity per pound and less efficiency because of the fact that the price per pound went down much more than that. And so that’s the kind of stuff that hits your profitability, of course too. There is – if I look at – there is some interesting things going on with some commodities. I was just looking at a chart coffee, the average – these are average sales but it’s consistent with average cost, down 16%. A lot of things, in the certain – cheeses are down 10% to 20%. I believe eggs are way down right now. And so those things are all impacting you. Now it impacts you on selling eggs, it helps you a little bit in selling muffins because we are obviously changing 6 impact a month and from making the numbers. We sold them for but $5.99 down 5$.89. And so you are going to – I would say the net of those twos is still a detriment to us. By the way, what I mentioned earlier about late fall, that had to do specifically with gas. We will see the inflection point, it looks like we are going to see an inflection point with gas all things being equal out there in the next couple of months.

Simeon Gutman

Okay. And then my follow-up is related to the credit card, I guess looking back, you only had a couple of months, but are there signs that there was some deferred spending on either big ticket items. And then if you have the data, is the same member who is either buying on AMEX or not on the co-branded card, is their spending up individually year-over-year, meaning they are incented by the card and they are actually spending more with you?

Richard Galanti

As it relates to the first question, absolutely. We probably saw it biggest and something that the millennials don't buy, affiliates. We saw a big decline for a few weeks leading up to it and big increase right afterwards. Also, on big ticket, but generally speaking, jokes aside on millennials, across the board we saw improving bigger ticket purchases, which again that make sense, people are waiting. Now there is all types of movement in both directions. You had existing – a member with existing Visa cards in his or her wallet and maybe they are using that one, not ours, that's fine. We still have a negotiated good rate on certain things. You have people that were using debit their whole lives because they perhaps did not want an American Express card or they applied for one and did not get one. And so for 16 years, they used cash, check and debit. Now, for the first time, they can use a credit card and I am sure that's where we saw many of these new signups as well or part of them, but in terms of are they buying more with us? Anecdotally, we are hearing that from our warehouse managers who talk with their biggest wholesale customers, but it's purely anecdotal at this juncture and I think we will see more of it. I haven't actually looked any statistics on that.

Simeon Gutman

Okay. Thanks, Richard.

Operator

And your next question comes from Matt Fassler.

Matt Fassler

Good afternoon, Richard. Matt Fassler from Goldman Sachs. Couple of questions. First of all, you spoke in fairly general terms about how you plan to make use of the better economics of the credit card where we hoped to direct it. If you think about the impact on the P&L this quarter along with launch, I don't know if there are special provisions in place for the cost of launch in the card. I am not sure if there are elements of the change of the arrangement that started to impact it, but would you say that there is any offset to SG&A or meaningful offset to gross margin that resulted from the transition this quarter?

Richard Galanti

Well, certainly there is certain costs were subsidized in the transition from our partners. But at the end of the day, there – yes, I mentioned I think when I was going through the SG&A, payroll and benefits for our company, were up year-over-year in the quarter in SG&A. And that was somewhat offset by and I said in particular, rounded up into anything related to this credit card transition. So, yes, there is improvement related to that.

Matt Fassler

Got it. And then second question, if you think about other international, obviously you didn't call out Asia, any of the Asian countries as strong countries, You spoke in over the course of the month it releases about comping some of the big openings that you had in recent years and the other international comp number is a bit lower than we have typically seen anything to think about the franchise in those markets or the macro or how you are resonating in that part of the world?

Richard Galanti

No, it has more I think to do with a little bit of cannibalization in a couple of those countries where you have got 10 or 12 locations in Korea and Taiwan or I think we had a cannibalization in Australia as well, but one location take a $200 million or $300 million building down $70 million, $80 million and that's what's in your comp, not the new building. So, that has much to do with it as anything. We feel really good about our markets. We feel very good. And as we have said, the one market that has been – we start, we remind ourselves that there is a time when we were going to close Korea and Taiwan and they are our most and almost our most profitable productive countries and locations. And we have talked about our first unit in Syria [ph], got off to a slow start. It's growing nicely now. Madrid got off to a much better start and it's growing nicely. And so, again, we are patient, but in terms of that other international comp number, I would guess and I don't have the detail in front of me, but what I have seen before is in recent times is that it's cannibalization more than anything.

Matt Fassler

And that's good to hear on Spain by the way. If you think about the cadence of openings and year ago openings and where the new stores are going to open in some of those markets, is this an issue, the cannibalization issue that should stay with you for a little while or is it that to abate at some point over the course of the fiscal year?

Richard Galanti

Which one?

Matt Fassler

The cannibalization primarily in Asia, presumably.

Richard Galanti

I hope it doesn’t abate. That means we are working hard to get more openings there. These are generally no-brainer locations in terms of very predictable successful locations for us. We feel we have developed a great franchise over there with great loyalty and great success and we would like to do it a little more if we can. We are working hard to get more locations in both Korea and Taiwan as an example. And it just takes a long time in Taiwan and longer than a long time in Korea because of zoning and other restrictions and it rains on everybody and other big boxes in those community – in those areas have the same impact.

Matt Fassler

Great. Thank you so much.

Operator

And your next question comes from Michael Lasser.

Michael Lasser

Good evening. Thanks a lot for taking my questions. Richard, are you seeing any evidence that you are attracting new members to your club as a result of the more lucrative credit card offer?

Richard Galanti

Yes. And again, this is very early. We have seen in the tens of thousands of signups or people that were members that signed up because of activities in Citi branches and bank branches. And we have seen from the blogs, of course, the first few weeks of the blogs always saw, was about the 30 minute waiting times or longer and other hassles like that. But the reality is we have seen, I would say, it’s still a small percentage, what I mentioned there was 703,000 new accounts, I would guess well less than 100,000, but 50,000 to 100,000, I am guessing, would be that. A lot of it has to do with existing members that we are seeing the value of that card when they walk in.

Michael Lasser

And do you have any plans to try and accelerate the sign-up of new members by raising awareness of the card through marketing effort?

Richard Galanti

We are doing that already. But maybe we are not doing a good enough job. But there is nothing else that we are doing right now and when I say that to our partners as well, because they are doing some things as well, but we are getting the word out in a big way in the warehouse with handouts, with signage, with people, the word is getting out. And we are, again, as I mentioned earlier, we are beating our own expectations of what we had planned for these initial 14 weeks, if you will. And so we feel pretty good about it.

Michael Lasser

And my follow-up question is so you are beating your expectations on the credit card overall, you mentioned that spending for maybe some of your larger customers on the card has been a little bit better and may pickup as a result of it. Yet, your overall columns have been a little more sluggish in the last couple of months. Does it actually suggest that you are seeing even though that marginal customer – that marginal member go away or some other behavioral change that was driving business model?

Richard Galanti

Yes, it’s really hard to tell. I mean, arguably, there is probably 50 different factors that impact sales everyday and every week and every month. And we look at – try to look at the big picture here. We feel very good about what we are doing in merchandising wise. We feel very good about what we have seen with the crossover to this. Our view has been we don’t think that many people left Costco, because they can’t use their American Express card. American Express is a great brand and it was a great relationship for many years. But at the end of the day, they are coming to Costco because of our quality in our value. And when we look around and as you would well know, we get a lot of questions all the time, well, are we impacted by the Internet, losing some? The internet is taking from everybody. Our view is it takes a little less from us. And interestingly, when you look at the categories within our slightly lower sales over the last couple of few months, the categories that have buffed that trend have been discretionary nonfood categories like apparel and housewares and electronics. So, now when we look at food and sundries, we absolutely do not believe its delivery services. We do absolutely believe its deflation more than anything. But again, everybody takes a little piece of something. It's a little piece that we would rather have ourselves or not lose. But again, we feel good about what initiatives we have got going on. And again, when I talk about the new card being a reward to the member based on their previous spending habits, 40% to 50% greater reward, that's big.

When I talk about going from 1% to 2% on Costco purchases when they use that card, that's big and it's not big overnight where they just change their habits completely. You will see at first in business members and that's where we have seen it. Mind you, during the transition, there was probably a little loss of sales for some of those business members in some cases. I am sure American Express didn't around not doing anything. They are good at what they do and they were able to figure out how to get people, they are marketing elsewhere. But we think that our members at Costco, primarily for us, I think again it's a lot of different things or different factors and again, having gone to our budget meeting forever but having gone every four weeks, just to name with the last few, some of the initiatives I see going on, merchandising wise, I think we got a lot of good things going on. Not that we are trying to solve a problem from yesterday, it's what we do everyday.

Michael Lasser

Thanks so much.

Operator

And your next question comes from Dan Binder.

Dan Binder

Hi. It's Dan Binder. Thanks. Just following on here, your comment about the web taking a little bit from everybody, does that change the way you think about your own web strategy, type of items you are willing to put on and delivery times, etcetera just to create greater convenience because price doesn't really show up on our screen as the major factor?

Richard Galanti

Well first of all, I don't see us – yes, we are doing some things anyway and are we doing more things, absolutely. But we are not freaking out about it. We are recognizing – we recognized that we are not going to be the provider. We may be the provider to somebody that wants to deliver like an Instacart or Google Express, but we are not going to be dropping off small items and our prices at your doorstep. That being said, we are, we have and we continue to add things. On the merchandise initiative side, we have added various sundries items and health and beauty items and on the apparel, trying to get to a more treasure hunt. I think you are going to see big differences literally in the next several weeks of the types of hot items that you see on there on the non-food side in the treasure hunt. On the – I think that's probably the biggest thing you will see. Operationally, there is a few things. We are by no means, we are one click. We recognize our site has had some challenges. You are going to see in the next few months a big improvement in the number of clicks. You are going to see in the next six months or eight months, some big improvement on search. You are getting much streamlined returns process. We have never been big on convenience. Our success has been based on pricing value, quality and quantity at the lowest possible price. We do appreciate that value also is convenience. We are going to greatly improve what we do, but it doesn't mean we are going to get something to you in tow hours. And I think again though, when I look at some of the things that we are doing internally, I am not trying be cute here, but there is something I can't talk about yet. You will see some differences and mostly the differences are from an offensive standpoint, not a defensive standpoint. But we look at our core business of getting you in the store still is paramount to what we want to do.

Dan Binder

And then if I heard the numbers correctly, it sounds like the growth rate slowed a little bit this quarter on .com, any particular callouts in terms of merchandise that was offered this year, not last year or any particular categories that are slower?

Richard Galanti

I wasn't going to bring that up only because I don't want to sound defensive. But there were two things last year in electronics that were big. The iPhone 6 launch last year was huge and the iPhone 7 launch was not as huge. And the other thing is last year was, the introduction of the Windows 10 and there are two things. Prior to a year ago comparison, a few months prior to that, people were waiting for the Windows 10 launch and so you had a lot of pent-up demand and the launch itself and compared to a year later. So those two things alone were part of that. That's frankly I think one of the bigger things. But again, I think as I have said jokingly, have seriously and have jokingly in the past, some of the things that we haven't done historically gives us the great opportunity to do these. And there are still some blocking and tackling like couple of things that I just mentioned. We have greatly improved our delivery, but it was from bad to better. It still takes too long and again, we are not going to get something to you in two hours. But you can see some logistically some things. And then on handling returns, particularly big ticket returns, we haven't done a good job of that and that's already in process. So you will see some changes that will help. The biggest thing though is going to be the merchandise initiatives. And again I think, you are going to see, we have added items and we are adding some items but we are not trying to figure out what 20,000 additional items because that’s not what we are going to do. But there will be velocity items or repetitive items in the sundries area as well. And you are right, when you look on your radar screen price is not way up there. But I challenge anybody on the call to compare the exact branded items and a big basket of them not just an occasional loss leader or some retailer or .com may have out there, you are going to see yes, it is a lot of savings here, but you will be shocked how much savings. And again, we recognize also we have got to move a little direction and we are doing that.

Dan Binder

Great. Thank you.

Operator

Your next question comes from Karen Short. Barclays

Karen Short

Hi. Thanks for taking my question. I guess it’s hard to put there my name in general. But I was just curious, on the gas impact, you gave the $0.02 impact, but I was wondering if you could give us some color on how much of that was gas margin versus maybe weaker gallon comps in light of fuel prices being down. And then I am wondering, as price per gallon increases, I am thinking it should obviously help traffic, is that fair, is there anything else to consider in terms of state of the consumer and the competitive landscape? And then I have a follow-up.

Richard Galanti

Well, the gas was $0.04. So last year, we had very strong gas prices, no worries. The year earlier in Q4, we had very strong gas profits. So that’s why a year ago, we didn’t really talk a lot about. This year, we actually beat our own internal budget by a little – a little from the beginning of the year, but again it was $0.04 lower this year, $0.04 this year than it was in Q4 a year ago. Generally, when prices go down, while it impacts some of these basis point percentage calculations, we make more money. When it goes up, we make a little less money although I would say, for the last couple of years, there has been a new normal. When prices went down, our view is as retail gas, overall, they would lower their prices but not as much as they could have. And we lowered it more than that and we are still able to benefit a little from it. So that was a positive. I think yes, it's the value proposition more than anything that gets people in our parking lot. And we are helped by the gas buddies out by .coms out there, the 2 years they have done it. And then the 4% rebate. There is a lot of different promotional things at the majors out there whether it's $0.10 a gallon off, 4% is big. As the price per gallon goes up, 4% gets bigger. And so I think that will be positive for us as well. But if you have been through our gas stations, when you have got, in some cases, 20 pumps now pumping at the same time and the lines move fast but there will be six people in each line. That not only drives the success of the gas business, but 51 or so of those people for every hundred come in and even if one them is incremental, that's good for us.

Karen Short

And so can you give us some color on what gallon comps were doing this quarter?

Richard Galanti

I don't know if we do that, but I know that it continues to be higher than the U.S. average. And my guess, I will get back to the answer in a minute, somebody is looking up for me. I believe it's in the mid-singles. It's in the mid-singles unless I say otherwise.

Karen Short

Okay. And then just to clarify on your comments on deflation, I know you were talking that deflation ensued and then there was also deflation I guess in fuel, so you had said that fuel prices should start to rebound in late fall, but deflation in food, are you just to clarify five months or six more months in deflation in food is that what you are trying to say?

Richard Galanti

That's our best guess. Talking to the buyers, that's our best guess.

Karen Short

And any – can you call it any categories in particular?

Richard Galanti

Well, the biggest ones would be protein. And you have got some other things, I was looking at my sheets here, hold on a second and this was just year-over-year, this past month. Walnuts were down 47%. That's our sell price. And I am sorry, that's our cost. Now a year ago, they had doubled from the prior year. So they were kind of back where they were, almonds down 38%, whole eggs, down 54%, large eggs, down 53%. I am just looking down the sheet of the top 50 items. So those things, particularly things like eggs really add up. On the inflation page, just for fun, nothing. Well I mean, there are some 20s and 30s, but if I look at the top 25 or so items, just in the last four weeks of the fiscal year, regular unleaded gasoline was down 12.8%. And it was over $3.5 million of credit, if you will, to LIFO. We don't book it every month like that, but that would have been $3 million. So, the biggest items on the deflation sheet add to the LIFO credit of $2 million to $3.5 million, $2 million to $4 million. The biggest items on the inflationary sheet at $300,000 to $500,000 of LIFO charge. So again, it gives you a sense of where it's going.

Again, another data point is the U.S. inventories at LIFO, that's an U.S. accounting concept. That was in the indices where you start off for costs on the exact items at the beginning of the fiscal '16 at 100.00 and was to go to. Food was down 2.25% with half of that, about 0.5% being just in the last couple of months. Sundries was about down at less than 0.5% and not terribly changed in the last 3 months. Apparel, almost right at the same

100.00 a year ago, almost right there. Computers, I expect down little under 2%. So, it's all over the board. Again, so you have extreme categories like meat which is high volume, but meat is also, we turn it so much faster. It has a higher churn. It turns, I would think, more than 52x a year where if you have – that's a deflationary item. If you have an inflationary item that is turning 8 times in nonfoods, that's going to be a different story. That's how it impacts the business.

Karen Short

Any color on produce? That was one category you had mentioned.

Richard Galanti

I didn't have that in front of me. It was not as big. I would guess I think it was in the 3 to – low to mid-singles, back yes.

Karen Short

Inflationary or deflationary?

Richard Galanti

I am sorry it was up a little inflationary in the last few weeks.

Karen Short

Got it, okay. Thanks very much.

Operator

And your next question comes from Paul Trussell.

Paul Trussell

Hey, good afternoon, Richard. First, just wanted to ask is there anything you have seen from Sam's Club or BJ's or other competition whether it's on price or membership that you felt like you needed to react to? And then second look I know it's been, I don't know, 6 or 7 years since you have given guidance but we are moving into a new fiscal year. And just big picture, wanted to know if there is anything you can highlight that we should keep an eye on as we model out whether it’s traffic, comps, thoughts on LIFO, IT spend, payroll, any help would be nice?

Richard Galanti

First of all, as it relates to competitive reaction, the answer is really no. I mean, we do that for living daily and weekly and they do it literally to their weekly comp shops in every market with direct warehouse club competition. And certainly in the fresh foods, people do more direct pricing competition on sale items at supermarkets, particularly on holiday week and some things like that and soda pop. But at the end of the day, if anything, our view is – the mode has continued to get bigger, in other words, our competitive position, pricing wise, is stronger than it’s ever been. But we are not resting on that. We are constantly trying to figure out how to widen it. That’s what we do.

As it relates to guidance, we don’t give guidance. The points of headwinds and tailwinds and anniversary of headwinds and tailwinds, things that I have talked – we talked about in the past we are hopeful that just from a simple FX standpoint, for 2 plus years now, the dollar has strengthened year-over-year. So, it was more than a 1 year anniversary. There was an inflection point of late although nobody knows what tomorrow brings on that. But it looks like it won’t be as impactful to the negative. We got through the headwind of the conversion. That should be a net positive, but I think it will be net positive over the next few years and probably not easily calculable, but we will figure that and we will try to figure that out. We know that will improve our SG&A component of what I will merchant and bank fees, in other words, things related to the new card offering. And again, we will be more quantitative as we get to the next couple of quarters. And it’s more definable than just for 14 weeks. But again, it’s good and we look forward to doing that. I mentioned the international membership fee increases in those certain areas. And that’s, again, that will improve over nearly 2-year period by about $50 million pre-tax of the membership fee line. I imagine you will see some of that offset on some of the margin line.

Although not – to be more competitive, but not reacting to the competition. I am trying to think other things. Gas, again, I think there is a new role in gas. I don't think there is going to be swings from time-to-time, but I don't think we are planning anything big. I think the other issue is as we have and some of you heard this before, we have lots of little things that are positive for us that continue to drive value whether it's pharmacy, optical, hearing aid or whether it's Costco travel. These are all things – these are all – our ticketing program in the warehouse, a new program which is brand new. We are just testing it in Southern California, with Ticketmaster. You can go to costcotickets.com and check it out. But again, some real savings on high end stuff and so there is a lot of things we are doing. We seem to have gotten some breakthroughs on the cosmetic side with SK-II. We hope that brings on others, but very clearly given some of the challenges that brick-and-mortar in that area are impacted by, we could sell the heck out of that stuff and provide great value to our members. And it's the kind of member we believe that these manufacturers want. Now talking to myself, I have talked myself into it we have got to talk them into it. In terms of gas stations, we continue to add gas stations and hearing aids not just to new locations, but to existing locations. I would say all those things help a little bit. Hello?

Paul Trussell

And then just lastly on IT modernization spending for this upcoming year?

Richard Galanti

Yes. Look, we will still have an impact as it hits the SG&A this year and probably into next year. I see pushing it out a year. I guess, the amount I push it out keeps getting shorter. It used to be a couple of years I push it out and then a year and hopefully every 6 months, but we are seeing deliverables. We are seeing lights at the end of the tunnel. Our single biggest, most expensive piece, which is the platform on which all the legacy buying systems and transportation systems is there in the process of being rewritten and improved. And I think you will get some real savings from some of those things. I know you will. And the first order of business is getting this in place. And so these are big chunks, but I know I can tell you when that inflection point was going to be. Couple of years ago, let's say, at the end of '14, I would guess that some time in late '16 early '17. Today, I would say some time in '18, probably. And if it is a little longer, it's because we have got more things that we are doing, not because anything screwed up. We have already gotten past a lot of the scrubber. We know we are spending money on and we are seeing some deliverables and there is more to do.

Paul Trussell

Thanks for the color, Richard.

Operator

Your next question comes from Sean Naughton.

Sean Naughton

Yes. Just continuing on the merchandise trends, you were going over some of these things, you didn't mention organic food, just curious kind of how that's still performing for you, I know that's been a good growth driver, I think it's a margin enhancer? Are you seeing tightness in supply? Are we experiencing the some sort of deflation in that category as you saw in the rest of the food across the store, any commentary there on where that's going?

Richard Galanti

Thank you for reminding me. No, I didn't call you to remind me. We expect organic to be up 20% this year. Now, some of that will be some cannibalizing of some traditional, conventional, but no, it's the perfect items for us, because it's our member. It helps us with millennials on top of that.

We get that. It creates a bigger competitive pricing mode, because we have as good, if not better quality at much better pricing. In terms of supply, I think the supply is starting to catch up with the demand out there and I think that some of the – you have heard me talk in the past about many of our global sourcing initiatives, I think that's going to continue to help us and make it more competitively advantageous to us. We have long-term relationships that we have had for a while now and have continued to build and there is going to be pockets of supply issues on different items sometimes, but overall, we are doing a lot in that regard ourselves whether it's produce, with farmers, seafood, poultries, you name it.

Sean Naughton

Okay, great. And then just another question just I think this is on a lot of people's minds just on the membership fee increase potential here in the U.S. or Canada where I think were close to the 5-year anniversary mark. I think this is something that's – I know there is no schedule, but typically done every 5 to 6 years. Can you just update us just on your thought process there with respect to MFI in the U.S.?

Richard Galanti

It will be U.S. and Canada. We will say we can't say anything or give any direction on it other than you are right, every 5 or 6 years, we have done something. I think the exact fifth anniversary in the last time would be this January and the sixth anniversary will be the following January – this November and the next November will be the sixth anniversary. Early this year, we have simply just said is we are going to get through the credit card conversion first, which we have now done. And the only other comments I have made in the past is that when we look at our member loyalty, the impact the previous increases had on renewal rates and anything like that, it's really a non-issue. And when we do it, we of course use it to be more competitive. So, it becomes a few year benefit not a one-time benefit. And but that all being said, we will let you know when we know. We haven't made any decisions yet and we haven't talked about it a lot internally. We actually tell you when we do things.

Sean Naughton

Yes, real quick. Just the $50 million pre-tax on the international price hike that you did in a number of markets, that's over the 23 or 24 months, is that correct, right?

Richard Galanti

That would also be over 23 months starting in January – I am sorry, starting in September now.

Sean Naughton

Thank you.

Richard Galanti

Sure.

Operator

And your next question comes from Greg Melich.

Greg Melich

Hi, thanks. I have a couple of questions. I just wanted to make sure I understood the dynamics of the new people signing up for the card. So, it was 730,000 new signups in just a couple of months.

Richard Galanti

New accounts.

Greg Melich

Right. Of new accounts. And so now that you are getting the payments for signing those people up, in terms of the SG&A, core ops may have delevered

6 basis points, but that's where the benefit of those signups would have showed, so that the payroll may have de-leveraged 10 or 12 and then that gave you some net, is that – am I thinking about that the right way?

Richard Galanti

Yes. Although, I believe again there is different pieces, I would get it all pretty just straightforward and simple, what is our effective merchant fee. Unfortunately, it doesn't all go into the SG&A line. There are certain items that benefit sales. I believe Bounty is one of them. So, Bounty goes to sales, which improves your margin a little bit. So, that might be a couple of basis points in there. I haven't calculated it out. But yes, some of the offset, again, we are talking a small piece of a big bucket is still decent to us, but we are only in it for a few months.

Greg Melich

Got it. And the headwinds from payroll, was how much of that was related to some of the weight?

Richard Galanti

Yes, we do. It reaches the top of the scale every year. Every 3 years, we announce what it's going to be to our employees for the next three Marches. This past March we also in the U.S. and Canada raised the bottom of scale by $1.50. So, $11 50 went to – $11 went to $12.50 – no, $11.50 went to $13 and $12 went to $13.50. Just that piece, the $1.50 at the bottom scale was I believe $39 million a year, we get 40 – call it $40 million a year. That would be March to March, so through the early weeks of Q3 – through the first month of Q3.

Greg Melich

That's great. That's helpful. And then I guess lastly and sort of thinking about how the card is being used, I know you said it's better than your expectations. I guess could you give us a little more color there especially with the people that are new to the card, right, new to Costco with it as to how much the card is being used outside of the club now that people have that?

Richard Galanti

I will be able to give more color on that in the next quarter. What I can tell you is one of the assumptions going into this we want this card just like we wanted our previous co-brand card to be our members top of wallet card. They are not only using it here, they are using it everywhere. The fact that historically I could not use my other card, in my case, my local drycleaner or my little local restaurant, if it is your top of wallet, there are more places you can use it. That grows that small merchant whoever card is being used at that small merchant, they pay a higher merchant fee. There is this whole equation of co-branding and revenue share helps us. And so I believe we are already above what we were on the old card in terms of outside to inside spend. It's higher than it was after growing, increasing it over a period of time, but we would have expected that. We certainly hoped it, but we have expected it. I don't think we necessarily knew what to expect to start with and we probably are little pleasantly surprised that it's already over that amount. And I think it will continue to grow. Yes, I mean, Bob was familiar that we cannot jump to conclusions on this. It's all 14 weeks old. And as it relates to new people that signed up, again, it's in the tens of thousands out of that 730,000, it's not 100,000, it's not 200,000. And I actually haven't even looked at the data on those. So, another good comment that Bob is making, it's been 14 weeks, some of them signed up last week or 2 weeks ago, I guess.

Greg Melich

One last housekeeping you said membership fee income was up 6% in U.S. dollar terms?

Richard Galanti

Yes.

Greg Melich

What was it up in local currency?

Richard Galanti

I believe it was the same. It was $47 million versus $50 million, but it is the same percentage increase.

Greg Melich

Okay. Great, thanks.

Richard Galanti

Yes. Why don’t we take two more questions?

Operator

And your next question comes from Oliver Chen. Oliver, your line is open.

Oliver Chen

Can you hear me?

Richard Galanti

Yes.

Oliver Chen

Hi, guys. Thanks, Richard. Congrats on solid results. A lot of our survey data at Cowen does indicate that the Amazon prime crossover has mathematically increased over a multiyear period. Just what would you highlight as some of the features of your story that make you on Amazon for the long-term? And as you do your consumer insight and your consumer research are there aspects of your business model, which are just wanting to really be on top of just to make sure that you continue to appeal with millennials and generation Z and as shopping habits kind of shift?

Richard Galanti

Well, I think the first piece of that question as it relates to the Cowen research piece that talked about, I guess you guys have surveyed, remember over the last – people over the last 5 or 6 years and there are more people, how many people used to have just a Costco card and then how many people had just an Amazon account, Amazon prime. And of course, over time, Amazon has picked up a lot and there is not as many unique ones. We would have expected that. My family has an Amazon card, not a card, but an account. And although I don't let them buy a lot, no, just kidding. At the end of the day, we will expect that. The internet in general is going to take its percentage of different categories. It's going to impact different categories and different retailers of such categories at different levels. I read the reports that some of you have written about that we and maybe one or two other retailers out there that are unique are Amazon proof or Internet proof. We don't buy that for a minute. We do believe that we do rely and we do expect we are going to be impacted loss. We also don't believe we have to go crazy on the other side, but we want both. But our value proposition is best served for us when it's in-store getting members to come in and buying when they can see everything there that we have.

And so we think that we can win on both cards, have we lost a sale of something to an Internet provider out there, whether it's Amazon or someone else? I am sure we have. Have we gained more often than not? Absolutely. As the whole media business, videos, CDs and books, many years later, books for us is a new normal and it's still quite strong, maybe it's 70% or 80% of what it used to be, but it's strong and growing. The other two have changed for a lot of reasons including streaming. That being said, an area that a lot of traditional retailers are getting filled in out there is apparel. We are now in our third year averaging compounding over the nearly 3.5-year period in the low to mid-teens. Probably the mid-teens, I don’t have the numbers in front of me and growing. And so – and then I think on the fresh food side, fresh is difficult and we don’t believe that everybody is going to just have everything delivered, but we are going to work hard to make sure that they want to come and see us. As it relates to, what was the last part of your question you were asking?

Oliver Chen

I am curious about demographics and as you think about younger versus older in your core and where your age profile is shifting, just the reality of new customers is the seamless shopping experience. And what you talked about earlier, Richard, in terms of the access of convenience being a factor in terms of that and what you are thinking as you modernize and continue to stay fresh with younger customers as well?

Richard Galanti

Well, again we have our limits by the way on some of those realities. I think for long time, again, convenience wasn’t a word we even thought about. There are certain things we are not prepared to do, again, so smaller sizes in our pricing and have everything in the world available to you. Part of our strength is what we do. I think going forward even with millennials when our successor again it didn’t start by 7 or 10 years ago, us sitting around on the table and saying how are we going to go after this new generation that want this staff?

We have great merchants and great operators in 8 different regions in the U.S. and elsewhere and they are out there trying things. And every month has got better, in this case, the Bay Area region, their compatriot sought another – tries things in other regions. We turn around and nobody can benefit as much and do it as good as well as we do and so I don’t think we sat around strategically by saying how do we go after them and evolved into that? Now, that we are there though, what else can we do for them and whether it’s food items or other things? We also look – our membership marketing people have done a study recently in our presentation recently and it showed whatever the previous generation was before, it was a gen whatever and I know I am one of those baby boomers, which is not a baby anymore. Our average age versus the U.S. population just in 3 or 4 years has come down 2 years from a 4-year gap to a 2-year gap. Our goal is not necessarily get it to a zero gap. Our goal is to drive more business. When we look at the age group of millennials versus that same age group when the previous generation was that age, they are buying a little less, but not a lot less. When we look at what we did and these are again data points or sound bytes, but when we did look what we did 2.5 years ago on LivingSocial and now we have a full year of renewals on them. It was very interesting. Clearly, we would have expected more of those people to be millennials that signed up on that LivingSocial 10 or 12-day initiative that we did. And that was correct.

What we were surprised at is that they actually shopped a little more frequently while a little less each time, but the aggregate of those two, they bought more over that year a little more, I mean, in the low single-digits, but there was more. It didn't have a bracket around it. And they renewed at a slightly higher rate. Now, then the walk in people that same months that would come in on their own just signed up, just walking together and the people that are walked in were on average a little older about 10 to 15 percentage point fewer penetration of millenials. And so that was encouraging to us. So while there is certainly extreme example in New York and the Bay Area and Teck there is a lot of people that still aren't embarrassed to tell they shop in-store and we got to have a lot of reasons to get you there. I am also excited of what we see we are going to be doing on .com, but I am not suggesting it's going to be trying to get your dinner there delivered to your doorstep if you have ordered by noon, that's not going to be us.

Oliver Chen

Okay. Thanks, Richard. That's super helpful. Last question is like we are really enthusiastic and encouraged by how well you have done with your store traffic, your core store traffic trends. Do you I mean – is your expectation for this kind of steady low single-digit positive momentum to continue? Do you foresee that being somewhat volatile just given the reality of traffic trends? And as we do our models, is there anything we should know as the .com deal closes as well? Thank you.

Richard Galanti

With regard to the latter, if they're doing a little business with us, they will probably stop doing a little business with us. There were a few items on there, I think they bought from us but not a lot. What was the first question, I got off on the tangent there?

Oliver Chen

About store traffic…?

Richard Galanti

No look, we look at all these things, we block and tackle everyday. I am very excited about our merchandising initiatives in store as well. I am excited about some of the global sourcing stuff we are doing. We come back from our every four week budgeting meeting. We got some deep stuff coming out. I am excited, it's small but anyhow being able to sell directly SK-II and a heck of a lot of it in terms of the total marketing of that product and people are talking about it. And again, over 90% of our members coming into Costco buy a fresh food item. So they are coming there. Those are kind of things, how do we get you in store, because we get you in store you are going to buy a lot more than – we see that even with Google Express. That customer shop a few less times in the store, shop several more times online as well, do both. They will buy a little more over the course of the year, but they are buying a lot more each time when they go in store, because they see all that stuff. And so that's what we kind of keep doing. I think the value thing, I would encourage to look at some – do your own pricing study of exact like items, maybe you got to adjust for quantity, because you got to buy 128 or something, 124 something instead of 24 or something. But at the end of the day, you will be going to shocked, the difference in pricing, not just here and so we think we got a lot of things going on for us. We have no allusion though that the Internet is going away or that we should do more of it online our self as well. But clearly, we feel good about what we are doing in store and what we are going to continue to drive that business.

Oliver Chen

Thanks. The SK-II is going to be great, baby boomers and luxury shoppers are going to love it, so congrats on that as well.

Richard Galanti

Thank you.

Operator

And your final question comes from Brian Nagel. Oppenheimer

Dan Farrell

Hi. This is Dan Farrell on for Brian Nagel. I was just wondering – thanks for sneaking us into. In terms of the membership benefits to some of the sales benefits you guys have been seeing after the new credit card signups, I was just wondering if you had any expectation on kind of how long those would persist throughout the year?

Richard Galanti

Well, I think your big hit is going to be in the first three months or four months. And really, my guess is through Christmas, because there is going to be a lot of people buying more items, more bigger ticket items during that period of time. There will be additional initiatives like there were for 16 years whether it’s tabling activities or other marketing pieces, that we will continue to do. I made a comment probably six months ago on one of these calls. In its own way, we think that this could be, in a way, a gift that keeps on giving. The value proposition of what we sell is great. Some of the new things that we have done merchandising wise whether it is our ticket not only the Costco tickets for events done in Southern California as the test, I am talking about the ticketing programs that we have in-store, the ever-increasing quality of our fresh foods, what we have done in apparel. There is a lot of things going on that I think will help us. And again I think the credit card, the new value proposition is – new value proposition will be one of them. When you think about the fact that effectively on virtually everything, you can get 4% off of Costco, between if you are an executive member and use the co-branded Costco, Citi Visa Anywhere card. For a company that markets its goods up 10% or 12% and I would think that we considered we can buy pretty well and put all our purchasing power in 3,700 items and then give you back up to 4% of that. That's a pretty good value and we have seen that anecdotally in a big way already from businesses. And I think we will continue to see it.

Dan Farrell

Okay, great. And then just a follow-up regarding the transition, did you guys see any I guess infection in sales of things like big-ticket items that people may have been holding off on any when the card is being transitioned and then once the transition card were activated, did you see any inflection in those items?

Richard Galanti

We did. Again, it's more dinner party discussion. We saw the biggest area we saw was hearing aids, a lot of things and of course that's not millennials. But – and the other thing would be big ticket electronics and the like. And my guess is in the case of the hearing aids, I wouldn't be surprised since there is a direct Costco employee member conversation eye to eye. I wouldn't be surprised if there were some people out there that are over there several weeks leading up to it. They said if you wait and use this card, you will get another 2% off on a $2,000 item. So, my guess is that, that impacted a little bit too.

Operator

And there are no further questions.

Richard Galanti

Okay. Well, thank you, everyone. Have a good day.

Operator

That does conclude today's call. You may now disconnect.