Third Quarter 2016
Investor Conference Call Prepared Remarks
December 1, 2016

Mike Schlotman, Executive Vice President and Chief Financial Officer:
Kate couldn't be here with us this morning, so I'll wish you a 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 third 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, Mike. Good morning everyone and thank you for joining us today.

To start, I want to say that I am proud of our associates for continuing to connect with our customers in a difficult operating environment. Their efforts helped us grow both total households and loyal households during the third quarter.

As expected, deflation persisted during the third quarter. And as we've said before, transitional periods create a difficult operating environment. This is the third time we've had deflation in 30 years, and in previous instances deflation lasted from three to five quarters in a row. We're in the middle of the cycle right now, and it's not fun. Still, our tonnage continues to grow, our total market share continues to expand, and we're focused on executing our strategy.

A silver lining of deflationary environments is that it reveals to us how we can run our business better by shining a light on areas we can improve. It is really tough when you are in it, but we'll be in a position to benefit from changes we're making today once we're out of this cycle.

We are firmly focused on our long-term strategy of improving our connection with customers and associates, and continuing to work on process changes to lower costs. We don't change our strategy based on quarterly swings in results. We remain committed to delivering our long-term earnings per share growth rate target of 8 – 11% on a 3-to-5-year time horizon, plus an increasing dividend.

We will continue to try to win every customer meal by driving our strategy and reacting appropriately to the environment.

Economy and Customer Shopping Behavior

Looking at the broader economy and customer shopping behavior, what we're seeing is mixed. Typically, our data shows our customers' economic concerns mirror what they see in headlines. For example, health care costs continued to be a worry for customers.

Consumer confidence retreated during the quarter, with customers telling us they expect the economy to get worse in the next three months. It is important to remember this survey was completed in October, and it is too soon to say what the mood of our customers is since then.

Foodie Trends

Natural and organic and health and wellness continue to be the food mega trends, and we're riding these trends well. Our natural and organic sales continue to outpace total sales growth. Simple Truth continued its strong double digit growth.

Simple Truth Organic Kombucha is very popular as more customers focus on digestive health. We've also just recently launched a 24-pack of Simple Truth Vapor Distilled Water with electrolytes. It is priced fantastically and selling really well.

Our produce, fresh-prepared and deli-packaged departments, sushi, Starbucks, wine and liquor sales, all saw comparatively strong growth during the quarter as well. If you can drink it or snack on it, it is selling.

A few on-trend examples are protein snacks such as Private Selection and Simple Truth Paninos – which are imported cured meats wrapped around a creamy cheese – as well as hand-crafted and real-sugar sodas.

Positioned for Long-term Growth

As I said at our investor conference here in Cincinnati four weeks ago, Kroger's earnings growth has outpaced our peers over both the last five years and the last 10 years. And we still see incredible growth potential as we look forward. We can clearly identify where we have $100-plus billion in market share growth opportunities in our existing markets alone.

But good enough today won't be good enough tomorrow. That is why we are both embracing change and *accelerating* change. For example:

- 84.51° is helping us spot trends and create unique customer experiences to drive growth. We continue to focus on solving customer needs on their terms.
- We now offer ClickList in more than 550 stores. That is 50 more locations than we were operating just four weeks ago.
- We're connecting with tens of millions of customers digitally – online and through our mobile app. Customers have now downloaded more than 3.5 billion digital offers.
- And we know the typical customer eats 35-45 times per week. Increasingly, we are positioning ourselves to solve for all of those meals or snacks, in addition to our historic model of solving for meals at home.

We've built a strong Customer 1st foundation over the last 15 years upon which we can confidently accelerate change. In doing so, we can deliver even better results for our customers, associates and shareholders.

Now Mike will offer more detail on Kroger's third quarter financial results and discuss our guidance for the fourth quarter and 2017. Mike…

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

I want to also thank our associates for their hard work and focus on connecting with customers. As a result, both household and unit growth were up during the quarter, as was market share.

Third Quarter ID Sales & Deflation

As we said at the investor conference, the last two weeks of the quarter would drive our identical supermarket sales results, and our IDs came in at the low end of our expectations for the quarter.

Deflation has not only persisted but has increased with overall deflation excluding pharmacy growing from 1.3% in the second quarter to 1.5% in the third quarter.

Pharmacy inflation declined 130 basis points to 3.3% during the third quarter.

Over the last four quarters we have relocated or expanded 49 strong-performing stores. This takes them out of our identical supermarket sales calculation. Further, we have opened 42 new stores over the same time frame. Both of these create a headwind to identical food store sales. By way of comparison, last year there were 19 new stores opened that affected nearby stores.

Third Quarter Operating Costs

Operating costs, excluding fuel, Roundy's, and an $80 million contribution to the UFCW Consolidated Pension Plan in the third quarter of 2015, grew by 19 basis points, of which 15 basis points were related to depreciation due to increases in our capital program.

We can clearly do better and we're redoubling our efforts to reduce these costs as a rate of sales over time. While the environment is difficult, managing operating expenses is something that is in our control. Our Customer 1st strategy is funded by saving costs in areas of the business that customers don't see in order to return value to our customers in the form of lower prices on the products they want, improved service and a shopping experience that makes them want to return. We are and will continue to look at a variety of options to improve processes and lower costs as a rate of sales in a strategic and conscientious way.

Retail Fuel

Now for an update on retail fuel. In the third quarter, our cents per gallon fuel margin was approximately 17.9¢ compared to 23.8¢ in the same quarter last year. On a rolling four quarters basis, we were at 17.0¢ this year compared to 18.8¢ last year.

Corporate Brands

During the third quarter, Corporate Brands represented approximately 28.1% of total units sold, and 25.5% of sales dollars, excluding fuel and pharmacy. As Rodney said earlier, Simple Truth continues to grow at an impressive rate.

Financial Strategy

Our net total debt to adjusted EBITDA ratio increased to 2.35, compared to 1.99 during the same period last year. This result is due to the mergers with Modern Health and Roundy's, Inc. At year end, Kroger expects net total debt to adjusted EBITDA to be near the high end of the company's targeted range of 2.00 to 2.20.

It is worth noting that over a longer time horizon, we do expect our net total debt to EBITDA ratio to grow if we continue to successfully negotiate restructuring of troubled multi-employer pension plan obligations to help stabilize associates' future benefits, as we did in the second quarter. We would not expect this increase to adversely affect our credit rating, as the ratings agencies already factor in our multi-employer pension plan obligations in their evaluations of our credit rating. When we take on additional debt to fund these plans, this reduces the off-balance-sheet amount of our estimated multi-employer pension plan obligations.

Over the last four quarters, Kroger has used cash to:

- Repurchase $1.4 billion in common shares,
- Pay $418 million in dividends,

- Invest $3.8 billion in capital, in line with our commitment to reduce planned capital expenditures for the year,
- Merge with Roundy's for $866 million, and
- Merge with Modern Health for approximately $390 million.

The flexibility to return value to shareholders is a core strength of our financial strategy.

Return on invested capital for the third quarter was 13.63%, excluding Roundy's, compared to 14.16% for the third quarter of 2015.

Labor Update

I will now provide a brief update on labor relations.

We recently agreed to a new contract with the UFCW covering Fry's associates in Arizona.

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

Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and compensation packages that provide solid wages, good quality, affordable health care, and retirement benefits for our associates. Kroger's financial results continue to be pressured by rising health care and pension costs, which some of our competitors do not face. Kroger continues to communicate with our local unions, which represent many of our associates, the importance of growing Kroger's business and profitability, which will help us create more jobs and career opportunities, and enhance job security, for our associates.

Fourth Quarter 2016 Annual Guidance

Turning now to our guidance for the remainder of the year.

We narrowed our net earnings guidance range to $2.03 to $2.08 per diluted share for 2016. The previous guidance range was $2.03 to $2.13.

Our adjusted net earnings guidance range per diluted share for the year is $2.10 to $2.15, which excludes the $0.07 charge from the company's commitment to restructure certain multi-employer pension obligations in the second quarter. The previous adjusted guidance range was $2.10 to $2.20.

For the fourth quarter of 2016, Kroger expects slightly positive identical supermarket sales growth, excluding fuel. The persistent and increasing deflation has caused us to adjust our view of identical store sales for the fourth quarter.

We continue to expect capital investments of $3.6 to $3.9 billion for the year, excluding mergers, acquisitions and purchases of leased facilities.

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

Fiscal 2017 Initial Guidance

Finally, I want to take a moment to look ahead to 2017. We are completing our business plan process for 2017 now and will provide specific guidance in March, as we normally do. We anticipate both positive identical supermarket sales and net earnings per diluted share growth, excluding the 53rd week. Net earnings growth will likely be below the low end of the company's 8 - 11% net earnings per diluted share long-term growth rate guidance.

We expect the operating environment in the first half of 2017 to be similar to today. The second half of 2017 should show improvement as we cycle the current environment.

As you know, we define long term as over a 3-to-5-year time horizon, and we are committed to achieving our net earnings per diluted share growth rate guidance of 8 – 11%, plus a growing dividend.

We expect 2017 capital investments of $3.6 to $3.9 billion, excluding mergers, acquisitions and purchases of leased facilities.

We will continue to make investments to reward our customers and will increase our intensity in finding cost savings for these investments.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:
Thanks, Mike.

We are both clear-eyed about the challenges before us and optimistic about Kroger's future. Transitions are no fun but they do create opportunities to improve the way we run our business. We will continue to focus relentlessly on our customers and our associates. We'll continue to accelerate our adoption of technology to deliver additional value, to provide convenience for our customers, and take costs out as Mike mentioned. All of these things set us up to grow our business. We have a unique opportunity for explosive growth in the $1.5 trillion U.S. food market, and our best days are still ahead of us.

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.

Being part of millions of family celebrations this holiday season is a great honor and privilege. Our Customers count on us to have what they need and more, and you make it all happen. Just last week, nearly 10.5 million Customers shopped with us on Tuesday and 13.5 million on Wednesday before Thanksgiving. That's incredible – a huge thank you!

No matter where you work, you make the holidays special for our customers, our communities, and each other.

I also want to thank our store teams for their outstanding response to our national hiring event in November for all military veterans and family members. We hired 4,000 veterans and family members in one day – which was nearly 3,000 more than last year's event. We are delighted to welcome them to our Kroger family as part of our continuing commitment to active duty troops and the nation's 23 million veterans.

Thank you for all you do every day. Merry Christmas and Happy Holidays to you and your 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," "anticipate," "should," 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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