First Quarter 2017
Investor Conference Call Prepared Remarks
June 15, 2017

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. With me to review Kroger's first quarter 2017 results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Customer 1st Promise

As we all know, there is a lot of change in the food retail industry – both in terms of the operating environment and competitive landscape.

The best thing we can do is to stay on offense by continuing to focus on our customers – what they want and need today and what we anticipate they will want and need tomorrow – and executing our strategy. We continue to manage our business for the long-term and to deliver net earnings growth on a 3-to-5 year time horizon.

We are making meaningful investments in our digital and online growth. We believe that customers of the future will want to shop with us for anything, anytime, and anywhere. In the first quarter, we saw more than 30% growth in new digital customers and a more than 30% increase in digital visits – with faster growth in mobile – compared to last year.

We are also building on our personalization expertise to benefit our customers. An example of this is *My Magazine*, which delivers personalized content like recipes to loyal households based on their shopping behavior and interests. In fact, we delivered more than six million unique *My Magazine* offers in the first quarter alone. This also allows us to offer personalized lower prices to our loyal households in addition to the low prices everyone can see. This is an example of how we leverage 84.51°'s expertise.

We are investing in our people. We are improving customer service by both increasing labor hours in certain areas and increasing starting wages in certain markets. Taken together, these steps will improve the customer experience and improve retention.

I share these examples to demonstrate that we are laser-focused on providing our customers with the right value proposition. This is our ***Customer 1st Promise*** – our commitment to provide friendly service, fresh foods, and low prices, every day. And this is what we will continue to do, regardless of external factors, because it's what our customers deserve and what we know ultimately delivers shareholder value.

These investments both maintain and enhance our position in our markets. And while it is still early in 2017, we are starting to see some traction. We are happy with the better ID sales results in the first quarter compared to the fourth quarter, and we are pleased to see that our current ID sales trend is positive. The last nine weeks of the first quarter were positive, and so is our second quarter to date.

Customer Trends

Our team continues to innovate in new and exciting ways that reflect where our customers are going.

Meal Kits

Recognizing the demand for convenience, high quality, and best value, Kroger's Culinary Development Team launched an incredible collection of *Prep+Pared* meal kits that we are currently piloting in Cincinnati stores. We can hardly keep them on the shelves! And it's easy to see why as soon as you try them. Kroger's *Prep+Pared* meal kits offer restaurant-quality meals that are easy to cook in about 20 minutes. We think customers will love knowing they are available in stores when they are wondering "what's for dinner?"

Our Brands

Our Brands are one of the primary means we have to differentiate ourselves from our competitors.

Last year, we commissioned an independent third party to conduct research that would give us an objective view of how our customers view *Our Brands*. This included blind taste tests with national brands and other private label foods.

The research showed that the *most-loved brands* sold in our stores are *Our Brands* – above even the national brands! And in the blind taste tests, *Our Brands* outperformed competitive national brand and other private label products…almost 100% of the time. The products in our *Private Selection* and *Simple Truth* and *Simple Truth Organic* brands rated significantly above their respective competitive offerings. Of course, our journey is never “done” – so our customers will continue to see rising quality and better value on *Our Brand* products in the future. By having brands our customers love that are only available from us, we gain loyalty and advocacy from our customers.

Our Brands represented approximately 28.0% of total units sold, and 25.6% of sales dollars, excluding fuel and pharmacy, during the first quarter.

Feed the Human Spirit^{SM}

Our customers’ needs are constantly changing. What doesn’t change is their desire for a welcoming customer experience and an abundant variety of foods, available when and how they want it, all at a great value. That’s why we regularly evolve the execution of our Customer 1st Strategy, while the core strategy itself doesn’t change.

Too often, American consumers have to make a choice between low prices and a great experience, compromising one for the other. Kroger is uniquely situated to eliminate the need for that compromise; serving customers who are hungry for more than food, who want to be nourished in ways that help them live their best lives.

Kroger’s purpose is to ***Feed the Human Spirit***. And we are more confident than ever that by living our purpose and delivering our Customer 1st Promise, we will produce long-term shareholder value that you can count on.

We remain committed to delivering our long-term net earnings per diluted share growth rate of 8 – 11%, plus a growing dividend.

And here is Mike to go into more detail on our first quarter results. Mike…

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

ID Sales

Like Rodney said, we were glad to see the better results compared to the fourth quarter. And, for the second quarter-to-date, our ID sales are positive.

Tonnage continued to be positive during the first quarter. We continue to focus on the areas of highest growth like natural and organic products as well as areas where we are saving customers’ time, such as ready-to-eat and ready-to-heat meal solutions.

Visits per household were flat in the first quarter. Basket size and price per unit were down, but those were offset by household growth. Loyal households grew 3.2% compared to last year. And our loyal households had positive ID sales growth in the first quarter.

Operating Costs, Gross Margin, Operating Profit Margin

In the first quarter, our gross margin was down, operating costs were up, and FIFO operating profit was down. While this is not representative of our typical expectations, it is important to keep in mind that we are making very deliberate and targeted investments in line with our Customer 1st Strategy.

As Rodney outlined earlier:

- We've made conscious decisions to increase starting wages in certain markets to improve associate engagement and retention that will create a better experience for our customers.

- We continued investing to grow our digital business. Our digital revenue more than doubled in the first quarter compared to last year. This includes revenue from *ClickList*, Harris Teeter's *ExpressLane* and *Vitacost.com*.

- And we continued to invest in price. As we often remind you, Kroger's investment in price can be seen very clearly if you look at our gross margins in the early 2000s and compare them to today. Kroger has invested more than $3.8 billion to lower prices for our customers over that time period. We have no intention of giving up the momentum we've gained on low prices.

These investments enable us to connect with our customers in a deeper way and increase our market share over time.

We are pleased that Kroger's market share, as traditionally calculated, was up in the first quarter. That said, we recognize there is no perfect metric for capturing market share. We are doing a lot of work to better define – or redefine – the market as "share of stomach" rather than "share among traditional grocery stores". We see food as a massive, $1.5 trillion market, and we have a substantial growth opportunity.

I also want to stress that we are committed to lowering costs as a rate of sales. Many of the things we are doing to pull costs out of the business today set us up for savings in the future. We will only further intensify our process improvement efforts.

Retail Fuel

Now for an update on retail fuel. In the first quarter, our cents per gallon fuel margin was approximately 17.1¢ compared to 14.3¢ in the same quarter last year. The average retail price of fuel was $2.28 versus $1.92 in the same quarter last year.

Financial Strategy

Our net total debt to adjusted EBITDA ratio increased to 2.33, compared to 2.12 during the same period last year. This result is due to the merger with ModernHEALTH and the repurchase of shares.

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

- Repurchase $1.5 billion in common shares,
- Pay $438 million in dividends,
- Invest $3.4 billion in capital, and
- Merge with ModernHEALTH for approximately $390 million.

The flexibility to return value to shareholders is a core strength of our financial strategy. We are committed to balancing the use of cash to maintain our current investment grade rating.

Return on invested capital for the first quarter, on a rolling four quarter basis, was 12.75%.

Labor Update

On the labor relations front, we are currently negotiating agreements with UFCW for store associates in Atlanta, Dallas and our Food 4 Less Warehouse Stores.

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.

Updated 2017 Guidance

Turning now to our guidance for fiscal 2017.

We had previously indicated that the environment during the first half of this year would be similar to the back half of 2016, and that is what we're seeing. As Rodney said, there is a lot of change in the food retail industry. That, coupled with the transition from deflation to inflation creates a challenging operating environment.

The deflationary environment was less severe in the first quarter compared to the fourth quarter, coming in at 20 basis points deflationary without fuel. Grocery was essentially flat during the quarter but had fluctuations up and down during it. Meat continued its deflationary trends. Produce, while deflationary for the quarter, showed inflation in the last four weeks of the first quarter. And pharmacy was inflationary.

As a result we increased our expectations for LIFO to $80 million; a $55 million increase over our initial expectations.

We also made some incremental investments in price in certain markets that had very hot features on milk and eggs. While this affects gross margin in the short term, it is less expensive than regaining a customer's loyalty.

These two, plus the incremental investments in hours and wages, are the primary factors causing us to lower our guidance for the year.

Our GAAP net earnings per diluted share guidance for 53 weeks is now $1.74-$1.79. Our adjusted net earnings guidance range is $2.00 to $2.05 per diluted share. The previous adjusted net earnings guidance range was $2.21 to $2.25 per diluted share. See Form 8-K for additional information on guidance.

Because this is an unusual year, we are going to provide a quarterly cadence relative to last year rather than compared to our long-term guidance rate, as we've done in the past. For net earnings per diluted share, we expect:

- the second quarter to be down compared to last year,
- the third quarter to be up slightly compared to last year, and
- the fourth quarter to be flat, excluding the 53rd week.

We continue to expect identical supermarket sales, excluding fuel, of flat to 1% growth for 2017.

We continue to expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be in the $3.2 to $3.5 billion range for 2017.

Over the long term, Kroger is committed to achieving a net earnings per diluted share growth rate of 8 – 11%, plus a growing dividend.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:
Thanks, Mike. We are making the investments necessary to continue being the best food retailer in the country. We know there is a lot of upheaval in the food retail industry. Our strategy is to focus on our customers – as their wants and needs change, we'll be right there with them. We are confident that we will continue winning with our people, our food, and the customer experience, and we *will not lose* on price.

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.

As you've heard us describe during this call, we're focused on executing our Customer 1st Strategy and living our company's purpose, to Feed the Human Spirit.

Feed the Human Spirit is our purpose because both our customers and you, our associates, told us it resonates powerfully with you, and also because it is authentic to Kroger – it's who we are.

We've been living our purpose in large ways and small for more than 134 years. Whether it is through providing a billion meals to feed hungry families in our neighborhoods over the last four years … committing to being a zero waste company by 2020 … or simply extending a smile or a helping hand to a customer … we and <u>you</u> make the world a better place one associate … one customer … and one community at a time. Thank you for all you do every day for our customers and each other.

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 "assumes," estimate," "expect," "committed," "objective," "will," "guidance," "continue," "believe," "anticipate," 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:

- 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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