Costco Wholesale (NASDAQ:COST) Q1 2013 Earnings Call December 12, 2012 10:00 AM ET

Executives

Richard A. Galanti - Chief Financial Officer, Executive Vice President and Director

Analysts

John Heinbockel - Guggenheim Securities, LLC, Research Division

Mark Wiltamuth - Morgan Stanley, Research Division

Gregory S. Melich - ISI Group Inc., Research Division

Matthew D. O'Connor - Deutsche Bank AG

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Karen F. Short - BMO Capital Markets U.S.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Daniel T. Binder - Jefferies & Company, Inc., Research Division

Deborah L. Weinswig - Citigroup Inc, Research Division

Trey Schorgl

Operator

Good morning. My name is Felicia, and I will be your conference operator today. At this time, I would like to welcome everyone to the First Quarter Fiscal Year 2013 Operating Results Conference Call. [Operator Instructions] Thank you, Mr. Galanti, you may begin your conference.

Richard A. Galanti

Thank you, Felicia. Good morning. Today, of course, is our first quarter earnings report for the 12 weeks ended November 25. As with every conference call, I'll start by stating that these discussions we're having will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and that 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.

To begin with, our 12-week first quarter operating results for the quarter. Our reported earnings per share came in at $0.95 compared to last year's first quarter of $0.73. As was noted in this morning's release, there were 2 onetime items that hit last year's Q1 results. The first of these was the settlement of an income tax audit at Costco Mexico last year in the first quarter. During that quarter, Costco Mexico recorded an after-tax charge of $24 million. The impact to Costco's net income, as a then 50% owner of Costco Mexico, was $12 million or $0.03 a share.

The second item that hit last year's earnings results was a $17 million or $0.04 per share charge to SG&A line for our contributions to the Washington State I-1183 Liquor Initiative. Excluding these 2 onetime items from last year's results, last year’s $0.73 reported figure would have been $0.79, making this year's $0.95 figure a 20% year-over-year increase. In terms of sales for the first quarter, our 12-week reported comparable sales figures in Q1 showed a 7% increase, 7% in the U.S. and reported; and 9%, internationally.

Excluding gas price inflation and the impact of FX, the 7% U.S. comp reported number would have been 6%. The 9% reported international comp would have been 7%, and the 7% overall would have been a 6%.

Other topics of interest, I'll talk about our opening schedule first. We opened 9 locations during the first fiscal quarter of 2013, 8 in the U.S. and 1 in Alberta, Canada. By the end of this week, we will have opened in the second quarter 5 additional locations: one in Washington, D.C.; one additional one in Canada; one in the U.K. and one in Korea, which is later this week, giving us 14 new openings thus far in fiscal 2013.

For all of '13, we have a current plan of 30 new locations: 14 of which are planned for the U.S.; 3 each in Canada and the U.K.; one in Australia, which will be our fourth in that country; a new one in Mexico, our 33rd location and the first new opening in Mexico in a little over 3 years; and 8 in Asia, including 5 in Japan, 2 in Korea and 1 in Taiwan.

Also this morning, I'll review with you our e-commerce activities, our membership trends, additional discussion about gross margins and SG&A in the first quarter, stock repurchase activities, which were relatively small, and of course the 2 subsequent events, the announcement of a $7 per share special dividend, which will be payable on December 18 and the sale of $3.5 billion of senior notes.

Okay, on to the discussion of the quarter. Again very briefly, the sales for the year or the 12 weeks ended November 25 were $23.2 billion, up 9.6% from last year's first quarter of $21.2 billion. On a reported comp basis, first quarter comps were up 7% for the quarter; and excluding gas and FX, up 6%. Again comprised of a 6% U.S. without gas and 7% international in local currencies. For the quarter, our 7% reported comp result was a combination of an average transaction increase of about 2.5% and an average frequency increase of just under 5%.

In terms of sales comparisons by geography, geographically, all the regions have been fairly consistent for the past few fiscal quarters, generally in the mid to high-single digit positive range. One outlier was due to Hurricane Sandy hitting the Northeast. Comps for the Northeast region in November were lower than it had been running by a couple of percentage points.

California has been in the mid singles positive range. Southeast and midwest in the mid to high singles. Internationally in local currencies during the quarter, Costco Canada continued strong coming in, in the low double digits for Q1 and in the mid to high singles in November. Where international sales results are being hit as in Asia, in a word, cannibalization. Since Q1 ended a year ago, we've opened one unit in Korea. We now have 8 there; one unit in Taiwan, which brings us to 9; and 4 new locations in Japan, so we now have 13 in Japan. So 6 new openings in the past year on a base a year ago of 24. And additionally in Korea, a few months ago we, like other big-box retailers in Korea, are now required to be closed 2 Sundays a month.

In terms of merchandise categories for the quarter, for the first quarter, September, October, November essentially, within food and sundries overall in the 4 to 6 range; with candy, deli and refrigerated being the relative standouts.

Our hardline sales were quite a bit stronger as compared to recent quarters. Majors electronics came in, in the high teens and hardware in the mid-teens. Overall, in the low double digits for hardlines. Within the low double-digit softlines comps, small electrics and women's apparel were the standouts, with media being the area of continued weakness. And within Fresh Foods, its comps had been in the mid to high-single digit range; also categories, pretty good results.

Moving down the income statement. In the first quarter, membership fees $511 million or 2.20%. That's up 14% or 9 basis points from the $447 million a year ago or $64 million increase. In terms of membership, we continue to benefit from several things. Certainly, we're still benefiting from the $5 and $10 membership fee increases that began last November in the U.S. and Canada for new sign-ups and this past January for renewals. Of the $64 million increase year-over-year in membership fee income, about $28 million we estimate was due to these increases based on how deferred accounting works.

The income statement benefit to the membership income line, as I mentioned before, will continue to show year-over-year -- incremental year-over-year increases throughout the 4 fiscal quarters of 2013 and to a partial extent, in the first quarter of fiscal 2014. In addition, we've got new openings that have helped, as well as strong renewal rates rounding up to 90% in the U.S. and Canada and 86% worldwide and continued increasing penetration of the $110 year executive membership in the U.S. and Canada.

Our new membership sign-ups in first quarter, company-wide, kept pace year-over-year with last year's sign-ups. While we did have more locations opened in the quarter, 9 versus a year ago of 4, we figure it's a pretty good outcome given that there were very strong international openings last year, which contributed to very large sign-ups in Q1 a year ago.

In terms of new members for Q1 end, at fiscal year end, we had 26.7 million gold star members. That's up to 27.3 million at Q1 end. Some of that, of course, is the conversion of some of our business add-ons as they converted to executive member to become their own separate membership.

So again, 26.7 million became 27.3 million. Primary business, 6.4 million at year end and 6.5 million at Q1 end. Business add-on, 3.8 and down to 3.6. Again, that's related to that conversion. And so all told, 36.9 million and now 37.4 million. Including add-on spouse cards, 67.4 million cardholders at the end of Q4 and 68.2 million cardholders 12 weeks later at Q1 end. At Q1 end, paid Executive Members were 12.9 million, an increase of 280,000 or about 23,000 a week increase in the quarter. Executive Members account for a little over 1/3 of our membership and a little over 2/3 of our sales. That trend continues as well.

In terms of renewal rates, they continued strong at 89.7% at Q1 end in U.S. and Canada; and 86.4% worldwide. Business was a 93.6 at Q4 end and picked up to a 93.8 at Q1 end. Gold Star remained constant at 88.7 and total 89.7. And again worldwide, 86.4, so continuing strong in all categories.

Overall, it certainly appears that the year ago's membership fee increase had a little or no impact on our renewal rates.

Going down the gross margin line. Margins were up 6 basis points year-over-year in the quarter from a 10 62 last year to a 10 68. And as usual, we'll just jot down a few numbers, give you a few less this time. We'll make 4 columns, and the line items are as follows -- 4 columns, by the way, would be reported fiscal year '12 and then fiscal year '12 without gasoline inflation. And then for the quarter, the same thing reported in Q1 '13 and then without gas inflation. So those will be the 4 columns.

Going across, core merchandising. For the year, it was minus 21 basis points. Without gas inflation, it was minus 13. For Q1, reported was minus 7 and without gas, minus 1. Ancillary, plus 1 and plus 2 for fiscal '12, reported and without gas. And in Q1, plus 14 and plus 15. 2% reward, minus 2 and minus 2; and in the quarter, minus 2 and minus 3. LIFO, plus 8 and plus 8 for last year; and plus 1 and plus 1 in the first quarter. All told, we reported for all of last year a 14% year-over-year decline in gross margins. But without gas inflation, it was minus 5. In the first quarter, we reported plus 6 but without gas inflation, it was plus 12.

So with that chart in front of you, you can see that our overall gross margin was higher year-over-year by 6, but again up 12 without gas inflation. In the first quarter, our core merchandising gross margin, again, was a minus 7, but only 1 basis point lower year-over-year, excluding gas inflation. This 1 basis point negative result compares favorably to the previous 4 fiscal quarter figures where the year-over-year core merchandising gross margin variances had ranged from minus 10 to minus 16 basis points. And again, as you can see in the chart, we just wrote down for all of last year range -- average of minus 13 basis points.

Ancillary business gross margins contributed 14, higher year-over-year gas sales both in dollars and gallons. And higher year-over-year gross margin in the business -- gasoline business represented about 2/3 of this positive year-over-year gross margin variance. Margins in our food and sundries department, which is a little over half of our core merchandise were up slightly year-over-year in the quarter. While in non-foods, hardlines was flat year-over-year; and softlines margins were down slightly as were Fresh Foods.

The 2% reward feature, again, just a little extra sales penetration there for a minus 2 basis point reward. That, of course, would imply about a percentage point increase in sales penetration to those numbers.

In LIFO, LIFO there was no charge or credit last year, and there was a very small credit this year of $2 million or 1 basis point, implying some minor amount of deflation during the fiscal quarter.

Moving on to SG&A. Our SG&A percentages in the first quarter were lower or better by 7 basis points coming in at 10.05% compared to 10.12% as a percent of sales last year in the quarter. Again, we'll do the same little chart with the 4 columns, 2 columns for '12, fiscal '12 reported and without gas; and 2 columns for Q1, reported and without gas.

First line item is core operations in fiscal '12 plus 18, and then without gas inflation, plus 12 meaning lower, better or lower by that much. In Q1, plus 10 and plus 5. Central was a small improvement last -- for the whole fiscal year of '12, plus 2; and then without gas, plus 1. And in Q1, SG&A was higher at central, minus 7 and minus 8 without gas inflation.

Equity compensation was minus 1 and minus 2 for all of last year and minus 4 and minus 4 in the first quarter, certainly a reflection of both the higher stock price, as well as every -- there are certain recipients that get them every other year, and we're trading off a year versus that when that doesn't happen. All told, plus 17 and plus 9 for last year. So reported SG&A -- I'm sorry, excluding quarterly adjustments.

Quarterly adjustments was basically that $17 million charge to SG&A last year in the first quarter for I-1183. For all of the year, that was a minus 2 in the reported fiscal '12 column and a minus 2 without the gas inflation. In Q1, it was plus 8 and plus 8. So lower year-over-year, of course. So a total of plus 7 and plus 1, meaning we reported 7 basis points of improvement and -- without gas inflation plus 1 -- 1 basis point improvement.

In terms of a little editorial, operations were lower again and you can see the chart by 10 basis points, but 5 excluding gas. Within core operations, our payroll as a percentage of sales improved year-over-year by 7 basis points. And I think for the first time in the few, past few quarters, we benefited slightly by 2 basis point improvement in health care cost line item.

Our central expenses were higher year-over-year in Q1 by 7 basis points, as you can see, 8 without gas. The big culprit there is something I mentioned in the past few quarters that has continued to increase as the IP modernization costs. We are now in full swing, and that represented year-over-year 7 basis point hit to SG&A.

Next on the income statement line is preopening expenses, $10 million last year. And of course with the ramp up in expansion, that's $8 million higher this year or that was 3 basis points to the company, but $18 million this year versus $10 million last year. Last year in the quarter, we had 4 openings. And this year, of course, we had 9, with 5 more just after Q1 end.

All told, reported operating income was $543 million compared to -- last year compared to $639 million this year or an 18% increase. Excluding the $17 million charge for I-1183, operating income last year would have been $560 million or up about 14%.

Below the operating income line, reported interest expense was much lower this year versus last year with Q '13 -- Q1 '13 coming in at $13 million versus $27 million in last year's Q1. Virtually, all of this is the paydown -- represents the paydown of $900 million of debt back in March, which we did on an annual basis beginning this past March, the annual pretax interest savings to Costco, even though we paid off 5.3% debt and were then foregoing interest at a much lower rate. And that's about $44 million pretax a year.

Now interest income and other in Q1 was much lower year-over-year as well by $17 million, coming in $20 million this year interest income and other and $37 million last year. Actual interest income within net interest income and other, it was only lower by $1 million coming in at $10 million versus $11 million.

The other component of the interest income and other amounted to $10 million this year versus $26 million last year or lower by $16 million. Now, $12 million of that negative variance related to a gain last year in the first quarter on U.S. dollars held in our Mexico joint venture, because the Mexico venture held U.S. dollars and the -- during that quarter, the peso declined relative to the value of the dollar. It's holdings of the U.S. dollar, which is a foreign currency to them required marketing not to market again. That $12 million, of course, half of that gain was ours ultimately since we own 50% of Costco Mexico at the time. So half of the gain was -- so all of the gain was in the interest income and other line a year ago, and half of it was down below in noncontrolling interest as an offset. Most of the remaining year-over-year decrease of approximately $4 million is just a normal swing, plus or minus, where buyers managing the cost of foreign denominated inventory purchases in our foreign operations, which required at the quarter end to mark those to market.

Overall, pretax income was up 17% last year from $553 million to $646 million this year. And again excluding I-1183, that would have been last year's -- $553 million would have been $570 million, so the increase would have been 13%.

In terms of tax rates, our company tax rate this quarter came in at 34.8%, much lower, of course, than last year's reported rate of 40.8%. But excluding the 2 items mentioned in the press release, our effective tax rate last year was a 35.3%, which I think is a more appropriate comparison. Still about a half a point higher last year than this year. And again, that reflects mostly the fact of increasing penetration of earnings outside the U.S. where our federal tax rates generally are lower.

Overall, net income was up 30%, as you know, in the press release. Excluding those 2 items in the press release, that would have been up 19%. Now for a quick rundown of other usual topics, the balance sheet is included in today's press release. Depreciation, amortization, $213 million for the quarter. Accounts payable as a percent of inventories reported, of course, it showed 108% year-over-year and up 5 percentage points from 103% last year. If you just looked at the merchandise inventory accounts payable compared to merchandise inventories, last year was 92% and again improved up to 94%. So most of our inventory's trade payable financed.

Average inventory per last year in the first quarter was $12,871,000. This year in the first quarter was $13,213,000. So up $432,000 or 3%. About $100,000 of that, just under $100,000 of that is that FX strengthening foreign currencies versus the dollar. Another $130,000 is in majors, principally televisions and cameras. We've done very well, as you know, in the monthly sales reports about our comps and the major areas it's been. And the rest is pretty much spread among many departments.

In terms of CapEx, in the first quarter, we spent $488 million. Our fiscal '13 CapEx is estimated to be approximately $2 billion. This compares to CapEx last year of just under $1.5 billion. Some of this higher annual year-over-year estimated expenditures are due to both the higher penetration of the number units planned in Asia, as well as anticipated higher ramp of total openings schedule for Q1 and beyond.

Also I want to mention our dividends, regular dividend. Our quarterly dividend of $0.275 per share quarterly is 110 -- $1.10 per share annualized dividend represents cost of the company just about $480 million. In terms of expansion, as you know, last year we opened 16 units, 17 openings and 1, including 1 relocation. So 16 net openings. For this year we've, as I mentioned, opened 9 new units with no relos. Actually, there's no relos all year. So in Q1, we opened 9. In Q2, we'll be opening later this week in Korea, we will open -- have opened 5 more, so 14 total. We planned 3 -- we planned 7 for Q3 and 9 for Q4, and that would give us our 30. Certainly we're going to get north of 25, and 1 or 2 of those slips will be it. But that's our current budget is 30.

So fiscal '12, the 16 units we added on a then beginning base of 592 represented 3% square footage growth. In '13, adding 30 on a base of the 608 that we began this fiscal year is about 5% square footage growth. And again, that includes 14 in the U.S., 3 each in Canada and the U.K., 2 in Korea, 1 in Taiwan, 5 planned for Japan, 1 in Australia and 1 in Mexico.

As of Q1, our total square footage ended at 88,259,000, which represents an average of just over 145,000 feet per Costco warehouse. In terms of stock repurchase during the quarter, for -- basically for -- as you recall, for all of fiscal '12, we repurchased 7.3 million shares for a total of a little over $600 million. This year in the first quarter, we repurchased 357,000 shares at an average price of $96.41. That represented about $35 million. Mind you that during the 12 weeks, there were only about 3 weeks that we actually purchased stock. For the first 5 or 6 weeks between the beginning of the fiscal quarter and through the day after of first quarter earnings announcement and I think the second week in December, we essentially were locked into a previous 10b5-1 filing, and the stock had moved above that matrix. So we weren't buying it, of course. Once we decided to do a special dividend, we held off on buying during the last few weeks of the quarter as well. So if I looked at the dates we actually bought on an annualized basis, it was in excess of 500 million on an annualized basis. But who knows what that brings for the future?

And lastly, the 2 subsequent events. 2 weeks ago on November 28, we announced the declaration of a $7 share special cash dividend. This dividend will be paid on December 18 to people who own the stock on the close of business on December 10. In total, the dividend represents return to our shareholders of just over $3 billion.

By the way, in connection with the Costco shares held by our employees in the 401(k) Plan, which totals approximately 22.6 million shares. These shares are held through Employee Stock Ownership Plan that had been established several years ago, and dividends paid on these shares are deductible for U.S. income tax purposes. So we will recognize a onetime income tax benefit of approximately $62 million in the second fiscal quarter of '13 in connection with the dividend payable in December 18.

Also on November 28, we announced the completion of a $3.5 billion public debt offering in the form of senior notes. The notes were issued amongst 3 tranches: 3 year, $1.2 billion worth; 5 year, $1.1 billion; and 7 year, $1.2 billion. Given the weighted average maturity of 5 years, our all-in annual rate of interest came in just under 1.25%. So we believe it's extremely attractive financing.

With that, I will turn it back over to Felicia. As you know, later this morning there'll be a supplemental information pack, which includes useful stats, and that will be posted to the Costco Investor Relations site later this morning. Felicia?

Question-and-Answer Session

Operator

[Operator Instructions] And your first question comes from the line of John Heinbockel with Guggenheim Securities.

John Heinbockel - Guggenheim Securities, LLC, Research Division

Richard, a couple of things. What are your merchants now saying about reflation in '13? I mean, it seems like it may be less than we originally thought, but there still would seem there's some price increases coming down the pike. What's their thought, and what's your thought in terms of what you put in the budget?

Richard A. Galanti

Well, I think the buyers are the ones that more put in the budget, but in polling the buyers just yesterday actually, the one -- the area that stands out would be components of Fresh Foods, notably protein, beef, poultry and pork. The view there is there's still additional mid to high-single digit inflation expected over the next 6 to 9 months. Beyond that, it's hit and miss. There's -- if I look at our LIFO statistics as an indication, apparel is down ever so slightly year-over-year, but that's probably because it was up a lot last year. So it's coming off of its peak. It's still probably higher than a few years ago. So I would say the overall view, aside from electronics being down slightly per like item, but actually our average price points are up a little, I believe, because we've tended to go towards higher end like 60 and 80-inch TVs and more SLR cameras, DSLR cameras and the like. But just looking down the list of some unusual items. Again, tuna looks like it's come up a little bit, canned tuna. As I mentioned, beef was up some. There's always going to be some ups and downs on produce just based on supplies. Grapes and blueberries are dramatic right now, higher year-over-year, but I'm sure it's weather related not anything else related. And on the downside when I scan the list of the top 20 or 30 items here, most of them are electronics with a few other things, I mean, just anecdotally, pecans and walnuts. But I know a year ago, again, they were way up. So if you put it all in, my guess is, is that gas, who the heck knows? Fresh Foods, inflationary. The rest of it kind of awash at this point. Nothing up or down a lot.

John Heinbockel - Guggenheim Securities, LLC, Research Division

But probably not enough to dampen demand, it sounds like, right?

Richard A. Galanti

Not on our part.

John Heinbockel - Guggenheim Securities, LLC, Research Division

Now, your big competitor has talked about price investments and other than rotisserie chickens, I can't see a lot of big change in the competitive environment or the intensity of competition. What have you seen in the -- it doesn't look like you've had to do any reaction thus far. Yet likely, that's sort of the plan going forward based on what you're seeing today?

Richard A. Galanti

I can always speak of today and yesterday and prior, but we don't see any big changes there.

John Heinbockel - Guggenheim Securities, LLC, Research Division

Okay, and then I guess finally, when you look out into January, is there any, either with your individual customers or small business customer, do you think that -- as best you can tell, do you think the cliff hasn't created any change in behavior to date? Do you think it will, or it's pretty much a nonevent for you?

Richard A. Galanti

Well again, we're a little jaded here because our numbers, particularly, our frequencies and our comps have been pretty darn good. I think we, like everybody, have a little of cautious optimism that they're going to do, at least, a compromise and -- or they better. So we're not really focusing a lot on it right now. I think that we do a little better than others, at least, if history continues.

Operator

And your next question comes from the line of Mark Wiltamuth with Morgan Stanley.

Mark Wiltamuth - Morgan Stanley, Research Division

I want to ask a little bit about the core merchandising margin only down 1 basis point x gas. Is there any change there, or do you really point to what was going on there to keep that number muted?

Richard A. Galanti

Not really. I mean as we've always said for many quarters, margins are more us than anybody else. No, there -- it's pretty much as you see it. It's a little better. I don't think we started the quarter saying let's get a little better or let's get that trend back to 0. But that's where it ended up. We're trying to do both, drive business and make money.

Mark Wiltamuth - Morgan Stanley, Research Division

And have you seen an uptick in your private label penetration or anything like that, that might be contributing?

Richard A. Galanti

Nothing out of the ordinary. I mean we continue to add products, everything from some wines and spirits to canned goods and all kinds of nuts and candy items. So I'd say it's nothing dramatic. The big dramatic number came in the first half of calendar '09 after the financial crisis where we saw an unusually large increase in sales penetration of private label. I think on the food and sundries side, over 6 months back then, it was like 300 basis points. But generally, we see 0.5% to 0.75% a year. I'm not aware of anything that is different than that right now.

Mark Wiltamuth - Morgan Stanley, Research Division

Okay, and then lastly Black Friday. How did that go for you? It looked like there was a lot of activity in the electronics part of the store, especially with the manufacturing rebates that were being featured there. How does that look for you on that category?

Richard A. Galanti

It was fine. No surprises versus what we had expected. We've now done some of our own Black Friday coupon handouts and the like for the last few years, and we're pleased with it.

Operator

Your next question comes from the line of Greg Melich with ICI Group (sic) [ISI Group].

Gregory S. Melich - ISI Group Inc., Research Division

It's Greg with ISI. Richard, one question on SG&A and then CapEx. What really drove that central increase? Is that some of the modernization impacts or getting the website up and running in the new format or what should we call out there?

Richard A. Galanti

Well, when I look at IT costs as a percent of sales year-over-year, they were up 7 basis points. My guess is, is 0.5 or 1 -- 0.5 basis point might be re-platforming. Maybe another 0.5 basis point or a whole basis point is normal increase in IT, but clearly, 5 plus of it is modernization. And that's probably has trended up a little extra year-over-year over the last few quarters and will probably peak this year. And then it'll be anniversary-ing against itself each year over the next 3 or 4 years.

Gregory S. Melich - ISI Group Inc., Research Division

Got it...

Richard A. Galanti

That -- go ahead.

Gregory S. Melich - ISI Group Inc., Research Division

Does it anniversary, do you expect it to go back to 0, or do you actually cycle it becomes a year-over-year down or a good guy?

Richard A. Galanti

Well, I don't think it's going to go down for 2 or 3 years. These things take on a life of their own, but it'll be a lot less than 5 to 7 basis points. I mean, I would hope -- again, we haven't budgeted that detail that far out, but I would hope it's 0 to 2, not 5 to 7 next year. And by the way, regarding the prior question as related to Black Friday, I just was looking. That week on a year-over-year basis, frequency was still darn close to 4%, just below 4%, so pretty consistent with what we've seen all over.

Gregory S. Melich - ISI Group Inc., Research Division

If I could follow-up on the CapEx front. I know it's going up because we're having more club openings. Could you help us on the international openings, and how many of those you actually build and own the store as opposed to lease it, because I imagine it's less when you go overseas than the U.S.

Richard A. Galanti

I don't have that detail in front of me. I can tell you that when we look at the average location cost, which might be on average over the last couple of years, company-wide in the mid-30s, it's tended to be a shade lower than that in the U.S. and Canada and higher, it might be in the 40s on average over like, let's say in Asia. But we've done a couple that are in the low 50s, and I would assume we'll continue to do that. In Korea, we tend to do more ground leases. In Japan, we tend to own. In Taiwan, I think we tend -- it's a combination, some ground leases as well. Australia, I think we own. And Mexico, we own. And the U.K., we own. And in Canada and the U.S. we generally own 80% plus.

Gregory S. Melich - ISI Group Inc., Research Division

Okay. So the ownership right doesn't seem to change dramatically if we're looking at international or...

Richard A. Galanti

No, particularly because we tend to -- right now we're, at least we're tending to open like in Asia, more in Japan than in Korea and Taiwan, where we tend to own more than lease.

Gregory S. Melich - ISI Group Inc., Research Division

And then just lastly, a follow-up on gross margin. I think you mentioned in hardlines, gross margins were flat. I'm just surprised with that, especially given the strength of electronics. Was there anything else going on in there that have impacted it?

Richard A. Galanti

Well, that's -- not really. I mean I think sales were strong, but in terms of the outright gross margin year-over-year -- look, there's a lot of hot deals over there. I don't -- I didn't really read anything into that. There's not a lot. We've certainly improved on our returns over the last few years as we changed our returns policy in electronics to 90 days instead of infinity. But I haven't, in terms of anecdotally in the last few budget meetings, there's not been nothing -- there hasn't been anything out of there in terms of any issues in electronics or hardline.

Operator

Your next question comes from the line of Charles Grom with Deutsche Bank.

Matthew D. O'Connor - Deutsche Bank AG

It's actually Matt for Chuck. Most of my questions have been answered. I was just wondering if you could you kind of flesh out your comments about the cannibalization you're seeing in Asia and kind of where that is relative to what you expected? And what you think is going to happen kind of going forward as you continue to open up?

Richard A. Galanti

Yes. Well, I mean it's as we expected. I mean as an example, I think in Taiwan, we opened North Kaohsiung, which took a bunch of business from Kaohsiung. In Japan and earlier this year, we opened and reopened Tamasakai, which was the one unit that was, that had been closed for about 10 or 11 months from the tragedy of the earthquake. Essentially, all of that business went to 2 or 3 nearby -- 2 nearby Costco's. When I say nearby, half an hour away. And the day it reopened, that unit is not comping because it had done these sales over the last year, but it took on that business out of the other 2. So on top of regular cannibalization, we had extreme cannibalization in that one. So all that was, yes, in March. That had subsided this March. But nonetheless, I mean we're opening a bunch of units over there. So that will continue as we expect.

Matthew D. O'Connor - Deutsche Bank AG

Okay. Great and then just a follow-up. In terms of the Northeast, you said it was obviously weak given Sandy, have you seen a recovery kind of take hold and are we back to normal in this area yet?

Richard A. Galanti

Yes, we are.

Operator

Your next question comes from the line of Colin McGranahan with Bernstein.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Just a quick follow-up on Asia cannibalization. It looks like the comps and international x currency were running kind of in the 10% range for all of fiscal '11, the first half of fiscal '12 and then the last 2 quarters in the 7% range. Is that entirely explainable by cannibalization, and can you quantify what that cannibalization impact is in total on the International business?

Richard A. Galanti

Yes. A big chunk of it is. I don't have all that detail in front of me, but if I look at Japan in local currency as an example, I mean it's easily from -- I don't have these, I don't have -- this morning, I'm sure it was running in the low-double digits and inflated in the high single-negative digits. And you look at it and we've opened 4 units in the last year. And what did that impact? Those units, those new units aren't in the calculation yet, and so half of the previous units or almost half of the previous units are being cannibalized and 1 extreme -- 2 of them extremely cannibalized because you had a high-volume Thomas [ph] unit existing location that have been closed for 11 months, and all those customers came back to their home base. So yes, we're -- and then again, there's the anomaly in Korea of having to close for 2 Sundays a month. If you just do simple math, that's 150. That's 6% or 7% of the days. You don't lose it all, but you certainly lose some or half of it or who knows?

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay. That's helpful, and then back in the U.S., how many clubs that don't have a gasoline station can still be converted at this point? And where are you on that entire path?

Richard A. Galanti

I think the U.S., we have about 440 locations, I could be off 1 or 2, and I think about 70 of them don't have gas. My guess without looking at detail is, is that half of them ultimately can have gas and half of them will never have gas. We're never going to have a gas station at 11th and Harrison in San Francisco or in Brooklyn. Just they're landlocked and forget about it. And I'm sure there'll be some that we're working on. I don't have the list in front of me, and there'll be others that we'll relocate. So I probably a best guess is over the next 5 to 8 years, half of those 70. And my guess is that when we open new ones, virtually, all of them do. There's -- there always will be one outlier, but virtually all of them have gas stations, as is in Canada. Now in

Canada, we have, In Canada, we have 83 locations, 38 of them have gas. So 45 of them don't, recognizing we've only been in gas in Canada for the last few years. So again, my guess is that 2/3 of those that don't have it will have it over time.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay. That's great, and then just very quickly. You went through the variance on other income relative to last year, but what's the $10 million of actual other income this year?

Richard A. Galanti

Bear with me. Oh, interest income.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Well, it's $20 million of other income, and there's $10 million of interest. So there's $10 million of other income.

Richard A. Galanti

Yes, there is. He's asking the $20 million that we had. Hold on, I got to look real quick. When I look at interest income and other, hold on a second. Okay, $10 million was investment income and $10 million -- it's mostly equity in earnings of -- hold on. Basically, it's about $8 million or $9 million of FX-related stuff. But by comparison, it's within $0.5 million of the year ago. So no change.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

Okay, I was just trying to figure how persistent it is for modeling purposes. I appreciate that, thanks.

Richard A. Galanti

Mind you, just because it's about the same year-over-year means nothing.

Colin McGranahan - Sanford C. Bernstein & Co., LLC., Research Division

I understand.

Operator

Your next question comes from the line of Karen Short with BMO Capital.

Karen F. Short - BMO Capital Markets U.S.

Just on the SG&A leverage, you also pointed out about payroll and health care. Just wondering how sustainable you think that might be throughout the year?

Richard A. Galanti

We always -- certainly payroll depends -- I mean I think we've certainly shown that we've focused a little more on expenses and payroll. And that's we've gotten it down. But certainly sales are a big part of that as well. And increased penetration outside the U.S. where payroll percentages, as a percent of sale, were lower to start with. Our $20.5 average hourly wage in the U.S. is 1/3 to 60% of that number in other countries and close to it in Canada, of course, and a couple of countries as well, so that helps increasing penetration. On the health care, I think if we've got a couple basis points, it's probably more related to sales being stronger and getting it down a little back to flat without it, so still hit and miss there. Several components of all the new health care legislation, which have kind of hit each year incrementally a little more. I think we're nearing the end of that. So a lot of that stuff, if you will, is in there by the end of this year and the end of next year rather. So I can't predict that it's a trend by any means yet.

Karen F. Short - BMO Capital Markets U.S.

Okay, and then any color on the online sales growth in general with the website revamp and the rollout of the U.K. site?

Richard A. Galanti

Yes, so far, so good. But I don't want to really give numbers out because it's only been a few -- 1.5 months and probably talk about that more on the second quarter call.

Karen F. Short - BMO Capital Markets U.S.

Okay, and then just last question. Any comments on fuel profits in the quarter, comp gallons and total fuel sales?

Richard A. Galanti

Gallons, I think I have. We generally don't give that but I'm here, so we'll give it. Volume, you have it handy? I don't have it. I think in the last couple of budget meetings, it's been running in the mid single-digit range positive, mid to high-single digits.

Karen F. Short - BMO Capital Markets U.S.

Okay. And then anything on tax rate going forward that we should think about?

Richard A. Galanti

I'm sorry?

Karen F. Short - BMO Capital Markets U.S.

Anything on the tax rate going forward that we should think about? I mean I know you've been commenting on the issue, the $60 million, I think, in the 2Q, but...

Richard A. Galanti

Other than that, I think the number in that 35 range.

Unknown Executive

[indiscernible]

Richard A. Galanti

On an overall basis, somewhere in the 35, maybe a shade higher. But the trend line if International's penetration continues, which we would see that again trending down ever so slightly, certainly, all things being equal.

Operator

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

Mark R. Miller - William Blair & Company L.L.C., Research Division

One thing that really stands out for me with Costco versus other discounters is that the comp growth is very consistent for you across the product categories. So not just food and consumables, but also very strong in general merchandise. So can you expand on what you think you're doing differently or better, especially in hardlines and majors?

Richard A. Galanti

Well, I think I gave you a different reason for some different categories. From the beginning of time, we've always known we can be strong in foods and fresh foods. And the key is how do you -- and those are fast-turning areas. So how do you turn the bigger-ticket nonfood items because you don't have to have add more square footage for it? If you can get somebody that's turning 6x and 8x up to 9 and 10, that's good in the bigger-ticket item. So we've always focused on that. I think of late, if I think of electronics, certainly our strength in 60- and 80-inch TVs, the bigger, higher quality TVs, that's helped us, clearly people in the door via gas and fresh foods and having them walk by those types of things. I think in apparel, certainly we've made a conscious bigger commitment in several of those areas over the last 1 year, 1.5 years. I think I used the example the last quarter, something as simple as like the men's wool Kirkland Signature pants, which I think we tested a couple of years ago with 100,000 units and last year 200,000 units and this year 1 million units. That's $60 or so a pair, and they're doing well and so not only are we making a decent margin on the KS shirt, we've gone from just a standard one to a couple of different styles with a spread collar. And so we're up to 4-plus million KS shirts. So overall, making some bigger commitments. Jewelry is strong and not just because some of the prices of components have gone up, but jewelry has been pretty good of late.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Great. New member sign-ups, I'm assuming, benefited in the first quarter due to the rise in gas prices during the summer, especially in California. I mean to what degree did that, was that material? And then gas prices have come down, might that slow member sign-ups in the periods ahead?

Richard A. Galanti

I don't think a lot of it relates to that. I mean yes, a little bit of it when we get somebody, when a newscaster talks about it again in the market, certainly that helps. When I look at the numbers on a base of about 1.3 million new sign-ups in each of the fiscal prior 2 fiscal quarters. Again, when I talked about Australia, Japan last year, which opened near the end of very, very just before Q1 '12 a year ago and into Q2 '12 Japan a couple of units, just those 2 markets represented almost 90,000 fewer sign-ups year-over-year because of the huge sign-ups we have in those markets during these 6 or 8 weeks prior to opening and then they're booked as of opening day. So that again dwarfed anything else, and the fact that we were flat year-over-year given 90,000 less than those few locations is pretty good.

Mark R. Miller - William Blair & Company L.L.C., Research Division

Great. My final question is previously, you indicated 27 to 30 new clubs as your plan for this year. This morning you said in your prepared remarks 30.

Is there anything I should read into that? I mean do you have higher visibility now for this year, or is that -- should I perceive it to be the same?

Richard A. Galanti

I think probably a quarter ago, I talked about 25 to 27. Again if pushed, I'd probably say 27 to 29, but 30 is our budget, and they're all doable. There's always the chance that a couple will fall out, but I think we're getting more confident of those numbers. So if my single point estimate was 27 or 26, now it's 28 or 29.

Operator

Your next question comes from the line of Dan Binder with Costco (sic) [Jefferies].

Daniel T. Binder - Jefferies & Company, Inc., Research Division

It's Dan Binder with Jefferies. I had a couple of questions. First on the membership growth. What do you think we should see given, I guess, the extraordinary sign-ups for club last year? What do you think average sign-ups per club should look like this year for the 30 or so stores that you're opening?

Richard A. Galanti

I don't have -- I haven't looked at it that way. And from a marketing -- our membership guy's not here, but it ranges. Again, somebody's locations overseas can be -- and again when I say opening day sign-ups, it's anything that was signed, any paid member sign-ups during the 6 or 8 weeks prior to opening when they got the tabling activities outside of the construction site through opening day. In the U.S. in very strong Southern California markets, but we're popping a unit in where we have a bunch of members already, it's just moving around where they shop or shopping more frequently because they're closer to a location. We might have 3,000 to 6,000 as of opening day and another 5,000 to 10,000 or 8,000 to 12,000 over the next 12 months for that first year. In a new market, a small new market, like Tennessee or a Carolina unit, we might have 4,000 to 7,000 or 8,000 new sign-ups in the first day as of that first day, which is more than a high volume L.A. unit when we opened it, but again it has somewhere to do that. Again over in Asia, we see numbers in the 25 to 50 range as of the opening -- through opening day, and so well over the company average for all members per warehouse, which is in the high 50s. I mean for all warehouses that have been opened, whether they have been opened a week or 29 years. So there's no right number there.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

And if we look at existing clubs, how does the new member growth rate look like in existing or comp clubs?

Richard A. Galanti

At the end of the day, again, I don't have that level of detail right in front of me. But what I've looked at it in the past, if our renewal rate is just under 90, let's say, in the U.S. and Canada and just call it 90 for a moment for simplicity, we lost 10, and we gained 11. I mean it's always up a little bit more, just a little bit more than it was at the beginning of the year. And that, of course, is cannibalized a little bit when we opened in existing market a little bit. But then those new sign-ups and those new markets help us. So it's a lot of -- there's no major trend changes if you take out cannibalizing units and take out some of the crazy high numbers and some of the new Asia units or the like.

Daniel T. Binder - Jefferies & Company, Inc., Research Division

And my last question was on SG&A. 7% comp, impressive. You got sort of flattish SG&A year-over-year rate. As we look forward, do you think that because of the accelerated store openings this year that to get leverage on SG&A going forward this year we need to be at 6% or 7%, or do you think you can achieve it at somewhat lower levels?

Richard A. Galanti

Well, I think a couple of things. Again, I feel my guess will continue for these next few quarters. What I didn't mention is there's always 4, 5 miscellaneous line items that generally should add up to 0, some a little higher, some a little less. If I look in the quarter, I think if I added up those types of things, it hit us by 2 or 3 basis points in the quarter versus being 0 or helping us by a basis point. So there's always going to be those things I would think that on average 0, not minus 2 or 3 as it was this quarter. Again, when I look at, I was pleased at payroll, which is -- payroll benefits are 70% of SG&A. The fact that we have increasing penetration overseas that helps us a little bit just because it is, on average, lower SG&A, but again offset that probably for the next year in Japan as an example where we're cannibalizing the heck out of it.

Operator

Your next question comes from the line of Deborah Weinswig with Citi.

Deborah L. Weinswig - Citigroup Inc, Research Division

So Richard, obviously with the 30 clubs that you're targeting at this point in the game, it's a very different from what was seen in the recent past. Can you talk about the difference in real estate process to get those 30 clubs open in 1 year?

Richard A. Galanti

Well, we've put a lot more people on the ground in countries. If I go -- we've been working a long time, and I know it was forever before we even got to perform in terms of how many we say we're going to do when we actually do. But if I look back 3 years ago, 2, 3 years ago as an example between Korea, Taiwan, Japan and Australia, all of that real estate activity was done with no real estate people on the ground. None of our real estate people on the ground in those countries. We now have 1 to 2 people in each of those countries. Same thing with Europe. We've always had pretty much in the

U.S. and Canada. So and the pipeline is more full. So again, as the pipeline -- as the time to get to opening in some of these countries are more difficult, takes a little longer anyway, we've built up the pipeline. So I think there'll be more confidence in the next few years of how many we can open based on the pipeline.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then in terms of looking at the 5% increase in frequency in the quarter, most retailers have been talking about traffic as being a major issue. Can you provide some additional color around your strong traffic numbers?

Richard A. Galanti

Well, the 5 -- my guess is, by the way, these months are a little strange for a couple of reasons. One, we had a 53-week fiscal year. So it ended like on the September 2 instead of late August. So how did that affect Labor Day a little bit. Same thing at the other end of the quarter. I think Thanksgiving was a week off and in terms of dating. So all those things are in that number. My guess is, is that getting even just below 5, and I mean just below 5, is there 0.5 point in there or a little more that could have been just how all these things ramp? Possibly. So I'm not banking on a plus 5, but certainly, that gives me comfort that our high 3s to low 4s that we've seen 3.5 to 4.5, hopefully, that will continue. There's nothing that we see that changed that until it changes.

Deborah L. Weinswig - Citigroup Inc, Research Division

All right and then...

Richard A. Galanti

Another point is as I've said over the years, the good news is it's a lot of little things. It's everything from the membership base and the demographics, and certainly, gas and fresh foods, certainly big screen TVs. I mean, there's lots of different things that we've been blessed by.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay, and you called out hardline sales as being quite a bit stronger as compared to recent quarters. Was that -- and you called out several specific categories. What -- was there any kind of key there or was it quite broad?

Richard A. Galanti

It was broad recognizing what we call majors is a big category within hardline, cameras and TVs and the like. Jewelry is not a big percentage category, but had these numbers. So again, that was across the board. I think also even in some of the little things when we bring in items within the furniture category, we've tended to do well with them. And certainly on the softline side, as I mentioned in apparel, that's been a help. So part of it is aggressiveness in some of these categories.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay, and then lastly, just could you give some color on how new clubs are performing in markets?

Richard A. Galanti

I'm sorry, what was the last part of that?

Deborah L. Weinswig - Citigroup Inc, Research Division

How new clubs are performing, both domestically and internationally?

Richard A. Galanti

Of the 13 openings this fiscal year that we've opened, we got the 14th coming in a couple of days. I think overall, they've done as good, if not a little better, than our overall plans. I mean Craig walks in happy from the opening trips.

Operator

[Operator Instructions] Your next question comes from the line of Michael Exstein with Credit Suisse.

Trey Schorgl

This is actually Trey Schorgl in for Michael. We were just wondering if you think there will be any impact from the retroactive income tax increase that was passed last month in California?

Richard A. Galanti

No.

Operator

[Operator Instructions] And there are no further questions at this time.

Richard A. Galanti

Well, thank you, everyone, and have a good holiday.

Operator

Thank you. This concludes today's conference call. You may now disconnect.