First Quarter 2018
Investor Conference Call Prepared Remarks
June 21, 2018

Rebekah Manis, 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 first 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.

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

Comments by Rodney McMullen:
Thank you, Rebekah. And congratulations on your recent promotion to director of investor relations. Mike and I look forward to working closely with you in your new role.

Good morning everyone and thank you for joining us. With me to review Kroger's first quarter 2018 results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

A Great Start for Restock Kroger & 2018

Restock Kroger is off to a great start. I'm especially proud of our team's execution of process changes that led to strong cost controls.

We are committed to knowing and serving our customers so well that Kroger serves all of their shopping needs. Our most fundamental strategy remains unchanged: As customers' tastes change and their shopping habits evolve, we will be there for them. That means we will make the investments needed to provide our customers with the best full-service grocery experience in America.

Plus, we are investing in our associates more than ever before and seeing improvements in retention.

We are creating a seamless environment where our customers can choose how to engage with us, both in-store and online. We are actively improving the store experience – our space optimization work is ahead of schedule and *Our Brands* achieved another period of record growth – while at the same time growing our digital sales by more than 66% in the first quarter, which was due to our ongoing expansion of ClickList, our delivery initiatives, and identical sales growth.

Our first quarter results enabled us to raise the low end of our EPS guidance for the year, while also setting us up well to deliver on our ID sales target range for 2018.

Restock Kroger Progress

As you know, *Restock Kroger* is our three-year plan to create shareholder value by redefining how America eats. We're making progress in each of the four main drivers: **Redefine the Grocery Customer Experience**, **Partner for Customer Value**, **Develop Talent**, and **Live Our Purpose**.

Redefine Grocery CX & Partner for Customer Value

Using our deep insights and experience, Kroger is imagining the future of retail by building on our core business plus adding exciting and innovative partnerships like Ocado and our planned merger with Home Chef.

Ocado

We believe the future of retail will include <u>both</u> physical and digital customer experiences. Everything we are doing today will enhance our ability to provide everyone in America with the convenience of shopping for anything, anytime and anywhere.

We are incredibly excited that it is Kroger who is bringing Ocado's technology to the U.S. for the first time. The platform includes online ordering, automated fulfillment and home delivery capabilities – so it is a perfect fit with our vision and strategy. We look forward to innovating together with Ocado to enhance Kroger's digital and robotics capabilities. And we are already working to identify the first three sites for development of the new, automated warehouse facilities in the U.S. to deploy Ocado's proprietary technology and distribution expertise.

Home Chef

Customers want convenience, simplicity and a personalized food experience. Our planned merger with Home Chef will accelerate our ability to deliver exactly this. There is a lot we admire about Home Chef … their creativity and entrepreneurial energy, and their use of data to connect with customers … to name just a few.

We believe that by taking over Kroger's meal solutions portfolio, Home Chef will bring our customers even more innovative and delicious offerings so customers can be the hero at meal time. Pat and his team at Home Chef will be able to leverage Kroger assets – both our physical stores and data – to drive their business even more. And by joining forces we can grow bigger together than either of us could have done alone.

Digital Progress

We continue to execute our digital strategy through our core business as well. As I've said before, the households that participate in our seamless offerings – those who engage with our digital platforms and with our physical stores – spend more per week than households that do not. And households that purchase from us online spend even more.

We've aggressively grown our existing seamless coverage area to reach approximately 75% of our customers. This includes our network of ClickList locations, stores offering home delivery through Instacart and other partners, as well as ship to home capabilities. Our goal is to reach 100% of our customers with the seamless experience – and, over time, to reach all across America. All the changes we are making to transform our business will make it even easier for families to share meals together. This business strategy enables us to live our Kroger purpose, because we know that families who share meals together have children who do better in all aspects of their lives.

Our Brands

Our Brands is another example of how we're redefining the grocery customer experience.

Kroger customers choose to put more *Our Brands* in their baskets and pantries every day. *Our Brands* grew faster than national brands in nearly every department and gained significant share overall. In the first quarter, *Our Brands* made up 28.7% of unit sales and 26.7% of sales dollars.

In fact, *Our Brands* set the record for the highest-ever retail dollar share in our history!

Our Brands achieved 5.1% sales growth and 3.4% unit growth in the first quarter, led by double-digit growth again in our popular Simple Truth and Simple Truth Organic lines.

Develop Talent & Live Our Purpose

Last quarter, we said that the federal Tax Cuts and Jobs Act would enable us to accelerate investments in *Restock Kroger*. This is possible because we are taking a balanced approach to how we are spending and investing the benefits – distributed evenly between our associates, customers and shareholders. This approach is in line with Kroger's purpose and is helping us make strategic investments in Develop Talent.

We are investing more than ever before in the associate experience. It all starts with the half-billion-dollar investment in wages for many store associates that is part of *Restock Kroger*. We're also increasing the company's 401(k) contribution match to help associates retire with more money in their pockets, plus expanding associate discounts to keep more money in their pockets today.

What I'm most excited about is **Feed Your Future** – our new offer of up to $3,500 in annual tuition assistance to any associate who wants to attend classes to build a better future for themselves. Whether they are interested in completing a GED or undergraduate degree, an

MBA or a professional certification, associates can take advantage of up to $21,000 in total assistance as long as they've been with us for at least six months on a full or part-time basis.

As someone who got his start stocking shelves on the night shift in Lexington, KY for Kroger in 1978, I can attest to education's life-changing power. I worked my way through college, and upon graduation I was so proud to accept a full-time job with Kroger. The incredible learning experiences and work that makes a difference in people's daily lives has kept me here ever since.

Kroger has always been a place where people can 'come for a job and stay for a career.' We believe that making education benefits available to more associates -- and at more generous levels than ever before -- is the best way to support their future career and personal growth. And, as part of *Restock Kroger*, we fully expect these investments will have an ROI that will create shareholder value.

Create Shareholder Value

We are in the process of transforming our business so that, in the future, we can connect with customers in ways that add more ease and convenience to their lives. To do this – and to do it profitability – we must have an economic model that supports this transformation.

Kroger is better positioned than anyone to make this transformation because we have a set of unique and differentiating strengths:

- Kroger has more data than any of our competitors, which leads to deep customer knowledge and unparalleled personalization.
- We have incredibly convenient locations and platforms for pickup and delivery within one-to-two miles of our customers.
- We have a leadership team that combines broad experience with creativity and diversity of thought.
- We have the scale to win with more than 60 million households shopping with us annually.
- We connect personally with our associates, customers and communities to uplift and improve lives.
- And, we have a proven track record of consistently returning capital to shareholders through an increasing dividend and share buyback program.

Because of these strengths, we are on track to generate the free cash flow and incremental FIFO operating profit that we committed to in *Restock Kroger*.

We are confident in our ability to deliver on both our plan for the year and our long-term vision to serve America through food inspiration and uplift.

Now, here is Mike to share more details on our first quarter results and to update you on our guidance for 2018. Mike…

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

We are very pleased with our first quarter ID sales and earnings results. We did slightly better than our internal expectations. We completed the sale of our convenience store business unit. And, as Rodney said, we had one of the best cost control quarters in a long time due to implementing process changes. This is important, because over the next three years *Restock Kroger* will be fueled by cost savings that we will invest in associates, customers and our infrastructure. Our goal is to continue generating shareholder value, even as we make these strategic investments to grow our business.

We expect *Restock Kroger* to generate $6.5 billion of free cash flow over the next three years. This is before dividends and considers the benefit of the tax plan.

We've already reprioritized the way we will invest in capital over the next three years, by both reducing the amount we spend and optimizing our capital allocation process.

We now look first for sales-driving and cost-savings opportunities across both brick-and-mortar and digital platforms. Second, we will continue to make sure our logistics and technology platforms keep pace with and scale to these demands through continued investment. Finally, we will allocate capital to storing activity. This process has allowed us to use less free cash flow for capital investments.

Our investment in Ocado is a good example of what's possible with our new approach to investing capital.

We continue to aggressively manage OG&A costs and implement new programs to reduce our cost of goods sold. A big focus continues to be on store productivity and waste. Our teams controlled shrink well in the first quarter. As we've said before, we won't leave a penny on the table as we seek to reinvest savings to grow our business.

We plan to generate $400 million in incremental FIFO operating profit through 2020. We are taking advantage of the lower federal taxes under the Tax Cuts and Jobs Act to pull investments forward to 2018 so we can move even faster on *Restock Kroger* than originally anticipated.

Our pull forward investments in *Restock Kroger* began the last four weeks of the first quarter. While the incremental 401(k) contribution match investment was retroactive to the first of the year, costs to support our new associate education program **Feed Your Future** have not begun in earnest. Our investments in wages will roll in as contracts are negotiated, and the education payments will also occur over time as associates take advantage of the opportunities to further their education.

We will make investments for the rest of the year to drive our strategy and to keep prices low to retain our customers. As a reminder, since 2000 we've reduced prices for our customers by over $4 billion. We intend to continue investing in price to drive unit and ID sales growth while still delivering on the bottom line for our shareholders.

We manage our business every day to drive shareholder value. Our investments in *Restock Kroger* – in redefining the grocery customer experience, partnering for customer value, and developing talent – will be paid for by cost of goods savings, strong ID sales, and productivity gains. This is precisely where the incremental FIFO operating profit will come from over the next three years.

ID Sales

For ID sales, we are pleased with our result for the first quarter. Several departments outperformed the company in the first quarter, most notably Meat, Seafood and our Floral departments. Natural Foods continued to generate strong double-digit growth in the first quarter. During the quarter, we saw growth in households and loyal households as well as unit growth.

As noted in our press release this morning, we reported identical supermarket sales, without fuel, of 1.4%. This result aligned with our internal expectations for the quarter.

When calculating identical sales to be more inclusive of company business units – including Kroger Specialty Pharmacy and ship-to-home solutions – our ID sales, without fuel, were 1.9% in the first quarter. We intend to use this calculation going forward as it presents a comprehensive view of our performance as we redefine the grocery customer experience, and is therefore a more appropriate measure of performance. We've looked at what others include in their ID sales calculations and have taken this step to be more consistent with how peers report.

Space Optimization

Our space optimization work is on track with our expectations for the year. We have about 30% of our planned 600 stores completed for 2018. Space optimization will continue to be a headwind to ID sales until late in the third quarter. Between now and then we expect the headwind to diminish as more stores mature and offset the upfront effect of new stores going through the process.

Retail Fuel

Retail fuel performance during the first quarter was good again. Our cents per gallon fuel margin was approximately 18.7¢ compared to 17.1¢ in last year's first quarter. The average retail price of fuel was $2.65 versus $2.28 in the same quarter last year. This includes convenience stores for the period prior to the divestiture.

Convenience Store Sale

In April, we completed the sale of our convenience store business unit for $2.15 billion. After tax proceeds totaled $1.7 billion. We are returning a significant amount of capital to shareholders through a $1.2 billion accelerated share repurchase program. And we used the balance of the after-tax proceeds to lower our net total debt to adjusted EBITDA ratio compared to the end of fiscal 2017.

Net Debt to EBITDA Ratio

Kroger's net total debt to adjusted EBITDA ratio increased to 2.43, on a 52-week basis. Our net total debt to adjusted EBITDA ratio target range is 2.30 to 2.50. We expect our net total debt to adjusted EBITDA ratio to increase throughout the year due to increased borrowings to fund our investment in Ocado, our planned merger with Home Chef, and tax payments related to the gain on the sale of our convenience store business unit.

Financial Strategy

Our financial strategy is to use our free cash flow to drive growth while also maintaining our current investment grade debt rating and returning capital to shareholders. We continually balance the use of cash flow to achieve these goals.

Over the last four quarters, we used cash to:

- Contribute an incremental $1.2 billion pre-tax to company-sponsored pension plans and $467 million pre-tax to satisfy withdrawal obligations to the Central States Pension Fund,

- Repurchase 110 million common shares for $2.7 billion, which includes $1.1 billion repurchased through the accelerated stock repurchase plan,

- Pay $442 million in dividends, and

- Invest $3.0 billion in capital.

As of the end of the first quarter, we had approximately $546 million remaining under the March share repurchase authorization. Purchases under the ASR will be completed no later than July 6.

Labor Update

We are investing an incremental $500 million in our associates – in wages, training and development – over the next three years through *Restock Kroger*. This will be in addition to our continued efforts to rebalance pay and benefits while also focusing on certifications and performance incentives, career opportunities, and training.

We have several major negotiations in 2018, including contracts with UFCW for store associates at Smith's in Albuquerque, Fred Meyer in Portland, and Kroger stores in Richmond and Ft. Wayne.

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. We continue to strive to make our overall benefit package relevant to today's associates. Our financial results continue to be pressured by inefficient health care and pension costs, which some of our competitors do not face. We continue to communicate with our local unions and the international unions, which represent many of our associates, the importance of growing our business and profitability, which will help us create more jobs and career opportunities, and enhance job security, for our associates.

2018 Guidance

Turning now to guidance for 2018:

We expect identical sales growth, excluding fuel, to range from 2.0% to 2.5% in 2018. This reflects our updated definition of identical sales and is supported by an expectation for identical supermarket sales that is the same as our original guidance for the year. To be clear, if we hadn't updated the ID sales definition, we would have confirmed our original guidance for the year this morning.

We have raised the low end of our net earnings guidance range to $3.64 to $3.79 per diluted share for 2018. The previous GAAP range was $3.59 to $3.79.

On an adjusted basis, we raised the low end of our net earnings guidance range to $2.00 to $2.15 per diluted share for the year, compared to $1.95 to $2.15 previously.

We feel very good about the year. We plan for the first quarter to be our strongest EPS quarter, which creates a tailwind for the investments we plan for the rest of the year. Our first quarter result was a $0.10 outperformance over the consensus forecast and, as I said earlier, was also a little better than internal expectations.

Looking at the consensus forecast for the remainder of the year, we believe the second and the fourth quarters are a little high compared to our own expectations, and the third quarter looks reasonable. I am taking the unusual step of commenting on this because if you simply added the $0.10 to your forecasts for the year, that would put the consensus above the high side of our guidance range.

We're off to a great start to 2018 and are on pace to deliver our $2.00 to $2.15 net earnings per diluted share guidance range for the year.

We continue to expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be approximately $3.0 billion for 2018.

Finally, we expect our 2018 tax rate to be approximately 22%.

And now I'll turn it back to Rodney…

Comments by Rodney McMullen:
Thanks, Mike.

When we announced *Restock Kroger*, we talked about retailers needing to constantly reinvent themselves. It takes time to do this. We're now past the half-way point, and everything we are doing today is transforming our business for renewed growth.

For 2018, we are a little ahead of where we thought we'd be. We're hitting our cost control targets due to process change, improving the associate experience, and innovating to create the future of retail. That innovation is both internal and external. We are joining up with external partners like Ocado and Home Chef to create customer value while also quickly expanding our seamless coverage area.

We remain confident in our ability to deliver on both our plan for the year and to execute *Restock Kroger* over the next three years, which will create shareholder value.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

We are incredibly confident about the future of Kroger, especially with *Restock Kroger*.

One of the exciting things about our earnings call is that many of our associates listen in to better understand and gain insights on our business. And of course, many of our associates are shareholders as well. So, before we end today's call, I'd like to share a few final comments directed toward them.

We are very proud of Kroger's opportunity culture – where you can come for a job and stay for a career. As you know, we took a third of tax savings to invest in new and enhanced benefits for our associates. We used part of that investment to establish our best in class educational offering, **Feed Your Future**.

I'm thrilled to see so many of you already taking advantage of these new benefits. Let me tell you the story of one of the first associates to take advantage of **Feed Your Future** … Lindsey is a Pharmacy technician in our Louisville Division. She was working her way through college, accumulating student loans, and had planned to stop working to focus on school full time. But after an assistant store manager told her about **Feed Your Future**, Lindsey decided to stay with Kroger while she finishes her bachelor's degree. And now Lindsey's goal is to pursue a graduate degree with dreams of becoming a physician's assistant for The Little Clinic.

Lindsey's story is exactly what we hoped for when we introduced **Feed Your Future**. We believe that when we support our associates and each other, our customers, business and shareholders will benefit.

Thank you for all you do!

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," "intend," "committed," "planned," "objective," "will," "would," "approach," "guidance," "continue," "believe," "plan," "vision," "target," "range," "forecast," "strategy," "confident," "could," "can," "expectation," and "goal." 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:

- 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 uncertain pace of economic growth; 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; the ability to execute on Restock Kroger; and the successful integration of merged companies and new partnerships. 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.

- 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.

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.

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