11-Sep-2026

The Kroger Co. (KR)

Q2 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to The Kroger Company Second Quarter 2026 Earnings Conference Call. After today's prepared remarks, we will host a question-and-answer session. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference call over to Rob Quast, Vice President, Investor Relations. Please go ahead.

Rob Quast

Vice President-Investor Relations, The Kroger Co.

Good morning. Thank you for joining us for Kroger's second quarter 2026 Earnings Call. I am joined today by Kroger's Chief Executive Officer, Greg Foran; and Chief Financial Officer, David Kennerley.

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. The Kroger Company assumes no obligation to update that information.

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.

I will now turn the call over to Greg.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

Thank you, Rob, and good morning, everyone. This quarter reinforced my view that we are pointed in the right direction. As I reflected on our performance in the quarter, I'm pleased with our eCommerce and retail media results. I'm pleased with the growth of Our Brands, especially in health and wellness and organic.

I'm pleased with the new talent we've recruited to build America's favorite grocer. I'm pleased with the improvement in value we are delivering customers and the cost savings which are funding this. Most importantly, I'm pleased with our continued progress on share.

Turning to our results. Sales were tracking well through the quarter until our final period, when we absorbed the impact of the Cyclospora outbreak, which cost us roughly 35 basis points of total company IDs without fuel, reflecting the impact of produce categories. Our identical sales without fuel grew 0.2% this quarter.

Customers continued to shop in our stores and online, and we saw traffic increase during the quarter. At the same time, the macro environment is challenging. We know that fuel over $4 has an impact on consumer spend. Lower drug prices in pharmacy reduced sales by approximately 140 basis points.

The top line was soft across the industry this quarter. Despite these industry wide challenges, our teams are executing our plan, keep the customer at the center, move with more speed, be great item merchants. We are resolute and committed to executing our plan. We're chasing every dollar we can save, and you can see that in our profit result.

Adjusted earnings per diluted share was $1.09. These results demonstrated the strength and flexibility of our operating model in a challenging sales environment, and I'm pleased with how our teams delivered. Our goal remains simple, we're building America's favorite grocer. Customers want value, quality, convenience, and a shopping experience they can trust. When we deliver those things consistently, we earn bigger baskets and more trips. A lot of the work we need to do is right in front of us. We're making progress on execution across the business, but there's still work to be done and opportunity remains inside our stores, better in-stocks, better merchandising, better standards, better shrink management. These are not new ideas, but customers notice when we execute well. This quarter, on-shelf availability reached an all time high, and our pickup perfect orders were our best ever.

We also have an opportunity to become stronger merchants. Whether it's fresh foods or prepared meals, we can do a better job helping customers answer what's for dinner and creating excitement around great products in our stores. When we've done that, customers have responded. Natural and our prepared meals grew well ahead of total sales.

At the same time, we have to be relentless on cost. Our teams are moving with more speed and urgency, and sourcing and savings came in ahead of planned this quarter. There is more work to do across sourcing, procurement, productivity and simplification. Every dollar we take out is a dollar we can reinvest in areas customers will see. That is how this becomes sustainable for customers and for shareholders. Value continues to matter and it matters more when budgets are tight. Our customer value plan is underway and progressing well.

We have opportunities to strengthen our value position, simplify promotions and make it easier for customers to recognize value in our stores. This is a multiyear effort and we'll have more to share at our investor update in October.

eCommerce is where most of the growth in our industry will come from over the next several years, and we intend to take our share of it. We've built real capability in our stores, give us a strong advantage, but customers have choices, and the bar for convenience and reliability keeps moving higher. Our objective is to grow eCommerce faster and more profitably and deliver an experience customers can count on every time.

And none of this works without great people. And that's why building a strong culture remains one of my highest priorities. Simplicity and focus matter. When the work is simpler, our associates spend more time with customers. This quarter, we welcomed Emilee De Martino as our Chief People Officer. Emilee brings deep experience leading people, teams in large frontline organizations, and she's already shaping our focus on leadership and talent development.

We're also pleased to welcome Nate Faust as Executive Vice President and Chief eCommerce Officer. Nate has spent more than two decades building successful eCommerce businesses, and he brings the mix of merchandising, supply chain and technology experience we need to accelerate our growth.

We're also pleased to welcome Mark Ibbotson as Executive Vice President and Chief Store Operations Officer. Mark brings extensive retail and operational leadership experience, and he will help us raise the level of execution across the enterprise. We know what great looks like in our best divisions. The opportunity now is to deliver that level of performance more consistently across the organization.

The work we have underway is beginning to take hold, and we are seeing early green shoots that the improvements we are making are resonating with customers.

Let me give you some more context on the environment we are operating in. Customers remained under pressure and that has affected the industry broadly. Unit growth has slowed since the start of the year. Reductions in SNAP benefits, higher fuel prices and softer consumer confidence are all putting pressure on household budgets. Customers are buying more on need.

At the same time, we're still seeing them prioritize their health. We continue to see strong engagement in natural and organic, and we're responding by expanding the assortment across the store. During the quarter, we added more than 600 new natural and organic items, giving customers more healthy choices at great value. We're also finding new ways to make health and wellness more accessible and convenient.

In August, we launched a new grocery and prescription delivery offering with Instacart, allowing customers to combine groceries and eligible prescriptions into a single order across nearly all our banners. It's another example of how we're using the strength of our ecosystem to reduce friction and improve service.

Cyclospora also affected results late in the quarter. While the categories impacted were limited, customers responded more broadly across our produce department. Our teams moved quickly, followed established protocols, and worked closely with suppliers and regulators. Food safety is our highest priority and protecting consumer trust matters.

We also remain disciplined, taking unnecessary costs out while delivering greater value to customers. Those priorities go hand in hand and supported strong gross margin performance, despite top line challenges. The formula is simple, savings fund value, value earns a trip, and the trip is what grows this business.

eCommerce had a strong quarter. During the quarter, adjusted eCommerce sales grew 20%, and combined with the continued strength of retail media, we delivered our second consecutive quarter of profitable eCommerce growth. We're also attracting new customers, up 20% versus last year, led by strong engagement during Online Deal Days. We have renewed our focus on in-store fulfillment and fast delivery, and we are seeing encouraging growth in delivery orders in less than an hour.

Demand continues to shift towards faster fulfillment, and we're positioning our network to meet it. Retail media grew 24% during the quarter, our best since 2021, with media monetization up 88 basis points. Stronger collaboration between our merchandising and media teams expanded advertising inventory and optimization efforts improved visibility and conversion for our brand partners. Our Brands remain a real point of difference. With 35 plants, we control the costs and quality in a way most retailers cannot.

Customers are looking for value, but they're not willing to compromise on quality. Our Brands answer both, and the momentum shows it, particularly in Private Selection and Simple Truth. Private Selection sales increased more than 14% during the quarter, driven by strong customer response to new products, including more ready-to-heat and ready-to-eat meals. Products like our Mandarin Orange Chicken and Italian inspired Gnocchi Alla Sorrentina are resonating with customers and reinforced the strength of our premium, convenient meal offerings. Across the portfolio, Our Brands sales grew faster than national brands, and penetration increased approximately 50 basis points.

Looking ahead, we're also expanding Smart Way, our opening price point brand with more items, broader coverage across the store, and improved visibility both in-store and online. Earlier this quarter, we expanded our loyalty program and rebranded Fuel Points as simply Points. Customers can now use Points for savings at the pump or apply them directly to their grocery bill in-store or online. What I like about this approach is that it gives customers more flexibility to decide where the value matters most. More ways to earn, more flexibility in how customers use them. That is what a loyalty program should do.

Let me also briefly touch on our planned acquisition of Giant Eagle. At its core, this is about serving more customers in more communities with the value, quality, and convenience they expect. We have a great deal of respect for the Giant Eagle team and the business they have built. Like Kroger, they have strong local relationships, trusted brands and a long history of serving their customers.

We believe this combination creates a stronger business for customers, associates and the communities we serve. We continue to expect the transaction to close in 2027 and remain focused on working through the regulatory review process.

Stepping back, we see clear opportunities to strengthen our sales momentum and we're going after them, item by item. We controlled what we could control. We managed costs. We strengthened value for customers. We grew our eCommerce business profitably. And we delivered our profit goals in a quarter where the top line made that hard to do. I've always believed periods like this reward the operators who stay disciplined and keep doing right by the customer. That is where our focus is. And it's why I like our position going into the back half of the year.

In October, we will hold our investor update. We will lay out the long-term framework, how we grow sales, in-store and online, how we fund the customer experience through cost savings and what that means for the earnings power of this company. I'm looking forward to it. The work is never done and that suits us, a little better every day, in a lot of places, at once.

I will now turn the call over to David.

David Kennerley

Executive Vice President & Chief Financial Officer, The Kroger Co.

Thank you, Greg, and good morning everyone.

Greg outlined the priorities that are shaping our business, and this quarter's results reflect both the progress we are making and the areas where we see opportunity.

Sales were softer than we planned and we still delivered the profit we committed to. Gross margins, improved, eCommerce profitability improved, we improved value for customers out of savings and we managed margins responsibly.

This quarter, we achieved identical sales growth without fuel of 0.2%. Let me walk through what drove that number, starting with where we grew. Natural foods, meat and seafood and bakery, all delivered strong results in the quarter. Within pharmacy, the core business was healthy. Scripts grew and we saw continued momentum in GLP-1 medications.

We continue to see impacts from the Inflation Reduction Act, which was an approximately 140 basis point headwind to identical sales without fuel, and the ongoing shift from brand to generic prescriptions reduced sales by approximately 60 basis points.

Outside of pharmacy, the impact from Cyclospora, Greg referenced, was a 35-basis-point headwind to company IDs without fuel from produce alone, and the lingering effect of egg deflation was another 30-basis-point headwind. Taken together, these headwinds represented a 265-basis-point drag on identical sales without fuel in the quarter.

In terms of units, grocery units decelerated slightly compared to the first quarter, driven by many of the factors Greg covered earlier. This was partially offset by overall food inflation, which was modestly higher than the first quarter. But what is important is that we continue to perform better than Circana's Rest of Market, a benchmark of traditional grocery competitors.

Against this backdrop, we stayed focused on delivering value for customers, working with suppliers to optimize costs, strengthening our value proposition versus competitors, and managing margins responsibly. Our FIFO gross margin rate excluding rent, depreciation and amortization and fuel, increased 13 basis points versus the second quarter of last year. This improvement was primarily driven by eCommerce profitability and media, pharmacy mix, tariff refunds and sourcing initiatives. These benefits were partially offset by higher shrink, increased transportation costs and investments in customer value. We continue to expect our FIFO gross margin rate to be positive on a full year basis, as cost savings initiatives ramp throughout the balance of the year.

Our operating, general and administrative rate increased 33 basis points versus the second quarter of last year. Driven by deliberate investments in associate wages, increased healthcare costs and sales deleverage, partially offset by lower incentive plan costs and ongoing productivity initiatives. Our adjusted FIFO operating profit in the quarter was $1.1 billion. Adjusted EPS was $1.09, representing 5% growth versus last year.

Let me also address tariffs. As we've previously discussed, our exposure is more limited than many of our competitors, reflecting the fact that the majority of what we sell is food sourced domestically. We did receive tariff refunds in the quarter, but they were not a meaningful driver of results, and they were fully reinvested back in value.

While sales were soft in the quarter, earnings continued to benefit from gross profit improvement, cost savings, fuel contribution and the progress we are making in eCommerce and media. Cost savings remain a core pillar of our long-term strategy. They are how we fund investments in customer value, while protecting the long-term earnings power of the business.

In the second quarter, we again delivered savings above our plan with broad-based contributions across both cost of goods sold and goods not for resale initiatives. We continue to see meaningful runway across sourcing, procurement, simplification and productivity, and we expect savings to build through the balance of the year. We look forward to sharing more specific long-term targets at our investor update in October.

Turning to fuel. Fuel remains an important contributor to our financial model. While industry fuel demand remained under pressure, our gallons increased in the quarter, outperforming the broader market by approximately 520 basis points. Gallon performance continues to be driven by our fuel rewards, which we supported with additional promotions in the quarter. Fuel redemptions increased nearly 6% versus last year. Our gallon performance combined with higher margins per gallon in a more volatile energy market drove modestly higher fuel profitability in the quarter.

Our associates are central to how we execute, and investing in them is directly tied to the customer experience we deliver. Competitive wages and benefits remain the foundation, and we're seeing positive results from those investments. Retail store retention continues to improve, exceeding our goal, helping us better serve our customers. That stability matters financially. Experienced associates are more productive, and we spend less on hiring and training.

Now, turning to capital allocation. We continue to allocate capital towards projects that strengthen the business over the long term. During the quarter, we completed 12 major storing projects, building density in markets, expanding our ability to serve customers and supporting future growth.

Kroger generated solid adjusted free cash flow this quarter, driven by our operating results. Free cash flow is important to our model, providing liquidity to our operations and allowing us to maintain a strong balance sheet.

At the end of the second quarter, Kroger's net debt to adjusted EBITDA was 1.91, compared to a net total debt to adjusted EBITDA target ratio range of 2.3 to 2.5. Over time, we expect to move back toward our target leverage ratio. We view this flexibility as a strategic asset. It gives us optionality to invest in high return opportunities while maintaining our commitment to investment grade credit.

Through the first half of the year, we repurchased approximately $1.2 billion of shares under our existing $2 billion authorization. Given our strong free cash flow generation and balance sheet flexibility, we remain well positioned to complete the remaining repurchases during the second half of the year.

Our capital allocation framework is grounded in improving ROIC, and that discipline guides every investment decision we make. It is how we fuel our investment in growth and generate long-term returns for shareholders.

Now let me turn to our outlook. We are lowering our full year identical sales without fuel guidance to a new range of 0.2% to 0.8% from our initial range of 1% to 2%. The update reflects our first half results, together with pressures that remain in the balance of year.

In the opening weeks of the third quarter, we continue to see lingering impacts from Cyclospora. Trends are improving, but we have taken a cautious view of how long the impact may last. And our outlook assumes some headwind to sales without fuel in the quarter. We expect additional sales headwinds in the fourth quarter. The identical sales without fuel impact from the Inflation Reduction Act is projected to accelerate to approximately 150 basis points as new high-cost drugs, including GLP-1s, are added to the formulary in January.

As is the case this year, we expect that pharmacy headwind to have no impact on profit in the fourth quarter or in 2027. Beyond pharmacy, we expect two headwinds related to prior year comparisons. We will begin to cycle the sales benefit from our new third-party delivery partnerships, which began last October. We also expect to cycle significant weather-related sales benefits from last year, which will weigh on identical sales excluding fuel in the fourth quarter. As a result, we anticipate ID sales without fuel will be slightly better in Q3 than in Q4.

Despite a lower sales outlook, we are maintaining our full-year guidance for adjusted FIFO operating profit of $5 billion to $5.2 billion and adjusted net earnings per diluted share of $5.10 to $5.30.

We have many levers in our financial model that provide us flexibility and allow us to deliver earnings growth despite top line pressure, and we have clear visibility into the drivers of our earnings growth ahead.

Through the back half of the year, we expect consistent year-over-year earnings growth between the third and fourth quarters. We expect cost-saving initiatives to build through the second half along with pharmacy margin contribution, further improvement in eCommerce profitability, and continued growth in our media business.

And as I mentioned earlier, we resumed share repurchases this quarter following the announcement of our planned acquisition of Giant Eagle. We expect share repurchases to support earnings per share growth over the remainder of the year.

These are drivers largely within our control. We have strong plans in place, and they are the basis for our confidence in the full-year outlook.

The second quarter demonstrated what that discipline looks like in practice. We managed margins against a softer top line and delivered the profit we committed to. We expect to do the same through the balance of the year.

Our priorities are unchanged: invest in the business for long-term growth, manage margins with discipline, and generate strong free cash flow that supports attractive returns for shareholders.

And with that, we look forward to your questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Michael Lasser with UBS. Your line is open, please go ahead.

Michael Lasser
Analyst, UBS Securities LLC

Q

Good morning. Thank you so much for taking my question. Your clear message this morning has been that you can fund price investments almost on a one-for-one basis through the savings that you're going to realize from the business. Now with that being said, how much did you invest in price in the second quarter? Where does Kroger's price gap stand today, where do they need to be, and what's been the impact of those price investments, especially in light of what seems like a cautionary outlook for the back half of the year? Sorry, so many multi-layered questions in there. Thank you so much.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Hi, Michael. It's Greg. Thanks for your question, and thanks for your interest. And we, like you, have a lot of interest in making sure that our customer value plan plays out. There's a number of points you've raised, just to reiterate, yeah, we can fund it. And really, this quarter is a demonstration of that, even though we've seen that the consumer has been pretty disciplined in terms of how they've spent, as they've dealt with gas and fuel and then, of course, Cyclospora. So, we're happy with that funding.

We're being very measured about how we do this, measured because the value proposition actually has to get layered in with running better stores and also making sure that our eCommerce offer is hitting where we want.

So, we'll share some more when we get to October in terms of how we see that playing out. We're not providing exact figures on the investment, but we have invested geographically. And I've also been very pleased with how the merchants have been managing our value generally. And what I've seen over this quarter is that our pricing relative to some of our competitors on what we call our white label, our basic shelf price has actually improved.

And then finally, the other measure that I take a lot of interest in is market share. And we spend a lot of time looking at that each week, each four-week period. We want to open up that gap on what we call Rest of Market. We've done that gap – we've done that, we've maintained that gap through Q2. And I think that's a pretty good performance when you consider that probably our Fresh mix is more heavily weighted, and we've had to deal with Cyclospora, particularly in light of the fact that that impacted us when most of the other retailers had already completed their quarter.

So, I hope that answers your questions. Dave, you want to add anything to that?

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.
A

Yeah. Michael, I just think one thing to add. We were pleased with the FIFO gross margin performance this quarter. I think that demonstrates for us the ability to invest in value, offset it with savings and that's going to be the model going forward. We're confident in the FIFO gross outlook through the balance of the year. And as we update you guys in October, that's going to be the model, generate savings, invest in value, expand the margins over time.

Operator: Your next question comes from the line of Robbie Ohmes with Bank of America. Your line is open. Please go ahead.

Robert F. Ohmes
Analyst, BofA Securities, Inc.
Q

Hi. Thanks for taking my question. Greg, I was hoping you could talk about just inflation pressures in general or lack of them. What are you thinking could happen with the grocery industry? Obviously, with diesel prices going up a lot and things, what's the inflation outlook for you guys and your assumption for the industry for the back half of the year? And how do you see that playing out?

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.
A

Yeah. Thanks for your question. And it is something that weighs on my mind. And as I see what's happening, particularly with gas prices, diesel prices. Historically, when you get an environment like this, you see it start to flow through.

We're taking a very measured approach because as David just shared, we've got a lot of active work underway at the moment in terms of cost savings. Some of that is built around what we call our COGS. And what we want to do is make sure that the great work that's happening in that area just isn't, if you like, fretted away as we then have to deal with price increases. So, there's some really good work that the teams are doing in this area, but I would expect that the pressure is actually going to mount. And we've seen a little bit more in Q2 than what we saw in Q1. But I'm very pleased with the way the teams are managing cost in retail and I'd reiterate again that actually our value proposition improved in Q2 vis-à-vis our competitors.

And that's what I want to see. And on top of that, the more definitive value proposition that we are starting to roll out has also come into play. So, there's some good managing of margins and costs in this business. And I mean, what I said in the call that I'm very pleased with how the teams have managed it.

Dave, what do you want to layer in terms of inflation?

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.

A

Yeah. Thanks, Greg. Couple of things. So, Robbie, our outlook broadly remains the same. So, our range is within this [ph] 1 to 2.5 (00:32:16) range for the balance of the year. As Greg said, I do think we will see a bit more pressure in the second half than we've seen in the first half, but I expect us to be below CPI.

Our focus, as we said, is about working with suppliers, take cost out, use that money to reinvest into value and protect margins. And so, I expect the FIFO gross margins to remain positive. So, we think we can manage it. But we do expect a little bit more pressure in the balance of the year.

Operator: Your next question comes from the line of Edward Kelly with Wells Fargo. Your line is open, please go ahead.

Edward Kelly
Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Good morning everyone. Greg, I wanted to ask you about the pricing strategy and the shift that you are looking to take here in terms of simplifying pricing and improving the value perception at the shelf. Can you just talk a little bit more about what you're looking to do there? How much of that involves less deals, better shelf price? How does it change the way that you deal with vendors around that?

And then pulling something like that off, how do you think about the way customers respond? Maybe customers that have become accustomed to looking for deals on like multipack, for instance, versus just better shelf price, just curious as to how you're thinking about all of that?

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks, Edward. It's a great question. And as you've laid out in that question, there are many layers to this and averages actually don't get you to the right answer.

Having been at this retail game now for a number of decades, I think I'm in my fifth decade, I guess I've seen a number of these things play out. Number one, you don't do this in five minutes or a quarter or even a year. This is a multiyear program.

Number two, there is a degree of common sense that plays out here that says a customer has got options, they can turn left and they can go turn right. What sort of gap do you want on the basket between yourself and your competitors? And that takes into account many aspects, quality of the assortment, the service, the quality of the shopping environment, quality of fresh foods. We know what that gap should be, and that's what we're working towards.

You don't do it all at once because you can't fund it all at once, and we've been quite deliberate about how we think about that. We generate savings through a combination of COGS, through imports for goods not for resale, through reductions in head count in the business because we've got more efficient at doing things, and we apply those savings to our shelf prices. And at the same time, we glide down, a bit like you do when you're flying a plane, to get from 40,000 feet to sea level; you take it down sort of a thousand feet at a time. You don't take too long to do it, but you don't try and do it too quickly. And you come up with a promotional mix that makes sense.

And once again, through having done this for a number of years, we know what that number is. So, this gets done by geography. We're well underway. We're encouraged actually by the results that we're getting. And what does good look like? Good looks like: do we sell more units, do we get more customers engaged in eCommerce? We track what competitors do when we do this.

And it's about positioning Kroger as a really good value option out there in the marketplace. We're not in the game of being the cheapest because we don't have the lowest costs, but we can provide the best value. And all of these points are woven into our approach. And we've made good progress, and you will continue to see us progress this approach. We're happy with it, and we'll share more in October.

Operator: Your next question comes from the line of John Heinbockel with Guggenheim Securities. Your line is open. Please go ahead.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

Greg, two related questions building on that last answer. When you think about – obviously you've got to move the reality of the price gaps down, but when you think about perception, the survey work you do, perception versus reality, how big do you think that gap is? How do you begin to change that? Is that partly a marketing issue? And then I assume you do have – right, you've got some businesses where food volumes are positive. And I guess, what are the commonalities there?

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Hi John. Good to talk to you again. Two very good questions. Perception versus reality, I would say to you, once again, having done this before, it takes a bit of time. So initially, when you take action on your shelf prices, actually your sales go down for the obvious reason that the item costs less. Over time, customers begin to understand what you're doing and they start putting extra items in your basket. And yes, part of this is coming up with the right marketing package, and that's something that we continue to refine and work on, and you'll see some more from us in that space soon.

I would say to you that over time, my experience has been that perception does equal reality. You can fool some of the customers some of the time, but you can't fool them all the time. I know, anecdotally, as I get around stores and I've probably done just over 100 now, but I also know from the research that we've done and 84.51°, that some of our customers understand our promotional package, but well over half do not.

And so, once again, we've got to balance that carefully, because some of the ones who do understand the package are some of our best customers. So, we've got to glide path this approach sensibly and carefully. But, we do understand how to do that.

There are some real highlights in our package in terms of what's working. I would say to you that one of the things that I really like is the excitement that we're starting to generate in the business around selling items. And, when I get into a couple of categories, might be deli and bakery, and I see that we're actually gaining market share in both dollars and units. I sort of know why that's working. And it's to do with some fantastic items that we have in that business, or the excitement that we had in the organization when we worked out how many chickens – rotisserie chickens we sold last week between the hours of 7 PM and 8 PM. Actually our sales during that particular hour were up 72% on where they were previously.

So, it's about having great items. It's about getting our stores engaged around these particular items, built into that is what we're doing with Our Brands, and as we accelerate that, I'd say that also puts a bit of pressure on the top line because you deflate your sales, good for profit.

So, I'm happy with what I'm seeing around the business. This isn't going to happen in five minutes. But I'd say to you, give us a year, we'll be a lot better than what we look today. Give us another year after that, it'll even be better. I'm feeling happy with the progress after just sort of being in this business 200 days.

Operator: Your next question comes from the line of Kelly Bania with BMO Capital Markets. Your line is open. Please go ahead.

Kelly Bania
Analyst, BMO Capital Markets Corp.
Q

Hi. Good morning, and thanks for taking our question. Greg, just to kind of level set, you called out the incrementals pharmacy headwinds quarter-over-quarter, which I think totals to about 30 basis points. So, I guess, just doing the math the rest of the quarter-over-quarter deceleration in comps is about 50 basis points. And I guess you outlined the Cyclospora, which is the large chunk of that. So, I just want to make sure I have that math right. There's just a lot of moving pieces here. So, I was hoping maybe you'd be willing to kind of just level set on what is that – what is that core grocery comp ex-pharmacy, and how is that you mentioned kind of some of the Fresh categories maybe clouding the picture of market share. So, can you just add a little more color on how you feel about market share and what that Fresh versus non-Fresh dynamic looks like?

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.
A

Yeah. Great questions, Kelly, and we'll dissect this as best we can. We don't disclose every single piece of data. But look, David and I have been chatting about this and David, I think you're better placed to answer this one.

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.
A

Yeah. Okay. So Kelly, let me try and unpack this one for you. So, the Inflation Reduction Act, obviously, we've been pretty clear that, that would have an impact, was a 140-basis-point impact to ID sales in the quarter. That was about 10 basis points worse than Q1. And in the balance of the year, we expect it to get worse again, largely as a result of new drugs coming in the formulary starting in January. No profit impact to stress.

We then had brand generics. So, [ph] we're seeing (00:43:29) a greater shift towards generic and away from branded. That obviously hurts the sales. Again, no impact on the profit, and that was about 60 basis points. Eggs, we saw it moderate, but it's still about a 30-basis-point impact to ID sales.

We then had on Cyclospora, a 35-basis-point impact to total company IDs. Just to stress, that's really the impact from produce alone. So when you add all of those things up, that's roughly a 265-basis-point headwind to the sort of comparable point versus last year.

Just in terms of the market share, and then I'll hand it back to Greg for any additional comments. The point on the market share is one of the things we're really pleased about through the first half of the year, and it was one of our objectives was to widen the gap to Circana's Rest of Market, so that sort of grocery competitive set. And we've done that, and we're really, really pleased about that.

We maintained the gap that we saw in Q1, in Q2. And the point is, is we've got largely a higher Fresh mix. So, we were more impacted or our hypothesis, we were more impacted by Cyclospora. So, our ability to hold that gap, we're really encouraged about. And when you break it down category by category and look at our market share versus the Circana Rest of Market, really pleased with it on a category-by-category basis.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co. A

I think that's exactly right, David. And, so far, as we get into Q3, it's where we would expect to be. We're still seeing a little bit of hangover from Cyclospora, but each week, that lessens and Q3 is where we want it to be.

Operator: Your next question comes from the line of Leah Jordan with Goldman Sachs. Your line is open. Please go ahead.

Leah Jordan
Equity Research Analyst, Goldman Sachs & Co. LLC Q

Hi. Good morning. Thank you for taking our question. On the fuel margin, can you talk about what's baked into the guide for the back half versus the front half? And how much of a tailwind has this been versus your initial plan for the year? And how do you think about lapping this heading into next year?

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co. A

Thanks, Leah. Thanks for the question. It's David here. So, as I think about Q2, a couple of things. We saw gallons up slightly. We outperformed the market on gallons, so we were pleased about that. If you look at CPG, so our sort of profit per gallon, we were again up slightly. And when you think about total fuel profit, year-over-year actually it wasn't a huge tailwind for us, it was basically kind of – I'm going to call it low-single digit profit growth on the fuel business.

As we've built into our guidance for the balance of the year, we are expecting and have baked into that fuel margin softer than H1, and that's what we've got in the outlook. Obviously, there's a huge amount of volatility in the fuel business, which makes it difficult to call. But our expectation is softer than [ph] we were seeing (00:46:53) in H1.

Operator: Your next question comes from the line of Simeon Gutman with Morgan Stanley. Your line is open. Please go ahead.

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC Q

Hi, Greg. Hey, David. So, Greg, we have a turnaround agenda or transformation and I'm sure you'll get more meat on it in October. The competitive and consumer backdrop feels like it's getting a little more difficult. And so at the quarter, sales weakened but you're holding profit well. Can you help us reconcile those two things at this stage of your turnaround? How do you think about the trade-off between protecting near-term profits and making the investments necessary that – to improve the customer proposition and then obviously gain market share? Thanks.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co. A

Hi, Simeon. Good to get your question. Yeah, it is getting a little bit tighter out there. And I'd say that what we're seeing is the consumer continues to be disciplined. They're not absent. They're turning up to the stores, but they're pretty disciplined about what they buy. I actually don't mind that. I like the fact that it's getting tight and tough, because I think those conditions create opportunities if you've got a good plan and you've got a great team to execute. And that team's coming together and I'm pleased with how that is looking.

The other thing I'd say to you is that 200 days into the job, I actually see even more opportunities than what I thought when I started. So, I don't spend any time sort of going, I'm not sure how we're going to fund this, how are we going to make it work? Whether it's what I'm seeing with unknown shrinkage, whether it's what I see with out-of-stocks, whether it's what I see with goods not for resale, whether I see cost of goods, imports, actually, all of those things are actually bigger than what I thought after 30 days. And, I'm really pleased with the discipline that we've got in the business in terms of going after them.

So, it's tough. You've got to deal with the environment and the conditions that we're playing in. I actually think that's to our advantage at the moment. We're assembling a team that I think will be a world-class team of retailers. We're clear on the plan. And we know how to execute it. And we did exactly that in Q2. And I'm pretty comfortable that we'll do it in Q3 and Q4.

So, I see the buckets of money. I know that we can get after them. And I'm feeling very good about the business.

Operator: Your next question comes from the line of Tom Palmer with JPMorgan. Your line is open. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning, and thanks for the question. I did want to dive a little bit into the gross margin that we saw in the second quarter. There were kind of four bucketed items in the press release, right, the eComm profitability, pharma, sourcing and the tariff refunds. Could you maybe frame their order of importance in terms of driving that margin expansion this quarter? And then, I think it would be helpful, if you could maybe quantify in some form the tariff refund, either in dollars or whether the magnitude swung gross margin ex-fuel from flatter to positive? Thanks.

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.

A

Hey, Tom. Thanks for the question. So, we were pleased with FIFO gross in the quarter. We'd always communicated that our plan was to grow FIFO gross on a full-year basis. And we feel good that we're going to be able to do that through quarter three and quarter four.

And I think as I reflect on kind of the model and this will be the go forward model, it's about take cost out, invest in the business, but also grow margins over time. So, we expect to do that through the balance of the year. And obviously, we'll talk more about our multiyear plans in October.

So, as I think about gross margin, I think a few things to think about. We were pleased with the eComm performance. That was a positive. Our media performance, as we said, best performance in, I think, five years, and then the pharmacy mix, as well as, good sourcing savings. So that's kind of broadly in terms of sort of order of importance. I want to stress, they were all pretty decent performance. It's not like any of these were small.

On the negative, we did see some shrink downside, mainly in Fresh, some of that, not all of that was related to Cyclospora. So Cyclospora definitely impacted us more than we expected on the shrink side.

And then the other thing, obviously, with increasing fuel costs, we did see a headwind relating to – in our transportation line from fuel, sort of similar impact to what we saw in Q1, and obviously that could be a headwind that we need to offset through the balance of the year.

In terms of tariffs, we're not going to quantify the number, but I'm going to tell you the way we think about it. Number one, the number was pretty modest. And the way we think about that is, if we get tariffs, we'll spend it. If we don't get tariffs, we won't spend it. So overall it was a neutral impact to gross margin because we reinvested that money back. And that's going to be the model going forward if we are to get any further refunds.

Operator: Your next question comes from the line of Greg Melich with Evercore. Your line is currently opening. Please go ahead.

Gregory Scott Melich
Analyst, Evercore ISI

Q

Hi. Thanks. I wanted to go back, I think in prepared comments, you said traffic was positive in the quarter. Could you help unpack that a little bit as to the sequential change in that? And then if that's the case, it seems like ticket was down. What was driving that, was it mix, items in basket, inflation?

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks, Greg. Good question. Yeah, we did have traffic up slightly, and we're pleased with that. And ticket was down. And I think you've picked the key items here. I think the customer is pretty disciplined. SNAP has an impact, gas had an impact, less item in the basket. What I would say is that where we are running our value proposition, actually, we went against that trend in terms of getting the extra items in the basket. So, overall you're correct. Yeah.

Operator: Your next question comes from the line of Krisztina Katai with Deutsche Bank. Your line is open. Please go ahead.

Krisztina Katai
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Good morning. Thanks for taking the question. Greg, a lot of the discussion today has focused on value, but some of the strongest examples that you highlighted included deli, bakery, prepared foods, think rotisserie chicken and private brands. When you look at the categories that are gaining most dollar and unit share, what is proving most important for the customer? What are some of the most important characteristics that you would find? And what does that suggest about progress, future growth algorithm maybe more sort of merchandising driven than price driven?

And then I wanted to ask a follow-up, I don't know if I heard this, but what did you assume in the back half of the year from incremental diesel and freight costs? Thank you.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Great. Thanks, Krisztina. I'll take the first bit, and David, if you can pick up diesel, freight costs, et cetera. What we're seeing is pretty much, if anything has a natural, organic, protein, health component to it, Krisztina, that's working extremely well.

We also see where we do a great value proposition that works extremely well. So, an item that we got on to just recently was a $20 sushi plate. And, we do pretty well with sushi. I think we may be just about the biggest seller of sushi in America. And we do well with that. It's in a number of our stores. We then introduced an item which is $20 sort of a family pack. I think it took about three weeks for that item to get over $1 million. And the excitement that I see as I get around is palpable.

So, anything sort of that has to do with health or organic, et cetera works, anything that is answering a customer's question around value, what's for dinner is working well. We launched a range of Private Selection Frozen Meals that I spoke about. They've just absolutely taken off, their exceptional quality, great value.

Customers, as I said, they're not absent. They're just disciplined. And as a retailer, it's our job to be their agent. And that's exactly what we charge our merchants [ph] doing with (00:57:08). David?

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.
A

Yeah. Let me just, Krisztina, cover the question on diesel and freight. So, the important thing for us is we expect gross margin to be positive through the second half of the year. We have assumed that we will get some incremental headwinds from diesel and freight costs through the balance of the year, but that's embedded in the outlook of positive FIFO gross through the balance of the year and on a full-year basis.

Operator: Your next question comes from the line of Rupesh Parikh with Oppenheimer. Your line is open. Please go ahead.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.
Q

Good morning, and thanks for taking my question. So just going back to your new store strategy and M&A. Just given the Giant Eagle acquisition, how should we think about balancing organic store growth versus M&A?

And then second, as we are in a weaker backdrop, does that at all impact how aggressive you are in store growth.

David Kennerley
Executive Vice President & Chief Financial Officer, The Kroger Co.
A

Rupesh, let me take that one. One of the things – I think we had 12 major storing projects go live this quarter. Combination of new stores, major remodels, et cetera. It's going to be a clear element of our strategy going forward, which is to open more stores.

We're going to do that both in geographies that we think are high growth, but we're also going to do that in places where we exist already, but we feel that we have an opportunity to give consumers the opportunity to see Kroger stores and take share from competitors. So, I think there's two angles to organic store growth.

From an M&A perspective, a bit like Giant Eagle, we're going to evaluate things as they come. We're going to be extremely disciplined about it. Greg already commented on Giant Eagle. At the end of the day this is about customers and accessing new customers in geographies where we don't play. We'll continue to look at things, but we're also going to be extremely disciplined about capital allocation and making sure we get really good returns.

Operator: Your final question comes from the line of Scott Marks with Jefferies. Your line is open, please go ahead.

Scott Marks
Analyst, Jefferies LLC

Q

Hey. Good morning, all. Thanks very much for squeezing us in here. Wanted to come back to the topic of inflation for a second. Specifically, we've heard more recently from a number of suppliers, larger suppliers, that they intend to take pricing to offset their own inflationary input pressures and they're willing to do so at the expense of volume. In fact, they're actually assuming that they may actually see their own elasticities maybe a little bit worse than what they've been historically. So wondering if you could maybe just comment on that a little bit and help us understand what the conversations are like with suppliers and what levers you have in your toolkit as you work through these negotiations with them to try to help maintain that value for the customer. Thank you.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks, Scott. We've got a number of things in our toolkit basically to answer that first. One of them is we've got a pretty extensive Our Brands program, and one which resonates well with customers, whether you're talking about opening price points and you're seeing us expand our range of Smart Way's products there, circa from about 130, we'll get that up to 1,000 over the next year and a bit. Some of those are already hitting the shelves, and we're very pleased with how they both look and taste and feel. Then of course we've got Kroger, we've got Private Selection, and we've got Simple Truth. So, this extensive portfolio where we picked up another 50 basis points of penetration, we'll talk some more with you in October about how we see that rolling out.

So, customers have choices, and it's up to us to provide them with that choice. Our job is to be the customers' agent. And we want to be fair and open and have great relationships with all our suppliers. But at the same time, we have to also represent the consumer, and if price increases are justified and make sense, then I'm happy that as a team of merchants we sit down and we work through those.

What we don't want to get in is a situation where people can just turn up and put prices up and not have full justification for that sort of increase. I'm not in the game of using inflation as a way of generating extra sales. I'm in the game of generating great comp sales, ID sales, because we represent terrific value to the customer, and they trust that Kroger is their representative in creating great value. So, we'll deal with that as it comes along. I would say that our relationships with suppliers is very good and very healthy. I really like the way that Mary Ellen and Mike and Carlo are managing with Ed as part of our business. And, I think we're in a good spot.

Gregory S. Foran
Chief Executive Officer & Director, The Kroger Co.

I would want to, just at this stage, thank everyone for your continued interest in Kroger and know that – we really value that. And finally, on the September 11, we pause to remember those lost and to thank first responders and service members who protect our communities every day. Thank you all for joining us.

Operator: This concludes today's call. Thank you for attending. You may now disconnect.