Third Quarter 2017
Investor Conference Call Prepared Remarks
November 30, 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 third quarter press release and our prepared remarks from this conference call will be available on our website at ir.kroger.com. While there, we encourage you to visit the Events & Presentations page to find the full slide-set outlining *Restock Kroger* as laid out at our Annual Investor Day on October 11th. *Restock Kroger* will be the framework we will be using over the next few years to clearly communicate how we plan to serve America through food inspiration and uplift and – as a result – create shareholder value.

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

Restock Kroger

I'd like to thank you for joining us at our 2017 Investor Conference in New York in October, where we outlined *Restock Kroger*, our plan to create shareholder value by redefining how America eats.

Food retailing is more exciting than ever. More Americans identify as foodies, and customers have more food choices than ever before. In the past we've defined our market as "share among traditional grocery stores." Today we've redefined our market as "share of stomach." This sharpens our focus when we look at our industry and our customers. We see anyone who sells food as competitors, which doubles the size of our market to $1.5 trillion. If you are eating, we want to serve you that meal. The fact that Kroger is trusted by more than 60 million households is an incredible competitive advantage.

Kroger has competed in an ever-changing retail landscape for 134 years because our touchstone has always been the customer. We place our customers at the center of everything we do. And because of our relentless focus on serving customers, Kroger is uniquely positioned to be the partner they turn to for meals.

Restock Kroger has four main drivers: **Redefine the Grocery Customer Experience, Expand Partnerships to Create Customer Value, Develop Talent,** and **Live Our Purpose.** These pillars, combined, will **Create Shareholder Value**.

Going forward, I plan to highlight an item or two each quarter that we've made headway on.

Shopping Seamlessly

This quarter, I'd like to begin by talking about how we're creating a seamless environment where our customers can choose how to engage with us in-store and online. Our efforts are all about making things easier for our customers and providing personalized, affordable and exclusive options that fit their needs. Seamless will play a major role in redefining the grocery customer experience.

Our hypothesis has always been that our customers want to have options for how they engage with us. This hypothesis shaped our strategy and we've been executing that strategy by accelerating Kroger's digital and ecommerce efforts for the last several years.

We know that our customers have already decided they love ClickList, which is why we continue to rapidly expand that offering. By year's end we'll be serving customers at more than 1,000 click-and-collect locations. Our third quarter digital revenue growth of 109% was driven by ClickList.

We also know that some customers desire home delivery. We've gone from zero to more than 300 locations offering home delivery in the span of a little over a year by partnering with service providers including Shipt, Roadie, Uber, and others. We'll continue to build up our home delivery offering in 2018 with these partners as well as Instacart – who we are developing a unique relationship with – and have initially launched a partnership with in Southern California. We'll continue to use our data and customer insights to make it really easy for our customers to navigate across the channels they choose when shopping with us, and we'll continue leveraging our physical proximity to customers as a competitive differentiator.

To do all this requires the investment we outlined in *Restock Kroger*.

Everything we're seeing in our data and in customer behavior tells us Kroger's transition to seamless is working. Today, households that engage in our seamless offerings – engaging digitally and with our physical stores – spend more per week than households that do not.

The future looks even more promising. We'll continue to add even more services, expand our available product selection, and more effectively use our insights to create a personalized experience that every customer will love.

Black Friday

Winning in a seamless world also means optimizing space and ensuring our brick and mortar experience is curated to deliver exactly what customers are looking for. We firmly believe that customers of the future will continue to frequent physical stores with compelling offers. A very recent example of this is that Kroger had our best ever Black Friday results for general merchandise, led by record sales at our Fred Meyer division.

Our Brands

Another focus area under redefining the grocery customer experience is winning with *Our Brands*. It's no surprise that America's most beloved grocery store has some of America's most beloved brands, which as a portfolio we will continue to champion for growth. In fact, *Our Brands* as a stand-alone company would be in the top third of the Fortune 500. In the third quarter, *Our Brands* continued to deliver strong performance, making up 28.2% of unit sales and 25.6% of sales dollars, excluding fuel and pharmacy. *Simple Truth* continues to resonate in a big way with our customers, with sales growing 19% in the third quarter.

Reducing Cost of Goods

Another important *Restock Kroger* area of focus is accelerating cost of goods savings and sales leverage.

We will continue to work on controlling costs to invest in the areas that matter most to customers. For example, we are leveraging our relationships with suppliers to drive cost and inefficiencies out of our various businesses. These processes have successfully driven significant savings in cost of goods, which allow us to invest in price for our customers. At the same time, this helps our suppliers generate volume growth. Our use of data and science create opportunities and efficiency that both parties benefit from.

Creating Shareholder Value

Across the board, customers are recognizing our efforts to redefine the customer experience and they are rewarding us with their loyalty. This, in turn, creates value for our shareholders. And that is exactly what *Restock Kroger* is designed to do.

We will **Create Shareholder Value** by generating incremental operating margin dollars and free cash flow over the next three years.

As our business continues to improve, we remain committed to delivering on our 2017 earnings guidance. We are also confident we have the ability to grow identical supermarket sales and market share in 2018.

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

Comments by Mike Schlotman:

Thanks, Rodney. Good morning everyone.

Our core business was strong in third quarter. We are very pleased with our ID sales exceeding 1% in the third quarter. We were especially happy to see the very strong performance in our fresh departments. The results in Produce and Meat were terrific, and we continue to see double digit growth in Natural Foods.

Our ID sales results were driven by both a higher spend per unit and strong growth in the number of households. Total visits continued to grow throughout the quarter. And our market share was up. Our business is gaining momentum and customers are recognizing the investments we are making.

Investing for the Future

We noted at our investor conference that over the next three years, *Restock Kroger* will be fueled by $9 billion in capital investments, cost savings, and free cash flow. We recognize that in order to be there for our customers today and – more importantly – to be where they are going in the future, we need to make investments more aggressively and faster than ever before.

Capital Investments

We've already reprioritized the way we invest capital by both reducing the amount we spend and optimizing our capital allocation process. 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.

Cost Savings

As Rodney said earlier, we are aggressively managing OG&A costs and implementing new programs to reduce our cost of goods sold. One example is our recent decision to require on-time and in-full delivery from suppliers. We are implementing penalties when scheduled deliveries are missed within a designated window. Over time, this will help keep costs down by ensuring more predictable operations. More importantly, it will ensure we have the products on our shelves that our customers want, when they want them.

Free Cash Flow

We expect *Restock Kroger* to generate $400 million in incremental operating margin over three years from 2018 to 2020. We also expect to generate more than $4 billion of free cash flow after dividends over the next three years.

Our goal is to continue generating shareholder value even as we make strategic investments to grow our business.

Retail Fuel

Fuel performance was also outstanding in the third quarter. Our cents per gallon fuel margin was approximately 24.9¢ compared to 17.9¢ in the same quarter last year. The average retail price of fuel was $2.46 versus $2.17 in the same quarter last year.

This, along with our strong core business results, demonstrates the diversity of our earnings.

The fuel performance in the quarter also created the opportunity for us to make an incremental $111 million contribution into our UFCW Consolidated Pension Plan. Funding these obligations proactively over time demonstrates our ability to meet our commitment to protect employee pensions while simultaneously delivering value for shareholders.

Convenience Store Update

As you know, we announced last month our intention to explore strategic alternatives for our convenience store business, including a potential sale. This was the result of a review of assets that are potentially of more value outside of the company than as part of Kroger. This process is ongoing and there has been a high level of interest.

As we stressed last month, our convenience store management and associates are an important part of our success. We value what they do and thank them for continuing to put our customers first every day as we conduct this evaluation.

Financial Strategy

Over the last four quarters, we used cash to:

- Contribute an incremental $1.1 billion to company-sponsored pension plans,
- Repurchase 59 million common shares for $1.7 billion,
- Pay $446 million in dividends, and
- Invest $2.9 billion in capital.

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

As of the end of the third quarter, our current share repurchase authorization had approximately $590 million remaining.

Return on invested capital for the third quarter, on a rolling four quarters basis, was 12.31%.

Pension Funding

I'm going to spend a lot more time talking about pension this quarter than I normally would. This is driven by not only what we've done this quarter but also what we've been doing over the past several years.

About a decade ago, we identified a great amount of exposure on pension plans, and recognized then that we would need to begin addressing that exposure like we would any big endeavor – one step at a time.

Our efforts began in earnest in 2011, when we negotiated and created the UFCW Consolidated Pension Plan. The keys for us were capping the prior service costs, negotiating a new benefit accrual going forward, consolidating four plans into one, and ensuring both professional and more efficient management of the assets going forward. We agreed to fund the plan over five years, but elected to fund it in January of 2012. This arrangement reduced Kroger's annual multiemployer pension expense and secured the pension benefits for tens of thousands of Kroger associates.

Including this agreement, we have since made more than $2.3 billion in payments and funding commitments with two objectives in mind:

- One, to address underfunding in company-sponsored pension plans; and
- Two, to address the liabilities of various, troubled multiemployer pension plans.

We've adopted this approach – in a low-interest-rate environment – to provide greater stability for the pension benefits earned by thousands of Kroger associates and retirees and to manage this liability proactively…or, frankly, to avoid kicking the can down the road.

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, we are updating 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 did not get picked up in our net total debt to adjusted EBITDA ratio. Our current result of 2.57 times is above this range. We expect to use free cash flow and potential proceeds from the sale of assets to get us back in the range.

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. Kroger is currently hiring to fill 14,000 part-time and seasonal jobs. This is in addition to the nearly 10,000 permanent new jobs we've already created in 2017.

Through *Restock Kroger*, we plan to invest an incremental $500 million in human capital – 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.

On the labor relations front, we recently ratified an agreement with the UFCW for store associates in Charleston, West Virginia. We are currently negotiating an agreement with the Teamsters for the Master Agreement.

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. 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.

Fourth Quarter and Fiscal 2017 Guidance

Turning now to our guidance for the fourth quarter of 2017 and fiscal 2017.

We expect fuel margins to moderate in the fourth quarter. We are seeing this already quarter-to-date.

We expect fourth quarter identical supermarket sales growth, excluding fuel, to exceed 1.1%.

We confirmed our 2017 net earnings guidance for 53 weeks of $1.74-$1.79 per diluted share. We confirmed our adjusted net earnings guidance range of $2.00 to $2.05 per diluted share. Both our GAAP and adjusted net earnings per diluted share guidance includes the effect of hurricanes.

The low end of this range is $0.04 above industry analyst's consensus forecast, demonstrating Kroger's ability to deliver shareholder value even in a dynamic transition year.

Our LIFO expectation has been lowered to $60 million from $80 million.

We expect capital investments excluding mergers, acquisitions and purchases of leased facilities, to be approximately $3.0 billion for 2017.

Before I turn it back to Rodney, I want to note that we filed an 8-k earlier today in which we reconfirmed our early thoughts on 2018. Rodney…

Comments by Rodney McMullen:

Thanks, Mike.

We are pleased with the third quarter results and the fourth quarter is off to a solid start. Our associates are providing friendly and fresh service to our customers in a seamless way.

In addition to *Restock Kroger*, we outlined our investment thesis at the Investor Day last month. I'd like to share it again today, because we feel really good about our strengths.

As America's grocer, we are growing in a fragmented market. Kroger has more data than any of our competitors, leading 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, Kroger has been named America's most loved grocery store several times. We connect personally with our associates, customers and communities to uplift and improve lives. We have a proven track record of consistently returning capital to shareholders through an increasing dividend and share buyback program.

And – with *Restock Kroger* in place – we are confident in our ability to continue winning with customers, growing our business, and creating shareholder value.

Now, we look forward to your questions.

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Comments by Rodney McMullen:

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

The **Live Our Purpose** pillar of Restock Kroger is what you make possible every day – by uplifting each other, our customers and our communities. Kroger's *Zero Hunger* **|** *Zero Waste* plan is our vision to end hunger in the communities we call home and eliminate waste across the company by 2025.

Last week – the day before Thanksgiving – I had the good fortune to celebrate "Friendsgiving" with our Roundy's team in Wisconsin. I also personally visited two local food pantries plus an innovative "Mobile Market" – a former NASCAR trailer converted into a fresh grocery "store" that goes twice a day to underserved neighborhoods around Milwaukee.

Being with our team and seeing how much we do in just **one** division for so many people in need really took my gratitude to a whole new level. I also happen to know that the Kroger Foundation just donated a brand new truck to the Feeding America Southwest Virginia food bank in our Mid-Atlantic region. It came complete with a big red bow for the holidays!

I was equally impressed to learn that in only 24 hours on Giving Tuesday, our associates and customers helped us donate over 1 million meals through social media. The generosity of our associates and customers never ceases to amaze me.

This is what it really means to Live Our Purpose: to Feed the Human Spirit.

Thank you for all you do each and every day! I wish you and your family a Merry Christmas and Happy Holidays!

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," "expectation," "intention," "committed," "objective," "will," "guidance," "continue," "believe," "feel," "anticipate," "plan," "target," "range," "strategy," "confident," "designed," 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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