First Quarter 2015
Investor Conference Call Prepared Remarks
June 18, 2015

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 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, Cindy. Good morning everyone and thank you for joining us today. With me to review Kroger's first quarter 2015 results are Mike Ellis, Kroger's President and Chief Operating Officer and Mike Schlotman, Senior Vice President and Chief Financial Officer.

A Strong Start for the Year

Kroger delivered strong first quarter sales and earnings results, and we are pleased with our start for the year.

- We achieved our 46th consecutive quarter of positive identical supermarket sales growth;
- We exceeded our goal to slightly expand FIFO operating margin, without fuel, on a rolling four quarters basis;
- And we continued to invest and innovate to grow our business, expanding our use of technology and our digital capabilities.

Kroger has produced consistently remarkable results for so long that it might be easy to take a quarter like this for granted, but these results don't happen accidentally. They happen because we lead and drive our business toward these goals.

Customer 1st and our four keys – our people, products, pricing and the shopping experience – remains our fundamental strategy. We strive for balance across these four keys, and each quarter we do a little better in each. And when we do that – consistently as we have for so long – our results are more powerful.

Based on the strength of our first quarter results, we are raising our identical supermarket sales growth guidance for the year, and we are on track to deliver on our long-term net earnings per diluted share growth rate of 8-11%, plus the dividend, in 2015.

Innovation in Technology and Digital Capabilities

One of the ways we continuously improve the shopping experience is by bringing new technology and digital capabilities to our business. Mike Ellis will provide an update on several digital efforts in a moment, but I wanted to mention what I think is a great example of how we are expanding our use of technology: our recent decision to establish 84.51°, which replaces our previous joint venture dunnhumbyUSA. 84.51° is helping us continue to use data science for the benefit of customers and to deliver a more personalized experience, both in store and online.

We are so excited to welcome the talented associates at 84.51° to the Kroger team, and we are already beginning to see their daily involvement in the business helping to accelerate our efforts. Just little things like 84.51° CEO Stuart Aitken participating in our senior officer meetings is making a big difference. We expect 84.51° to be an innovation engine and game-changer for Kroger and our customers.

Economy and Customer Shopping Behavior

We are pleased to see the economy moving in the right direction, albeit slowly. One of the important ways we are able to deliver so consistently is that we offer attractive value for <u>all</u> of our customers, all of the time. When you want to splurge you can splurge, when you want to save, you can do that too. So while Murray's Cheese, Starbucks and Boar's Head, for example, are performing very well, so are our entry-level price point brands.

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

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

Our associates continue to deliver an exceptional experience in ways that make a difference for our customers. Over the past year, more customers have noticed improvements in Kroger's product selection, product quality and customer service.

Loyal Customer Growth

Our strong identical supermarket sales growth was primarily driven by an increase in the number of households shopping with us in the first quarter. We also met our goal to grow the number of loyal households at an even faster rate than total household growth again in the quarter.

Fuel Margins, Inflation/Deflation and Tonnage

We are especially proud of our loyalty and sales results when you consider the current operating environment, which has less certainty than normal. We are addressing the volatility we see out there. Fuel margins, for example, have returned to normal compared to where we ended last year.

Another factor is product costs; some commodities are up, and some are down. We are seeing deflation in Milk, Produce and Seafood, which is driving more tonnage volume. Milk is one of our most price-elastic categories. When milk prices come down, people tend to buy a lot more. We're at an advantage because we have a vertically-integrated supply chain for milk. When our dairy plants run at higher volume we become more efficient and productive.

We continue to see inflation in generic pharmaceuticals and in certain commodities in the meat department.

Overall, inflation continued but at a lower rate during the first quarter, which is in line with what we expected.

Tonnage growth was very strong during the first quarter. In fact, we saw the strongest first quarter tonnage performance since 2010, which is a clear indication of our ability to get pricing right for our customers. If you look back over the past several years, we've had periods of high and low inflation and we've shown that regardless of the environment, we will deliver greater value and convenience for our customers.

Strong Corporate Brands

Corporate Brands had a solid first quarter, accelerating company sales growth and representing approximately 26.9% of total units sold, and 25.4% of sales dollars, excluding fuel and pharmacy.

Customer 1st Innovation: Expanding Digital Presence

A key driver of sustainable growth is Customer 1st Innovation. And as Rodney said, we are actively expanding Kroger's use of technology, which we see as a catalyst for improving our connection with customers and growing our market share.

Kroger's digital team has developed a popular mobile app that our customers use millions of times each week. In April, we were one of the first food retailers to release an app that is compatible with the AppleWatch. And this month, we reached a new milestone: More than two billion digital coupons have been downloaded from our digital properties since we began offering digital coupons in 2009. It took four years to reach our first billion and only 15 months to reach our second billion … and the third billion will take even less time.

Also this month, our Cincinnati division began inviting local customers to try our order online, pickup at the store solution we are learning from Harris Teeter, which we have been beta-testing for a few months and is now available in two of our Cincinnati area stores to all customers.

Our integration with Vitacost.com continues to go very well, and just this week Vitacost helped us launch a new natural and organic eCommerce website called King Soopers *Live Naturally* that is open to King Soopers customers who live in and around the Denver metro area. The website – which utilizes Vitacost's technology platform and fulfillment network – creates an "endless aisle" experience with ship-to-home service for thousands of additional health foods, vitamins, minerals and supplements than are available in our Denver-area stores today. We are excited to see the results of this new pilot program.

Labor Update

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

We recently agreed to new contracts in both Las Vegas and Louisville, and we agreed to a master agreement with the Teamsters covering several distribution and manufacturing facilities. Four of five Teamster locals have also ratified this agreement.

We are currently negotiating contracts with the UFCW for store associates in Columbus, Denver, Memphis and Portland.

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.

Opportunity Culture

Before I turn it over to Mike Schlotman, I'd like to say a little more about the culture of opportunity we work hard to create here at Kroger.

Being a Kroger associate means being part of our family – part of something bigger. Every day, we hire people who come to Kroger for a job, then decide to stay for a career. In fact, two-thirds of our store managers today started as an hourly clerk, stocking shelves or bagging groceries. We continue to increase our investment in training to build skills so our associates are ready for opportunities to advance and lead others. We offer so much more than a job: A chance to connect with their community, to be part of a giant team stretching from coast to coast, and to work with colleagues who want to make a difference, too. We think this *Opportunity Culture* is a differentiator for us today and will continue to be in the future.

Now Mike Schlotman will offer more detail on Kroger's financial results and update our guidance for 2015. Mike?

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

First Quarter Growth Metrics

I'd like to spend a few minutes discussing our results for the quarter in each of the key performance target areas for our long-term growth plan.

<u>Identical Supermarket Sales</u>

Our first metric is identical supermarket sales without fuel. We are pleased with our first quarter identical supermarket sales growth of 5.7%. This strong performance was supported by identical supermarket 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 Meat, Deli and Pharmacy departments also posted strong identical supermarket sales growth.

<u>FIFO Operating Margin</u>

Rolling four quarters FIFO operating margin – excluding fuel, the 2014 and 2013 adjustment items and the contributions to the pension and foundation in the 3rd and 4th quarters of 2014 – increased by 10 basis points. This exceeded our commitment to grow the rate slightly over time on a rolling four quarters basis.

<u>Return on Invested Capital</u>

Return on invested capital, on a rolling four quarters basis, was 14.03%. We are not presenting a comparative number this quarter because the prior year first quarter calculation does not include a full year of Harris Teeter assets and results. We do expect return on invested capital for fiscal 2015 to increase slightly from the fiscal 2014 result.

This is an important metric as we continue to increase our capital investment to drive our future growth.

First Quarter 2015 Results

Now, I'll share our first quarter 2015 results in more detail.

First Quarter Total sales

As you know, we don't provide guidance for total sales because of the unpredictability of fuel margins on our results. Total sales in the first quarter increased 0.3% to $33.1 billion, compared to $33.0 billion of the same period last year. Excluding fuel, total sales increased to 6.4% for the first quarter compared to the same period last year.

First Quarter Net Earnings
In the first quarter, our net earnings totaled $619 million, or $1.25 per diluted share.

Kroger's net earnings during the first quarter last year included charges related to the restructuring of certain pension obligations to help stabilize associates' future benefits. Excluding the effect of those charges, Kroger's adjusted net earnings in the same period last year were $557 million, or $1.09 per diluted share.

First Quarter LIFO
We recorded a $28 million LIFO charge during the first quarter, consistent with the same quarter last year.

First Quarter FIFO Gross Margin
FIFO gross margin, excluding retail fuel operations, decreased 7 basis points from the same period last year.

First Quarter Total Operating Expenses
Strong identical supermarket sales growth and cost controls allowed Kroger to leverage operating expenses as a rate of sales in the first quarter.

Total operating expenses – excluding retail fuel operations and pension agreements – decreased 15 basis points as a percent of sales compared to the prior year.

Retail Fuel Operations
Now for retail fuel operations. In the first quarter, our cents per gallon fuel margin was approximately 11.6¢ compared to 13.1¢ in the same quarter last year.

Financial Strategy

Our long term financial strategy continues to be to:

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

Share Repurchases
Our strong financial position has allowed us to return $1.1 billion to shareholders through share buybacks and dividends over the last four quarters.

During the first quarter, Kroger repurchased 8.0 million common shares for a total investment of $585 million.

Capital investments

Capital investments, excluding mergers, acquisitions and purchases of leased facilities, totaled $915 million for the first quarter, compared to $709 million for the same period last year.

We continue to expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be in the $3.0 to $3.3 billion range for the year.

Our plan to increase capital on an annual basis remains in place. We are pleased with the early returns from these investments. We continue to have a long list of strong projects that will compete for these investments.

Maintain Current Investment Grade Debt Rating

The company's net total debt to adjusted EBITDA ratio decreased to 2.09, compared to 2.40 during the same period last year.

Kroger's net total debt is $11.3 billion, consistent with last year.

It is constructive to understand we have maintained our absolute debt level while returning $1.1 billion to shareholders through share buybacks and dividends over the last four quarters, and investing $3.0 billion in capital on a rolling four quarters basis, plus an additional $411 million on mergers, acquisitions and purchases of leased facilities. In other words, we are keeping our commitments to our bondholders and shareholders.

Updated 2015 Guidance

Now I'd like to update our growth objectives for 2015.

Based on our strong first quarter results, we raised our identical supermarket sales growth guidance, excluding fuel, to a range of 3.5% to 4.5% for 2015. The original guidance was 3.0% to 4.0%.

We are confirming our net earnings guidance range of $3.80 to $3.90 per diluted share for 2015. This range is within 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.

As we look at quarter comparisons in relation to our 8 – 11% annual growth rate, we believe quarter 2 will be slightly above the range, quarter 3 will be at the high end of the range, and quarter 4 will be below the range. For the full year, we expect to be within the range and still somewhat dependent on where fuel margins shake out.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:

Thanks, Mike.

This was another terrific quarter. Our associates are making a difference for our customers by providing excellent service and product quality and selection. As I said earlier, results like this don't happen by accident. We create these results by connecting with our customers through our powerful Customer 1st Strategy. When we take care of our customers, we create sustainable value for our shareholders.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

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

We recently wrapped up our Red White & BBQ celebration in stores across the company. Special thanks to each of you for making this exciting event possible. Our customers loved kicking off the summer grilling season with fresh flavors and fun ideas to share with their family and friends.

I also want to thank you for helping show Kroger's gratitude to our active duty troops and our nation's 23 million veterans this summer. Through our partnership with the USO and the Honoring Our Heroes campaign, we hope to raise an additional $2 million for our military men and women. Together, Kroger's associates and customers have raised more than $11.9 million since 2010 to support USO programs. This represents the largest gift to the USO in its history. Visit the Honoring Our Heroes website for more information about how you can help.

We also continue to hire our heroes – more than 29,000 veterans have joined our team since 2009, including more than 6,000 associates last year. Thank you for helping welcome them to our Kroger 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 cash flow to continue to repurchase shares, fund dividends, increase capital investments and maintain our investment grade debt rating, could be affected by unanticipated increases in net total debt, our inability to generate 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; 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. Our ability to achieve sales and earnings goals may also be affected by our ability to manage the factors identified above.

- 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 plans, 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.

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