Third Quarter 2012
Investor Conference Call Prepared Remarks
November 29 2012

Cindy Holmes, 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 third quarter press release and our prepared remarks from this conference call will be available on our website at www.thekrogerco.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.

I will now turn the call over to Dave Dillon, Chairman and Chief Executive Officer of Kroger.

Comments by Dave Dillon:
Thank you, Cindy. Good morning everyone and thank you for joining us today. With me to review Kroger's third quarter 2012 results are Rodney McMullen, Kroger's President and Chief Operating Officer, and Mike Schlotman, Senior Vice President and Chief Financial Officer.

Third Quarter Performance

We are obviously delighted about the numbers we just released. Both our GAAP and adjusted earnings per share growth are the results of the powerful foundation we have laid for our business to grow.

Our core business drove earnings per share growth by more than 20%. This strong result excludes the two items identified in our earnings release and the swing in LIFO from year to year. This was a remarkable quarter by several measures:

- We achieved our 36th consecutive quarter of positive ID supermarket sales growth,
- Realized a record third quarter EPS,
- Increased total FIFO operating profit dollars, and
- We saw the highest increase in unit movement since the second quarter of 2010.

This quarter illustrates that the strength of our core business positions Kroger to accelerate our earnings per share growth.

Economy and Consumer Sentiment

The economy is slowly improving but value customers are still struggling. We continue to monitor changes in gas prices and inflation. Customer concern over fuel and energy costs lessened as gas prices decreased through the quarter. Rodney will have more to say about declining inflation shortly, which contributed to the growth of our unit movement in the quarter. Overall, consumer confidence is up but it remains fragile. Uncertainty around issues like the fiscal cliff can have a short-term impact on consumer sentiment, as we saw last year during the debt ceiling debate. Kroger is well-positioned to successfully navigate through these factors.

Growth Strategy

I'd like to thank you again for your participation in our investor conference in New York City last month. The purpose of that event was to outline for you our plan to accelerate Kroger's earnings growth.

We are implementing our long term growth strategy and we are committed to achieving fully diluted earnings per share growth of 8% to 11%, plus a higher dividend over time, supported by:

- Targeting capital expenditures to grow our business in new and existing markets;
- Leveraging dunnhumby insights to solve varied customer needs, through both traditional and digital channels; and
- Continuing our share buyback program.

This is what we believe will grow Kroger and shareholder value, and we are bullish about our future.

Rodney will now discuss how Kroger is executing our growth plans and our positive business results in the third quarter.

Comments by Rodney McMullen:
Thank you, Dave, and good morning everyone.

Growing Kroger

It is definitely an exciting time at Kroger. We have aligned our senior leadership team to accelerate our growth strategy. All across the business, our associates are executing to deliver growth results.

- In 2013, we plan to build, expand or relocate 50 supermarkets, compared to 40 expected this year.
- We are making good progress adding square footage in four fill-in markets, and others are being identified based on various metrics.
- We are narrowing the list of new markets for future expansion.
- Earlier this month, we announced that Kroger will acquire the outstanding shares of Axium Pharmacy, a leading specialty pharmacy that provides specialized drug

therapies and support services for patients with complex medical conditions. Axium has skills Kroger doesn’t have, and Kroger’s size can help Axium grow. Offering specialty pharmacy services will give our customers greater access to drugs we don’t currently dispense and access to additional services we don’t currently provide. We’re very excited about this new partnership.

Consumer Shopping Behavior and Tonnage Growth

One of the most important measures of our business is loyal household growth, because it lets us know how well we are connecting with our best customers. During the third quarter, we grew the number of loyal households in all divisions. Our loyal household count grew at a much faster rate than total household growth, which was also up for the quarter.

We also achieved positive identical supermarket sales growth for all households. ID sales growth among loyal households outpaced total household growth.

Customers continued to visit our stores more frequently and buy more on a monthly basis. Customers also purchased more items on each trip, a welcome change from what we’ve seen for the last several quarters. As a result, total units sold were up compared to last year. This tonnage growth confirms our belief that we continue to make market share gains in the overall food retailing industry.

The rate of product cost inflation in the third quarter continued to flatten faster than originally anticipated. We estimate the rate of inflation declined to 1.4%, excluding fuel. Once again every store department had inflation with the exception of Produce and Seafood, which both were deflationary.

Pharmacy Performance

Before I discuss our sales results, there were a couple of events that affected our pharmacy and overall identical supermarket sales results. The growth of generic drugs reduced total identical supermarket sales by 1% in the quarter. Our ability to attract and retain Express Scripts business has largely offset this effect.

The effect of generics is consistent with what we outlined at the start of this year.

I want to congratulate and thank our pharmacy teams for managing through a difficult year. They have done a phenomenal job – and that is an understatement.

Identical Supermarket Sales Trend

We are very pleased with our third quarter identical supermarket sales growth of 3.2% without fuel. The cadence of identical sales throughout the quarter was balanced. We’ve also had a consistent sales trend through the year when you look at our identical sales excluding both fuel *and* pharmacy. And I realized this is a number we normally don’t give, but in this quarter we thought it would be helpful. On this basis, identical sales were a strong 3.2% in the first quarter and 3.1% in the second and third quarters.

Corporate Brands

Moving now to Kroger's Corporate Brands. We recently introduced our new Simple Truth and Simple Truth Organic brands, which are free from 101 artificial ingredients and preservatives that some customers have said they do not want in their foods. Together, these are our fastest-growing brands. We are very excited about our early results.

Corporate Brands represented approximately 26.0% of Grocery department sales dollars in the third quarter, and Grocery department Corporate Brand units sold were 32.9%. Some of the decline in Corporate Brands share in Grocery is due to some CPG companies getting more aggressive in promoting certain items. While we strive to grow the Corporate Brand part of our business over time, we have long said our goal is to give the best value to our customers, and in this quarter some of the national brands provided a great value. The mix between national brands and Corporate Brands fluctuates in any given quarter, and we continue to be a market leader in Corporate Brands.

Operating Leverage

Kroger leveraged operating expenses in the third quarter, as OG&A costs plus rent and depreciation, without fuel and the two adjustment items, were down 21 basis points as a percent of sales. On this basis, we have had seven consecutive years of improvement in this metric, and expect to achieve our eighth consecutive year.

Great People Initiative

Last quarter, I provided several examples of investments we are making in the non-price Keys of our Customer 1st strategy – our People, Products and Shopping Experience. Today I'd like to share one of our Great People initiatives that is designed to improve the health and wellness of our associates and keep our health care costs down.

Earlier this year, we partnered with Anthem Blue Cross Blue Shield to develop an innovative program to provide our associates with access to the top-performing health care providers for several common but expensive surgeries. Participating associates pay less out of pocket at these facilities and benefit from higher quality of care. Kroger pays about 15% less at these hospitals than at others for the same services, even including travel costs. We are excited to be on the leading edge with this kind of program, and pleased with the results so far. We believe it improves our connection with our associates, which in turn strengthens our connection with customers.

Labor
Finally, an update on labor relations. Associates in Arizona, Columbus and Memphis have ratified labor agreements. We continue negotiations on many contracts, including in Indianapolis, Nashville, and Portland for store clerks, and a distribution center in Delaware, Ohio. Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and compensation packages that provide good wages, a quality, affordable health care, and retirement benefits for our associates.

Next, Mike will share additional detail on Kroger's third quarter financial results and guidance for the rest of the year. Mike?

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

Third Quarter 2012 Results
I'd like to also thank you for your participation in our investor's meeting last month. At the meeting we laid out four key performance targets for shareholders to measure our success, including:

- ID sales growth
- FIFO operating margin growth
- A stable and growing return on invested capital
- Market share growth

We believe holding ourselves accountable for these key metrics will drive shareholder value. We will measure our progress on the first three on a quarterly basis and continue to report market share growth on an annual basis, at year end.

Rodney went into a lot of detail about the strength of our identical supermarket sales and our ability to leverage operating costs. We are very pleased with our strong performance in these metrics.

Third Quarter FIFO Gross Margin
FIFO gross margin was 20.35% of sales for the third quarter of fiscal 2012. Excluding retail fuel operations, FIFO gross margin decreased 25 basis points from the same period last year.

Third Quarter Net Earnings
Net earnings for the third quarter totaled $316.5 million, or $0.60 per diluted share. This includes a $0.14 benefit from a settlement with Visa and MasterCard and a reduction in the company's obligation to fund the UFCW consolidated pension fund created in January.

Excluding the benefit of these two items because they were not the result of our normal operations, Kroger's adjusted net earnings for the third quarter totaled $242.4 million, or $0.46 per diluted share. Net earnings in the same period last year were $195.9 million, or $0.33 per diluted share.

Third Quarter LIFO Charge

I want to spend a couple of minutes on LIFO. Many of the items we discuss are on a FIFO basis. We manage the company without regard to our LIFO charge. When we develop our expectations for any given year we estimate LIFO last. The reason for this is LIFO is merely an accounting convention. We don't believe our operations should generate more or less EBITDA because LIFO is higher or lower in a given period of time. As a result, if LIFO is lower than the prior year our EPS growth rate will be higher than our targets; and if LIFO is higher than the prior year, our EPS growth rate will be lower than our targets.

This quarter is a good example. We reduced our LIFO charge estimate to $125 million for the year. Previously, we internally estimated the LIFO charge at $150 million. The change in our LIFO estimate for the year benefitted the quarter by 2 cents.

FIFO Operating Margin

Third quarter FIFO operating profit, excluding the two adjustment items, increased approximately $29 million over the prior year. Excluding fuel and the adjustment items, on a rolling four quarters basis, the company's FIFO operating margin was 7 basis points lower compared to last year. Kroger expects to have a slightly higher FIFO operating margin rate, excluding fuel, for the full 2012 fiscal year, in line with our commitment to grow the rate slightly over time on a rolling four quarters basis.

Return on Invested Capital

Return on invested capital in the third quarter was 13.3%, compared to 13.5% during the same period last year. As I said in New York, we are committed to growing our ROIC over time.

Retail Fuel Operations

Turning now to retail fuel operations. We disclose many items with and without fuel due to its effect on operating costs and gross rates, but we view fuel as a core department that over time is expected to contribute to earnings per share growth. About half of our supermarkets have fuel centers today. In the third quarter, our supermarket fuel centers margin per gallon was approximately 14.9 cents per gallon compared to 13.0 cents in the same quarter last year.

Financial Strategy

Our planned uses of cash remain unchanged:

1. Fund capital expenditures
2. Repurchase shares
3. Pay dividends to shareholders and
4. Maintain our current investment grade debt rating.

Capital expenditure

Capital expenditures, excluding acquisitions and purchases of leased facilities, totaled $473.5 million for the third quarter, compared with $497.0 million for the same period last year. We continue to expect full-year capital expenditures to be in the $1.9 to $2.2 billion range and expect 2013 to be approximately $2.4 billion.

<u>Share Repurchase & Dividends</u>
During the third quarter, Kroger repurchased 14.5 million common shares for a total investment of $333 million.

Kroger's strong financial position has allowed the company to return more than $1.7 billion to shareholders through share buybacks and dividends over the last four quarters. As it relates to dividends, you should receive the first payment since our 30% increase this coming Monday.

<u>Debt</u>

Net total debt was $8.7 billion, an increase of $1.0 billion from a year ago. On a rolling four quarters basis, Kroger's net total debt to adjusted EBITDA ratio was 2.08 compared with 1.89 during the same period last year. Our objective is to maintain our current debt rating. We believe a net total debt to EBITDA ratio of 2.0 to 2.2 will support this objective.

<u>Updated Guidance for Fiscal 2012</u>

Now I'll update our guidance for the fourth quarter.

As a result of solid performance in our core business, Kroger raised its earnings per diluted share guidance, excluding the two adjustment items, to $2.44 to $2.46 for the full year, up from the previous guidance range of $2.35 to $2.42. This implies a $0.68 to $0.70 earnings per diluted share result in the fourth quarter.

With only one quarter left in the year, we believe fourth quarter identical sales guidance is most important. In the fourth quarter, we expect ID sales between 3.0% and 3.5%.

We also want to remind you – as you start thinking about your own estimates for 2013 – that you will need to adjust 2012 results to remove the benefit of the extra week and the two items that total 14 cents. We will provide an estimate of the benefit of the 53rd week when we provide full guidance in March.

Now, I will turn it back to Dave.

Comments by Dave Dillon:
Thanks, Mike.

When you look at how Kroger has strengthened our business for the last ten years and compare us to other food retailers, you'll see that we took the road less travelled. And when you look today at our ability to deliver positive growth results, you'll understand why we believe that has made all the difference. Kroger's proven Customer 1st Strategy continues to increase customer loyalty, identical store sales and market share. With that foundation firmly in place, we are focused on deploying capital to further accelerate growth and improve ROIC. We are committed to delivering shareholder value through stronger earnings per share growth, higher dividends and stock buybacks.

Now, we look forward to your questions.

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Comments by Dave Dillon:

Before we end the call, I'd like to share some additional thoughts with our associates listening in today.

I have two special messages for our associates today. First, we take time to honor our veterans this month. I am pleased that we support our veterans and military families in so many ways at Kroger. I want to thank you for your support in launching *Honoring Our Heroes*, our company-wide partnership with the USO. Since 2010, Kroger has raised more than $5 million to assist service members and their families. This has been possible because of you, our customers and our vendor partners. Your generous support helps fund the USO's variety of programs that benefit our troops, their families and veterans.

In addition, Kroger announced *Hiring Our Heroes*, a renewed commitment to hiring veterans. More than 17,000 veterans have joined Kroger's ranks since 2009. By the end of this year, our Human Resources team will attend 15 RecruitMilitary veterans career fairs, and they plan to attend even more in 2013. As always, we are pleased to welcome veterans to our Kroger family, and we continue to support our active-duty military associates who work for us.

My other message for associates is about this holiday season. Because of you, Kroger is the trusted and preferred store for millions of families at this very special time of year. Your enthusiasm and creativity clearly show as we visit our stores across the country. We appreciate everything you do to delight our customers and keep our stores running smoothly. Today, our busy shoppers have more retail choices than ever before. Offering to help find something, keeping items stocked on our shelves, making checkout fast and easy – these are all ways you can make their day more pleasant.

Thank you for your hard work during this holiday season.

That completes our call today. Thanks for joining. Merry Christmas and Happy Holidays to you and your families!

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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 "expect," "objective," "will," "guidance," "continue," "believe," "committed," and "plan." These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially. Our ability to increase return on invested capital and to achieve identical supermarket sales and earnings growth and earnings per share goals, the timing that those earnings occur within the year, and our ability to expand our FIFO operating margin, 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 nontraditional 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 success of our Customer 1st Strategy; 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; changes in government-funded benefit programs; volatility in our fuel margins; the effect of prescription drugs going off patent has on our sales and earnings; our expectations regarding our ability to continue to obtain additional pharmacy sales from third party payors such as Express Scripts; 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, as well as our views regarding the trend of those 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, and the effect that increased numbers of generic pharmaceuticals, which generally carry lower retail prices than brands, have on our sales. Earnings and sales also may be affected by adverse weather conditions and natural disasters particularly to the extent that those 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, including the cost of transportation; and the benefits that we receive from the consolidation of the UFCW pension plans. Our results also will be affected by rising commodity costs, the inconsistent pace of the economic recovery, changes in government-funded benefit programs, consumer confidence, and changes in inflation or deflation in product and operating costs, and the effect of the consolidation of the UFCW pension plans. Our capital expenditures, our plans to increase capital expenditures, to build, expand or relocate a certain number of supermarkets, and to grow our business in both new and existing markets, 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. Increases in total shareholder return, increasing dividends over time, our plans to use cash flow from *operations to fund capital expenditures, and to reward shareholders through quarterly dividends and share repurchases, and our ability to maintain our current debt rating, will depend on our ability to generate free cash flow, which will be affected by all of the factors identified above, as well as the extent to which funds can be used for those reasons while maintaining our debt rating. Our FIFO operating margin, without fuel, will be affected by changes in product costs during the year, if our estimates of product cost changes or the timing of those changes prove incorrect, and if competitive or other factors cause our margins on product sold to fail to meet our objectives. Our objective to maintain a particular net total debt to EBITDA ratio will be affected by unanticipated increases in net total debt, our inability to generate free cash flow at the levels anticipated, and our failure to generate expected earnings and the extent to which that ratio will support our current debt rating depends on how the rating agencies view our overall financial condition. Our ability to continue to decrease OG&A plus rent and depreciation as a percentage of sales will depend on our ability to identify and implement sustainable cost controls, including those related to rent. The acquisition of the outstanding shares of Axium Pharmacy Holdings, Inc. is dependent on the satisfaction or waiver of certain conditions to closing, as well as the sellers' consummation of the transaction, much of which is outside of the control of Kroger. Please refer to Kroger's reports and filings with the Securities and Exchange Commission for a further discussion of these risks and uncertainties.*