Fourth Quarter and Full Year 2017
Investor Conference Call Prepared Remarks
March 8, 2018

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 fourth 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 fourth quarter and full year 2017 results is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Restock Kroger **Momentum**

At our investor conference in October, we discussed the need for retail companies to constantly reinvent themselves in order to remain relevant, and Kroger is right in the middle of such a reinvention. We are proactively addressing customer changes and we've made strategic decisions to invest in a seamless digital experience, technology, associate wages, and low prices.

Combined, these efforts came together in *Restock Kroger*, our plan to create shareholder value by redefining how people eat. Our vision is to serve America through food inspiration and uplift. *Restock Kroger* has four main drivers: **Redefine the Grocery Customer Experience**, **Expand Partnerships to Create Customer Value, Develop Talent**, and **Live Our Purpose**. Combined, these focus areas will **Create Shareholder Value**.

We announced *Restock Kroger* six months ago – while also in the middle of one of the most complicated years in our history. Throughout 2017 we continued to challenge our team to deliver our revised ID sales and earnings guidance from June. We are proud to share today that we delivered on those revised commitments for the year, finishing 2017 with strong sales and business momentum.

In 2017 we also:

- Grew digital sales by more than 90% and expanded ClickList to more than 1,000 locations,
- Gained market share for the 13th consecutive year,
- Achieved $16.7 billion in annual natural and organic sales, including $2 billion in Simple Truth® sales.
- Launched Zero Hunger | Zero Waste, our commitment to end hunger in the places we call home and eliminate waste across our business by 2025, and
- Created 10,000 new American jobs in our supermarket locations across the country.

All of this is encouraging as we start 2018.

Accelerating *Restock Kroger* with Lower Taxes

Looking at 2018 and beyond, the Tax Cuts and Jobs Act is a catalyst that will enable us to accelerate investments in *Restock Kroger*. And, as we've shared a few times since the fall, we are taking a balanced approach to ensure tax reform benefits our associates, customers and shareholders.

- Shareholders will benefit from approximately a third of the tax savings flowing through to net earnings per diluted share.

- For our customers, we'll make strategic investments to continue redefining the grocery customer experience through a combination of improved services, lower prices, and added convenience.

- And for our associates we are developing plans now to invest in long-term benefits including education, wages and retirement. We are looking at ways to differentiate our associate experience, with the underlying philosophy that we want to provide more than a one-time award; we want to make investments in our associates' future. As an example of this, we're doing a lot of work right now to develop an industry-leading education offering for associates. Kroger has always been a place where people can 'come for a job and stay for a career'. We believe an enhanced commitment to employee education will drive the **Develop Talent** focus area of our plan.

These investments underpin and accelerate *Restock Kroger*, which means we fully expect a strong return. Sharing the benefits with our associates and customers will create a more sustainable and stronger business model to support Kroger's future. The investments are also aligned with Our Purpose, Our Promise and our values. We look forward to sharing more details on our plans with associates in the coming weeks.

Seamless Shopping

We continue to create a seamless environment where our customers can choose how to engage with us in-store and online.

Whether through ClickList or home delivery, we continue to test, learn and scale what works, using our data and customer insights to make it really easy for our customers to navigate across the channels *they* choose when shopping with us.

In the fourth quarter we introduced a seamless digital shopping experience that fully integrates our ClickList experience with our other digital services – coupons, recipes, rewards and more. After just a couple of months, we already know our customers love it. Customers are making purchases on the site at a higher frequency than before and spending more per online order.

Households that participate in our seamless offerings – those who engage with our digital platforms and with our physical stores – spend more per week than households that do not. And households that transact with us online spend even more.

These results further validate our hypothesis – which has always been that our customers want to have options for how they shop with us. And that hypothesis continues to shape our strategy to further accelerate our digital and ecommerce efforts.

When you look at our customer coverage area for seamless shopping, more than 2/3 of our customers – more than 40 million shoppers – have pickup and/or delivery available from Kroger. Our goal is for every customer to have access to our convenient services. In 2018, we will expand our digital coverage area and enhance our digital shopping experience to provide customers with relevant products, recipes, digital coupons, weekly ads, smart shopping lists and more. To support this growth, we offer customers 1,091 pickup locations and more than 872 delivery locations across the country – and it continues to grow.

Our Brands

Next, I'd like to discuss how winning with *Our Brands*. And this helps Kroger **Redefine the Grocery Customer Experience**. *Our Brands* performance this past year was extraordinary. I'll share just a few of the highlights. In 2017, *Our Brands*:

- Achieved its highest-ever unit share,
- Reached $20.9 billion in total sales, and
- Reached $2 billion in annual Simple Truth sales – which is all the more remarkable when you consider the brand is only five years old.

We also announced a partnership with Fair Trade USA. Simple Truth now offers more Fair Trade Certified products than any other private label brand in the country.

For the fourth quarter, *Our Brands* made up 29.5% of unit sales and 26.0% of sales dollars, excluding fuel and pharmacy.

I think it's incredibly easy to take this success for granted. But I've seen the energy our teams have put into creating the right items. And it's a really big deal that independent third-party research has validated the progress we've made. When you look at the results, they are extraordinary and I am incredibly proud of our team. The data is clear: Customers love *Our Brands*. Better than the national brands, and better than other private label offerings – *Our Brands* outperform even the private label brands you immediately think of as best in class.

And we're going to shout about it so that customers who have yet to experience *Our Brands* no longer miss out. We will be particularly focused on our top brands: *Kroger*, *Private Selection*, and *Simple Truth*. Our customers will be treated to an amazing array of enticing new *Our Brand* product introductions throughout the year – an assortment that will add excitement and simplicity to their lives … all at amazing prices. And *Our Brands* are only available at Kroger.

This is why *Our Brands* play such a pivotal role in *Restock Kroger*.

Shareholder Value

Restock Kroger is off to a great start. Our leadership team and associates are aligned behind the effort, which is further reinforced by our annual incentive plan. Customers are letting us know that they see, feel and appreciate our efforts to redefine the customer experience. And they continue to reward us with growing loyalty. This is the cycle that creates value for shareholders.

We are confident that we will grow identical supermarket sales and market share in 2018. And we will **Create Shareholder Value** by generating incremental operating margin dollars and free cash flow over the next three years.

Now, here is Mike to share more details on our fourth quarter and fiscal 2017 results, and to discuss our 2018 guidance. Mike…

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

***Restock Kroger* – Investing for the Future**

Over the next three years, *Restock Kroger* will be fueled by cost savings that we will invest in associates, customers and infrastructure. Our goal is to continue generating shareholder value even as we make strategic investments to grow our business.

Free Cash Flow

We expect *Restock Kroger* to generate $6.5 billion of free cash flow over the next three years. This is before dividends and considers the benefit of the tax plan.

We've already reprioritized the way we will invest in capital over the next three years, by both reducing the amount we spend and optimizing our capital allocation process.

We now look first for sales-driving and cost-savings opportunities across 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. Finally, we will allocate capital to storing activity. This process has allowed us to use less free cash flow for capital investments.

Cost Savings

We are aggressively managing OG&A costs and implementing new programs to reduce our cost of goods sold. A big focus will be on store productivity and waste. Both of these will benefit from the $9 billion in capital investment over the next three years. For example, store productivity will improve with the scheduled launch of Scan-Bag-Go in 400 new locations this year. We are also pleased that shrink continued its steady improvement throughout the year with good results in the fourth quarter.

We plan to generate $400 million in incremental operating margin from 2018 to 2020. We are taking advantage of the lower federal taxes under the Tax Cuts and Jobs Act to pull investments forward to 2018 so we can move even faster on *Restock Kroger* than originally anticipated.

Fourth Quarter and Fiscal 2017 Results

Turning to our results for the year, as you know we revised our outlook in June to address the environment we were operating in. We provided a narrow net earnings guidance range of $2.00 to $2.05 per diluted share, and we are pleased to have been near the top end of that range for the year.

As you can imagine, in a company our size, there are many moving parts in our operations. Our goal is to manage the business on at least an annual cycle period. This can lead to quarterly fluctuations, but we always have our eye firmly on annual results and the long-term strength of the company. We saw an opportunity at the beginning of the fourth quarter to invest in the shopping experience and price while still delivering on our annual commitment. This is why our results reflected a gross profit rate decline of 31 basis points in the fourth quarter, but only 19 basis points for the year.

As a result of these investments, we saw growth in both households and total visits, unit growth and market share growth. Since 2000, we’ve reduced prices for our customers by $4.1 billion. We intend to continue investing in price to drive unit and ID sales growth while still delivering on the bottom line for our shareholders.

This is the strategy we’ve been following for years, and it has served us well over time. It is a cornerstone of our *Restock Kroger* plan to invest more in redefining the shopping experience, partnering for customer value, and developing talent that will be paid for by cost of goods savings, strong ID sales, and productivity gains. This is where the incremental operating margin will come from over the next three years.

We continued to make investments in our associates through both higher wages and additional hours for the expansion and rollout of ClickList and other services.

Despite higher inflation during the fourth quarter, LIFO turned out to be a tail wind due to lower inventory levels in departments most affected by the higher inflation, primarily pharmacy.

ID Sales Results

Speaking specifically about ID sales, we are very pleased with result of 1.5% growth in the fourth quarter. Several departments outperformed the company in the fourth quarter, including Produce, Deli/fresh prepared, Meat and Seafood. Our Natural Foods department continued to generate strong double digit growth in both the fourth quarter and the full year. 18 of our 22 supermarket operating divisions had positive IDs for the year as well, demonstrating the consistency of our results across the enterprise.

2017 Market Share

Kroger's market share grew for the 13th year in a row in 2017. Our consistent market share gains drive both top and bottom line growth to generate lasting shareholder value.

We report on market share annually, and look at it the way customers would look at it – where they spend their money. We use market share data as a directional measure, and not a specific one. It is also worth noting that market share is calculated based on total sales and not ID sales.

According to IRI point of sale data, Kroger's overall market share of the products we sell in the markets where we operate grew approximately 21 basis points in 2017 – a slight acceleration over last year's growth of 16 basis points based on IRI's calculations.

Fourth Quarter and Fiscal 2017 Adjustment Items

Both our fourth quarter and full year results included several adjustment items as described in Table 6 from this morning's press release. I want to spend a couple of minutes walking you through that table.

These items are <u>not</u> included in our fourth quarter adjusted net earnings per diluted share result of $0.63, and they are <u>not</u> included in our 2017 adjusted net earnings per diluted share result of $2.04.

As a result of the Tax Act, we recognized a tax benefit of $922 million in the fourth quarter. This was due to the re-measurement of deferred tax liabilities and the reduction of our statutory income tax rate for the last few weeks of the fiscal year.

As part of the company's annual review of goodwill balances in the fourth quarter, we recognized a goodwill impairment charge of approximately $110 million related to our Kroger Specialty Pharmacy business. This is primarily due to lower rebates and gross margins we built into our future expectations. Kroger Specialty Pharmacy continues to perform well.

In the third quarter of 2017, certain assets and liabilities, primarily those related to our convenience store business unit, were classified as "held for sale" on the Consolidated Balance Sheet. Due to these assets being classified as "held for sale", these assets are no longer being depreciated. We benefited from this classification in both the fourth quarter of 2017 and fiscal year 2017 by not having to record $19 million of depreciation associated with those assets.

Our results were also affected by the previously-announced settlement of obligations under the company-sponsored pension plan. We also made significant headway throughout the year and in the fourth quarter, in particular, on our long-term effort to address exposure in our pension plans, while at the same time working with the unions to provide Kroger associates with a more secure pension.

During 2017, we proactively managed future risk in several ways:

- Most recently in December, Kroger and International Brotherhood of Teamsters announced the ratification of a new labor agreement that provided for Kroger's withdrawal from the Central States Pension Fund. We recognized a $351 million charge in the fourth quarter of 2017 for the obligations associated with this decision and subsequently negotiated a lump sum settlement of the withdrawal obligation due to the pension fund.

- This was in addition to $192 million recognized in the first quarter of 2017 for the obligations associated with a planned withdrawal of Roundy's associates from the same fund and a $7 million charge for a separate multi-employer pension fund.

- We made a lump sum payment to Central States for $467 million pre-tax. This replaces what would have been approximately $3 million in pre-tax monthly withdrawal obligation payments for both withdrawals for the next 20 years.

- In the third quarter, we announced a $1 billion contribution to our company-sponsored pension plans. This funded a $502 million settlement charge – accounted for in the fourth quarter – for the termination of the cash balance company-sponsored pension plan that we previously announced.

Retail Fuel

Fuel performance was very good in the fourth quarter. Our cents per gallon fuel margin was approximately 19.8¢ compared to 17.2¢ in the same quarter last year. The average retail price of fuel was $2.46 versus $2.18 in the same quarter last year.

For 2017, our cents per gallon fuel margin was 20.6¢ compared to 17.1¢ the year before. The average retail price of fuel for 2017 was $2.36 versus $2.10 in 2016.

Convenience Store Update

In February, we announced a definitive agreement for the sale of our convenience store business unit to EG Group for $2.15 billion. Our convenience store business has been a part of the company for many years, and I can't stress enough how important to our success Kroger's convenience store management and associates have been.

We have been impressed with EG Group's professionalism, commitment to people, and understanding of the U.S. convenience retail market. And we are very pleased EG Group plans to establish their North American headquarters in Cincinnati.

We continue to expect to close the transaction during the first quarter of our fiscal year. And we look forward to working with them closely to ensure a smooth transition for associates.

As we previously announced, we plan to use the proceeds from the sale to repurchase shares and lower our net total debt to adjusted EBITDA ratio.

Financial Strategy

Our financial strategy is to use our free cash flow to drive growth while also maintaining our current investment grade debt rating and returning capital to shareholders. We continually balance the use of cash flow to achieve these goals.

In 2017, we used cash to:

- Contribute an incremental $1.2 billion pre-tax to company-sponsored pension plans and $467 million pre-tax to satisfy withdrawal obligations to the Central States Pension Fund,

- Repurchase 61 million common shares for $1.6 billion,

- Pay $444 million in dividends, and

- Invest $3.0 billion in capital.

As of the end of the fourth quarter, our current share repurchase authorization had approximately $270 million remaining.

Return on invested capital for 2017, on a 52-week basis, was 12.03%.

Net Debt to EBITDA Ratio

We have said for some time that we expect our net total debt to adjusted EBITDA ratio to grow. This is because we are bringing an off-balance-sheet item on to our balance sheet or funding an obligation already on our balance sheet. As a result, in the third quarter we updated our target range for this ratio to 2.20 to 2.40. These obligations – whether recorded on- or off-Kroger's balance sheet – have generally been considered when our credit profile has been reviewed, but since they weren't funded, they previously did not get picked up in our net total debt to adjusted EBITDA ratio.

The lump sum settlement negotiated with the Central States Pension Fund in the fourth quarter of 2017 is the most recent example of the company taking advantage of low interest rates and more favorable tax rates to secure the retirement benefits we have promised our associates. Because negotiating this settlement and bringing the obligation onto our balance sheet was not contemplated when we updated our target last quarter, we are again updating our target range for this ratio to 2.30 to 2.50. Just as in the past, this obligation has always been part of our credit profile. The funding in the fourth quarter now picks up this obligation in our net total debt amounts.

Our current result of 2.65 times, on a 52-week basis, is above this range, due primarily to funding the above-mentioned various pension obligations. We expect to use free cash flow and a portion of proceeds from the sale of assets to get us back in the range. This includes the sale of our convenience store business unit.

Talent and Labor Update

Protecting associate and retiree pensions is one significant way that we take care of our associates. Another is hiring and job creation. As we noted in this morning's press release, Kroger created 10,000 supermarket jobs in 2017.

Through *Restock Kroger*, we are investing an incremental $500 million in our associates – in wages, training and development – over the next three years. This will be in addition to our continued efforts to rebalance pay and benefits while also focusing on certifications and performance incentives, career opportunities, and training.

Our store associates in our Cincinnati-Dayton division are currently voting on a tentative agreement between Kroger and the UFCW. This will be our first contract under *Restock Kroger* and it includes our added investment in wages, raising starting pay to at least $10/hour and accelerating rate progressions to $11/hour after one year of service.

Looking ahead, we have several major negotiations in 2018, including contracts with UFCW for store associates at Smith's in Albuquerque, Fred Meyer in Portland, and Kroger stores in Richmond and Ft. Wayne.

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. We continue to strive to make our overall benefit package relevant to today's associates. Our financial results continue to be pressured by inefficient health care and pension costs, which some of our competitors do not face. We continue to communicate with our local unions and the international unions, which represent many of our associates, the importance of growing our business and profitability, which will help us create more jobs and career opportunities, and enhance job security, for our associates.

2018 Guidance

Turning now to our guidance for 2018:

We expect 2018 identical supermarket sales growth, excluding fuel, to range from 1.5% to 2.0%. We expect net earnings to range from $1.95 to $2.15 per diluted share for 2018.

We expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be approximately $3.0 billion for 2018.

We expect our 2018 tax rate to be approximately 22%.

And now I'll turn it back to Rodney…

Comments by Rodney McMullen:
Thanks, Mike.

We're proud of how our team finished 2017, ending the year with positive momentum in sales and the overall business. We delivered the revised sales and earnings guidance we promised, gained market share for the 13th year in a row, continued to grow our natural and organic food sales, grew digital sales by more than 90% and now offer a seamless digital experience to more than 40 million customers in America. And, of course, we launched *Restock Kroger*.

As we embark on our first full year of implementing *Restock Kroger*, we are committed to continuing this great momentum. We will only accelerate our efforts …

- to Redefine the Grocery Customer Experience through investments in digital, technology, pricing and convenience;
- to Expand Partnerships to Create Customer Value by forming meaningful alliances with partners who share our commitment to putting the customer first;
- to Develop Talent by investing in associate wages and education; and
- to Live Our Purpose through our Purpose & Promise and Zero Hunger **|** Zero Waste commitments.

We are focused on these key drivers of *Restock Kroger* because we know that when we execute them well, we will Create Shareholder Value.

We are encouraged at the start of 2018 and confident in our ability to deliver on both our plan for the year and our long-term our vision to serve America through food inspiration and uplift.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

We are incredibly excited about the future of Kroger, especially *Restock Kroger*.

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

It's fitting that today is International Women's Day. Kroger is proud to join organizations around the world to support and celebrate the social, economic, cultural and political achievements of women.

This day is a great opportunity to **Live Our Purpose** and demonstrate our values of diversity and inclusion by uplifting the women in our workplace. At our headquarters building in Cincinnati we are joining with several other downtown companies in lighting up our building with the female symbol to celebrate women in business. I'd also encourage you to check out a video we are sharing online that highlights several women executives. We are proud to be a 'workplace that works for women' and to support their career aspirations and goals. This is what it really means to live our purpose: to Feed the Human Spirit.

With St. Patrick's Day and a pretty big basketball tournament around the corner, March is always a fun, celebratory time of the year. I encourage you to take advantage of the opportunity we have to uplift every way and help our customers have great celebrations…great parties…and a great experience in our stores and through our digital experiences.

Thank you for all you do each and every day!

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 "estimated," "expect," "intend," "committed," "commitment," "objective," "plans," "will," "guidance," "continue," "believe," "belief," "anticipated," "plan," "target," "range," "grow," "strategy," "confident," "could," "may," 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; the successful integration of Harris Teeter and Roundy's; and the successful completion of the sale of our convenience stores business unit. 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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