Second Quarter 2016
Investor Conference Call Prepared Remarks
September 9, 2016

Kate Ward, 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 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.

Please save the date for our 2016 Investor Conference, which we will hold in Cincinnati on November 1st and 2nd. Details will be coming soon and we hope you can join us.

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

Comments by Rodney McMullen:

Thank you, Kate. Good morning everyone and thank you for joining us today. With me to review Kroger's second quarter results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Our core business remained strong in the second quarter, as we continued to increase market share, improve tonnage, and grow loyal households.

As we often say, we are focused on long-term performance over a three-to-five year horizon. We have the right strategy, the right people, and the financial flexibility to execute our strategy, which allows us to continue investing in our associates, our business, and growing market share. By remaining focused on our strategy, we create long-term value for our shareholders.

An example of staying on our strategy is continuing to add hours to support tonnage growth in a deflationary environment. This increases our costs as a rate of sales, but without this investment the shopping experience – an important element of our Customer 1st Strategy – would be negatively affected.

Revised Guidance

The transition from inflation to deflation creates a difficult operating environment. We estimate we had deflation without pharmacy of 1.25%, including 1.5% deflation in the grocery category.

I want to stress that we've been through environments like this before. In 2009 we transitioned from inflation to deflation in a very similar way. Of course, in 2009 we also had a much more difficult macroeconomic backdrop. Even though the current environment is volatile, we are confident that we will navigate today's challenges and continue to deliver value for our customers and shareholders.

While we have revised our identical supermarket sales growth and net earnings per diluted share guidance for the year, our growth objectives are on a 3 to 5 year rolling cycle, and we remain confident in those targets. We are in this for the long run and not a 12-week quarter or even a particular year. We have demonstrated our ability to invest at the appropriate times to create momentum when the environment improves.

While we expect continued deflation and tough year-over-year comparisons for the remainder of this year – and even into the first quarter of next year – as we know from past experience, the environment won't be deflationary forever.

Kroger's long-term focus is one of the reasons why our business continues to generate healthy free cash flow, which allows us to both invest for the future *and* maintain financial flexibility to create shareholder value. To this end, we have decided to allocate approximately $500 million less to capital investments for 2016 and for 2017, which will allow us the flexibility to return value in the near term. This could include utilizing our current, board-authorized, $500 million share repurchase authority, as market conditions provide the opportunity.

Economy and Customer Shopping Behavior

We often say the only certain thing in retail is that it is always changing. That is certainly true for ever-shifting customer preferences as well as the overall competitive environment. We believe one of the reasons for our continued success – regardless of operating conditions or competition – is our ability to generate increasingly sophisticated customer insights. Our team at 84.51° helps us figure out what our customers want so we can make highly-informed, strategic investments based on rigorous data analytics, rather than simply reacting to competitors.

Customer insights give us a big advantage in challenging environments like this one. A lot of what we are seeing suggests a gradual tightening of budgets. Our customers tell us they are less confident about the economy now than they were three months ago, and they expect the economy to get worse in the next three months.

We are as committed as ever to doing what is right for the customer. Our team's execution of our Customer 1st Strategy helped deliver growth in loyal and total households, units and market share compared to last year. Customers continue to vote with their dollar and, on that basis, Kroger continues to win.

Positioned for Long-term Growth

We believe that it is easier to steer a big ship when the waters are smooth, but when the water gets rough the right people and right strategy make all the difference.

These are some of the same reasons why you should continue to believe in Kroger:

- We are focused on the long-term,
- We have the financial flexibility to execute our strategy, and
- We have the right people and right strategy to weather any storm.

Our merchandisers and operators are the best in the business. Our senior management team brings a great mix of new ideas and long tenure – propelling innovation while remaining steady at the helm. Like any high-performance team, the mindset of our leaders is agility and responsiveness to changing customer and economic dynamics.

We remain focused on growing market share and will continue to invest in our associates and our business, providing value to our customers both today and for the future.

Modern-Axium Merger

One example of our long-term focus is our recent merger between our specialty pharmacy, Axium, and ModernHEALTH. The merger, which closed last Friday, further expands our presence in the high-growth specialty pharmacy area, and connects nicely with our retail pharmacies and broader health and wellness strategy. We are excited to welcome ModernHEALTH's 500 associates to the Kroger family.

DJSI

A second example of our long-term focus is our progress integrating sustainable practices into our business operations. We believe that customers and associates increasingly make decisions based on how well companies take care of their people, their communities and the planet. So we are very proud to share that Kroger has earned a spot on the Dow Jones Sustainability Index for the 4th consecutive year. More than

600 companies in North America are evaluated each year, and only the top 20% are listed on the index. This recognition, of course, is only possible thanks to the thousands of individual activities our associates do on a daily basis in our stores, manufacturing and distribution facilities, and offices.

Through all of our growth initiatives, we strive for balance between our core business, beyond the core, and innovation. This fundamental approach is how we'll continue to win with customers and create sustainable, long-term value for shareholders.

I noted earlier that we operate our business on a 3-to-5 year rolling cycle. Over both time horizons we have been performing consistently above our long-term, net earnings per diluted share growth rate guidance of 8 – 11%, plus a growing dividend.

Now Mike will offer more detail on Kroger's second quarter financial results and discuss our guidance for the remainder of the year. Mike…

Comments by Mike Schlotman:

Thanks, Rodney. Good morning everyone.

As Rodney said, we've been through periods like this before and we have the leaders and the strategy to continue delivering value to our customers, associates and shareholders. While the quarter and the year aren't shaping up the way we expected, we continue to be well-positioned for the long-term.

We continue to see a strong flow of capital projects. We've tried to be very clear about our deliberate ramp up of capital spending since 2012. As a management team we recognize the environment and believe it is prudent to reduce capital investments, excluding mergers, acquisitions and purchases of leased facilities, to $3.6 to $3.9 billion for 2016 and for 2017. This is still a substantial investment in the business.

Consistent with our long-term financial strategy, we are maintaining flexibility with our cash flow to invest in the business, repurchase shares and maintain a growing dividend. Our philosophy is to always create value for shareholders – and while our Customer 1st approach remains our distinctive business strategy, we implement multiple approaches to deliver shareholder value.

There are many gives and takes in any given quarter and year. We view our ability to adjust to return value to shareholders as a core strength of our financial strategy.

Second Quarter ID Sales & Inflation

Identical supermarket sales, without fuel, came in at 1.7%, impacted by deflation across most departments, with the exception of Produce and Pharmacy. We are seeing significant deflation in milk, eggs and cheese.

We will continue to focus on growing households, growing units, and making sure we are delivering the right value proposition for our customers. As Rodney pointed out, we continued to do all three of these things during the second quarter. That our team accomplished this in such a deflationary environment is no small feat and demonstrates that our associates continue to connect with our customers in personal and meaningful ways.

As you know, a strength of our Customer 1st model is that we make regular investments in our people, products, shopping experience, and price. As Rodney said, we added hours to keep up with unit growth and we also continued our price investments as evidenced by our lower gross margin. We balance these investments based on the needs we see in the business to drive sustainable results over time.

Operating costs excluding fuel, Roundy's, and the pension agreements were better by 6 basis points in the second quarter. A lower expected bonus is one driver of this result. We'll continue to focus on cost controls and use those savings to provide additional value to our customers.

Retail Fuel

Now for an update on retail fuel.

In the second quarter, the average retail price of a gallon of gas declined by 47¢ compared to last year. Our cents per gallon fuel margin was approximately 19.8¢ compared to 19.0¢ in the same quarter last year. On a rolling four quarters basis, we were at 18.4¢ this year compared to 18.6¢ last year. We expect this rolling four quarter comparison to further decline as we cycle some very strong margin quarters for the rest of the year.

Second Quarter EPS

A variety of factors contributed to our net earnings per diluted share results in the second quarter. Deflation was clearly a headwind, and that was offset by a lower-then-expected effective income tax rate due to the adoption of a new accounting standard.

Our second quarter net earnings per diluted share, on a GAAP basis, was $0.40, compared to $0.44 during the same period last year.

Our net earnings per diluted share result includes charges related to the restructuring of certain pension obligations to help stabilize associates' future benefits. Excluding the effect of these charges, Kroger's adjusted net earnings were $454 million, or $0.47 per diluted share.

Roundy's Integration Update

Our integration with Roundy's continues to be on plan. We have two dedicated management teams, one for Roundy's in Wisconsin and one for Mariano's in Illinois, to take into account the uniqueness of the formats in each location. These leadership teams have a mix of Kroger and Roundy's experience. We are pleased with the early results of our Roundy's investments in Wisconsin and we remain excited about this opportunity.

Corporate Brands

During the second quarter, Corporate Brands represented approximately 27.4% of total units sold, and 25.5% of sales dollars, excluding fuel and pharmacy.

Our Corporate Brands team continues to drive innovation in important categories. Earlier this week, we launched a new, more affordable corporate brand line of cage-free eggs. You may know that earlier this year, we committed to a 100% cage-free egg supply chain by 2025. In order to reach that goal, we want to help customers shift from conventional eggs to the cage-free category. By offering a lower-price alternative to most other cage-free eggs on the market today, we believe our mainstream customers will begin to migrate to the cage-free category.

Financial Strategy

Our net total debt to adjusted EBITDA ratio increased to 2.11, compared to 2.02 during the same period last year. This result illustrates our commitment to use free cash flow to both grow our business and return cash to shareholders, while maintaining an appropriate level of leverage for our credit rating.

Over time we would expect our net total debt to EBITDA ratio to grow if we continue to successfully negotiate restructuring of troubled multi-employer pension plan obligations to help stabilize associates' future benefits. We would not expect this increase to adversely affect our credit rating, as the ratings agencies already contemplate our multi-employer pension plan obligations and the additional debt we take on to fund these plans will be offset by the reduction in our multi-employer pension plan obligations.

Over the last year, Kroger has used free cash flow to:

- Repurchase $1.1 billion in common shares
- Pay $406 million in dividends
- Invest $3.8 billion in capital, and
- Merge with Roundy's for $866 million.

Return on invested capital for the second quarter was 13.95%, excluding Roundy's, compared to 14.24% for the second quarter of 2015.

Our balance sheet is as strong as ever.

Labor Update

I will now provide a brief update on labor relations.

We recently agreed to new contracts covering store associates in Little Rock, Nashville, and Southern California.

We are currently negotiating contracts with the UFCW for Fry's associates in Arizona, and store associates in Michigan and Atlanta. We are also negotiating a new contract with the Teamsters for our Roundy's Distribution Center.

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, 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.

Multi-Employer Pension Commitments

I'd like to take a moment to highlight our $111 million commitment to the UFCW Consolidated Pension Plan. This is part of an agreement to transfer the liabilities of two troubled multiemployer pension plans, which protects pensions already earned and will provide greater stability for the future benefits of more than 6,500 Kroger associates and retirees.

This is the latest in a series of steps we've taken during the last four years to provide greater stability of current and future benefits for Kroger associates and enhance the prospects for future returns, while continuing to deliver strong shareholder value.

In 2012, we agreed to establish the UFCW Consolidated Pension Plan by working with the union to consolidate four multi-employer pension funds into one. That agreement protected earned benefits and provided greater stability for the future benefits of more than 65,000 Kroger associates.

In 2014, we announced similar agreements with two additional multi-employer pension funds, and, in 2015, we accelerated contributions to the consolidated plan.

We are proud of our ability to do this even in a tough operating environment.

We intend to continue looking for opportunities to leverage our strong financial flexibility to safeguard our associates' benefits, increase certainty and control over future pension obligations, and continue delivering strong shareholder value.

Fiscal 2016 Annual Guidance

Turning now to our 2016 guidance.

As a result of continued deflation, we lowered our net earnings guidance range to $2.03 to $2.13 per diluted share for 2016. Kroger's adjusted net earnings guidance range per diluted share for 2016 is $2.10 to $2.20, which excludes the $0.07 charge from the company's commitment to restructure certain pension obligations. The previous guidance range was $2.19 to $2.28, which did not anticipate the $0.07 charge from the company's commitment to restructure certain pension obligations.

Shareholder return will be enhanced by a dividend that is expected to increase over time.

For identical supermarket sales growth, excluding fuel, we expect the remainder of 2016 to be in the 0.5% to 1.5% range, which is 1.4% to 1.8% for the full year.

Finally, we now expect Kroger's full-year FIFO operating margin in 2016, excluding fuel, to *decline slightly* compared to 2015 results.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:

Thanks, Mike.

We are in this for the long-term. Whether it is our sustainability initiatives, job creation, or return to shareholders…none of these are short-term ventures or quick fixes. We've been through business cycles like this before, and we know the best and right thing to do is deliver on our promise today while investing for the future. We are as committed as ever to our Customer 1st Strategy and we are confident that we will continue to deliver long-term value for shareholders.

Now, we look forward to your questions.

***

Comments by Rodney McMullen:

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

I want to thank the many associates sharing in the Kroger journey. We have six generations working with us today. Each associate makes a unique contribution. You bring your energy and ideas, your experiences and expertise.

We are a better company because you have made Kroger the place where you want to be and work.

Even as we have grown and gotten bigger as a company, I know that when the doors open and the lights go on at our stores, offices, distribution centers and manufacturing facilities, everyone is giving their best to our Customers, our Company and each other.

That means a lot – thank you for everything you do for our Customers every day! 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,” “anticipate,” 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 achieve 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; our ability to negotiate modifications to multi-employer pension plans; 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 and Roundy’s. Our ability to achieve sales and earnings goals may also be affected by our ability to manage the factors identified above. Our ability to execute our financial strategy may be affected by our ability to generate cash flow.

- 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.

- 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 fuel generates lower profit margins than our supermarket sales, we expect to see our gross margins decline as fuel sales increase.

Kroger assumes no obligation to update the information contained herein. Please refer to Kroger's reports and filings with the Securities and Exchange Commission for a further discussion of these risks and uncertainties.

###