Second Quarter 2010

Investor Conference Call Prepared Remarks
September 14, 2010

Carin Fike, Director of Investor Relations:
Good morning and thank you for joining us. Before we begin, I want to remind you that today's discussion will include forward-looking statements. We want to caution you that such statements are predictions, and actual events or results can differ materially. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings, but Kroger assumes no obligation to update that information.

Both our second quarter press release and our prepared remarks from this conference call will be available on our website at www.kroger.com.

After our prepared remarks, we look forward to taking your questions. In order to cover a broad range of topics from as many of you as we can, we ask that you please limit yourself to one topic with one question, and one follow-up question, if necessary. Thank you.

On behalf of all of us at Kroger, we look forward to seeing many of you later this month here in Cincinnati for our 2010 Investor Conference on September 28 and 29. It will be an engaging and informative session and we appreciate you taking the time to join us to learn more about Kroger.

Now, I will turn the call over to David Dillon, Kroger's Chairman and Chief Executive Officer.

Comments by Dave Dillon:
Thank you, Carin. Good morning everyone and thank you for joining us today. With me to review Kroger's second quarter 2010 results are Rodney McMullen, Kroger's President and Chief Operating Officer, and Mike Schlotman, Senior Vice President and Chief Financial Officer.

Second Quarter Performance
Kroger's Customer 1st strategy is on target, as our strong second quarter results show. We continued to grow identical sales even as we worked to better balance margin investments. Identical supermarket sales increased 2.7%, without fuel, during the quarter. This represents more than six years of positive identical sales growth for our Company – an impressive record by any measure and even more so considering the uncertain economy and the competitive environment.

The strength of Kroger's identical sales growth, excluding fuel, continues to be broad-based across the store and nearly all geographies. Seventeen of our 18 supermarket divisions produced positive identical sales growth, excluding fuel, during the quarter. The other division was essentially flat.

Kroger's ability to sustain such long-standing identical sales growth is a direct result of the effort and commitment of our talented associates. Our associates strive daily to make each shopping trip the best experience possible for each customer. This relentless focus on our customers – day after day, year after year – builds long term credibility with our shoppers. Our team understands the importance of finding ways to make each customer visit better than the last one. I want to thank all of our associates for their outstanding work in producing the results Kroger reported today.

Our performance reflects the consistent, successful execution of all aspects of our strategy – not simply a single factor. We are building momentum through our Customer 1st strategy, which serves Kroger customers, associates, shareholders and our communities well.

Our Customer 1st strategy continues to deliver results through improvements in all four key areas we target: our people, our products, the overall shopping experience in our stores, and prices. As a result, the total number of families we serve continues to grow and our most loyal customers are buying more with us. We are creating value for shareholders by reducing debt and returning value to them through dividends and share repurchases.

Growth in loyal households and strong sales of our own brands and national brands continued throughout the second quarter, demonstrating the strength of Kroger's overall competitive position and the value proposition we provide to customers.

Influencing Factors

The economy, food costs, and the competitive environment continue to influence Kroger's business. Customers are uneasy in this economy, and the variability of their spending behavior continues to reflect their concerns about the job market, cost of living and health care expenses.

Customers in all segments continue to adjust their lifestyles even if their households aren't directly affected by the economy. Many are making significant lifestyle changes while others feel that they should spend less as the economy continues on its uneven path to recovery. This environment is consistent with our view at the beginning of the year.

Changing food costs are also affecting Kroger's financial results. During the quarter, most of our perishable departments experienced higher product costs compared to the same period last year. But we continued to see product cost deflation in the center-of-the-store. Rodney will provide some additional color on this topic in a few minutes.

The competitive environment remains challenging. During the quarter, we saw significant and aggressive promotional pricing at several competitors. Our customers tell us that while price is important, it is not the only factor that influences their shopping decisions. The customer experience matters and this is why Kroger's strategy incorporates all elements that are important to our customers.

Our sales have remained solid in the face of competitive and economic challenges because of the strong credibility we have with our customers. We continue to build momentum through our strategy, which serves all of our various customer segments well.

Guidance

As our results show, we are committed to achieving solid financial results in the near-term while we invest in the future growth of Kroger's business. We have confirmed our identical supermarket sales and earnings guidance for fiscal 2010.

Mike will share more details on guidance with you shortly. But first, Rodney will offer more details on our performance during the quarter. Rodney?

Comments by Rodney McMullen:

Thank you, Dave. Good morning everyone.

I want to thank everyone on the Kroger team for their outstanding efforts during the quarter. I am particularly pleased with our operating cost results. Excluding retail fuel operations, Kroger's OG&A rate increased 7 basis points compared with the same period last year. This year's second quarter OG&A expense included increases in reserves related to workers' compensation claims in prior years. It also includes expenses associated with the transition to a new banking partner for Kroger Personal Finance. Excluding these items, Kroger's non-fuel OG&A rate would have shown 3 basis points of improvement compared to the second quarter last year, even with the rising credit card fees, health care costs and pension expense that we continue to face.

There is incredible enthusiasm and excitement in our stores and our customers are responding as growth in both total and loyal households continued. I will also share updates on customer feedback, corporate brands, food costs and food safety initiatives.

Loyal Household Growth

Let's begin with household counts. The number of total households we serve continued to grow in the second quarter. Customers in all income brackets are consolidating more of their household spend with Kroger. While we believe this ongoing trend is an important indicator for our business, we focus more intently on growing our loyal household base. Loyal households represent our very best customers. We define them based on several factors, including total basket and frequency of purchase.

Our loyal household count grew at a faster rate than the total household count. During the course of a month, loyal households visited our stores more frequently and purchased more items from us than they did this time last year. This is a very important trend. We believe this outcome is a reflection of our Customer 1st strategy, which is designed to reward our loyal customers and not cherry-pickers who simply shop various outlets based on the lowest available price. The insights I have shared with you indicate that Kroger's best customers are the primary beneficiaries of the investments we are making in the four key areas of our Customer 1st strategy.

Our strong partnership with dunnhumby allows us to use shopping behavior data from our loyalty cards to create specific offers and savings for individual households. This enables Kroger and our family of stores to reward our best customers for their increased loyalty.

Customer Tracker

Our Customer 1st strategy is based on listening to what our customers and associates tell us is important to them and acting on their feedback. Every quarter, we track what our customers are saying about us across four key areas: our people, our prices, our products and services and the overall shopping experience in our stores. We measure our progress in specific categories, such as the friendliness and attentiveness of our store associates.

These surveys, which track feedback from more than 50,000 customers each quarter, provide valuable insight we use to improve what we offer customers. During the first half of 2010, our customers have told us we continue to make steady progress in each of the four key areas we target. We continue to seek feedback from our customers and incorporate what they tell us into our business plans.

By the way, we conduct similar surveys with our associates. We listen to them and use their feedback to make improvements because we want Kroger to be a great place to work. Associate engagement is a critical element of our Customer 1st strategy.

Strong Corporate Brands

Our Corporate Brands are a key competitive advantage for Kroger. Our exclusive, preferred brands help strengthen customer loyalty because of their quality, price advantage and breadth of offerings. And they can only be found at Kroger!

Kroger's Corporate Brands team has created a Best In Class program that is difficult for competitors to emulate. We continue to introduce new items based on what our customers tell us they want. In the past year, we launched over 600 new Corporate Brand items, including several in the second quarter such as the enhanced Kroger Wholesome@Home line in the Deli, and new refrigerated salads and side dishes to complement our rotisserie and fried chicken. Our Deli chicken meets our customers' needs for quick meal solutions and now our new salads and sides, such as BLT Pasta – one of my favorites – round out our meal offerings.

We partnered with one of our large national brand vendors to develop the new salad recipes through a customer-driven process. The process started with customers selecting their favorite salad ideas, providing input as prototypes were developed and gaining their approval on the final product.

Customer acceptance of all three tiers of our Corporate Brands portfolio continues to be strong. In the Grocery department, Corporate Brand units, excluding milk, were up slightly for the quarter compared to the prior year. Recall that is on top of double-digit growth this time last year. By the way, I'm excluding milk because overall customer demand diminishes as retail prices increase. Our milk tonnage remains strong compared to overall milk consumption.

While we continue to be pleased with our progress in Corporate Brands, we do not have a target for share growth in this part of our business. Our approach is to offer high-quality, innovative and fresh Corporate Brand products that provide good value to our customers, and then we let our customers decide whether to purchase our brand or the national brand.

That is why we were also pleased to see continued strong growth in the Grocery department of national brand tonnage compared to the same period last year. In fact, we saw tonnage growth across all of our store departments. That includes Produce, which enjoyed double-digit tonnage growth in the same quarter last year.

Food Costs

As Dave mentioned, most of our perishable departments experienced higher product costs compared to the same quarter year. Across all of our supermarket departments, excluding fuel, we estimate that our second quarter product cost inflation was roughly 1.0%.

Yet product cost deflation persisted in the Grocery department, which represents about half of a typical supermarket. Excluding milk, we estimate that our Grocery department experienced product cost deflation of approximately 1.6%. This compares to the 1.8% deflation figure we experienced last quarter. Earlier in the year, we did expect Grocery deflation to moderate, but it hasn't, largely due to increased promotional spending from vendors.

Some investors view food inflation as a positive indicator for our business and food deflation as a negative indicator. The experience of our Grocery department this quarter illustrates why the relationship is not that simple. Gross profit dollars for our Grocery department were higher this quarter compared to the same quarter last year, despite the deflationary trend that I described for you.

Food Safety

Food safety is a priority in our business. We partner with our customers to help them keep their families safe. All of Kroger's manufacturing facilities have been certified using food safety audits benchmarked by the Global Food Safety Initiative, an international organization that promotes comprehensive food safety standards. In fact, all of our manufacturing plants passed certification on their first audit. We are an industry leader in mandating that all of our private label manufacturing partners receive the same certification.

And our customers have praised our recall communication program, where customers can receive updates about the most serious recalls via our loyalty data through multiple channels: our website, messages on their receipts, phone calls to their home and in-store signs.

We are also hopeful that Congress will do its part by sending a food safety reform bill to the President this year. Kroger has endorsed comprehensive food safety reform legislation and we believe our customers and our business will benefit from these reforms.

Labor

Turning now to labor relations, our objective with every contract is to reach an agreement that is good for our associates, good for our customers and good for the company. Our goal is to continue to provide our associates good wages, high-quality affordable health care and stable pension funds. At the same time, we are very mindful that we must manage labor and all costs carefully, so we can reinvest in lower prices and the other important aspects of our strategy customers care about to keep Kroger competitive and grow sales.

We are very candid with union leadership about our goals and challenges, especially in this economy and competitive environment. We have been able to achieve agreements that manage rising health care costs for both our associates and the company. Pension funding remains a significant part of our labor discussions too.

We have successfully negotiated agreements for Michigan, North Carolina and Richmond. Negotiations continue with UFCW locals including Houston, Little Rock, New Mexico, Portland, Seattle and Toledo, and with Teamsters in southern California. We will begin negotiations soon in Cincinnati. All of these negotiations are challenging for the reasons I mentioned.

Now, Mike will offer more detail on the quarter and Kroger's financial strategy. Mike?

Comments by Mike Schlotman:
Thanks, Rodney. Good morning everyone.

Second Quarter 2010 Results
Earlier today, Kroger reported strong second quarter financial results. We believe these results demonstrate that we are managing our business well in a challenging operating environment.

Kroger's second quarter net earnings were $261.6 million, or $0.41 per diluted share, compared to $254.4 million, or $0.39 per diluted share, in the same period last year.
We are pleased with these results. Our lower effective tax rate was offset by the transition expenses associated with Kroger Personal Finance and the increase in prior years' workers' compensation reserves that Rodney mentioned. As a result, these three items had essentially no net effect on Kroger's reported earnings per share.

These results are consistent with the fiscal 2010 forecast we shared with investors in March. We forecasted first quarter earnings below the results we reported for the first quarter of 2009, second quarter results more comparable to the prior year, and solid growth in the third and fourth quarters compared to the corresponding periods in 2009. Our outlook for the balance of the year has not changed.

FIFO Gross Margin
Turning now to some of the details behind our second quarter earnings, FIFO gross margin, excluding our retail fuel operations, decreased 16 basis points. Supermarket selling gross margin, excluding fuel, declined 12 basis points as we began to lap many of the significant pricing investments we made last year. While it remains our objective to deliver additional value to our customers through permanent price investments, we are committed to striking a better balance between investments in all four keys of our Customer 1st strategy and near-term financial results.

Operating Margin
Rodney already covered OG&A, so I'll move on to Kroger's second quarter

operating margin, which declined 20 basis points as a rate of sales, excluding our retail fuel operations. This is a sequential improvement from the first quarter of this year when Kroger's non-fuel operating margin declined 85 basis points. Combining the first two quarters of fiscal 2010, Kroger's non-fuel operating margin rate declined 57 basis points compared to the same period of the prior year. For the full year, we now expect a slight decline in this measure. In order to achieve that result, we are still predicting an increase in Kroger's non-fuel operating margin rate for the second half of the year compared to the same period last year. We have not altered our long-term business model of slight expansion in Kroger's non-fuel operating margin on an annual basis.

Tax Rate

Kroger's second quarter tax rate was 31.7% this year compared to 34.8% for the same period last year. During the quarter, the IRS concluded an examination that resulted in an adjustment to our tax contingency reserves. This adjustment benefited Kroger's second quarter earnings by approximately $0.02 per share. Including this adjustment, we now anticipate a full-year effective tax rate of approximately 35.5%.

Retail Fuel Operations

Strong margins at Kroger's retail fuel operations added approximately $0.01 per share to second quarter earnings on a year-over-year basis. The cents per gallon fuel margin was 14.3¢ compared to 13.6¢ for the same period last year. On a rolling four-quarters basis, the cents per gallon fuel margin was 11.9¢ compared with 13.3¢ in the same period last year. Our guidance for fiscal 2010 assumes a normalized margin for this business of approximately 11¢ per gallon.

Because fuel prices can be volatile, we manage this business by focusing on gallons sold. We are very pleased that our convenience stores and supermarket fuel centers delivered another quarter of strong identical gallon growth.

Guidance

As Dave mentioned, today we confirmed Kroger's full year 2010 earnings guidance of $1.60 to $1.80 per diluted share. We are striving to achieve results in the top half of this range. Several factors are affecting Kroger's business this year, including inflation and deflation in product and operating costs, the competitive environment, fluctuating fuel margins, and the uneven pace of the economic recovery and its influence on our customers' purchasing behavior. Uncertainty remains in all of these areas, but we believe we can continue to manage Kroger's business appropriately to generate solid rewards for shareholders. This is a key part of Kroger's value proposition for investors – the ability to create and deliver shareholder value in a variety of operating environments.

Financial Strategy

We are creating value for shareholders by reducing debt and maintaining our capital spending and returning value to them through dividends and share repurchases.
The strong cash flow of Kroger's business allows us to maintain our current debt rating. We reduced Kroger's net total debt by nearly $400 million compared to one year ago. We still expect to invest approximately $1.9 to $2.1 billion in capital projects this year with a strong bias towards remodels and infrastructure projects. This is exciting because these investments allow us to maintain and improve the quality of our asset base by keeping our stores fresh, inviting and innovative, which enhances our customers' shopping experience.

We also remain committed to deliver value to our shareholders through a solid quarterly dividend and Kroger's share repurchase authorization. We view these as important components of overall shareholder return.

Now Dave would like to make a few remarks before we take your questions. Dave?

Comments by Dave Dillon:
Based on the results we reported today, it is clear that the Kroger experience is the right answer for today's shoppers. Even as the economy continues to languish, we remain focused on delivering results for customers and shareholders through our Customer 1st strategy.

We understand the importance of building credibility over the long-term while taking the right steps in a challenging economy to invest in our people, our stores, and innovation to refine our customers' overall shopping experience. Our customers reward us with their loyalty. We believe our strategy will continue to differentiate Kroger today and will position us well for profitable growth for years to come.

As we head into our prime selling season – Halloween through New Year's – our associates are energized and focused on delivering a great experience in our stores for all of our shoppers. Ensuring success in the second half of the year will take discipline. Our team is committed to executing our strategy well to benefit our customers and shareholders.

As Carin mentioned earlier, we look forward to seeing and talking with many of you here in Cincinnati later this month. It is always a pleasure to have you with us. Creating sustainable, long-term value for you is our objective and we will discuss that more in depth during the conference.

Now, we look forward to your questions.

Comments by Dave Dillon:

Before we end the call, I want to thank our associates for a terrific quarter! Because of your individual efforts, our results were a little better than this time last year – a remarkable outcome considering the operating environment of the past year and the challenges it continues to present.

The real test now comes as we enter the second half of the year. It will take the collective efforts of each of us to make our entire year successful. There are many variables in play. This environment requires continued discipline in order to keep Kroger the right solution for today's shoppers. Just as we listen to our customers, we also listen to you. The Associate Survey, which is underway now, provides valuable insight we use to make positive changes that matter to you. We look forward to hearing from you.

On behalf of your leadership team, we look forward to seeing your enthusiasm and creativity at work for our customers as we head into the holiday season. Thank you for making each shopping visit a special one for our customers!

That completes our call today. Thank you for joining us.

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The remarks contain certain forward-looking statements about the future performance of the Company. These statements are based on management's assumptions and beliefs in light of the information currently available to it. Such statements are indicated by words or phrases such as "anticipate," "guidance," "expect," "committed," "striving" and "predicting." These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially. Our ability to achieve identical supermarket sales and earnings growth and earnings per share goals, the timing that those earnings occur within the year, our ability to achieve results in the upper half of our earnings guidance range, and our ability to continue to deliver shareholder value through dividends and share repurchases, may be affected by: labor disputes, particularly as the Company seeks to manage health care and pension costs; industry consolidation; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition; our response to these actions; unexpected changes in product costs; the state of the economy, including interest rates and the inflationary and deflationary trends in certain commodities; the extent to which our customers exercise caution in their purchasing behavior in response to economic conditions; the number of shares outstanding; the success of our future growth plans; goodwill impairment; volatility in our fuel margins; and our ability to generate sales at desirable margins, as well as the success of our programs designed to increase our identical sales without fuel. In addition, any delays in opening new stores, or changes in the economic climate could cause us to fall short of our sales and earnings targets. Our ability to increase identical supermarket sales also could be adversely affected by increased competition and sales shifts to other stores that we operate, as well as increases in sales of our corporate brand products. Earnings and sales also may be affected by adverse weather conditions, particularly to the extent that hurricanes, tornadoes, floods, and other conditions disrupt our operations or those of our suppliers; create shortages in the availability or increases in the cost of products that we sell in our stores or materials and ingredients we use in our manufacturing facilities; or raise the cost of supplying energy to our various operations. Our results also will be affected by the inconsistent pace of the economic recovery, consumer confidence, and changes in inflation and deflation in product and operating costs. Our capital expenditures could vary from our expectations if we are unsuccessful in acquiring suitable sites for new stores; development costs vary from those budgeted; our logistics and technology or store projects are not completed on budget or within the time frame projected; or if current operating conditions fail to improve or worsen. Our fuel margins could fail to normalize at 11¢ per gallon if rapid changes in fuel costs occur. Our non-fuel operating margin guidance could change if we are unable to pass on any cost increases, if our strategies fail to deliver the cost savings contemplated, or if changes in the cost of our inventory and the timing of those changes differ from our expectations. Any change in tax laws, the regulations related thereto, the applicable accounting rules or standards, or the interpretation thereof by federal, state or local authorities could affect our expected effective tax rate. Please refer to Kroger's reports and filings with the Securities and Exchange Commission for a further discussion of these risks and uncertainties.

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