Third Quarter 2014
Investor Conference Call Prepared Remarks
December 4, 2014

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, which includes a reconciliation of certain non-GAAP measures discussed today, and our prepared remarks from this conference call will be available on our website at ir.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 question, and one follow-up question, if necessary. Thank you.

Thanks again to those who participated in our October Investor Conference in person or via webcast. We appreciate that many of you made the trip to Cincinnati, and, as always, we enjoyed the dialogue and opportunity to show you our stores.

I will now turn the call over to Rodney McMullen, Kroger's Chief Executive Officer.

Comments by Rodney McMullen:

Thank you, Cindy. Good morning everyone and thank you for joining us today. With me to review Kroger's third quarter 2014 results are Mike Ellis, Kroger's President and Chief Operating Officer and Mike Schlotman, Senior Vice President and Chief Financial Officer.

Consistently Remarkable

Kroger continues to deliver consistently remarkable results. We are well on our way to achieving our tenth consecutive year of lowering costs and reinvesting those savings in our people, products, pricing and improved store experience – which together are driving our growth. Few can deliver this level of sustainable high performance. After a while, it can be easy to take this consistency and reliability for granted – so it is important to keep in mind that these results are possible only because 375,000 associates engage with our customers every single day.

Growth Strategy

Our associates delivered yet another quarter of inspired Customer 1st performance.

We continue to implement our growth strategy and consistently deliver on the key performance indicators we first outlined in October 2012. In the third quarter, we achieved our 44th consecutive quarter of positive identical supermarket sales growth, excluding fuel; we exceeded our goal to slightly expand FIFO operating margin, without fuel, on a rolling four quarters basis; and, we continued to gain market share.

Our third quarter financial results were driven by strong sales and core business performance, which was better than we expected. Higher fuel margins drove our results above our previous guidance range. Our guidance range for the full year assumes fuel margins will not be as strong in the fourth quarter as they were in third quarter. Mike Schlotman will have more to say about our supermarket fuel operations in a few minutes.

Economy and Customer Shopping Behavior

How our customers are doing today depends on the stability of their family's finances. Overall, our customers continue to spend a little more as confidence in the economy improves over time.

While inflation is apparent in certain commodities, fuel prices have been going down, which helps all customers, especially those on a budget. We try to help those customers stretch their food budget in a variety of ways. Our weekly promotions and fuel rewards help, along with price investments. We continue to make natural and organic foods affordable and accessible to all customers, especially with Simple Truth. Our expansive Corporate Brands offering is resonating with customers seeking high quality food at very good prices. In fact, Corporate Brands had their best performance in several years in the third quarter. Our ability to deliver this combination of value sets us apart.

Now, I'll turn it over to Mike Ellis to discuss our operational performance in the third quarter. Mike?

Comments by Mike Ellis:

Thanks, Rodney. Good morning everyone.

Loyal Customer Growth

During the third quarter, we continued to grow the number of loyal households, and our loyal household count grew at a much faster rate than total household growth, which was also up for the quarter. Loyal household growth is an important measure of our business because it lets us know how well we are connecting with our best customers.

Tonnage Growth and Inflation

Inflation increased in the third quarter, as Rodney mentioned, among commodities such as meat and pharmacy, and increased to a lesser extent in all other supermarket departments. As Mike will discuss shortly, we raised our LIFO charge estimate for the year again this quarter due to the higher than expected inflation.

We estimate product inflation was 3.5%, excluding fuel, for the third quarter.

Even so, we saw strong tonnage growth in the third quarter compared to last year, and in fact it was slightly ahead of the second quarter's unit growth.

Outstanding Corporate Brands Results

Corporate Brands had an outstanding third quarter, representing 27.3% of total units sold and 25.8% of sales dollars, excluding fuel and pharmacy. In fact, Corporate Brands experienced its highest sales growth and total retail dollar share of any quarter in the last three years. Clearly, our rebranded opening price point and Kroger banner brands are a hit with our customers. Simple Truth and Simple Truth Organic continue to earn double-digit unit and sales growth.

Customer 1st Innovation

A key driver of Kroger's sustainable growth is Customer 1st Innovation. For the past few quarters we have been highlighting innovations that are improving our connection with customers. This quarter, I will highlight some of the new and exciting work of our Dairy manufacturing team.

We recently opened a state-of-the-art dairy processing plant in Denver. We built and engineered the plant to deliver exceptional quality and freshness for our customers, and to provide an avenue for innovation in the dairy category. We incorporated new technologies for our customers that ensure our milk will stay fresher, longer than ever before. We are the first dairy in the US to deploy robotic technology that enables us to pack cases and pick and palletize orders entirely by automation.

Another innovation that this dairy will bring is the ability for us to produce long-shelf-life products to meet growing demand for aseptic products and packaging.

The dairy – our first ground-up manufacturing plant of any kind in 20 years – opened in May and began full production of fresh milk in August. We have been producing fresh milk, organic milk, juices and drinks, and customer response has been very positive.

Labor Update

Now, I will provide a brief update on labor relations.

We recently completed several successful contract negotiations covering Smith's associates in New Mexico, Fry's and Smith's associates in Arizona, Food 4 Less associates in Southern California, and Kroger associates in Toledo, West Virginia, and the Ohio valley.

We are currently negotiating with the Teamsters covering several distribution and manufacturing facilities.

Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and compensation packages that provide solid wages, good quality, affordable health care, and retirement benefits for our associates. Kroger's financial results continue to be pressured by rising health care and pension costs, which some of our competitors do not face. Kroger and the local unions, which represent many of our associates, should have a shared objective – growing Kroger's business and profitability, which will help us create more jobs and career opportunities, and enhance job security, for our associates.

Before I turn it over to Mike, I'd like to thank our associates for the impressive quarter. Once again, you showed our customers how much we care about them, each and every day. Because of your efforts, we are able to continue investing in our products, lowering prices and improving the shopping experience in ways that generate customer loyalty.

Now Mike will offer more detail on our financial results and our guidance for the remainder of the year. Mike?

Comments by Mike Schlotman:

Thanks, Mike. Good morning everyone.

Third Quarter Growth Metrics

As you know, when we outlined our growth strategy in 2012, we identified the key performance targets for shareholders to measure our progress. I'd like to spend a few minutes discussing the results in each metric.

<u>ID Sales</u>

Our first metric is identical supermarket sales without fuel. Identical sales performance is the best measure of our growing connection with customers over time. We are very pleased with our third quarter ID sales growth of 5.6%, without fuel. This strong performance was supported by ID sales growth in every supermarket department and division. Our Natural Foods department continues to lead with double digit growth.

<u>FIFO Operating Margin</u>

Rolling four quarters FIFO operating margin, excluding fuel and adjustment items, expanded by 9 basis points. This exceeded our goal to slightly expand FIFO operating margin, without fuel, on a rolling four quarters basis.

<u>Return on Invested Capital</u>

We are not reporting our third metric, return on invested capital, this quarter because the calculation would overstate our result. We expect our year-end ROIC, which will fully reflect Harris Teeter in our calculation, to be similar to our ROIC at the end of fiscal 2013.

Third Quarter 2014 Results

Now, I'll share the rest of our third quarter 2014 results in more detail.

Please note that this quarter includes Harris Teeter in Kroger's consolidated statements of operations. Year-over-year percentage comparisons are affected as a result.

Third Quarter Net Earnings
In the third quarter, our net earnings totaled $362 million, or $0.73 per diluted share.

This includes a $0.04 benefit in the third quarter due to certain tax items. Excluding these items, Kroger's adjusted net earnings were $345 million, or $0.69 per diluted share, for the third quarter. We view these tax benefits as non-recurring, so as you begin to think about 2015 please note that we will not be growing off of that next year.

Net earnings in the same period last year were $299 million, or $0.57 per diluted share. Last year's third quarter net earnings per diluted share benefited from certain adjustments totaling $0.04 per diluted share. Excluding these adjustments, last year's third quarter net earnings were $0.53 per diluted share.

Third Quarter LIFO
We recorded an $85 million LIFO charge during the quarter compared to a $13 million LIFO charge in the same quarter last year, resulting in an incremental $0.09 per diluted share charge to net earnings in the third quarter compared to the same quarter of last year.

We began fiscal 2014 estimating a LIFO charge for the year at $55 million; at the end of the first quarter we increased our LIFO guidance to a charge of $90 million, and at the end of the second quarter, we increased our LIFO charge estimate for the year to $100 million. As reported this morning, we again increased our LIFO charge estimate for the year to $180 million.

Third Quarter FIFO Gross Margin
FIFO gross margin decreased 2 basis points from the same period last year, excluding retail fuel operations.

Third Quarter OG&A Expenses
Operating, general and administrative costs plus rent and depreciation, excluding retail fuel operations and the adjustment items, decreased 21 basis points as a percent of sales compared to the prior year as a result of good expense control and strong sales leverage.

Retail Fuel Operations
Now for retail fuel operations. In the third quarter, our cents per gallon fuel margin was approximately 23.2¢ compared to 17.1¢ in the same quarter last year. This does not

include debit and credit card fees. Last year's third quarter margin was well above historical averages, which means this quarter's margin performance was remarkable.

Financial Strategy

Our long term financial strategy continues to be to:

1. Maintain our current investment grade debt rating,
2. Repurchase shares,
3. Have an increasing dividend, and
4. Fund increasing capital investments.

<u>Maintain Current Investment Grade Debt Rating</u>

Achieving a 2.00 – 2.20 net total debt to adjusted EBITDA ratio by mid-to-late 2015 remains a key objective. Kroger took on debt to finance the Harris Teeter merger, and has not yet realized a full year of Harris Teeter EBITDA. As a result, the company's net total debt to adjusted EBITDA ratio increased to 2.29 as of the close of the third quarter, compared to 1.86 during the same period last year, as described in table 5 of our press release. This is an improvement from the 2.33 reported last quarter.

Kroger's net total debt is $11.5 billion, an increase of $3.4 billion from a year ago, including debt related to the Harris Teeter transaction and Kroger's share repurchase activity.

<u>Share Repurchases</u>
Kroger's strong financial position allowed the company to return more than $1.8 billion to shareholders through share buybacks and dividends over the last four quarters.

During the third quarter, Kroger repurchased 600,000 common shares for a total investment of $29 million. All $500 million of the buyback authorization granted in June remains available.

<u>Capital investments</u>
Capital investments, excluding mergers, acquisitions and purchases of leased facilities, totaled $681 million for the third quarter, compared to $641 million for the same period last year.

We expect capital investments to be at the low end of the $2.8 to $3.0 billion range, including Harris Teeter, for fiscal 2014.

Updated Fiscal 2014 Guidance

Now I'd like to review our updated growth objectives for fiscal 2014.

Based on our strong third quarter results, we raised and narrowed our adjusted net earnings per diluted share guidance to a range of $3.32 to $3.36 for fiscal 2014. The previous guidance was $3.22 to $3.28 per diluted share.

For the fourth quarter of fiscal 2014, Kroger expects identical supermarket sales growth, excluding fuel, of approximately 4.0% to 5.0%. We acknowledge this is a wide range for one quarter – and we are seeing great strength and momentum at the start of the fourth quarter – but this year's fourth quarter is difficult to project narrowly because of uncertainties relative to one year ago, including the positive effect that weather had on our identical supermarket sales during last year's fourth quarter.

Fiscal 2015 Initial Guidance

As you start to think about fiscal 2015 estimates, we encourage you to build your models based on fiscal 2014 adjusted results, which exclude certain tax benefits and charges related to the restructuring of certain pension plan agreements. If fuel margins return to historical levels, we expect fiscal 2015 results to be closer to the low end of our long-term net earnings per diluted share growth rate guidance of 8 – 11%. Shareholder return will be further enhanced by a dividend expected to increase over time.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:

Thanks, Mike.

Our third quarter performance is further evidence that Kroger is improving our connection with customers and delivering growth for our shareholders. We continue to increase capital investments, which creates exciting opportunities for our business and for our associates. We enjoyed discussing several of those opportunities with you during our investor conference in October. Our positive momentum is expected to carry through the fourth quarter and sets us up well as we look to 2015.

More importantly, Kroger's "to do" list remains longer than our "done" list. There is a lot more to come.

Now, we look forward to your questions.

***

Comments by Rodney McMullen:

Before we end today's call, I would like to say a few words about Dave Dillon, who is listening in this morning. All of you know Dave well, and this is his last official earnings call as Kroger's chairman.

Dave has been a friend and a leader to all of us, and a mentor to many of us. Thousands of associates can relate to that comment. For me personally, Dave has been a partner like no other. On behalf of the entire Kroger family, we wish Dave and his family all the best as they begin their next chapter together. Dave, thank you from all of us.

Finally, I'd like to share some thoughts with our associates listening in.

During the next few weeks, there will be a lot of activity in our stores as we help customers prepare for their holiday celebrations. Thank you for helping make the holidays brighter for our customers and the communities we serve.

During Kroger's *Season of Giving*, with your help and help from our customers, we will donate 30 million meals to local food banks. Customers will have opportunities to add their support by dropping change in coin boxes at check stands and donating non-perishable food in collection barrels in stores.

Thank you for all that you do for our Customers and each other! Merry Christmas and Happy Holidays to you and your family.

That completes our call today. Thanks for joining.

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." Various uncertainties and other factors could cause actual results to differ materially from those contained in the forward-looking statements. These include the specific risk factors identified in "Risk Factors" and "Outlook" in our annual report on Form 10-K for our last fiscal year and any subsequent filings, as well as the following:

- The extent to which our sources of liquidity are sufficient to meet our requirements may be affected by the state of the financial markets and the effect that such condition has on our ability to issue commercial paper at acceptable rates. Our ability to borrow under our committed lines of credit, including our bank credit facilities, could be impaired if one or more of our lenders under those lines is unwilling or unable to honor its contractual obligation to lend to us, or in the event that natural disasters or weather conditions interfere with the ability of our lenders to lend to us. Our ability to refinance maturing debt may be affected by the state of the financial markets.

- Our ability to use free cash flow to continue to maintain our investment grade debt rating and repurchase shares, pay dividends, and fund capital investments, could 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.

- Our ability to achieve identical sales, earnings and cash flow goals may be affected by: labor negotiations or disputes; changes in the types and numbers of businesses that compete with us; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition; our response to these actions; the state of the economy, including interest rates, the inflationary and deflationary trends in certain commodities, and the unemployment rate; the effect that fuel costs have on consumer spending; volatility of fuel margins; changes in government-funded benefit programs; manufacturing commodity costs; diesel fuel costs related to our logistics operations; trends in consumer spending; the extent to which our customers exercise caution in their purchasing in response to economic conditions; the inconsistent pace of the economic recovery; changes in inflation or deflation in product and operating costs; stock repurchases; our ability to retain pharmacy sales from third party payors; consolidation in the healthcare industry, including pharmacy benefit managers; natural disasters or adverse weather conditions; the potential costs and risks associated with potential cyber-attacks or data security breaches; the success of our future growth plans; and the successful integration of Harris Teeter. Our ability to achieve sales and earnings goals may also be affected by our ability to manage the factors identified above.

- Our capital investments could differ from our estimate if we are unsuccessful in acquiring suitable sites for new stores, if development costs vary from those budgeted, if our logistics and technology or store projects are not completed on budget or within the time frame projected, or if economic conditions fail to improve, or worsen.

- During the first three quarters of each fiscal year, our LIFO charge and the recognition of LIFO expense is affected primarily by estimated year-end changes in product costs. Our fiscal year LIFO charge is affected primarily by changes in product costs at year-end.

- If actual results differ significantly from anticipated future results for certain reporting units including variable interest entities, an impairment loss for any excess of the carrying value of the reporting units' goodwill over the implied fair value would have to be recognized.

- Our effective tax rate may differ from the expected rate due to changes in laws, the status of pending items with various taxing authorities, and the deductibility of certain expenses.

- The actual amount of automatic and matching cash contributions to our 401(k) retirement plans will depend on the number of participants, savings rate, compensation as defined by the plan, and length of service of participants.

- Changes in our product mix may negatively affect certain financial indicators. For example, we continue to add supermarket fuel centers to our store base. Since gasoline generates low profit margins, we expect to see our FIFO gross margins decline as gasoline sales increase.

###