First Quarter 2016
Investor Conference Call Prepared Remarks
June 16, 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 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, Kate. Good morning everyone and thank you for joining us today. With me to review Kroger's first quarter results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Q1 2016 Highlights

Our associates delivered another solid quarter. We continue to execute our growth plan and to deliver on our financial performance commitments. Most importantly, we continue to strengthen our connection with our customers, growing loyalty and market share, and achieving Kroger's 50th consecutive quarter of positive identical supermarket sales growth, excluding fuel. Most companies only aspire to achieve these results. It says a lot about our consistently remarkable performance, and our ability to grow in a balanced way with a long-term focus.

We've managed through nearly every conceivable operating environment, and demonstrated through different cycles that by providing value to our customers and partnering with our associates, we'll continue to make a difference for our customers, associates and communities. And when we do that, we create value for shareholders, as evidenced by our growing dividend and our consistent net earnings per diluted share growth above our long-term guidance of 8 – 11%. In fact, our net earnings per diluted share growth rate, on a compounded annual basis, was 14.1% for three years, and 18.8% for five years.

Investing for the Future

We demonstrate our long-term focus by continuing to invest for the future. We are making investments in our people, our digital and online capabilities, and strategic partnerships.

Investing in People

Across the board, Kroger has an incredibly strong management team and a deep bench of leaders who are making us better every day. We continue to make strategic investments in leadership development and training for all of our associates, including high-volume store managers and future senior leaders.

Many people come here for a job and Kroger creates opportunities for all associates to build a career. Despite record-low unemployment figures, when we held a one-day hiring event in every supermarket location in May, we received more than 116,000 applications. From that pool we hired more than 12,000 new associates. We see our Opportunity Culture as a competitive advantage.

Investing in Digital

We are expanding our digital presence and marching steadily toward a time when we can provide our customers with anything, anytime, anywhere.

As you know, we take a disciplined approach to digital growth, testing new offerings in local markets so we can make sure that we get it right before we scale offerings more broadly. Our *ClickList* and *ExpressLane* offerings are now available in 25 markets, with more to come. Our merger with Harris Teeter gave us a base of learnings that allowed us to quickly ramp up the development of *ClickList*. Customers have downloaded nearly three billion digital coupons and offers from our mobile app and website. And we continue to experiment with Vitacost.com's ship-to-home technology and platform.

Earlier this week, Kroger's Technology business unit was named one of the Top 100 places to work by *Computerworld* magazine. We are very proud of this honor. We've launched a new website, *Kroger dot com backslash "Live KT"*, to connect with and recruit top talent from around the world to join the Kroger team. Similarly, we are finding out that *ClickList* also serves as a great tool to both hire and retain great people. Kroger is a terrific place for tech talent to build careers because the technology they create can improve the lives of millions of customers each and every day.

Investing in Strategic Partners

In April, we announced a strategic investment in Lucky's Market, a specialty grocery store chain focused on natural, organic and locally-grown products currently operating in 22 locations. We invested in Lucky's because of their great people and unique go-to-market strategy, which includes smaller format stores that resemble an indoor farmers market, plus a culinary department that showcases amazing, restaurant-quality prepared foods. Lucky's approach is very much aligned with our efforts to provide affordable, fresh organic and natural foods as a part of our Customer 1st Strategy. We expect to learn a lot from each other.

Economy and Customer Shopping Behavior

There are a lot of questions out there about the economy and the customer – inflation or lack thereof, consumer sentiment, or competition. These are all issues we have managed through, some several times, over the last 50 quarters. Inflation, for example: I have often said that 2-3% inflation would be a great environment to operate in. However, you rarely get the perfect operating environment.

What we know is that focusing on our associates and our customers will be a winning formula in the future as it has been in the past. At times like this, it is even more important to have 84.51° on the team so we can generate insights into what our customers want, and figure out a way to give them that without having to guess at it.

Kroger's core business is solid. We are providing exceptional customer service and the highest quality, freshest products. Customers are giving us higher marks for better product selection and store layout, as well as friendlier service. We remain focused on customer loyalty that grows tonnage and both our top and bottom lines, which creates value for shareholders.

Where we are right now, it looks like we will be at the low-end to mid-point of our 2016 net earnings per diluted share range. Where we end up in the full range will be driven primarily by fuel margins. I do want to stress that we are never satisfied … and our "to do" list remains longer than our "done" list.

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

Comments by Mike Schlotman:

Thanks, Rodney. Good morning everyone.

First Quarter ID Sales & Inflation

ID sales came in at 2.4%.

As Rodney said, we have been in environments like this before and we will continue to focus on growing households, growing units, and making sure we are delivering the right value proposition for our customers.

Inflation was non-existent in the first quarter. Lower inflation has persisted and in fact was slightly deflationary without pharmacy. When you add pharmacy back in we had approximately 30 basis points of inflation. This is the lowest we've seen in the last six years.

During the quarter, trips per household grew at a faster rate than units per basket declined. This, combined with more households, led to positive tonnage growth.

First Quarter Operating Costs

Operating costs excluding fuel and Roundy's were better by 4 basis points in the first quarter. Operating, general and administrative expenses were 11 basis points better, and grew by approximately 2.9%. Rent and depreciation were a combined 7 basis points worse.

We continue to work diligently to keep operating costs in check. As you know, this is the fuel we use to run our Customer 1st Strategy. As Rodney likes to say, our "to do" list is longer than our "done" list – and this area is no exception.

Retail Fuel

Now for an update on retail fuel.

In the first quarter, the average retail price of a gallon of gas declined by 45¢ compared to last year. Our cents per gallon fuel margin was approximately 14.3¢ compared to 11.6¢ in the same quarter last year. On a rolling four quarters basis, we were at 18.2¢ this year compared to 18.4¢ last year. We expect this downward trend to accelerate as we cycle some very strong margin quarters for the rest of the year.

First Quarter EPS

Our first quarter net earnings per diluted share increased 12.9% to $0.70, compared to $0.62 last during the same period last year.

This result was helped primarily by our operating results and higher fuel margins during the first quarter. A lower LIFO expense and share buybacks also contributed to EPS growth.

Roundy's Integration Update

Our integration with Roundy's is well underway. Synergies are coming together nicely. We are beginning to focus on physical assets in Wisconsin while continuing to open new Mariano's stores in Chicago. Roundy's associates share our deep commitment to putting our customers first, which makes it easy for us to work together as one team.

Corporate Brands

For our Corporate Brands portfolio, we are off to an exciting start on new innovations in 2016.

Last quarter, we told you that we had just introduced Simple Truth household and personal care products – expanding our popular natural and organics line into a true lifestyle brand. Customers have responded enthusiastically as both sales and unit volume have exceeded our expectations in all categories. We continue to launch new Simple Truth offerings in laundry, household, baby and health & beauty care.

We also continue to push the boundaries of culinary trends with new Private Selection spices, marinades, condiments and cooking sauces. Customers are savoring global flavors in our delicious Private Selection products such as Korean Black Garlic Kalbi marinade and Peruvian Aji Amarillo hot sauce.

During the first quarter, Corporate Brands represented approximately 27.9% of total units sold, and 25.9% of sales dollars, excluding fuel and pharmacy.

Financial Strategy

The company's net total debt to adjusted EBITDA ratio increased to 2.12, compared to 2.09 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 the last year, Kroger has used free cash flow to:

- Repurchase $1.1 billion in common shares
- Pay $397 million in dividends
- Invest $3.6 billion in capital, and
- Merge with Roundy's, Inc. for $866 million.

Kroger's strong EBITDA performance resulted in a return on invested capital for the first quarter of 14.08%, excluding Roundy's, compared to 14.03% for the first 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 Houston, Indianapolis, Portland and Roanoke.We are currently negotiating contracts with the UFCW for store associates in Little Rock, Nashville, 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, 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.

Fiscal 2016 Annual Guidance

Turning now to our 2016 guidance.

We continue to expect identical supermarket sales growth, excluding fuel, of approximately 2.5% to 3.5% for 2016. This reflects lower inflation as well as Roundy's results, which are an approximately 30 basis point headwind to identical supermarket sales growth.

For full-year net earnings, we continue to expect 2016 to range from $2.19 to $2.28 per diluted share. As Rodney said earlier, based on current fuel margin trends we expect to be at the low-end to mid-point of our guidance range. We expect fuel margins will be at or slightly below the five-year average.

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

In thinking about the cadence of our quarterly results compared to our long-term 8-11% guidance, we believe:

- The second quarter will be the toughest quarter, with slight growth over 2015. Keep in mind the second quarter last year grew 26%.
- Both the third and fourth quarters will be at the low end to midpoint of the range.

We continue to expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be in the $4.1 to $4.4 billion range for 2016.

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

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:

Thanks, Mike.

We are proud of our team's performance during the first quarter – especially in light of the challenging operating environment. We've been through business cycles like this before; the best thing we can do is to deliver on our promise while investing for the future. We will continue to execute our Customer 1st Strategy and, by doing so, will create long-term 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.

I want to take a moment to extend our deepest sympathies to the family and friends of those who lost their lives in the recent horrific attack in Orlando. What happened is tragic and heartbreaking.

I want to thank the first responders, who put their lives in danger every day to protect us.

I know our family of associates – those at Axium Healthcare outside of Orlando, across Florida and throughout the rest of the country – is deeply saddened by what has happened. We stand in support of the LGBT community.

An event like this affects each and every one of us, no matter where we live or work. It serves to remind us of what is most important – and that is taking care of each other. I want to thank our associates everywhere who demonstrate our values of diversity, inclusion and respect every day: to treat all with dignity; to seek and embrace the differences among people; and to lift each other up.

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," 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 FIFO 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.

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