
Section 1: 8-K (8-K)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report: **March 2, 2017**
(Date of earliest event reported)

THE KROGER CO.

(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction
of incorporation)

No. 1-303
(Commission File Number)

31-0345740
(IRS Employer
Identification No.)

1014 Vine Street
Cincinnati, OH 45202
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(513) 762-4000**

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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Item 2.02 Results of Operations and Financial Condition.

On March 2, 2017, The Kroger Co. issued a press release announcing its fourth quarter and full year 2017 results. Attached hereto as Exhibit 99.1, and filed herewith, is a copy of that release.

Item 7.01 Regulation FD Disclosure.

Fiscal 2017 Annual Guidance

Identical supermarket sales (excluding fuel sales)

Flat to 1.0% growth

Net earnings per diluted share

For 2017, we expect net earnings to range from \$2.21 to \$2.25 per diluted share, including an estimated \$0.09 for the 53rd week. We expect the first quarter to be in the \$0.55 to \$0.59 range, the second quarter to be up slightly compared to last year, the third quarter to be up strongly compared to last year, and the fourth quarter to be up high single-digits

compared to last year, without the benefit of the 53rd week.

Non-fuel FIFO operating margin

We expect full-year FIFO operating margin in 2017, excluding fuel, to decline approximately 10 basis points compared to 2016 results.

Capital investments

We expect capital investments, excluding mergers, acquisitions and purchases of leased facilities, to be \$3.2 to \$3.5 billion. These capital investments include approximately 55 major projects covering new stores, expansions and relocations; 175 major remodels; and other investments including digital, technology, minor remodels, and upgrades to logistics, merchandising systems and infrastructure to support our Customer 1st business strategy.

Supermarket square footage growth

Approximately 1.8% before mergers, acquisitions and operational closings.

Expected tax rate

We expect the 2017 tax rate to be approximately 35%, excluding the resolution of certain tax items.

Product Cost Inflation/LIFO

We anticipate product cost, without fuel, to be inflationary in 2017 and a LIFO charge of approximately \$25 million.

Pension Contributions/Expenses

Company-sponsored pension plans

We expect 2017 expense to be approximately \$110 million. We are not required to make a cash contribution in 2017.

Multi-employer plans

In 2017, we expect to contribute approximately \$360 million to multi-employer pension funds. Of this amount, \$35 million has been accrued for as of year-end. This excludes any additional multi-employer restructuring that could occur.

Labor

We are currently negotiating agreements with UFCW for store associates in Atlanta and Michigan. In 2017, we will also negotiate agreements with UFCW for store associates in Dallas and Food 4 Less Warehouse Stores. Negotiations this year will be challenging as we must have competitive cost structures in each market while meeting our associates' needs for solid wages and good quality, affordable health care and retirement benefits.

Also, continued long-term financial viability of our current Taft-Hartley pension plan participation is important to address.

Long-Term Guidance

Our long-term net earnings per diluted share growth rate guidance is 8-11%, plus a dividend that we expect to increase over time.

Forward Looking Statements

This Current Report contains certain statements that constitute "forward-looking statements" about the future performance of The Kroger Co. 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 such as "guidance," "expect," "estimate," "anticipate," "will," "could," and "continue." 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.
- 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.

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Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|-----------------------------------|
| 99.1 | Press Release dated March 2, 2017 |

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

THE KROGER CO.

March 2, 2017

By: /s/ Christine S. Wheatley
Christine S. Wheatley
Group Vice President, Secretary and General Counsel

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EXHIBIT INDEX

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|-----------------------------------|
| 99.1 | Press Release dated March 2, 2017 |

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Section 2: EX-99.1 (EX-99.1)

Exhibit 99.1



Q4 EPS of \$0.53 and Full Year 2016 EPS of \$2.05 (Adjusted EPS of \$2.12)

Q4 ID Sales Without Fuel -0.7% and 2016 ID Sales Without Fuel 1.0%

2017 Net Earnings Per Diluted Share Growth Guidance

of \$2.21 to \$2.25, Including a 53rd Week

Fiscal 2016 Highlights

- **12th consecutive year of market share gains**
- **Added more than 420 *ClickList* locations for 640 online ordering service locations**
- **Record high unit share for Corporate Brands**
- **Created 12,000 new supermarket jobs in 2016**

CINCINNATI, March 2, 2017 — The Kroger Co. (NYSE: KR) today reported net earnings of \$0.53 per diluted share and identical supermarket sales, without fuel, of -0.7% in the fourth quarter of 2016, which ended on January 28, 2017.

Fiscal 2016 net earnings were \$2.05 per diluted share and identical supermarket sales growth, without fuel, was 1.0%. The company's fiscal year net earnings per diluted share included charges related to the restructuring of certain multi-employer pension obligations to help stabilize associates' future benefits. Excluding the effect of these charges, Kroger's fiscal year adjusted net earnings per diluted share were \$2.12.

Comments from Chairman and CEO Rodney McMullen

"True to our history, we will continue making proactive investments in our Customer 1st Strategy to maintain our strong competitive position. We are lowering costs to invest those savings in our people, our business, and technology. This approach will enable us to deliver on our long-term net earnings per diluted share growth rate target of 8 – 11%, plus an increasing dividend, as it has in the past.

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"In 2016, Kroger grew market share, increased tonnage, and hired more than 12,000 new store associates. For 2017 and beyond, we will continue delivering for our customers while also setting the company up for our next phase of growth and customer-first innovation."

Details of Fourth Quarter 2016 Results

Net earnings for the fourth quarter totaled \$506 million, or \$0.53 per diluted share. Net earnings in the same period last year were \$559 million, or \$0.57 per diluted share.

Total sales increased 5.5% to \$27.6 billion in the fourth quarter compared to \$26.2 billion for the same period last year. Total sales, excluding fuel, increased 4.4% in the fourth quarter over the same period last year. Recent mergers with Roundy's and ModernHEALTH contributed to this growth.

Gross margin was 22.2% of sales for the fourth quarter. Excluding fuel, recent mergers and the LIFO charge, gross margin decreased 22 basis points from the same period last year.

Kroger recorded a LIFO charge of \$0.2 million in the fourth quarter, compared to a \$30 million LIFO credit in the same quarter last year.

Operating, General & Administrative costs as a rate of sales — excluding fuel, recent mergers, and a \$30 million contribution to the UFCW Consolidated Pension Plan in the fourth quarter of 2015 — declined by 11 basis points; rent and depreciation with the same exclusions increased by 24 basis points.

Fiscal 2016 Results

Net earnings for 2016 totaled \$1.98 billion, or \$2.05 per diluted share. Excluding the restructuring of certain multi-employer pension obligations, adjusted net earnings totaled \$2.05 billion, or \$2.12 per diluted share. Net earnings in 2015 were \$2.04 billion, or \$2.06 per diluted share.

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Total sales increased 5.0% to \$115.3 billion in 2016 compared to \$109.8 billion in 2015. Excluding fuel, total sales increased 6.7% in 2016 compared to 2015. The company's mergers with Roundy's and ModernHEALTH contributed to this growth.

Gross margin was 22.4% of sales in 2016. Excluding fuel, recent mergers and the LIFO charge, gross margin decreased 7 basis points compared to 2015.

Kroger's LIFO charge for 2016 was \$19 million, compared to a \$28 million LIFO charge in 2015.

Operating, General & Administrative costs as a percent of sales — excluding fuel, recent mergers, the 2016 restructuring of certain multi-employer pension obligations, and the 2015 contributions to the UFCW Consolidated Pension Plan — declined 5 basis points; rent and depreciation with the same exclusions increased by 12 basis points in 2016.

FIFO operating margin for 2016 decreased 14 basis points compared to the prior year, with the following exclusions: fuel, recent mergers, the 2016 restructuring of certain multi-employer pension obligations and the 2015 contributions to the UFCW Consolidated Pension Plan.

Financial Strategy

Kroger's long-term financial strategy is to use its financial flexibility to drive growth while also returning capital to shareholders.

The company's net total debt to adjusted EBITDA ratio increased to 2.31, compared to 2.08 during the same period last year (see Table 5). This result is due to the merger with ModernHEALTH and changes in working capital.

In 2016, Kroger used cash to:

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- Repurchase \$1.8 billion in common shares,
- Pay \$429 million in dividends,
- Invest \$3.6 billion in capital, and
- Merge with ModernHEALTH for approximately \$390 million.

Capital investments, excluding mergers, acquisitions and purchases of leased facilities, totaled \$3.6 billion for the year, compared to \$3.3 billion in 2015.

Return on invested capital for 2016 was 13.09%. This result was affected by current year results and recently-merged companies.

2017 Guidance

Kroger anticipates identical supermarket sales, excluding fuel, to range from flat to 1% growth for 2017.

The company expects net earnings to range from \$2.21 to \$2.25 per diluted share, including an estimated \$.09 for the 53rd week.

Kroger expects the operating environment in the first half of 2017 to be similar to the second half of 2016. The company's results in the second half of 2017 are expected to show improvement as the company cycles the previous year.

The company expects 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.

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Every day, the Kroger Family of Companies makes a difference in the lives of eight and a half million customers and 443,000 associates who shop or serve in 2,796 retail food stores under a variety of local banner names in 35 states and the District of Columbia. Kroger and its subsidiaries operate an expanding ClickList offering — a personalized, order online, pick up at the store service — in addition to our 2,255 pharmacies, 784 convenience stores, 319 fine jewelry stores, 1,445 supermarket fuel centers and 38 food production plants in the United States. Kroger is recognized as one of America's most generous companies for its support of more than 100 Feeding America food bank partners, breast cancer research and awareness, the military and their families, and more than 145,000 community organizations including schools. A leader in supplier diversity, Kroger is a proud member of the *Billion Dollar Roundtable*.

Note: Fuel sales have historically had a low gross margin rate and operating expense rate as compared to corresponding rates on non-fuel sales. As a result Kroger discusses the changes in these rates excluding the effect of fuel.

Note: Kroger discusses the changes in operating results, as a percentage of sales, excluding recent mergers due to them affecting comparability to last year.

Please refer to the supplemental information presented in the tables for reconciliations of the non-GAAP financial measures used in this press release to the most comparable GAAP financial measure and related disclosure.

This press release contains certain statements that constitute “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. These statements are indicated by words such as “expect,” “anticipate,” “guidance,” “committed,” “goal,” “target,” “will,” and “continue.” 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 Kroger’s annual report on Form 10-K for the last fiscal year and any subsequent filings, as well as the following:

- Kroger’s 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 Kroger; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition;

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Kroger’s 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 Kroger’s logistics operations; trends in consumer spending; the extent to which Kroger’s 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; Kroger’s ability to retain pharmacy sales from third party payors; consolidation in the healthcare industry, including pharmacy benefit managers; Kroger’s 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 Kroger’s future growth plans; and the successful integration of Harris Teeter and Roundy’s. Kroger’s ability to achieve sales and earnings goals may also be affected by Kroger’s ability to manage the factors identified above. Kroger’s ability to execute its financial strategy may be affected by its ability to generate cash flow.

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.

Note: Kroger’s quarterly conference call with investors will be broadcast live online at 10 a.m. (ET) on March 2, 2017 at ir.kroger.com. An on-demand replay of the webcast will be available at approximately 1 p.m. (ET) on Thursday, March 2, 2017.

4th Quarter and Fiscal Year 2016 Tables Include:

1. Consolidated Statements of Operations
2. Consolidated Balance Sheets
3. Consolidated Statements of Cash Flows
4. Supplemental Sales Information
5. Reconciliation of Net Total Debt and Net Earnings Attributable to The Kroger Co. to Adjusted EBITDA
6. Net Earnings Per Diluted Share Excluding the Adjustment Items
7. Return on Invested Capital

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Contacts: Media: Keith Dailey (513) 762-1304; Investors: Kate Ward (513) 762-4969

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Table 1.
THE KROGER CO.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share amounts)
(unaudited)

| | FOURTH QUARTER | | | | YEAR-TO-DATE | | | |
|---|----------------|--------|-----------|--------|--------------|--------|------------|--------|
| | 2016 | | 2015 | | 2016 | | 2015 | |
| SALES | \$ 27,611 | 100.0% | \$ 26,165 | 100.0% | \$ 115,337 | 100.0% | \$ 109,830 | 100.0% |
| MERCHANDISE COSTS, INCLUDING ADVERTISING, WAREHOUSING AND TRANSPORTATION (a), AND LIFO CHARGE (b) | 21,483 | 77.8 | 20,193 | 77.2 | 89,502 | 77.6 | 85,496 | 77.8 |
| OPERATING, GENERAL AND ADMINISTRATIVE (a) | 4,483 | 16.2 | 4,355 | 16.6 | 19,178 | 16.6 | 17,946 | 16.3 |
| RENT | 215 | 0.8 | 181 | 0.7 | 881 | 0.8 | 723 | 0.7 |
| DEPRECIATION AND AMORTIZATION | 572 | 2.1 | 508 | 1.9 | 2,340 | 2.0 | 2,089 | 1.9 |

| | | | | | | | | |
|--|----------|------|----------|------|----------|------|----------|------|
| OPERATING PROFIT | 858 | 3.1 | 928 | 3.6 | 3,436 | 3.0 | 3,576 | 3.3 |
| INTEREST EXPENSE | 126 | 0.5 | 113 | 0.4 | 522 | 0.5 | 482 | 0.4 |
| NET EARNINGS BEFORE INCOME TAX EXPENSE | 732 | 2.7 | 815 | 3.1 | 2,914 | 2.5 | 3,094 | 2.8 |
| INCOME TAX EXPENSE | 230 | 0.8 | 250 | 1.0 | 957 | 0.8 | 1,045 | 1.0 |
| NET EARNINGS INCLUDING NONCONTROLLING INTERESTS | 502 | 1.8 | 565 | 2.2 | 1,957 | 1.7 | 2,049 | 1.9 |
| NET (LOSS) EARNINGS ATTRIBUTABLE TO NONCONTROLLING INTERESTS | (4) | — | 6 | — | (18) | — | 10 | — |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. | \$ 506 | 1.8% | \$ 559 | 2.1% | \$ 1,975 | 1.7% | \$ 2,039 | 1.9% |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. PER BASIC COMMON SHARE | \$ 0.54 | | \$ 0.57 | | \$ 2.08 | | \$ 2.09 | |
| AVERAGE NUMBER OF COMMON SHARES USED IN BASIC CALCULATION | 929 | | 966 | | 942 | | 966 | |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. PER DILUTED COMMON SHARE | \$ 0.53 | | \$ 0.57 | | \$ 2.05 | | \$ 2.06 | |
| AVERAGE NUMBER OF COMMON SHARES USED IN DILUTED CALCULATION | 943 | | 980 | | 958 | | 980 | |
| DIVIDENDS DECLARED PER COMMON SHARE | \$ 0.120 | | \$ 0.105 | | \$ 0.465 | | \$ 0.408 | |

Note: Certain percentages may not sum due to rounding.

Note: The Company defines First-In First-Out (FIFO) gross profit as sales minus merchandise costs, including advertising, warehousing and transportation, but excluding the Last-In First-Out (LIFO) charge.

The Company defines FIFO gross margin, as described in the earnings release, as FIFO gross profit divided by sales.

The Company defines FIFO operating profit as operating profit excluding the LIFO charge.

The Company defines FIFO operating margin, as described in the earnings release, as FIFO operating profit divided by sales.

The above FIFO financial metrics are important measures used by management to evaluate operational effectiveness. Management believes these FIFO financial metrics are useful to investors and analysts because they measure our day-to-day operational effectiveness.

- (a) Merchandise costs and operating, general and administrative expenses exclude depreciation and amortization expense and rent expense which are included in separate expense lines.
- (b) A LIFO charge of \$0.2 and a credit of \$30 were recorded in the fourth quarter of 2016 and 2015, respectively. For the year to date period, LIFO charges of \$19 and \$28 were recorded for 2016 and 2015, respectively.

Table 2.
THE KROGER CO.
CONSOLIDATED BALANCE SHEETS
(in millions)
(unaudited)

| | January 28, 2017 | January 30, 2016 |
|----------------------------------|---------------------|---------------------|
| ASSETS | | |
| Current Assets | | |
| Cash | \$ 310 | \$ 277 |
| Temporary cash investments | 12 | — |
| Store deposits in-transit | 910 | 923 |
| Receivables | 1,649 | 1,734 |
| Inventories | 6,561 | 6,168 |
| Prepaid and other current assets | 898 | 790 |

| | | |
|--|------------------|------------------|
| Total current assets | 10,340 | 9,892 |
| Property, plant and equipment, net | 21,016 | 19,619 |
| Intangibles, net | 1,153 | 1,053 |
| Goodwill | 3,031 | 2,724 |
| Other assets | 965 | 609 |
| Total Assets | \$ 36,505 | \$ 33,897 |
| LIABILITIES AND SHAREOWNERS' EQUITY | | |
| Current Liabilities | | |
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 2,252 | \$ 2,370 |
| Trade accounts payable | 5,818 | 5,728 |
| Accrued salaries and wages | 1,234 | 1,426 |
| Deferred income taxes | 251 | 221 |
| Other current liabilities | 3,305 | 3,226 |
| Total current liabilities | 12,860 | 12,971 |
| Long-term debt including obligations under capital leases and financing obligations | 11,825 | 9,709 |
| Deferred income taxes | 1,927 | 1,752 |
| Pension and postretirement benefit obligations | 1,524 | 1,380 |
| Other long-term liabilities | 1,659 | 1,287 |
| Total Liabilities | 29,795 | 27,099 |
| Shareowners' equity | 6,710 | 6,798 |
| Total Liabilities and Shareowners' Equity | \$ 36,505 | \$ 33,897 |
| Total common shares outstanding at end of period | 924 | 967 |
| Total diluted shares year-to-date | 958 | 980 |

Table 3.
THE KROGER CO.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

| | YEAR-TO-DATE | |
|--|---------------------|--------------|
| | 2016 | 2015 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings including noncontrolling interests | \$ 1,957 | \$ 2,049 |
| Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,340 | 2,089 |
| LIFO charge | 19 | 28 |
| Stock-based employee compensation | 141 | 165 |
| Expense for Company-sponsored pension plans | 94 | 103 |
| Deferred income taxes | 201 | 317 |
| Other | (2) | 100 |
| Changes in operating assets and liabilities, net of effects from mergers of businesses: | | |
| Store deposits in-transit | 13 | 95 |
| Receivables | (110) | (59) |
| Inventories | (382) | (184) |
| Prepaid and other current assets | (172) | (28) |
| Trade accounts payable | 16 | 440 |
| Accrued expenses | (118) | 275 |
| Income taxes receivable and payable | 261 | (359) |
| Other | 14 | (114) |
| Net cash provided by operating activities | 4,272 | 4,917 |

CASH FLOWS FROM INVESTING ACTIVITIES:

| | | |
|---|-------------------|-------------------|
| Payments for property and equipment, including payments for lease buyouts | (3,699) | (3,349) |
| Proceeds from sale of assets | 132 | 45 |
| Payments for mergers | (401) | (168) |
| Other | 93 | (98) |
| | <u> </u> | <u> </u> |
| Net cash used by investing activities | (3,875) | (3,570) |

CASH FLOWS FROM FINANCING ACTIVITIES:

| | | |
|---|-------------------|-------------------|
| Proceeds from issuance of long-term debt | 2,781 | 1,181 |
| Payments on long-term debt | (1,355) | (1,245) |
| Net proceeds (borrowings) on commercial paper | 435 | (285) |
| Dividends paid | (429) | (385) |
| Excess tax benefits on stock-based awards | — | 97 |
| Proceeds from issuance of capital stock | 68 | 120 |
| Treasury stock purchases | (1,766) | (703) |
| Investment in the remaining equity of a noncontrolling interest | — | (26) |
| Other | (86) | (92) |
| | <u> </u> | <u> </u> |
| Net cash used by financing activities | (352) | (1,338) |

NET INCREASE IN CASH AND TEMPORARY

| | | |
|------------------|----|---|
| CASH INVESTMENTS | 45 | 9 |
|------------------|----|---|

CASH AND TEMPORARY CASH INVESTMENTS:

| | | |
|-------------------|---------------|---------------|
| BEGINNING OF YEAR | 277 | 268 |
| END OF YEAR | <u>\$ 322</u> | <u>\$ 277</u> |

Reconciliation of capital investments:

| | | |
|---|-------------------|-------------------|
| Payments for property and equipment, including payments for lease buyouts | \$ (3,699) | \$ (3,349) |
| Payments for lease buyouts | 5 | 35 |
| Changes in construction-in-progress payables | 72 | (35) |
| Total capital investments, excluding lease buyouts | <u>\$ (3,622)</u> | <u>\$ (3,349)</u> |

Disclosure of cash flow information:

| | | |
|--|--------|----------|
| Cash paid during the year for interest | \$ 505 | \$ 474 |
| Cash paid during the year for income taxes | \$ 557 | \$ 1,001 |

Note: Certain prior-year amounts have been reclassified to conform to current-year presentation.

Table 4. Supplemental Sales Information
(in millions, except percentages)
(unaudited)

Items identified below should not be considered as alternatives to sales or any other GAAP measure of performance. Identical supermarket sales is an industry-specific measure and it is important to review it in conjunction with Kroger's financial results reported in accordance with GAAP. Other companies in our industry may calculate identical supermarket sales differently than Kroger does, limiting the comparability of the measure. These results include Roundy's sales for stores that are identical as if they were part of Kroger in the prior year.

IDENTICAL SUPERMARKET SALES (a)

| | FOURTH QUARTER | | YEAR-TO-DATE | |
|------------------------|----------------|-----------|--------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| INCLUDING FUEL CENTERS | \$ 24,453 | \$ 24,318 | \$ 103,180 | \$ 103,106 |
| EXCLUDING FUEL CENTERS | \$ 21,981 | \$ 22,135 | \$ 92,451 | \$ 91,568 |
| INCLUDING FUEL CENTERS | 0.6% | 1.7% | 0.1% | 1.1% |
| EXCLUDING FUEL CENTERS | -0.7% | 3.7% | 1.0% | 5.0% |

(a) Kroger defines a supermarket as identical when it has been open without expansion or relocation for five full quarters.

Table 5. Reconciliation of Net Total Debt and

Net Earnings Attributable to The Kroger Co. to Adjusted EBITDA
(in millions, except for ratio)
(unaudited)

The items identified below should not be considered an alternative to any GAAP measure of performance or access to liquidity. Net total debt to adjusted EBITDA is an important measure used by management to evaluate the Company's access to liquidity. The items below should be reviewed in conjunction with Kroger's financial results reported in accordance with GAAP.

The following table provides a reconciliation of net total debt.

| | <u>January 28, 2017</u> | <u>January 30, 2016</u> | <u>Change</u> |
|--|-----------------------------|-----------------------------|-----------------|
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 2,252 | \$ 2,370 | \$ (118) |
| Long-term debt including obligations under capital leases and financing obligations | <u>11,825</u> | <u>9,709</u> | <u>2,116</u> |
| Total debt | 14,077 | 12,079 | 1,998 |
| Less: Temporary cash investments | 12 | — | 12 |
| Less: Prepaid benefit payments | <u>385</u> | <u>275</u> | <u>110</u> |
| Net total debt | <u>\$ 13,680</u> | <u>\$ 11,804</u> | <u>\$ 1,876</u> |

The following table provides a reconciliation from net earnings attributable to The Kroger Co. to adjusted EBITDA, as defined in the Company's credit agreement.

| | <u>YEAR-TO-DATE</u> | |
|---|-----------------------------|-----------------------------|
| | <u>January 28, 2017</u> | <u>January 30, 2016</u> |
| Net earnings attributable to The Kroger Co. | \$ 1,975 | \$ 2,039 |
| LIFO charge | 19 | 28 |
| Depreciation and amortization | 2,340 | 2,089 |
| Interest expense | 522 | 482 |
| Income tax expense | 957 | 1,045 |
| Adjustments for pension plan agreements | 111 | — |
| Other | <u>(12)</u> | <u>(5)</u> |
| Adjusted EBITDA | <u>\$ 5,912</u> | <u>\$ 5,678</u> |
| Net total debt to adjusted EBITDA ratio | <u>2.31</u> | <u>2.08</u> |

Table 6. Net Earnings Per Diluted Share Excluding the Adjustment Items
(in millions, except per share amounts)
(unaudited)

The purpose of this table is to better illustrate comparable operating results from our ongoing business, after removing the effects on net earnings per diluted common share for certain items described below. Items identified in this table should not be considered alternatives to net earnings attributable to The Kroger Co. or any other GAAP measure of performance. These items should not be reviewed in isolation or considered substitutes for the Company's financial results as reported in accordance with GAAP. Due to the nature of these items, as further described below, it is important to identify these items and to review them in conjunction with the Company's financial results reported in accordance with GAAP.

The following table summarizes items that affected the Company's financial results during the periods presented. In 2016, these items included charges related to the restructuring of certain pension obligations. In 2015, The Kroger Co. did not have any adjustment items.

| | <u>FOURTH QUARTER</u> | | <u>YEAR-TO-DATE</u> | |
|--|-----------------------|---------------|---------------------|-----------------|
| | <u>2016</u> | <u>2015</u> | <u>2016</u> | <u>2015</u> |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. | \$ 506 | \$ 559 | \$ 1,975 | \$ 2,039 |
| ADJUSTMENTS FOR PENSION PLAN AGREEMENTS (a)(b) | <u>—</u> | <u>—</u> | <u>71</u> | <u>—</u> |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. EXCLUDING THE ADJUSTMENT ITEMS ABOVE | <u>\$ 506</u> | <u>\$ 559</u> | <u>\$ 2,046</u> | <u>\$ 2,039</u> |

| | | | | |
|---|---------|---------|---------|---------|
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. PER DILUTED COMMON SHARE | \$ 0.53 | \$ 0.57 | \$ 2.05 | \$ 2.06 |
| ADJUSTMENTS FOR PENSION PLAN AGREEMENTS (c) | — | — | 0.07 | — |
| NET EARNINGS ATTRIBUTABLE TO THE KROGER CO. PER DILUTED COMMON SHARE EXCLUDING THE ADJUSTMENT ITEMS ABOVE | \$ 0.53 | \$ 0.57 | \$ 2.12 | \$ 2.06 |
| AVERAGE NUMBER OF COMMON SHARES USED IN DILUTED CALCULATION | 943 | 980 | 958 | 980 |

- (a) The amounts presented represent the after-tax effect of each adjustment.
- (b) The pre-tax adjustments for the pension plan agreements were \$111.
- (c) The amounts presented represent the net earnings per diluted common share effect of each adjustment.

Table 7. Return on Invested Capital
(in millions, except percentages)
(unaudited)

Return on invested capital should not be considered an alternative to any GAAP measure of performance. Return on invested capital is an important measure used by management to evaluate our investment returns on capital and our effectiveness in deploying our assets. Return on invested capital should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. Other companies may calculate return on invested capital differently than Kroger, limiting the comparability of the measure.

The following table provides a calculation of return on invested capital for 2016 and 2015. The January 30, 2016 calculation of return on invested capital excludes the financial position and results for the Roundy's transaction.

| | YEAR-TO-DATE | |
|---|---------------------|---------------------|
| | January 28, 2017 | January 30, 2016 |
| Return on Invested Capital | | |
| Numerator (a) | | |
| Operating profit | \$ 3,436 | \$ 3,576 |
| LIFO charge | 19 | 28 |
| Depreciation and amortization | 2,340 | 2,089 |
| Rent | 881 | 723 |
| Adjustments for pension plan agreements | 111 | — |
| Other | — | (13) |
| Adjusted operating profit | \$ 6,787 | \$ 6,403 |
| Denominator (b) | | |
| Average total assets | \$ 35,201 | \$ 32,197 |
| Average taxes receivable (c) | (262) | (206) |
| Average LIFO reserve (d) | 1,283 | 1,259 |
| Average accumulated depreciation and amortization | 18,940 | 17,441 |
| Average trade accounts payable | (5,773) | (5,390) |
| Average accrued salaries and wages | (1,330) | (1,359) |
| Average other current liabilities (e) | (3,265) | (3,054) |
| Adjustment for Roundy's transaction (f) | — | (714) |
| Rent * 8 (g) | 7,048 | 5,784 |
| Average invested capital | \$ 51,842 | \$ 45,958 |
| Return on Invested Capital | 13.09% | 13.93% |

- (a) Represents year-to-date results for the periods noted.
- (b) Represents the average of amounts at the beginning and end of year.
- (c) Taxes receivable is recorded in the Consolidated Balance Sheet in receivables.
- (d) LIFO reserve is recorded in the Consolidated Balance Sheet in inventories.

- (e) The calculation of average other current liabilities excludes accrued income taxes.
 - (f) Adjustment to remove the assets and liabilities recorded at year end 2015 for the Roundy's transaction.
 - (g) The factor of eight estimates the hypothetical capitalization of our operating leases.
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