Costco Wholesale Corporation (COST) Q3 2024 Earnings Call Transcript

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Company Participants

Gary Millerchip - EVP & CFO
Ron Vachris - CEO

Conference Call Participants

Simeon Gutman - Morgan Stanley
Michael Lasser - UBS
Chuck Grom - Gordon Haskett
Scott Ciccarelli - Truist Securities
Kelly Bania - BMO Capital Markets
John Heinbockel - Guggenheim Securities
Peter Benedict - Baird
Brandon Cheatham - Citigroup
Greg Melich - Evercore ISI
Rupesh Parikh - Oppenheimer
Christian Carlino - JPMorgan
Scott Mushkin - R5 Capital
Edward Kelly - Wells Fargo
Oliver Chen - TD Cowen
Joe Feldman - Telsey Advisory Group

Operator

Thank you for standing by. My name is Krista, and I will be your conference operator today. At this time, I would like to welcome everyone to the Costco Wholesale Corporation Third Quarter 2024 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I will now turn the conference over to Gary Millerchip, Executive Vice President and Chief Financial Officer. Gary, you may begin your conference.

Gary Millerchip

Good afternoon, everyone, and thank you for joining the call today. I'd like to start by saying how excited I am to be part of the Costco team, and it's a pleasure to be hosting my first Costco quarterly conference call. The whole Costco team has been incredibly welcoming. And as you might imagine, my first three months working alongside Richard have been a lot of fun.

It's also been great visiting warehouses and facilities to immerse myself in the Costco culture and experience firsthand how this is positioning the company for continued growth. Over recent months, I've spent time and met with many analysts and investors, several of whom I know through my prior role. And it's clear you value and appreciate the company's current approach to investor communications. While I can't promise to be able to match the humor that Richard Galanti has become famous for, I can promise the same level of open dialogue and transparency you've come to expect. Oh, and to clear up some recent media speculation, I also want to confirm the $1.50 hot dog price is safe.

Before I talk about our results, I wanted to mention that Ron Vachris is also join today's call. Many of you have expressed interest in hearing from Ron, and so we thought it would be a good idea to have Ron join the discussion and he can also take a few questions. Ron, would you like to add anything before we talk about the quarter?

Ron Vachris

Thank you, Gary, and again, welcome to Costco. I'm very happy to report that the transition from Richard to Gary has gone very well and we're very excited to have Gary on board as part of Costco, and I look forward to working together on the growth opportunities ahead for our company.

Before we jump into the quarter, I want to make a couple of comments on the leadership transition. As Richard has mentioned on previous calls, I've worked closely with Craig Jelinek for many years, including side-by-side for the last two years as President. And so the current CEO transition has been very seamless process. Since January, my time has been focused on working closely with the teams around the world to ensure we continue to deliver the best quality merchandise that are best value for our members. I'm incredibly proud of our employees and I believe our consistency of the results is a reflection of their commitment to our members and to each other.

Consistent with how Craig and Richard manage investor communications, I intend to have Gary host the quarterly conference calls and I will join as business permits to answer a few questions. So Gary, let's go to the results and I'm happy to jump back in for the Q&A portion to field some questions today.

Gary Millerchip

Thanks, Ron. I'll start by stating that these discussions will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that may cause actual events, results and/or performance to differ materially from those indicated by such statements. The risks and uncertainties include, but are not limited to, those outlined in today's call, as well as other risks identified from time-to-time in the company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made and the company does not undertake to update these statements except as required by law. Comparable sales and comparable sales excluding impacts from changes in gasoline prices and foreign exchange are intended as supplemental information and are not a substitute for net sales presented in accordance with GAAP.

In today's press release, we reported operating results for the third quarter of fiscal 2024, the 12 weeks ended May 12. Before I walk through all the numbers, new for this quarter, we are making available a slide presentation on our investor site under Events & Presentations. These slides summarize much of the information I will share today, including Richard's famous matrices. We intend to make this information available every quarter.

Reported net income for the third quarter came in at $1.68 billion or $3.78 per diluted share, up from $1.3 billion and $2.93 per diluted share in the third quarter last year. Last year's results included a non-recurring charge to merchandise costs of $298 million pre-tax or $0.50 per diluted share, primarily for the discontinuation of our charter shipping activities.

Net sales for the third quarter were $57.39 billion, an increase of 9.1% from $52.6 billion in the third quarter last year. The following comparable sales reflect comparable locations year-over-year and comparable retail weeks.

U.S. comp sales were 6.2% or 6% adjusted for gas inflation and FX. Canada was 7.7% or 7.4% adjusted. Other international was 7.7% or 8.5% adjusted, and this led to total company comp sales of 6.6% or 6.5% adjusted for gas inflation and FX. Finally, e-commerce comp sales were 20.7%, both on a reported basis and adjusted for foreign exchange.

In terms of Q3 comp sales metrics, traffic or shopping frequency increased 6.1% worldwide and 5.5% in the U.S. Our average transaction or ticket was up 0.5% worldwide and up 0.7% in the U.S. Foreign currencies relative to the U.S. dollar negatively impacted sales by approximately 20 basis points, while gasoline price inflation positively impacted sales by approximately 30 basis points.

Moving down the income statement to membership fee income. We reported membership fee income of $1,123 million, an increase of $79 million or 7.6% year-over-year. Membership fee income growth was 8%, excluding FX. In terms of renewal rates, at Q3 end, our U.S. and Canada renewal rate was 93%, up one-tenth of a percent from Q2 end. The worldwide rate came in at 90.5%, the same as Q2 end.

We ended Q3 with 74.5 million paid household members, up 7.8% versus last year, and 133.9 million card holders, up 7.4% year-over-year. At Q3 end, we had 34.5 million paid executive memberships, an increase of 661,000 since Q2 end. Executive members now represent over 46% of paid members and 73.1% of worldwide sales. Our reported gross margin rate in the third quarter was higher year-over-year by 52 basis points, coming in at 10.84% compared to 10.32% last year and up 54 basis points, excluding gas inflation. Core was flat and higher by 2 basis points without gas inflation.

In terms of core margin on their own sales, our core-on-core margins were higher by 10 basis points. Ancillary and other businesses gross margin was lower 6 basis points and lower 5 basis points, excluding gas inflation. This decrease year-over-year was driven by gas, partially offset by e-commerce. 2% reward was lower by 1 basis point, both with and without gas inflation with higher sales penetration coming from our executive members.

LIFO was a benefit of 2 basis points. We had an $11 million LIFO credit in Q3 this year compared to no LIFO charge or credit in Q3 last year. This is the third LIFO credit this year following a $15 million LIFO credit in Q1 and a $14 million credit in Q2. And finally, other was higher 57 basis points or 56 basis points, excluding gas inflation. This was all related to lapping last year's negative impact from the $298 million pre-tax charge for charter shipping activities.

Moving on to SG&A. Our reported SG&A rate in the third quarter was lower or better year-over-year by 15 basis points, coming in this year at 8.96% compared to last year's 9.11%. SG&A was lower year-over-year by 12 basis points adjusted for gas inflation. The operations components of SG&A was lower by 14 basis points and lower by 12 basis points, excluding the impact from gas inflation, despite an increase in warehouse wages this year. Higher labor productivity and great cost discipline by our operators drove the improved core SG&A results for the quarter. Central was better by 1 basis point and flat with our gas inflation, and stock compensation and pre-opening were both flat year-over-year.

Below the operating income line, interest expense was $41 million this year versus $36 million last year and interest income and other for the quarter was flat year-over-year as lower interest income was offset by a foreign exchange gain in the quarter. In terms of income taxes, our tax rate in Q3 was 26.4% compared to 26.5% in Q3 last year. Overall, reported net income was up 29.1% year-over-year, and excluding last year's charge related to the discontinuation of charter shipping activities, it was up 10.3% year-over-year. A few other items of note.

In terms of warehouse expansion, in the third quarter, we opened two new warehouses, both in the U.S. Additionally, since the end of Q3, we had two more openings. Last week, we opened in Loomis, California, and two days ago, we opened our seventh building in China in the Nanjing market. For the remainder of fiscal 2024, we plan to open another 12 new locations, nine in the U.S, two in Japan and one in Korea. This would bring the total for the full year to 30 openings, including one relocation for a net of 29 new warehouses.

Regarding capital expenditures, Q3 spend was approximately $1.06 billion, and we estimate full year 2024 capital expenditure will be between $4.3 billion and $4.5 billion. Diving a bit deeper into some of the key themes we saw during the quarter. Non-foods have the highest comps of our core categories. This strength was aided by lapping some softness in sales a year ago, but was really driven by our merchandising teams doing a great job identifying high-quality items with values that really resonated with our members and buying those items with conviction.

As inflation has leveled off, our members are returning to purchasing more discretionary items. And growth in the category was led by toys, tires, lawn and garden and health and beauty aids. Bakery sales also showed great momentum in the quarter as our fresh foods team has reinvented that department with a number of new and exciting items, including the Kirkland Signature Lemon Blueberry loaf and Morning Buns.

Within our ancillary businesses, the food court had the strongest quarterly sales with continued success of the chocolate chip cookie that was added to the food court this year. On the inflation front, it's more of the same from last quarter. Across all core merchandise, inflation was essentially flat in Q3, with fresh foods close to zero and slight inflation in food and sundries being offset by some deflation in non-foods. The deflation in non-foods was led by hardware, sporting goods and furniture, all still benefiting from lower freight costs year-over-year. Keep in mind that when we speak to inflation or in the case of non-food deflation, we're referring to our selling prices. We're intentionally creating incremental value for our members by delivering lower prices wherever possible. We believe our strategy of delivering value to drive unit volume and member satisfaction is the winning combination for us. In that vein, our buying teams are constantly aware of changing costs across all of their SKUs and are ensuring that we are capturing all cost decreases quickly so that we can pass on incremental value through price reductions.

If we are unsuccessful in delivering ultimate value with branded goods, we evaluate the potential for new high quality Kirkland Signature items with a goal of providing at least 20% value versus what we would sell the national brand item at. This quarter, we released a new Kirkland Signature men's walking shoe and new Kirkland Signature facial wipes, both of which are doing very well. We also reduced prices on a number of existing items, including lowering Kirkland Signature pine nuts from $29.99 to $24.99 and reducing the price of our Kirkland Signature frozen shrimp SKUs by $1. These are just a couple of examples that came out of our recent monthly budget meetings where each country and region shares new and exciting items they have introduced to their warehouses and items where they've lowered prices.

Turning now to digital. We continue to make enhancements to the app and website and are excited about the traction that these initiatives are getting with members. Total e-commerce sales growth in the quarter was led by Gold and Silver bullion, gift cards and appliances. In appliances, Costco logistics is playing a key role in providing both greater value and a better end-to-end experience for members. Deliveries through Costco logistics were up 28% in the quarter. Costco Next, our curated marketplace also continues to grow nicely and we added eight new vendors in Q3, bringing the total to 75. Our app downloads were up 32% versus a year ago with about 2.5 million new downloads in the quarter, bringing total downloads to more than 35 million. Site traffic was up 16% and average order value was up 8%.

You may have also recently seen an announcement that we are expanding our relationship with Uber. Previously, Uber Eats delivered Costco orders in Texas and this new agreement allows consumers the ability to order from Costco through Uber Eats across all of Canada as well as 17 states in the U.S. We are also working to expand this partnership to several of our international countries in the coming months. In addition to the increased access to Uber Eats customers, the agreement will allow us to sell Uber gift cards globally and offer discounted Uber One annual membership to Costco members. Finally, in terms of our upcoming releases, we will announce our May sales results for the four weeks ending Sunday, June 2nd, on Wednesday, June 5th, after market close. Also, remember that our fiscal fourth quarter ending September 1, 2024, will have 16 weeks versus the 17 weeks in the fiscal fourth quarter last year.

And with that, we will now open it up for Q&A.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Your first question comes from the line of Simeon Gutman with Morgan Stanley. Please go ahead.

Simeon Gutman

Good afternoon. Hey, Gary, how are you doing?

Gary Millerchip

Hi, Simeon.

Simeon Gutman

We're going to take a stab at this membership question. The way that we've thought about it is it's an inflation offset to the model. And it was described as if you have enough levers in the middle of the P&L to deliver whatever stated EBIT growth you're trying to do, you didn't need to touch the membership fee. Is that still the way that you look at it? And is that visibility on enough levers still intact?

Gary Millerchip

Yes. Thanks, Simeon. And you're talking about a membership fee increase now. Is that where your question is coming from?

Simeon Gutman

Right. Yeah. Yes.

Gary Millerchip

Yes. I would really kind of revert back to some of the comments that Richard shared previously. I don't think that we're thinking about it any differently than he's talked about in the last few calls. We've historically looked at increasing the membership fee every five years or so. And obviously, we're beyond that time period now in terms of what would be the typical cycle. There's nothing about anything that we see within how the business is performing that's changing our view on that. We feel really good about membership renewal rates. We feel really good about the test of are we delivering significantly more value to members than we were or have since we last increased the membership fee.

But I think we are our own probably toughest competitor and that we look at what's happened in the marketplace over the last few years and when we were seeing high inflation and the risk and concern around recession. We -- as I know before I joined the company, it was talked about extensively and it continues to be talked about as it's something that is still a case of when we increase the fee rather than if we increase the fee. But we are still evaluating those considerations to determine what the right timing is. And when we reach that point where we feel it is the right time, of course, we'll be very open and direct in communicating that.

Simeon Gutman

Okay. Fair enough. Can I ask about your opinion on the U.S. expansion, it's been holding in a lot better. It's been more giving than we would have thought several years ago. Do you have any thoughts just your own perspective, you're probably looking at members per warehouse. Are you surprised at the runway you still have in the U.S.? You think it could be even more than what we're aware of today less? Just curious if there's anything surprising on that item.

Gary Millerchip

I think it's only surprising in as much as I know we've talked previously about we thought that we would potentially run out of runway for new warehouses in the U.S. And as you know, this year we're opening close to 29 net new warehouses and many of those will be continuing in the U.S. and we still see significant runway to continue to opening more warehouses in the U.S. in the future.

I think that sort of 25 to 30 new warehouse count is a reasonable proxy for what we think the runway is for the foreseeable future for new warehouses. And I'd be surprised if at least half of those weren't in the -- continue to be in the U.S. because we still see significant growth when we open those new warehouses.

And what it's doing for us in fill in markets is it's creating capacity for our members that are shopping very busy warehouses today to be able to shop more frequently and drive more engagement with us and also it increases membership renewal rates over time as well. So I think we still see plenty of runway in the U.S. to continue to open more warehouses, but we also see a lot of growth opportunity, of course, in the international markets as well.

Simeon Gutman

Okay. Thanks, Gary. Appreciate it.

Gary Millerchip

Thanks, Simeon.

Operator

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

Michael Lasser

Good morning. Good afternoon. Thank you so much for taking my question. There's been a lot of announcements from consumable retailers in recent times about making price investments. Do you think you need to make a sizable price investment in the next couple of quarters in order to remain competitive?

Ron Vachris

This is Ron Vachris. No, I think that this is part of our everyday DNA. I mean, we are competitive on a daily basis. Our buyers are on top of pricing daily, weekly and we all review them each month. And so we feel very good about where we are today and our runway to continue to be as competitive as we are moving forward.

Michael Lasser

My follow-up question is, given some of the changes in leadership over the last year or so, is there any thought given to being more aggressive with some of the evolution on the model, things like buy online pickup in-store, deploying more technology in the store or capitalizing on the ever so great amounts of data that Costco has in the form of trying to monetize it through retail media. Thank you very much.

Ron Vachris

That's no -- and I think the answer to that is yes, on all those fronts. We are working on all those aspects. Right now, we're rolling out an expanded buy online pickup in warehouse that is always going to be limited in scope based on the volume in our warehouses that we have. We can't expand to all categories, but we're expanding as we currently speak in televisions and other electronic items that are there as -- and so yeah, we see that as a real opportunity for us. Technology is going to be one of our key priorities moving forward.

How do we improve that member engagement and the relationship we have with them in our brick-and-mortar warehouses as well as online and through other aspects such as travel and so forth. So technology we see is a great opportunity to enhance the member relationship with Costco and also drive a lot more business for us as well as we move forward.

So we're going to continually innovate. I mean, with the management changes, I wouldn't expect major changes as we have a proven strategy now. But as we've done for the past 41 years, we continue to innovate to the needs of our members. Oh, and the last on data, absolutely. We see a great opportunity for data. We have expanded our group there. We have a significant program now with retail media and we see some great upside potential. We've expanded that team and we see some good potential and some good runway for us in that as well, things like personalization and so forth.

Michael Lasser

Thank you very much.

Gary Millerchip

Thanks, Michael.

Operator

Your next question comes from the line of Chuck Grom with Gordon Haskett. Please go ahead.

Chuck Grom

Hey, good afternoon and congrats again, Gary. And historically, Richard and team have been steadfast on the 14% to 15% margin ceiling, which has clearly paid dividends for the company over the years. I'm curious how you and Ron view this threshold you going to adhere to it? Do you think you can earn more? Just your thoughts on the margin front?

Ron Vachris

No, that 14%, 15% has been part of our life for many years. And so I think that's -- our objective, our buyer's goals is really how aggressive they can get on pricing and deliver the best value. So I don't see there's no plans to move that cap at all.

Gary Millerchip

And Chuck, maybe just one thing to build on that too. I think as you think about some of the opportunities that Ron mentioned on the earlier call, I completely echo Ron's comment about we have a really clear growth strategy that's obviously delivering momentum in the company today and these opportunities through technology and media, I think, are great opportunities for us to find new ways to unlock value. But again, I think we see those very much in the mindset of how do we give 90%-ish of that back to the member, so that we're continuing to drive member engagement, member loyalty and member value.

Chuck Grom

Great. And then just to kind of build off Michael's question, just wanted to get your high level thoughts on digital e-com. What do you think Costco's strengths are? What do you think the weaknesses are today? And where do you think the biggest focus is going to be for the company in the coming years?

Ron Vachris

Our biggest strength on digital e-com is, of course, the merchandise and the value that we have. I mean that's what works for us in our brick-and-mortar. You know, the technology, the systems that we have, the teams have got a great roadmap of where they're going. A lot of the work that's being done right now is very foundational. So better fulfillment, quicker delivery times, the reliability of the site, those type of things. So those are the things. And then following that will come iterative changes of forward facing improvements that you'll see in the sites and move forward. So I think we've got a very good roadmap to do that. But I think that does -- it's -- I think personalization is a big deal for members that we could do a much better job on and also a better correlation of the warehouse and the online business. We're working towards warehouse inventory online. So members could use that in the app. But app functionality is one of our greatest opportunities.

Chuck Grom

Great. Thank you.

Gary Millerchip

Thanks, Chuck.

Operator

Your next question comes from the line of Scott Ciccarelli with Truist Securities. Please go ahead.

Scott Ciccarelli

Thanks, guys. Scott Ciccarelli. So given the strength of your discretionary sales following the well that we've seen with -- as the economy got a little funky, does that suggest your members are starting to feel better and more willing to spend on wants rather than needs?

Ron Vachris

Yes. It does indeed look that way. I've got to tell you that the discretionary spend we're seeing, I mean, we're definitely winning in consumables as we see the food business and dining away from home has softened up a bit and people are eating and we're seeing that in our fresh foods. But I have to tell you that categories such as the home division and toys are categories that have lagged quite a bit post-COVID that with great excitement, I mean, our buyers have come out and delivered some great items, have phenomenal values, have really rejuvenated those categories. And those are both leading categories for us in sporting goods, toys, furnishings, domestics, all those categories are really coming on very strong now and all of it discretionary in nature.

Scott Ciccarelli

Fascinating. And then today, we had a presentation. Obviously, Ron, you joined the call. Are there other changes we could potentially expect given some of the C-suite changes?

Ron Vachris

I mean, again, like I said, there's no major changes planned. The team is -- the team that's been running this company for some time. Gary has been a great addition to us and is contributing nicely. But our model is working. It's working around the world. Great value on quality merchandise seems to resonate in every region that we do business. So we'll continue to innovate. We'll continue to see new things and be relative to what our members needs are, but I can't sit here today and tell you to expect anything -- any great momentous changes in the near future. We just want to continue to actually execute well.

Gary Millerchip

And Scott, maybe just to add from my perspective of being new to the role and new to the company, early observations to me, obviously, the incredibly impressed with the culture and the strategy is clearly working very well. So my first priority is to really being new to the company is to really acclimatize and to support and enable a smooth transition with the culture to make sure the momentum that we have continues going forward. And I think the other point, as we talked about a little bit earlier on the call is we're on a journey with technology and data. And so hopefully, there's things that I can bring to work with the team and help us continuing on that journey and accelerate that journey. And really that's the priorities in my mind being new into the CFO role.

Scott Ciccarelli

Very helpful. Thanks, guys.

Ron Vachris

Thank you.

Operator

Your next question comes from the line of Kelly Bania with BMO Capital Markets. Please go ahead.

Kelly Bania

Thanks for taking our questions. And Ron and Gary, pleasure to have you both on the call and love the slides. Thank you. I wanted to just maybe go back a little bit to retail media strategy and personalization. I think, Ron, you noted a hire or maybe some key hires in that department. And Gary, I think you bring a unique perspective to this area or both of these areas. So I guess just can you help size up the opportunity for us on these two fronts in retail media and personalization? Is it at all different than a typical retailer because of Costco's unique model and SKU count or anything along those lines? And I guess, would that -- would your plans in these areas include any increase in technology spend in coming years?

Gary Millerchip

Sure. Thanks, Kelly. Yeah, I'll go first and then Ron may want to add some color as well. I think many of your comments are relevant to how we think about the opportunity. And from -- the first thing I guess I would say as being new and having joined the company is as you think about where a lot of companies talk about alternative profit streams, there are a lot of areas today where Costco is doing great things in that area today. So using the strength of the membership relationship in driving a very large co-brand payment program that delivers value to members and delivers values to the company. The travel services business that we have, which is pretty unique in retail, but I think in any other company would be viewed as a way of generating new revenue and alternative revenue streams from sort of expanding from that overall retail relationship.

And then thirdly, I would say we have media revenue today in areas of the business. So it's not as though it isn't something that actually the business is delivering on today. But I think as Ron mentioned in an earlier comment that as technology and data are something that we're sort of building a path towards, I would still say there's significant opportunity for us to grow in that space because of the unique nature of the relationship we have with our members and the ways in which we can deliver value for them and tap into that data and tap into the growth that we're creating both in the warehouse and through digital channels. I think it's a little bit early to sort of size it in totality because you're right, there are also some unique elements about our model that would make our opportunity a little bit different.

But from what we know today and from the team that's been brought in to help the company think through it, we certainly believe it's got significant runway to drive a lot of growth for the company. And as I mentioned earlier, though, I would definitely think of it as something that we'll look at to as we do with everything, reinvest in the member to really accelerate the growth of the company overall.

Ron Vachris

I would have to mirror what Gary says. We are -- we do have a unique model. We have a relationship with all of our members. Our responsibility is use that data wisely and respectfully. As far as IT spend, yeah, there will be some IT spend. We don't see as we look in the future, we don't see that to be anything that will really change our trajectory of our cap investments. But there will be some IT requirements, but we feel that will be in the normal course of business.

Kelly Bania

Thank you.

Ron Vachris

Thanks, Kelly.

Operator

Your next question comes from the line of John Heinbockel with Guggenheim Securities. Please go ahead.

John Heinbockel

So guys, I want to go back to personalization again. Where do you think just conceptually the biggest opportunities are, right? When you think about wallet share, every one of your members is going to be a little different, but you can probably do cohorts. Why are they not buying from you and why personalized promotions, outreach on new items coming into the warehouse. I mean, where do you think the biggest opportunities are to build further wallet share?

Ron Vachris

John, I'll go ahead and start out. I think the biggest opportunity is, just like you said, the awareness of the warehouse and keeping our members in tune on what's active, what's going on in the warehouse near them and how we can continue to enhance and drive those sales. I think that that's probably our greatest opportunity with digital as we see moving forward. Personalization is good. We talk here a lot about a fair reasonable amount of personalization. We never want to compromise the treasure hunt of Costco. And that's equally as important as people that go to costco.com, never knew that they needed a 16 foot shed and they see a phenomenal value as they do in the warehouse. And so we don't want to personalize to a detriment, that changes our DNA and who we are. But we do know that there's definitely some improvements we could have that would enhance the member experience. And that's everything that our team is focused on is that how does this move to the member and how does it improve their experience with us digitally.

John Heinbockel

Okay. Maybe -- and then as a follow-up, Gary, you talked a little bit about the core-on-core. But maybe you step back a little bit if you -- and I know the idea is not necessarily to maximize margin, but maybe some thoughts core-on-core this quarter and I know I think there had been pressure on fresh, right, as you kind of normalize post-COVID back to a regular level. Are we now through that process of fresh getting back down to a certain level?

Gary Millerchip

Yes. Thanks, John. Just maybe to give you a little bit more color on the core-on-core and how it kind of played out during the quarter. And so if you think about the three main categories in core between foods and sundries, fresh and non-foods, fresh would have continued to have been slightly lower year-over-year, and that's a very deliberate strategy for us to make sure we're delivering more value for the member, and we think that's a really important place for us to drive member engagement and support, especially as we're still seeing some commodities that are a little bit inflationary right now.

So that would have been very much part of the plan from our perspective. But it was more than offset, as you mentioned by the improvement in non-foods during the quarter, which was what led to the 10-basis point improvement on core-on-core. Food and sundries actually was pretty flat overall. So we feel good about the way that we're managing the balance while staying true to that principle of delivering the best value for the member. And we were pleased with how it played out during the quarter based on the work all the merchandising teams did.

John Heinbockel

Thank you.

Gary Millerchip

Thanks, John.

Operator

Your next question comes from the line of Peter Benedict with Baird. Please go ahead. Peter, if you're on mute.

Peter Benedict

Sorry about that. Yeah. Sorry about that, guys. Thanks for taking the question. Ron, maybe one for you. Just kind of back to the member behavior, maybe back to Scott's question a little bit. Can you just talk about maybe just your observations around maybe income cohorts, any other ways you bucket or slice your membership base, just how the behaviors have evolved here over the last several months. Is there any change that you think is interesting to call out? You talked about the better general non-foods trends. Just curious if this environment reminds you of anything else historically? That's my first question.

Ron Vachris

Okay. It's a very healthy environment from what we see from our members right now. And as you take a category such as our meat department, which is growing very nicely. A lot of volume being driven in ground beef and our new everyday lower price on boneless skinless chicken breasts, really driving a lot of volume units there, while Wagu Beef and prime are growing at a great clip for us as well. So we're seeing that benefit from both sides of the consumer that great value in both areas are doing very well. The non-foods, I tell you that non-foods is strictly driven by newness and excitement and we see big and bulky going very well. It's been a year of our $1,200 swing set that we have on the floor. We can't get enough. They're just blowing out. But it's again that continuous innovation of merchandise that is exciting our members and really driving some sales force there. Executive membership continues to -- yeah, and that drives our executive base and because people are engaging at a much higher level.

Peter Benedict

Sounds good across the board. But we're expecting a dryer to get delivered from Costco logistics on in the next couple of days. So looking forward to that. And then the second question would be, yeah, Ron or Gary, either one of you, just your view on vertical sourcing. I mean, this has been something that has been evolved in for several years going across different categories as you guys continue to grow your business, you need more, I guess, definable sources of supply. Just curious your view of vertical sourcing, where you are today, and what areas you might focus on over the next several years? Thank you.

Ron Vachris

Sure. We have -- we've gotten into vertical integration and sourcing as the need arises. And if you think back in the infamous story about the hot dog and coke at $1.50 and how are you going to figure out how to keep that price there, while we're going to open our own meat plants. And as we looked at the prices of optical lenses going up and then we opened up our optical grinding plants. So we did that to continue to look at those things. The chicken plant came because we saw an inflection point where supply was not going to meet demand. So we had to get involved and because we didn't have a partner that was willing to expand into that area as well.

There is a focus that I have a group focused on too is that let's not try and be everything though. Let's -- we've got a business to run here and we're not going to get vertically integrated just because it's something we can do. It really is going to be driven by where the needs are and when do you need to step in. It's equally -- we have great partners out there that supply our goods for us and they're long-term suppliers. And so it's strategically using that relationship is going to be the key in the future. So there's nothing that I could announce at this time that we're going to expand into, but we continue to keep that in our back pocket should we need to.

Peter Benedict

Terrific. Thanks so much.

Ron Vachris

You're welcome.

Operator

Your next question comes from the line of Paul Lejuez with Citigroup. Please go ahead.

Brandon Cheatham

Hey, everyone. This is Brandon Cheatham on for Paul. Thanks for taking our question. Recently, you were selling Instacart gift cards at a discount online and in warehouse and thought that was pretty interesting because it's potentially a gift card that could be used at a competitor as well. So I'm just curious, is there any strategy behind that? Are you trying to drive member engagement online and if there are any learnings from that initiative?

Ron Vachris

You know the strategy behind it was another avenue to bring value to our members is really what that was about is that there is an upcharge on having grocery delivered to home. We work closely with Instacart, now we will with Uber to try and keep those costs at a minimum, but they've got people to pay on their side as well. So the partnership was really to how do we continue to enhance that service for our members and drive more sales. And so that was truly the -- yes, somebody can go out and use that somewhere else. But again, our job is to save the members where we can and be it airline tickets or Uber Drive tickets or Instacart shopping, we look at all those opportunities to add value to the member.

Brandon Cheatham

Got it. Thanks. And my follow-up, how do warehouses react when you open an infill warehouse? Does it open differently than other new markets? Does the current market feel an impact? And how many warehouses that you opened over the past year would you quantify as infill versus new markets? Thanks.

Ron Vachris

I guess how they react. We normally have good data before we'll open up an infill building and we can judge based on our member information what cannibalization will realize in what building. So we're able to get in front of that and adjust labor and payroll and buying and all those type of things for the upcoming cannibalization that we plan. And our team does a very good job. They're normally within a percent or so of what reality is to the execution of where our plans are as well. So we've gotten pretty good at planning those things out. And with -- it's strategic and the number of cannibalized locations I'd have to tell you, I'd have to say that we probably opened eight this year that cannibalized other buildings. Some may have cannibalized one warehouse, others may be in the middle and we had one in Toronto that cannibalized four buildings around it, but they've built back their sales within six months. So those are the opportunities where you know to Gary's earlier point, frequency improves significantly because members can get back into a high volume club. And so it's strategic cannibalization, if you would, as we look around the world.

Brandon Cheatham

Very helpful. Thank you.

Operator

Your next question comes from the line of Greg Melich with Evercore ISI. Please go ahead.

Greg Melich

Hi, thanks. Ron, I wanted to follow up on the gross margin cap still very much in place at 14%, 15%. Is there any reason that SG&A now that it's back under 9% of sales couldn't fall to 8% if you keep having the growth that you have?

Ron Vachris

No, that's a very fair -- that's a very good point. No, we continue to see -- I mean, the company, we had a very healthy SG&A number this quarter. Inventory was flowing very well. We had fresh goods coming through the system. Our warehouses did a phenomenal job. SKU counts are in line. And so it's one of those things where all the stars aligned and this is the way we operate well. When you can deliver that kind of a top-line growth at our size now, our operators do a tremendous job leveraging that to the SG&A. So what could that -- could that get to? I'd hate to say 8%, but I do think that we can have continued runway of driving down that number.

Greg Melich

That's great to hear it. And on maybe some insight on gas gallons in the quarter. I know it was volatile and there's certainly a [indiscernible] pressure for a lot of members and consumers. Did that help the traffic acceleration in the quarter -- gas gallon growth?

Ron Vachris

Yes. We were 5% up in gallons, you know. And again, that's -- I think all those things when you can save people on gas, that's also going to lend to your traffic as well. But gallons were up 5% for the quarter.

Greg Melich

A great number. And I think a follow-up on gas. Is that still -- is the profitability in gas, Gary, kind of similar versus a year ago or last quarter or is that trending up or down?

Gary Millerchip

Yes, the gas profitability would have been down a little bit. I think you may have heard me mention in the prepared comments that when we looked at the overall gross margin rate for the quarter and the sort of headwind that we had was in the ancillary businesses, the other businesses, and it was essentially gas that created that headwind. So we did see a reduction in gas profitability during the quarter, but overall, the core-on-core margin improvement and e-commerce improvement essentially offset that to bring us pretty close to flat overall when you adjust for gas inflation in the results.

So it was down. I would say general, we've seen on gas profitability, it's been relatively consistent to slightly improving if you look over the last few years, but obviously, there are points in time when you think about volatility in fuel prices where you can have those ups or downs in any given quarter and that was -- this last quarter was one where we did see a headwind in year-over-year gas profitability.

Greg Melich

That's fantastic. Well, welcome and I'll let somebody else ask about how much gold volume drove the comp. Take care, guys.

Ron Vachris

Thank you.

Gary Millerchip

Thanks.

Operator

Your next question comes from the line of Rupesh Parikh with Oppenheimer. Please go ahead.

Rupesh Parikh

Good afternoon. Thanks for taking my question. So just going back to unit growth. In recent years, it's been stuck in that, let's call that mid 20s, it looks like this year will be closer to 30. Just want to get a sense of the opportunities to potentially accelerate that unit growth, especially in the U.S. just given some of your competitors are planning to accelerate growth from here.

Gary Millerchip

You know it is a good risk. When you look at -- I talked before about managed cannibalization and when you do these infills and 29 locations is a solid number for us. As you start getting into infills, some of these projects take a little longer. It's a little tougher than there's not a whole lot of greenland out there for us to go in and open up a warehouse. So we have to do some creative things to find a way to infill in a very high market. International expansion continues to be strong. Some of the countries or regions that we do business in take quite a bit longer to get things done. So I think you'll see that ebb and flow. That number 25 to 29 or 25 to 30 is a good number for us. We feel good with our staffing and leadership and building out the infrastructure behind these warehouses. So we open with great solid support there.

Rupesh Parikh

Great. And maybe just one follow-up question. So in terms -- you guys added Uber to a number of locations. So as you guys think about the intermediate to longer-term, would you expect multiple providers at all Costco U.S. stores over time? So maybe just more the rationale in terms of adding Uber and their longer-term vision?

Gary Millerchip

You know we saw -- we were testing Uber for some time in Texas. We had the tests going on there and we did see a new cohort of members engagement that are on the Uber platform. Uber also allowed us to expand our international footprint too. So we're going to be out in Japan, Korea, Taiwan, UK and that we'll be expanding and where we don't have grocery delivery now. So there were some real benefits to that relationship, along with the long standing Instacart relationship that we had has been very good for many years. So we think that it does open up a window for us for some new member engagement and we also think that it's going to be very good for us internationally and expansion there as well.

Rupesh Parikh

Great. Thank you.

Operator

Your next question comes from the line of Christopher Horver with JP Morgan. Please go ahead.

Christian Carlino

Hi, good afternoon. It's Christian Carlino on for Chris. Could you speak to some of the innovation you're seeing in non-foods and anything else you think is driving some of the performance, particularly in discretionary categories. You called out toys, sporting goods and homes. So maybe any incremental color you can provide on those in particular? And while you're clearly gaining share, when you compare your own performance to some of the syndicated data out there, does the emerging newness suggest there's also somewhat of a rising tide in some of these categories that saw some pull-forward over the pandemic? Thanks.

Ron Vachris

Well, yeah, I think if you look at -- if you talk about the home category and definitely is furnishings, which is one that was quite soft post-pandemic that has come back strong in furniture, those type of things. Then home decor, it's been some very unique items. I mean we've got 7 foot artificial trees that have come in and just exploded out and just blowing out of the warehouses and those are going at a nice clip. Domestics, the most unique items, Swedish dish towels, import items we're finding from around the world are doing very well. But it really comes down to unique items at great values that are exciting to members in all those categories. The housewares categories have been great. You know, sporting goods and toys, inflatable outdoor toys have been a big, big category for us as well. We've added the Kirkland Signature driver into our golf lineup that has -- that sells out as quick as it goes online. So we're seeing wins in several different categories.

Christian Carlino

Got it. That's really helpful. And just broadly, are you seeing the competitive environment heat up in terms of peers investing in price, particularly in non-foods? You have some peers talking more and more about looking to drive units. Others are talking about a big step up in appliance promotions recently. So any color on what you're seeing competitively?

Ron Vachris

Yes. There'll be ebbs and flows with the competition, but I'm very confident that we are always in the right position and we're staying ahead of that to keep the value there for our members. So these are -- those things are cyclical, but we're going to be a value every day.

Gary Millerchip

And I think maybe just one thing to mention on that, Ron too, you mentioned it earlier, but with on the appliances, obviously, making sure we're always very competitive on price. But I do think the acquisition of Innoval Costco Logistics now and the value that we offer members there through both including the delivery and the insulation and the removal of the old appliance is proving to be a real differentiator for us on the member experience as well.

Ron Vachris

Absolutely.

Christian Carlino

Got it. Thank you very much.

Operator

Your next question comes from the line of Scott Mushkin with R5 Capital. Please go ahead.

Scott Mushkin

Hey, guys. Thanks for taking my questions. And Gary, welcome. It's nice to be talking to you at Costco. And Ron, thanks for [indiscernible].

Gary Millerchip

Thanks, Scott.

Scott Mushkin

I appreciate it. So my first question is kind of the opposite what everyone asks all the time around the fee. But given some of the stuff you've outlined around media and maybe driving the SG&A down, why do you need to increase the fee, right? Your sales are strong, your fee income growth is strong. So what -- just because you've always done it doesn't mean you should do it. So what would be the rationale behind driving a fee increase at this point?

Gary Millerchip

You know fee increases go back to the members in lower prices. I mean that's -- it creates -- I mean and that's one of the key parts that we use that money for is that it allows us to broaden that distance from the competition and bring greater values than improving our operation overall for the member. So that's the primary focus.

Scott Mushkin

Okay. And then my next question actually is kind of dovetails on the last one. But you guys talked about the consumer being a little bit better overall. And I guess what I was wondering is, is that really a Costco phenomenon? In other words, are you gaining share and that's what's really driving your improvements in some of these categories like electronics and appliances and big ticket rather than the consumer actually getting better. Is there any way to tease that out?

Ron Vachris

I would say that that's very fair. We -- our merchants report monthly on industry trends in the country and/or internationally as we're seeing. And we can see our sales performance compared to the rest of market. And I would think that you're spot on when you say that we're gaining market share.

Gary Millerchip

Scott, maybe one thing I would just add to is, I think we're all reading a lot about the consumer, of course and what they're going through right now. And I think what we see is that value and quality has never been more important. And so that plays to, as Ron described earlier, what we deliver, and we're making sure that the teams are laser focused on every day delivering that value and quality. And so I think we're drawing customers to what Costco has offer for many years and it's never more relevant than now based on what we're hearing from members and consumers.

Scott Mushkin

Yes, we definitely like our Costco here at the Mushkin residence. So thanks, guys. Appreciate it.

Ron Vachris

Thanks, Scott.

Operator

Your next question comes from the line of Edward Kelly with Wells Fargo. Please go ahead.

Edward Kelly

Hi, good afternoon, everyone.

Edward Kelly

I wanted to ask you about maybe membership fee increase, but in a different way. And you just touched upon it a little bit about membership fee increase, right, just gets reinvested to your members. But can you talk a little bit more about how you think about the areas of reinvestment? I'm sure you probably have already done a lot of work around like where you would like that to go. Is there anything that's unique about where you know reinvestment might come to this time -- this time around just thoughts around that?

Ron Vachris

It moves as time moves and you see pricing in categories and where we have the greatest opportunity to be more competitive for our members. And it may be in an area that if fresh foods is seeing some price inflation, we may invest more in the fresh foods departments for that period of time. The nice part about our model with 3,600 SKUs, 3,700 SKUs is we're still quite nimble as big as we are. So we can shift and based on the needs of our members and where we think the best investment in margin would take care of them. We're able to shift that thought process and then move it around. So I wouldn't say that there's any set, okay, if membership fee goes up, it's going to be spent in these areas. We work as a team and we continue to monitor it throughout the year and we act as needed.

Edward Kelly

Okay. And just a quick follow-up on club throughput. I mean, it's remarkable how you drive up to a Costco club and it's hard to find a place to park, but yet you guys can still comp the way that you do. How are you thinking about throughput and ways to improve that? And I don't know if both buy online and pickup is part of that. How do you think about things like scan and go or maybe it's club density? Just curious as to how you solve for that over time.

Ron Vachris

The part -- a good part of those is things like our e-commerce business and how we can -- how we can move out some of those goods out of the warehouse and move that business online. And as Gary spoke to, now that we have control over Costco logistics, we can bring great value to that experience as well. We continue to look at technology. We're testing some front door scanners that are going to -- they're speeding up our registers significantly when we get all the scanning and memberships are verified at the front door, it has shown a significant improvement in our register speed. And so that in turn turns over parking spaces much quicker. And so those kind of things along with strategic infills to help open up parking opportunities and gas expansions where those are needed as well. So there are several different levers that we'll continue to pull on how we can best serve the member in that building and where we need to make sure that we can look at throughput.

Edward Kelly

Great. Thank you, guys.

Ron Vachris

You're welcome.

Operator

Your next question comes from the line of Oliver Chen with TD Cowen. Please go ahead.

Oliver Chen

Hi, Ron and Gary. You've done some really creative merchandising around UPTs and units per transaction with pickup items and innovation on that treasure hunt. What are your thoughts there? And also, big ticket and electronics, previously, previously, it was a bit of a drag. Just would love your thoughts on what you're seeing there. And third part is marketplace, the marketplace model and the concession model, and alternative inventory models. Just what are your views of opportunities there because they're really big ones and your member is so loyal to you as well. Thank you.

Ron Vachris

On your UPT, you were asking about the transaction impact?

Oliver Chen

I'm thinking strategically about adding units to people's baskets going forward and merchandising in that way as well if it's something you see in terms of an opportunity.

Ron Vachris

Absolutely. We -- that's one of the big -- we were just in a session with our grocery divisions and talking there. And we've seen a great success in international foods that have been brought in to the U.S. and then of the like from the U.S. into the other regions of the world where we do business. But you want to take care of not only the consumables in the grocery side, but when we bring in an item that's a success in Taiwan or Korea or the UK and it creates that excitement for the member, that's when we really have done a good job of triggering that impulsive purchase where members are trusting the buyers and they will add that additional item to their cart. So that's been a big win for us. And again, it goes a lot of times with that treasure hunt. I mean, you've heard the plays, people come in to spend $100 and walk out with $300. That's because our buyers do and our operators do a great job in making the warehouses exciting and keeping those on the forefront of what they're -- when they come in and do their basic shopping, they pick up a few additional items that just compel them at the time.

Gary Millerchip

I think maybe just to add on that, Ron too. I mean, the nice thing about the opportunity there for us is with trips up by 5%, that's really why the average basket size has been more flat recently and that's because we've been growing member engagement in consumables, as Ron mentioned, with food and fresh. And so it does present a great opportunity. And I think it also speaks to the team doing a good job of driving more frequency of member visits. So it creates a great opportunity for us to drive more of that basket size as well.

Ron Vachris

And then your question on marketplace is a significant opportunity for us moving forward. I mean, we really do indeed see that. I think especially with our limited SKU count in the warehouse, how can we expand the offering to the members, bring value to their membership card beyond what's within our four walls or what's on costco.com and we see this as a great growth driver for us in the future and a way to bring expanded value to the members as we look forward. So I'm quite bullish on Costco Next and what that can become in the future.

Gary Millerchip

I think the difference for us on that would be, of course, as we are with Costco Next is just being very curated for the member. So we're unlike a traditional marketplace that is about maybe just sheer volume for us, it's about making sure the member is getting something that truly is unique and valuable and being consistent to who we are, but it's tremendous upside opportunity there in that regard.

Oliver Chen

Okay. And finally, on that big ticket question, would love any green shoots on electronics or TVs? And the last question on Asia, you have same day in China and you've done a lot of great things in the Asian region. Just would love any update there in terms of progress you made and the big opportunity for more end sales as well. Thank you.

Gary Millerchip

Yes, I think just briefly on electronics, so we believe -- I think Ron referenced earlier, we look at a lot of the market data and we believe that we're winning with the member there in terms of the value that we're delivering and when we look at our trends versus the market. So we feel good about our ability to continue to outpace the market there and we're seeing a good opportunity within digital in particular to really drive more connection with the member and take some of those big ticket items from the warehouse to online as well.

And in Asia, I think it would be consistent with what we've talked about with warehouses in the past that we think all of the markets offer us a great opportunity for growth. Some of those markets in Asia are more mature, but there's still significant opportunities to open new warehouses and fill in those markets. And then obviously, we have markets like China where we're really just sort of starting that journey, but there's tremendous growth opportunity as we identify the right path forward in that market.

Ron Vachris

So the grocery delivery in China, we're up and going on six buildings we all just opened our seventh warehouse this week. That will start up this weekend. It's been a big win for our members. Its delivery within two hours is what is able to be done. And so we're seeing some good incremental shops initially out of that program, and we look forward to good things in the future on that.

Oliver Chen

Thank you. Best regards.

Ron Vachris

Thank you.

Gary Millerchip

Thanks.

Operator

Our final question comes from Joe Feldman with Telsey Advisory Group. Please go ahead.

Joe Feldman

Great. Hey, guys. Thanks for taking questions. A lot have been asked, but I do want to ask with Costco Logistics, what was driving that 28% increase, which is very strong? Was it new relationships with some of the other retailers or partnerships or just anything you could share on that would be helpful.

Ron Vachris

Yes, that is other -- that is only -- we only deliver Costco members' orders through Costco Logistics. There are no partnerships going through those numbers that you see. We do a trace amount of series numbers, but that's not in any of the numbers that we report the growth in. That is just part of the past relationship that's there as well. And it is appliances, furnishings and outdoor were the three big drivers. Appliances were almost 30% growth for us in the period. And again, to Gary's point, it's that member value of the all in, what you see is what you pay price for delivery, installation, haul-away, everything you need done at one time that has really resonated with our members and has been a great driver of sales force.

Gary Millerchip

Joe, I'll give you the practical example as a new entrant to the Seattle market. I just had Costco Logistics deliver two mattresses, three TVs and a couple of chairs as well for me. So that's the kind of stuff I think that we're seeing really resonate with members.

Joe Feldman

Got it. That's great. That's great. Thanks, guys. And then just one other question. I know it's still relatively small, I think, but the Costco Next, is that sort of -- it seems like it's ramping nicely. I guess how will that continue to ramp in the future? Like where do you see that going and how important is that a driver? Like is that sort of the basis for this marketplace that Oliver was just asking about?

Ron Vachris

As Gary mentioned earlier, Costco Next is a bit unique, but is it a fully curated marketplace. As there's many other marketplaces out there that are just for somebody to go on and sell goods on this marketplace. These are relationships that our buyers have with our suppliers and we're creating new suppliers as well. This has not only been a new way to sell goods, we've also found that we can find some really neat items that are selling through Costco Next that we in turn then bring into our warehouse. So it is a great testing ground for newness -- new items, a way to expand categories of accessories for certain categories that you have swing sets that we sell online, but you have additional swings and slides and other activities that you sell that we normally wouldn't be able to fit into a warehouse. So it really complements the core warehouse business, but gives us an opportunity to expand member value to these other partners as well. So we see a lot of upside there.

Joe Feldman

Got it. That's great. Thanks, guys. Good luck with the fourth quarter.

Gary Millerchip

Thank you.

Ron Vachris

Thank you.

Operator

We have no further questions in our queue. And with that, this does conclude today's conference call. Thank you for your participation and you may now disconnect.

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