



**Second Quarter 2017
Investor Conference Call Prepared Remarks
September 8, 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 second 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.

Please save the date for our 2017 Investor Conference, which we will hold in New York on October 11. Details will be coming soon and we hope you can join us.

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 second quarter 2017 results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Always Customer 1st

Kroger has competed in an ever-changing retail landscape for 134 years. Our success over time boils down to one thing – our relentless focus on the customer. That focus allows us to deepen our connection with customers and create shareholder value. The customer remains the center of everything we do.

The four core elements of our Customer 1st Strategy are as relevant today as when we first introduced them. How we invest each year to drive customer engagement changes regularly based on customers' changing needs and wants.

This showed in our second quarter results, as we returned to positive identical supermarket sales growth and both loyal and total households increased. Traffic was up, unit movement was up and market share was up. Our customers' perception of our prices is excellent and continues to get even better.

Based on our second quarter results and expectations for the balance of the year, we have confirmed our annual net earnings guidance.

Redefining the Customer Experience

The operating environment will continue to be incredibly dynamic. But more importantly, customer behavior is changing faster than ever before.

For the last few quarters we've talked with you about our expanded view of all the food our customers eat, and how we've been working to redefine the market as "share of stomach" rather than "share among traditional grocery stores". We know that the massive, \$1.5 trillion U.S. food market creates a unique and substantial growth opportunity for Kroger. You'll see changes in the way we go to market as a leading indicator of the new lens through which we view our market. We see anyone who sells food as competitors in the future.

Kroger has a history of successfully evolving to meet our customers' changing needs, because we put the customer at the center of everything we do. We are transforming today, too. We are reprioritizing and accelerating investments in our Customer 1st Strategy in order to anticipate and meet rapidly-evolving consumer demands to shop with us for anything, anytime, anywhere. Our transformation is all about redefining the customer experience.

As our business continues to improve, we remain committed to delivering on our guidance in 2017 and believe we have the ability to grow identical supermarket sales and market share in 2018. In this dynamic operating environment, we will continue to provide annual guidance as we have done for many years but will no longer provide longer-term guidance. This will provide needed flexibility in how we invest to position us for future success.

We look forward to getting into the details of our goals and priorities at our upcoming investor conference in October. But in the meantime, I'd like to begin to create a vision by sharing several ways we are redefining the customer experience to be America's inspiration and destination for everything food. We're doing this by:

- combining our knowledge of food with our ability to personalize through the use of data analytics,
- doubling down on digital, and
- leveraging new and ongoing partnerships to both deepen our connection with customers and drive revenue.

I'll take a few minutes to share more about each of these areas where we have deep credibility from our past and are aggressively developing for our future.

Food Authority

Food retailing is more exciting today than ever before – especially as more of us become “foodies”. Customers have a nearly unlimited number of options when you combine tastes, flavors and types of meals with the growing number of food outcomes that consumers are focused on. Those outcomes might include eating for health or for enjoyment, for example, or for lifestyle or performance reasons.

Kroger is uniquely positioned to be the partner our customers turn to for their meal needs because *we know food* and *we know our customers* better than anyone.

Meals have always been our expertise. Kroger is often the one driving change and innovation behind the scenes.

We are very proud of the role we’ve played for over a decade in making natural and organic products more affordable and accessible to America, especially for shoppers on a budget. We’ve always believed that our customers shouldn’t have to pay higher prices just because a product is natural or organic. We developed our Simple Truth brand to be honest, easy and affordable because our data told us this was a customer need in the marketplace. Today, Simple Truth is the biggest natural and organic brand in the country by volume. This market continues to provide a robust opportunity for Kroger.

Similarly, our culinary innovation team is bringing truly affordable and incredibly tasty meal kits to American households through our *Prep+Pared* offering. Just last week we announced that we are expanding our offering of *Prep+Pared* to more than 50 stores in three of our divisions – Cincinnati, Louisville, and Ralphs.

Data Personalization

Across Kroger, we know our customers better than anyone. We have a 13-year advantage of using data insights to connect with customers. Data analytics are fully integrated in our business, as 84.51° helps us make merchandising, operations and marketing decisions. In the last year alone, Kroger has made more than three *billion* personalized recommendations to customers through product offers, promotions, recipes and more.

Data analytics is helping us win with *Our Brands* by identifying the best products to bring to market based on consumer behavior and taste trends. Research by an independent third party shows that our customers favor *Our Brands* over national brands and competitor offerings. The strength of *Our Brands* is that our customers realize Kroger quality is superior, at a very affordable price. It truly is quality without compromise – customers get the best and most innovative quality at the best prices. We will build on this momentum to be the premier private label destination in America.

Combining our love of food with our data expertise allows us to offer content that inspires. We recently launched a new “My Recipes” feature on Kroger.com that serves up a personalized selection of suggested recipes. The recipes offer a greater diversity of meal ideas – all based

on your individual purchase behavior. Our growing collection of recipes is also searchable by a variety of filters including seasonality, world cuisine, meal or dish type, and cooking style. While online recipes are not new, serving up personalized recipes that your family will love is new. And distinctly Kroger.

Doubling Down on Digital

Personalized recipes are just one example of how we are bringing the combination of food and data together to create new and highly-relevant customer experiences, especially through digital and ecommerce. Customers expect a great store shopping experience AND the ability to interact with us digitally or online in a seamless way. Our digital efforts are all about making things easier for our customers and providing personal, affordable and exclusive options that fit their needs. This includes our mobile app, for example, in addition to Vitacost.com, ClickList, Express Lane and home delivery. Today, we have more than 25 million digital customer accounts. As we said in our press release, our total digital sales are up 126%, driven by ClickList.

We operate more than 813 ClickList and Express Lane locations offering the convenience of online ordering and curbside pickup. By the end of the year we will offer the service at more than 1,000 locations. Customers continue to respond exceptionally well to ClickList.

We know that in the future more customers will want the option of home delivery, so we are also testing various home delivery models with companies like Uber and Shipt in more than 154 stores.

We will keep making the strategic investments to serve customers anything, anytime and anywhere in the near future.

Driving Customer Value through Partnerships

With new entrants in a fragmented market, we're also transforming our business and building partnerships to deepen our relationship with, and create value for, our customers. We've been preparing for new market entrants for years, and the fact that Kroger is trusted by more than 60 million households annually is a great strength when customers have more food choices than ever before. We continue to gain share in key categories like natural foods, produce and fresh prepared foods. We will continue to focus on growing our core business to generate free cash flow and deepen our personal connection with customers.

These changes also create opportunities to work with our existing partners to deliver more value for customers and to identify new partnerships to create alternative revenue streams.

Now, here is Mike to share more details on our second quarter results and to walk you through changes to our capital allocation process and long-term guidance. Mike...

Comments by Mike Schlotman:

Thanks, Rodney. Good morning everyone.

We're pleased with our second quarter results – especially the return to positive identical supermarket sales. That, combined with strong market share, tonnage growth and both loyal and total household growth demonstrates our ability to evolve with the changing preferences of customers. Kroger has the team, the skills, the knowledge, the scale and the data analytics to be a winner in food retailing.

Another positive sign is that we had overall product cost inflation for the first time since 2015. As you know, the change from inflation to deflation and back again is the toughest operating environment for our stores and we're proud of our team's ability to manage through it.

Investing for the Future

Our Customer 1st Strategy has always guided our strategic investments to be there for our customers today and – more importantly – to be where they are going in the future.

To undergo the transformation Rodney discussed, we recognize that we need to make these customer-first investments more aggressively, and faster, than ever before.

Like Rodney said earlier, we are eager to share the specific elements of our plan with you at our Investor Conference in October. But, today I will highlight two examples:

- First, 84.51° has helped us redefine space optimization for the entire store. As this comes to life, it will drive sales and operating profit growth. In the short run, there is a cost to doing this but we feel the return is significant. This is another example of using 84.51° in new and innovative ways.
- Second, we're making sure we have the right products at the right cost and the right retail prices for our customers.

We are approaching these efforts, along with the areas Rodney outlined earlier, with even more focus and urgency than we have in the past.

For example, we've already reprioritized the way we invest capital by both reducing the amount we spend and by turning our capital allocation process upside down. We now look first for sales-driving and cost-savings opportunities through both brick-and-mortar and digital platforms. Second, we will continue to make sure our logistics and technology platforms keep pace with and scale to these demands through continued investment. Then finally we will allocate capital to storing activity. This process has allowed us to use less free cash flow for capital investments.

One thing I want to be very clear on is that we are not talking about a new strategy to replace Customer 1st. We are talking about better executing the elements of our plan to deliver on all Four Keys for our customers. As Rodney said, our customer remains our focus.

Growth through Our Brands

We continue to see strong growth and amazing potential in *Our Brands*.

During the second quarter, *Our Brands* sales grew more than national brands in our grocery, drug/gm and meat departments. Identical sales for *Our Brands* also outpaced identical supermarket sales. The second quarter brought strong sales and unit growth, with *Our Brands* representing 27.7% of total units sold, and 25.4% of sales dollars, excluding fuel and pharmacy.

All of this is consistent with the research we commissioned last year to 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.

Retail Fuel

Now for an update on retail fuel. In the second quarter, our cents per gallon fuel margin was approximately 21.7¢ compared to 19.8¢ in the same quarter last year. The average retail price of fuel was \$2.28 versus \$2.20 in the same quarter last year.

Financial Strategy

Our net total debt to adjusted EBITDA ratio increased to 2.37, compared to 2.11 during the same period last year. This result is due to the merger with ModernHEALTH and the incremental repurchase of shares.

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

- Repurchase \$1.7 billion in common shares,
- Pay \$448 million in dividends,
- Invest \$3.1 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. We have reduced our 2017 and 2018 planned capital investments by a total of \$600 million to maintain this balance and flexibility.

Return on invested capital for the second quarter, on a rolling four quarter basis, was 12.37%.

Labor Update

On the labor relations front, we recently ratified an agreement with the UFCW for store associates in Atlanta and Dallas.

We are currently negotiating an agreement with the UFCW for store associates in our Food 4 Less Warehouse Stores and with Teamsters for the Master Agreement. This fall, we will begin negotiations with the UFCW for store associates in Charleston, West Virginia.

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 inefficient health care and pension costs, which some of our competitors do not face. Kroger continues to communicate with our local unions and the international 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.

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 saw. Cost inflation trends for the second quarter were consistent by department, with grocery, liquor, produce and meat all positive for the quarter. Deli was deflationary. Pharmacy continues to be inflationary.

We are confirming our 2017 net earnings guidance for 53 weeks of \$1.74-\$1.79 per diluted share. We are also confirming our adjusted net earnings guidance range of \$2.00 to \$2.05 per diluted share. Our LIFO expectation remains unchanged at \$80 million.

We expect identical supermarket sales growth, excluding fuel, of 0.5% to 1% growth for the remainder of the fiscal year.

Our guidance does not include any effect from hurricanes Harvey or Irma. Our insurance provides coverage and caps losses at \$26 million dollars for each event. Until the claim is finalized, it is difficult to provide an exact amount.

We expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be in the \$3.0 to \$3.3 billion range for 2017.

Now, I will turn it back to Rodney.

Comments by Rodney McMullen:

Thanks, Mike.

I'm often reminded of the saying, "may you live in interesting times". These are interesting times in our industry, and I know some of you wonder how Kroger can continue to thrive in such a dynamic operating environment. We have a history of evolving to meet our customers' ever-changing needs. The key is to proactively see where the customer is going and to proactively address the changes. That is what we are doing today. Through innovation, Kroger is redefining the food and grocery customer experience based on our core strengths.

Kroger has more data than any of our competitors, which leads to deep customer knowledge and unparalleled personalization. We have incredibly convenient locations and platforms for pickup and delivery within one-to-two miles of our customers. We have a leadership team that combines deep experience with creative new talent. We have the scale to win with more than 60 million households shopping with us annually. In fact, we've been named America's most beloved grocery store several times. We have a proven track record of consistently returning capital to shareholders through an increasing dividend and share buyback program. And, we have a track record of connecting with our associates, customers and communities to uplift and improve lives, as evidenced by our team's response to Hurricane Harvey.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

Kroger is playing to win. The things we are doing today are to improve our connection with customers and associates in the future, and when we do both of those, our shareholders are rewarded as well. Business continues to generate free cash flow and we have great opportunities ahead of us.

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

I'd like to send our well wishes to the people of Houston, and especially members of our Kroger family, whose lives were turned upside down by the recent hurricane and its aftermath. Our thoughts and prayers are with those who are now bracing for Hurricane Irma as well.

Since the rains stopped in Houston, you have shown that nothing can stop the strength, resilience and power of our amazing Associates. Many of you stayed in or couldn't easily leave stores, distribution centers, plants and offices overnight and worked tirelessly to not only serve our customers, but to provide food and supplies to first responders and local shelters.

As a company we've sent nearly 2,800 semis packed with food, water and other critical supplies to the region. More than 350 individual associates from all corners of the country traveled to Houston to lend their hands to help uplift the community.

Having a physical presence and truly being part of a community is always important. This is perhaps never more apparent than when natural disasters strike. You and our stores are a vital part of the communities we serve.

What I'm most proud of is how you've taken care of each other. Whether giving a hug to someone who needs it or traveling across the country to work side by side in reopening our stores and warehouse - we take care of each other – it's who we are.

Each day we open our doors and welcome our neighbors with true hospitality and generosity ... and together, we make the world a better place. Thank you for all you do, in big ways and small ways, to Feed the Human Spirit™ - we are truly #KrogerStrong!

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 "estimate," "expect," "committed," "objective," "will," "guidance," "continue," "believe," "feel," "anticipate," "plan," 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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