Fourth Quarter and Full Year 2013
Investor Conference Call Prepared Remarks
March 6, 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 fourth 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 Rodney McMullen, Chief Executive Officer of Kroger.

Comments by Rodney McMullen:

Thank you, Cindy. Good morning everyone and thank you for joining us today. With me to review Kroger's fourth quarter and full year 2013 results are Mike Ellis, Kroger's President and Chief Operating Officer and Mike Schlotman, Senior Vice President and Chief Financial Officer.

Accelerating Growth

Our associates continue to execute our accelerated growth plan, resulting in a great quarter and a full year we are proud of.

Kroger is delivering on the key performance targets we committed to when we outlined our long-term growth strategy at our October 2012 investor meeting. Mike Schlotman will have more details about each of the four metrics, but I'd like to share the highlights:

- We achieved our 41st consecutive quarter of identical supermarket sales growth;
- Expanded our rolling four quarters FIFO operating margin, excluding fuel;
- Improved return on invested capital, even as we increased capital investments;
- And we increased our market share in 2013.

For the full year, we continued to perform for shareholders by delivering:

- Adjusted earnings per share growth of 13%,
- Our ninth consecutive year of reducing operating expenses as a rate of sales,
- And $928 million to shareholders through share buybacks and dividends.

That we accomplished all of this while also successfully completing our merger with Harris Teeter is testament to our associates' determined focus on serving our customers. We are confident that 2014 will be a great year and that we will continue to deliver growth that investors can count on.

Economy and Customer Shopping Behavior

Consistent with what we have been saying for the last several years, we expect the economic recovery in 2014 to remain fragile and uneven. Things will continue to get better for some customers while others remain under economic stress, and we are doing all we can to help.

For the customer focused on their budget, we continue to offer low entry price points on key items, especially in our Corporate Brands portfolio. If you look at our SNAP households during the fourth quarter, they increased their total monthly spending in our stores for each of the three months since the benefit reductions took effect, compared to last year. What we saw play out in the fourth quarter was what we anticipated: that SNAP customers spent more of their own cash on food.

All of our customers are benefitting from our relentless focus on friendly service and fresh products, including our organic and natural foods and our own unique brands like Simple Truth.

We have a lot of room to grow because the overall industry in which we operate is expanding. We continue to improve our connection with customers across the entire spectrum. Whether value, mainstream or upscale customers, we are competitively positioned to deliver the right value proposition, and our customer insights help us to focus on the right opportunities for growth in each segment, so that we capture more share of the massive food market.

Now, I'll turn it over to Mike Ellis to outline our operational performance. Mike?

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

Loyal Customer Growth

We continue to have tremendous opportunity with our loyal customers, because on average we capture 50 cents of every dollar they spend on the products we sell. This figure has remained steady due to the effect that new loyal households have on this calculation. As we told you in December, our loyal household count has increased by an outstanding 83% over the past decade. We do, however, see incrementally more spending from our mature loyal households.

During the fourth quarter, we continued to grow the number of loyal households, and at a much faster rate than total household growth, which was also up for the quarter.

We continue to improve our friendliness, product freshness, shopping experience and price perception in our customers' eyes. As you know, we closely track these 4 Keys against our competitors. What we have been tracking internally is consistent with the independent *American Customer Satisfaction Index*, released last month, which reported steady improvement in Kroger customer satisfaction.

Inflation was low in the fourth quarter. We expect inflation to be low in 2014 as well, which is reflected in our identical store sales guidance for the year, which Mike will outline shortly.

Customer 1st Innovation

A key driver of growth is our commitment to Customer 1st Innovation. As you know, we have done a lot of innovative things over the past couple of years to create unique competitive advantages for Kroger, like our faster checkout initiative. Each quarter, we will highlight one or more innovations that improve our connection with customers and improve our market share. This quarter, I will highlight Corporate Brands and Digital.

<u>Corporate Brands</u>

Corporate Brands continues to be a leading differentiator for Kroger. We introduced 937 new products in fiscal 2013, including 100 new Simple Truth items. Simple Truth continues to grow at an astonishing pace and we now expect it to reach "Billion Dollar Brand" status by the end of fiscal 2014!

Corporate Brands continued to gain market share during the fourth quarter, with Corporate Brands representing approximately 27.2% of total units sold, and 24.4% of sales dollars, excluding fuel and pharmacy.

<u>Digital Growth</u>

We recently announced the exciting new acquisition of our digital coupon marketing provider, YOU Technology. We believe that YOU Tech has strong growth potential and will over time become *the* leading digital coupon provider for US retailers, not just Kroger.

YOU Tech has helped us reach another digital milestone recently. We began offering digital coupons in early 2010, and within three years our customers had downloaded 500 million digital coupons. Customers downloaded the next 500 million in only 14 months. In fact, at approximately 5:57 PM ET on February 6, a customer downloaded

Kroger's 1 billionth digital coupon! It was an exciting moment for us, and one that demonstrates the growth and customer acceptance of our digital efforts.

Labor Update

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

We are currently negotiating contracts in Cincinnati, Atlanta and Southern California.

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.

In fact, we added more than 7,000 jobs last year and more than 40,000 jobs over the last six years. Those numbers are even larger when you include Harris Teeter's more than 25,000 associates.

Now Mike will offer more detail on Kroger's growth metrics and financial results, as well as our guidance for 2014. Mike?

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

Growth Metrics

We exceeded our expectations for the quarter and the year thanks to our associates performing to deliver growth.

We continue to implement our long-term growth strategy, which includes:

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

As Rodney mentioned earlier, when we outlined our accelerated growth strategy at our October 2012 investor conference, we also identified four 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. We are very pleased with our fourth quarter ID sales growth of 4.3%. This strong performance was supported by ID sales growth in every department and every supermarket division. We continue to see outstanding, double-digit identical sales growth in our Natural Foods department. Our Produce and Deli/Bakery departments also posted strong ID sales growth, highlighting our customers continued demand for fresh products. Kroger's pharmacy department continues to outperform as well. Our identical sales results in light of the slow economic recovery and low inflation throughout the year are quite remarkable.

Weather conditions across much of the country were a net positive as well. Our team's Customer 1st response to winter weather events kept our stores open and shelves stocked, which, coupled with our convenient locations, made Kroger more accessible for customers who flocked to stores to stock up before winter storms.

FIFO Operating Margin

Rolling four quarters adjusted FIFO operating margin, excluding fuel and the extra week, increased by 11 basis points compared to the adjusted fiscal 2012 result. This is in line with our commitment to grow the rate slightly over time on a rolling four quarters basis.

Return on Invested Capital

The third target metric is return on invested capital. We reported a return on invested capital, excluding the Harris Teeter transaction, on a 52-week, rolling four quarters basis, of 13.43%, compared to 13.42% during the same period last year.

As we increase capital investments, it will be more difficult to grow ROIC in the near term; however, as these investments mature, we expect them to be accretive to ROIC.

Annual Market Share Growth

Our fourth target metric is market share growth, which we report on annually. We look at market share the way customers would look at it – where they spend their money.

In the past, we used Nielsen Homescan data as our source for market share. We are now using a different Nielsen product, Nielsen POS+, which includes all point of sale data from several competitors and includes all departments inside our stores, except for pharmacy. We believe Nielsen POS+ data is a good and consistent source. While POS+ does not include all of our competitors today, it captures roughly 85% of the items we sell, including most perishable items, which Nielsen Homescan did not include.

According to Nielsen POS+ data, Kroger's overall market share of the products we sell in the markets where we operate grew approximately 50 basis points during fiscal 2013. This data also indicates that our share increased in 16 of the 18 markets outlined by the Nielsen report, and was down slightly in 2 markets.

Walmart Supercenters are one of our top two competitors in 13 of the 18 marketing areas outlined in the Nielsen report. Kroger share increased in 12 of those markets, and declined slightly in one market.

The Nielsen POS+ data is generated by retailers who report their sales to Nielsen. This includes food, drug, mass and dollar channels. It does not include c-store and club channels.

Fourth Quarter 2013 Results

Now, I'll share our fourth quarter and fiscal 2013 results.

Please note that Harris Teeter is included in the company's ending balance sheet, but because of the timing late in the year it had no effect on our adjusted fourth quarter or fiscal 2013 earnings.

If you remember last year we gave you details to better understand how our core business performed. This year, we similarly outlined our adjustments for fiscal 2013 and 2012 in Table 6 of our earnings release. The following results are all adjusted as outlined in Table 6, and exclude the effect of the 53rd week last year.

<u>Fourth Quarter Net Earnings</u>
In the fourth quarter, our net earnings totaled $421.9 million, or $0.81 per diluted share. Excluding the items outlined in Table 6, Kroger's adjusted net earnings per diluted share grew 10% to $0.78 in the fourth quarter.

<u>Fourth Quarter LIFO</u>
We recorded a $9.7 million LIFO charge during the quarter compared to a $41.2 million LIFO credit in the same quarter last year.

<u>Fourth Quarter FIFO Gross Margin</u>
FIFO gross margin increased 11 basis points from the same period last year, excluding retail fuel operations.

<u>Fourth Quarter OG&A Expenses</u>
Operating, general and administrative costs plus rent and depreciation, excluding retail fuel operations, declined 16 basis points as a percent of sales compared to the prior year's adjusted fourth quarter.

<u>Retail Fuel Operations</u>
Before I move on to discuss Kroger's full-year 2013 results, I'll share some data on our retail fuel operations.

About half of our supermarkets have fuel centers today. In the fourth quarter, our cents per gallon fuel margin was approximately 11.3¢ compared to 13.0¢ in the same quarter last year, after adjusting for the additional week last year.

For the full year, the cents per gallon fuel margin was roughly 14.1¢ compared with 14.0¢ last year, after adjusting for the additional week last year.

Fiscal Year 2013 Results

Turning now to Kroger's full-year results for 2013.

FY 2013 Sales
Kroger reported total sales of $98.4 billion in fiscal 2013, an increase of 3.9% after adjusting for the 53rd week last year. On this basis and excluding fuel, total sales increased 4.2% over the prior fiscal year.

Identical supermarket sales, without fuel, increased 3.6% in fiscal year 2013 compared with the prior fiscal year.

FY 2013 Earnings
Net earnings for fiscal 2013 totaled $1.52 billion, or $2.90 per diluted share. Adjusted net earnings totaled $1.50 billion, or $2.85 per diluted share, a growth of 13%.

FY 2013 LIFO Charge
Kroger's LIFO charge for fiscal 2013 was comparable to fiscal 2012.

Operating Leverage
Strong identical sales and cost controls allowed Kroger to leverage operating expenses as a rate of sales for our ninth consecutive year. In fiscal 2013, OG&A costs plus rent and depreciation, without fuel and the extra week, were down 24 basis points.

Financial Strategy

For 2014, our planned uses of cash remain unchanged:

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

Net total debt was $10.9 billion, an increase of $2.3 billion from a year ago as a result of the Harris Teeter transaction and, due to the timing late in our fiscal year, we realized no incremental EBITDA in 2013 from this transaction. Therefore, Kroger's net total debt to adjusted EBITDA ratio was 2.43, compared to 2.04 during the same period last year. Kroger remains committed to managing its free cash flow to achieve a 2.00 – 2.20 net debt to EBITDA ratio over the next 18-24 months.

Capital investments
Capital investments, excluding mergers, acquisitions and purchases of leased facilities, totaled $2.3 billion for the year, compared to $2.0 billion in 2012.

For 2014, we expect capital investments to be in the $2.8 to $3.0 billion range including Harris Teeter.

As you know, part of our long-term growth strategy is to increase capital investments over time. This will take the form of adding square footage in markets where we believe our business model is already resonating with customers. With a better presence we can grow our market share and return on invested capital. We continue to make good progress adding square footage in our fill-in markets, and we have identified others based on various metrics. Additionally, we continue to narrow our focus on markets where we do not currently operate, with the intention of selecting one to enter organically.

In 2013, we opened the first stores under our new capital allocation strategy. It is still early, but we are pleased with their performance to budget, and expect these and future stores will greatly support our growth plans.

<u>Share Repurchase & Dividends</u>
During fiscal 2013, Kroger repurchased 16.1 million common shares for a total investment of $609 million.

Since the end of the fourth quarter and through the close of the market yesterday, Kroger has approximately $18.7 million remaining under the $500 million stock repurchase program announced in October 2012.

Fiscal 2014 Annual Guidance

Now I'd like to outline our specific growth objectives for fiscal 2014.

Kroger anticipates identical supermarket sales growth, excluding fuel, of approximately 2.5% to 3.5% for fiscal 2014. This range takes into account the expectation of low inflation during the year and includes Harris Teeter.

Full-year net earnings for fiscal 2014 are expected to range from $3.14 to $3.25 per diluted share. This guidance includes Harris Teeter. Growing fiscal 2013 adjusted earnings per diluted share of $2.85 by our long term growth rate of 8 – 11% equates to a range of $3.08 to $3.16 per diluted share. We then added net accretion to earnings from the Harris Teeter merger of $0.06 – $0.09 per diluted share, excluding transition and transaction expenses, resulting in a 10 – 14% growth rate for fiscal 2014. As you think about early estimates for 2015, we would expect to return to our 8 – 11% long-term growth rate.

As we report earnings during 2014, we will not break out Harris Teeter results separately, which is consistent with our treatment of supermarket divisions today.

Shareholder return will be further enhanced by a growing dividend.

And, we expect Kroger's full-year FIFO operating margin rate in 2014, excluding fuel, to expand slightly compared to adjusted fiscal 2013 results.

When looking at our cadence by quarter, we expect the first, second and fourth quarters to be within the 10 – 14% range, and the third quarter to be above it.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:
Thanks, Mike.

Being part of a growing retailer is exciting for our associates. 7,000 new jobs last year means not just new team members, but opportunities for our current associates to grow and advance as well.

Our business is strong, our merger with Harris Teeter is going well, and our associates continue to execute our growth strategy.

The remarkable consistency of Kroger's performance has shown time and again that serving our customers is serving our shareholders. I can think of no better example than our associates' dynamic response to the severe weather in many of our markets during the fourth quarter. Often, our logistics and distribution team sped up deliveries to keep stores stocked several days before major storms. Most of our stores remained open even in the worst of the winter weather. In some cases, our associates even welcomed stranded travelers in extreme freezing conditions to spend the night in one of our stores. Our customers trust that their neighborhood Kroger will be open and stocked when it matters most, and we couldn't be more proud of the way our associates rose to the occasion.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

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

First, I'd like to welcome Harris Teeter associates to the Kroger family. We couldn't be happier.

Also, I'd like to thank our associates for your hard work and connection with our customers. We finished 2013 strong because of your hard work to provide friendly service and fresh products to every customer, every time, every day. You also helped keep costs under control so we can reinvest the savings in things that matter most to our customers. They are taking note of your efforts and giving us credit for making a difference. Special thanks to each and every one of you for all you do for our customers and each other.

This week, we will host our third annual Associate Recognition Event in Cincinnati. Our 33 associate honorees come from across the company, including our retail divisions, C-stores, Manufacturing and Logistics facilities, Fred Meyer Jewelry, The Little Clinic and General Office. They will be recognized during this two-day event for their friendly service, strong leadership, dedication to their communities and courage in the fight against cancer.

Finally, I'd like to say thank you to our chairman, Dave Dillon, for his leadership and the powerful foundation he and our team have put in place. I am humbled to be serving as your CEO, and excited to work with our outstanding leadership team. We're not done serving our customers, growing our business and performing for shareholders… indeed, we're just getting started.

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 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 to reward our shareholders 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 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; 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; the effect of brand prescription drugs going off patent; our ability to retain additional pharmacy sales from third party payors; natural disasters or adverse weather conditions; the success of our future growth plans; and the successful integration of Harris Teeter. The extent to which the adjustments we are making to our strategy create value for our shareholders will depend primarily on the reaction of our customers and our competitors to these adjustments, as well as operating conditions, including inflation or deflation, increased competitive activity, and cautious spending behavior of our customers. 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.

- 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 Savings Account Plan 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 profit margins decline as gasoline sales increase.

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