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The Kroger Co. (KR)

Business Update Call

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MANAGEMENT DISCUSSION SECTION

Unverified Participant

Ladies and gentlemen, welcome to the 2022 Kroger Business Update Meeting. Our meeting will now begin.

Rob Quast

Director-Investor Relations, The Kroger Co.

Good morning, and thank you for joining us for Kroger's 2022 Business Update. I am Rob Quast, Director of Investor Relations, and we are glad that you could join us today here in Florida. Our leadership team is looking forward to updating you on the progress we've made on our strategy outlined last year of Leading with Fresh and Accelerating with Digital.

Within our presentations today, you will hear additional details about our unique customer value proposition and go-to-market strategy, the continued strength of our operations, where our associates are delivering every day for our customers, and an update on our digital progress through our seamless ecosystem, including the integration of Customer Fulfillment Centers powered by Ocado. For those of you who are able to join us here in person today, we are incredibly excited to be able to offer you a tour of our recently opened CFC in Groveland after the conclusion of our Q&A session. You will have a chance to see how Kroger's investment in technology and automation comes to life and creates a differentiated customer experience that no other retailer in America can offer.

Before we begin today, I do have a few important disclosures. I want to remind you that today's discussions 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 filing. The Kroger Company assumes no obligation to update that information. During this presentation, we may discuss certain non-GAAP financial measures. For reconciliation of non-GAAP measures as well as other information regarding these measures, please refer to the Investor Relations section of our website.

Now, before I turn it over to Rodney, our Chairman and CEO, let's take a look at what an incredible year we had.

[Video Presentation] (02:03-03:30)

W. Rodney McMullen

Chairman & Chief Executive Officer, The Kroger Co.

Thank you, Rob. Good morning, everyone.

And as Rob said, we're delighted to have everyone here in person. It's so exciting. Obviously, the video is exciting as well and really appreciate it. So I'm Rodney McMullen, Chairman and CEO of Kroger, and it's great to be with you here today in person. And I'm so excited to update you on the progress that we've made since our last Investor Meeting in March of 2021. I'm incredibly optimistic about the future of Kroger and our ability to deliver for all stakeholders. This was evidenced by our strong 2021 results that we shared with you yesterday. And I hope that will further be reinforced today by the presentations that you will see. Throughout our presentations, we will

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share with you how we're delivering today and investing for the future. And I always think that's a very important thing to know and to be able to see. Through our strategy that we shared with you last year, we're Leading with Fresh and Accelerating with Digital.

With that in mind, there are four key themes that we wanted you to take away from today. First, we want to continue to grow our food business through our competitive moats. We start with food and it's the glue that holds everything together. Today, we are stronger than ever before. Through innovation and investments in innovation, technology, partnerships and our people, we have a clear path to grow our supermarket business. Second, our core assets allow for significant growth through our data and traffic, we have developed a margin accretive opportunities, including retail media, health and wellness, fuel, Kroger Personal Finance, all have clear paths to additional growth. Third, we are delivering against our strong and sustainable total shareholder return model, and we remain committed to delivering against this over time. And fourth, we are continuing to deliver on our Zero Hunger | Zero Waste commitment that the centerpiece of our ESG strategy.

So, let's first begin with a snapshot of our business. Kroger has significant assets including a store footprint where 82% of our customers live within 5 miles of one of our stores. And in fact, the majority of our customers live within 2 miles. Over 60 million households across the US comes through our doors annually. From a digital perspective, we cover 98% of our customers through seamless pickup and delivery ecosystem, including 18.5 million households who engaged with us online in 2021. Kroger's our brand (sic) [Our Brands] portfolio has four unique $1 billion brands, and during 2021 in total, they totaled total sales of nearly $28 billion. We continue to demonstrate our leadership position in Fresh, as evidenced by our 15.6% sales growth in our fresh departments since 2019. Further driven by traffic generated by our supermarket business, our alternative best profit portfolio has grown by double digits over the last four years.

The US food market is split between food at home and food away from home, both segments remain highly fragmented. In the food at home channel, we maintained our position as the top number one or number two food retailer in the majority of the markets we serve. In addition, we've made meaningful progress in food away from home through partnerships with local restaurants that customers just love, over 1,100 Starbucks locations, sushi and sushi delivery in partnership with DoorDash, ghost kitchen concepts with Kitchen United and ClusterTruck, and our partnership that we merged with Home Chef a few years ago. All of those are channels where we're trying to improve our share of food away from home, because we see it as a massive opportunity growing going forward.

Our priorities today reflect our long-term focus. Every decision we make, we make it on the basis of a five- to ten-year horizon in terms of what's right for our customers, what's right for our associates and what's right for our shareholders. And we see a long runway ahead to drive growth and gain share in all food channels. We are continuing to enhance our customer loyalty and attract new customers with investments in our four competitive moats. Fresh, Our Brands, Personalization or Curation and Seamless. They are strong today and they are growing in relevance as customers eat more food at home. Our competitive moats enable us to convert structural changes in customer behavior from the pandemic into lasting competitive advantages, advantages that will enable us to drive sustainable growth and profitability for the long-term. They are integral to our ability to create our value creation model and continue to invest in widening and deepening them for the future.

Our growth opportunities are not one dimensional. They are multi-faceted. We are evolving our business model to serve customers across an ecosystem of offerings that complement and build on our food first mentality. Our unique collection of assets allow for additional growth opportunities outside of the traditional grocery retail segment. And I think that's incredibly important as you look at Kroger of the future versus Kroger of the past. It's one of the biggest critical decisions that people need to look at as they evaluate our company. By using food as

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our foundation, we are competing effectively across these differentiated and highly profitable channels. We will continue to look for opportunities that allow us to build on our food platform and show up for our customers in new and exciting ways.

Our leading position in food also underpins Kroger's value creation model. We continue to invest in assets in areas of our business that matter most to our customers to drive sales growth in our retail supermarket business. This in turn generates data and traffic that enables our fast growing alternative profit streams. Our financial model is to continue using our free cash flow to invest in the business that drives long term sustainable net earnings growth by identifying high return projects. This flywheel creates an incredible value for shareholders. It gives us confidence to consistently grow earnings of 3% to 5% per year and increase operating cash flow that enables us to fund capital projects to grow the business, increase the dividend over time, and return excess cash to our shareholders through share repurchases, which we've done a lot of as you know.

Companies talk about their ESG initiatives in many different ways. But at Kroger, driving sustainability and social good are not just things that happen alongside our business. They are embedded in our business, and to me, that's a big difference on most companies, and we believe that's the thing that we'll have where there was a long runway and where it really will be sustainable, no pun intended, in the long term. One example of this, and it's something that's obviously very important to all of us and to me personally and it's critical to our business that as a whole and that's our Zero Hunger | Zero Waste social and environmental impact plan. And with that, let me show you a video of what that means.

[Video Presentation] (12:06-13:49)

Through our Zero Hunger | Zero Waste, we are helping create a more resilient and sustainable future food system. And as the video stated, since 2017, our teams have been able to direct more than 2 billion meals in the United States to fight food insecurity in our communities that we call home. We continue to make progress toward the goal of Zero Waste as well. Our ESG strategy is designed to unlock value that is driving action across the business to improve our operational performance, achieve positive impacts for people and our planet. We have an ambitious carbon emissions reduction plan and sustainable packaging goal for all of our brand products as well by 2030. Programs to eliminate waste, reduce water use and expand access to affordable fresh food for everyone.

Delivering an amazing customer experience starts with all of us, all 450,000 associates who serve customers every day. We've always listened thoughtfully to our associates and listened to their needs and enhanced our employee value proposition to attract and retain the best talent. Since 2017, we've invested an incremental $1.2 billion annually in our associates, which has raised our average hourly rate to just a little over $17, and it grows to over $22 per hour when you include best-in-class benefits from pension, health care and other aspects. Kroger is stronger today than before the pandemic.

Through an assortment of everything and everything that we've done for our associates, we have an incredible assortment of Fresh products, high quality and affordable Our Brands offering and a world-class digital platform that we will continue to elevate our food position as a food authority that's really underpinning everything we do. We want customers when they think food, they think Kroger. We believe they'll go to the app first. And we don't care whether you come into a store, get pick up, get delivery, if it's dinner tonight, if it's something you need in 30 minutes, all of those things are incredibly important. And when you look at it, that's really the 50,000 foot view of everything that we're doing and everything that we're doing to build and sustain our advantage as we move forward for all the details.

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So, let's get started and turn to the program for the day. This morning, you will hear from an outstanding team of leaders who are representing thousands of associates and who are responsible for driving the incredible work I just outlined. First, you will hear from Stuart Aitken, our Chief Merchant & Marketing Officer, who will highlight Kroger's go-to market strategy and growth initiatives through our customer value proposition. Then, you will hear from Mary Ellen Adcock, our Senior Vice President of Operations, who will communicate Kroger's operational strength and how our execution is separating us from the pack.

Next, you will hear from Yael Cosset, our Chief Information Officer, who will take you through Kroger's digital strategy and how we are solving the needs of our customers with digital by creating a world-class, seamless ecosystem. Yael will also provide an update on our goals that we announced in 2021 to double digital sales and profitability by 2023. And if you had a chance to listen to our call yesterday, you heard me I mentioned that Yael will also give a little bit more detail when we talk about customers making no compromise. What no compromise really means. And then finally, Gary Millerchip, our Chief Financial Officer will conclude with a discussion on how our value creation model has delivered sustainable earnings growth and attractive total shareholder returns and how we expect to deliver on our TSR commitment over time. One thing that I think is really important as you listen to everyone's presentations is listen to how we're leveraging technology to change and grow our business.

When we launched Restock Kroger, we made the strategic decision to use technology in ways that would drive our business forward. Today, we decided to not make technology a separate conversation, but to embed technology in everyone's presentation because we cannot accomplish what we're trying to accomplish for our customers, for our associates, for our communities and then for our shareholders without technology being an integral part of everything we do and technology is really driven by the needs of the business, the needs of the customer, the needs of our associates. We've deliberately invested capital and expense in technology and innovation, and today, technology, as I said, is just integrated in everything. And one of my favorite quotes is if you know you're using technology, then it's not good enough. So, everything that we're trying to do is to make sure we're using our data, our technology to enhance the customer experience, to enhance our supply chain, to enhance our business operations and productivity, and most important of all to make the lives of our associates easier.

And before I turn it over to Stuart, I would like to thank our nearly a half a million associates across this country. Every one of you make the Kroger family strong, resilient and sustainable. I've been in this business for over 40 years and our associates continue to inspire me, our associates continue to amaze me, they're amazing. With every new challenge and every new challenge thrown at them, they rise to the occasion. Our entire team remains engaged, energized and focused on our customers, our associates, and living our purpose.

With that, thank you, and I will turn it over to Stuart.

Stuart W. Aitken

SVP, Chief Merchant & Marketing Officer, The Kroger Co.

Good morning, everybody. Thank you, Rodney.

This morning, I want to share with you our customer value proposition and go-to-market strategy, which is fundamentally supported by our four competitive moats, positioning Kroger for both sales growth and margin expansion. Before I go deep into the presentation itself, I want to draw your attention to the wheel before you. You're going to see it multiple times today, and this really is Kroger's go-to-market strategy. On the outer ring, you have our four competitive moats. Inside of that, the gray inner ring are enablers. And then inside of that, I'm going to get into our growth drivers, margin expansion and how we're looking at achieving that, as well as how we see our stores as a true asset to our company. And then inside of that, we have, as Rodney just talked about, our

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customers and our associates. Every decision we make at Kroger has the customer at the center of it, and our associates are the ones who bring this wheel to life, the ones who make our strategy a reality. This wheel truly does encapsulate the way we think about Kroger's go-to-market strategy, highlights our unique position within the geographies we serve.

While most of you will recognize the various elements within, I want to spend some time walking you through how they come together to support our current business and provide us with growth both now and into the future. Our go-to-market strategy is comprised of four competitive moats, which we spent many, many years cultivating. Fresh, Personalization, Our Brands and Seamless. These moats represent the key elements that truly differentiate us and are truly important to our customers, and I'll get into that in a moment. Strong competitive moats ultimately drives trips for customers, loyalty as well as enable us to win share. We continue to invest in these to further help accelerate our growth and differentiation.

Competitive moats enable our organization to ultimately thrive. They accelerate and enable three primary levers that allow us to serve our customers even better and in turn, grow faster. First, growth drivers are way we see customer trends and long-term industry growth that we'll ultimately capitalize on. Our focus here gives us accelerated growth, more share and improvement in ROIC. Next, margin expansion is way we manage our mix, leverage Our Brands as and where we deploy a suite of tools that help us manage our customer experience as well as margin. Finally, stores as an asset. Our stores are a real asset, both from a brick-and-mortar standpoint as well as from an e-commerce standpoint. No one else can bring brands together like we can. Think about Murray's Cheese, Starbucks, Boar's Head and Simple Truth under one roof, that's Kroger.

From an e-commerce perspective, we are today in the neighborhoods of our customers, which allow us to deliver or allow for pickup, much simpler, much faster and much easier for our customers. Our customers and associates are truly at the heart of our business. We will keep our customers at the center of our strategies, plans and decisions, and our associates are the people that bring our strategy and make it a reality. We are transforming the way we attract talent by simplifying processes we're also allowing for cost reductions within our ecosystem. Our plans are ultimately very ambitious, but we're confident it will accelerate growth. Mary Ellen in a moment will share more about our associates and our operations. Our go-to-market strategy is battle tested and is resilient in all economic times, especially now, given our current environment and where we are seeing record levels of inflation, we have the playbook that delivers for customers.

Think about our personalization efforts. We are seeing customers leveraging or targeting our coupons that we are delivering to customers that are relevant to them. Rodney talked about that on the call yesterday. Through our breadth of high quality, great value Our Brands products, through our fuel program for discounts on fuel when our customers need it most now and delivering fresh products anytime, anywhere on their terms. Having shared how our wheel depicts our go-to-market strategy, I want to now share how Kroger is leveraging these elements to build momentum within our business and how we'll continue to drive that momentum as we look to the future. Fresh is the number one determinant of store choice. 70% of all customers decide where to shop based on fresh products, which is why we are focused on being the fresh food destination. Today, 92% of our customers buy fresh products from Kroger, demonstrating just how relevant this is to us and to our customers.

And let me walk you through the five ways we are delivering the freshest product from field to table. First, we are leveraging data and technology and you're going to hear that from me multiple times. We've chosen the best suppliers for which to establish long-term relationships with. These negotiations prioritize supply and quality. Second, we are strengthening our supply chain to maximize freshness, decreasing the time a product spends in transit in our DCs, in our stores, before it hits our customers' table. Third, in merchandising, we are leveraging data and science to optimize our assortment. Implement our pricing strategies and promote in a much more

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intelligent way. Fourth, we are spending capital on mobile refrigeration. Thank you, Gary. That product in that mobile refrigeration lasts longer for customers, which means it lasts longer for the customer at home. Finally, we are simplifying processes that drive consistent execution and deliver fresher product. This approach all adds up to more days of freshness for our customers.

The produce departments in our initial rollout are performing better than similar stores that haven't implemented the in-store portion of our end-to-end process, and we have plans for continued rollout in 2022. And produce is just the beginning of our end-to-end initiative. We see similar opportunities across the store in meat and seafood and of course in dairy. Our supply chain allows us to win in Fresh. Our approach is to leverage data, leverage science and collaborate with our partners to ensure we have the right distribution process and reduce the amount of time from farm to table, suppliers, supply chain operations are all working together to reduce the age of the product, minimize dwell time in our distribution network and protect the integrity of the cold chain. In-store, we are accelerating our vendor accountability efforts, including updating technology that provides data in real-time for our suppliers, holding them far more accountable to our vendor service levels, like delivering more days of freshness, Our Brands is a true competitive advantage that exceeds customer expectations. Our Brands has been a pillar of success and will continue to be so for the years to come.

Right now, we are working on bringing new items to meet the customer needs of today with pantry staples, but also exceeding their expectations with innovative new flavors, products and healthy alternatives. Going forward, we will expand Simple Truth, Private Selection into complete offerings that provide breadth of assortment desired by the customer as well as a compelling presence on shelf. We are incredibly proud of our Home Chef brand, which became a $1 billion brand in 2021, and we will continue to expand this brand across our family of companies. Our assortment is connecting with the customer through ready-to-eat meals, rotating seasonal programs, new appetizers, as well as our first plant-based protein in partnership with Custom Made Meals and Impossible. Our Brands is nearly $28 billion in annual sales. This would make us the ninth largest CPG in the United States. I want to say that again, Our Brands is a $28 billion business and they are brands our customers love with Net Promoter Scores 10 points higher than comparable brands. In addition, we have net promoter – we test all of our new products and 100% of our new items are tested and validated by a third party to be as good or better than national brand equivalents.

We manufacture nearly 30% of Our Brands products. This is truly a competitive advantage for Kroger and it helps us lead in the space. Manufacturing lowers costs for us, gives us control over quality and supply, and allows us to offer innovative products that our customers can only get in our stores. The way we think about Our Brands, as if you own the stage, the store and you write the play, the promotional plan, you can determine who the star is, Our Brands. Our Brands has a leading position in private label brands in the US, and it's an important margin driver for Kroger. Looking ahead, we are executing an accelerated strategy to expand and elevate the Kroger brand, our flagship brand, national brand equivalent, with better innovative products. Given the inflationary environment we're in right now, this brand especially delivers for customers who are looking for real value and quality. Our Kroger brand was nearly $15 billion in sales last year and we see huge opportunity for that brand going forward.

We will accelerate our growth of Private Selection and Simple Truth as well. I was with one of you last night who called out Simple Truth as the holy grail of natural and organic products, that wasn't me, that was one of you, and you'll remain anonymous. Those two brands are capitalizing on two major trends in the US right now. One is the natural and organic brand, and the other is premiumization. These two brands hit those head on. We are transforming to truly a customer-centric category management process powered by both data and science. We are making improvements in every step of the process, including customer testing, product and packaging innovation, and speed to market.

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Lastly, we will continue to strengthen our brand equity by investing in marketing and the quality of our products. Today, we have four brands that each deliver over a $1 billion in sales. Kroger brand, Private Selection, Simple Truth and Home Chef, and our portfolio is only growing. Our best-in-class data science platform allows us to create tailor-made experiences. This personalization creates value for customers, and drive loyalty. We will leverage our data to make surgical price investments, in categories that matter most to our customers, investing in elastic items that increase sales and margins. We have a track record of best-in-class targeting. We serve up billions of personalized interactions. As a result, we are seeing industry-leading outcomes in terms of redemption and conversion. Relevancy science has personalized the digital shopping experience, delivering product and offer recommendations that save customers' time to order. Our approach to data and science is broad based and helping us change the way we scale and implement price, promotion and display. For example, utilization of machine learning algorithms and optimized forecasting models allow us to enhance personalized pricing to maximize reach and effectiveness of all of our promotional investments.

Loyalty programs are another critical element of our data and personalization efforts. Fuel points have long time been a core part of Kroger's go-to-market strategy. It's integral to our loyalty program. Fuel engaged customers spend $4 billion more than non-fuel engaged customers who look similar. And we are building on this success by launching the next generation of loyalty program with Boost. In just a few short months, Boost membership is growing rapidly. The best example I have for you, for that is our Monroe facility in Ohio, where we've launched Boost and already 30% of the customers using that facility have enrolled in Boost. The best part about Boost as well is that we are seeing a significant portion of customers who are not enrolled in our fuel program or our delivery program enrolling in our new loyalty program, Boost.

Growth drivers are the top areas of our business where we see double-digit growth. We focus energy and effort here to capture our fair share of this market growth. Natural and Organics has been growing for the three years prior to COVID at a 14% CAGR, huge opportunity for us in that space. Multicultural tastes and preferences are increasing food trend in the United States as our population evolves. Our customers' appetites are shifting and we are seeing increasing openness to worldly foods. Not only that, this cohort of customers is where we see household growth in America growing over the next 10 years, 95% of our growth in the US will be this multicultural household. Customer data and science right now is helping us with our assortment what we put on display and promote in the appropriate stores.

Our customers love new items, and they love to be surprised and delighted by these new items. New product innovation accounted for $2 billion worth of sales for us in 2021. Innovation, this innovation delivered over 300 basis points in market share versus the total store. And if you track what happens with innovation and market share on the life of a new product, those retailers who gain that share early on retain it for the life of that product. We're building on that innovation. In 2022, we have a $2 billion pipeline in innovation as well, but we're looking beyond that by creating true partnerships with the likes of Bed Bath & Beyond. We also are working with third-party delivery with the likes of DoorDash, who can deliver meal services. And we're also working with partners in the alternative farming space like 80 Acres.

In addition, health, hygiene and home cleaning is growing significantly due to the fact that the American psyche has fundamentally changed because of the COVID pandemic. Kroger has seen 8.2 million households shopping these categories, and it's our job and our focus to keep these customers within our ecosystem buying these products that are generally higher margin as well. Our strategy is to expand margin, allow us to continue to invest in price. First, data and science enable us to promote in a way that benefits both customers and Kroger by focusing our promotional plan on highly elastic items. Our data and science allows us to manage inflation. As a result, we can manage cost increases, maintain margins, stay competitive on price. We continue to invest in price. However, we're being much more deliberate on how and where we invest.

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Another way we're expanding margin is through improving mix. Our trade up program is moving towards customers towards more profitable items. Mix can also be improved through personalized offers. They are some of our highest sales to cost performance in our portfolio and customers love relevant offers. This is something we are great at. I spoke to you earlier about our strategy to grow Our Brands. Gross margin is higher for Our Brands. Incremental sales here drive the gross margin line, plus our manufacturing delivers more margin flow through for us as well. Like other areas of the business, we are focused on reducing costs that impact margins. Enterprise sourcing for example, is on a multi-year journey towards delivering significant and sustainable savings for our organization. In 2021, sourcing delivered hundreds of millions of dollars in savings. And we have a clear path ahead to continue on this journey.

As we improve our customer experience, we are simultaneously reducing the cost to serve through technology and simplifying processes. We are in a position of strength. We are truly transforming our business. We are leveraging our data science and technology to evolve our growth culture. We are thinking long-term. We are Leading with Fresh and Accelerating with Digital. Our customers are always at the center of everything we do. Our deep appreciation and understanding of their needs allow us to make faster decisions and in the process, produce higher returns. None of this is possible without our amazing associates who bring our strategy to life every day. We've made major commitments to train our current associates on the latest trends and technologies to upskill our labor force. In growth areas like e-commerce, we are recruiting and hiring top talent with the skills now to deliver the innovation for tomorrow.

Now, you'll hear from Mary Ellen Adcock, our Senior Vice President of Operations, on how our operations and our associates are executing at a higher level every day. Mary Ellen?

Mary Ellen Adcock

Senior Vice President - Operations, The Kroger Co.

Great. Thank you, Stuart. I'm Mary Ellen Adcock, Senior Vice President of Operations and I'm glad to be here with you today to showcase how we are elevating the customer experience.

And our elevated customer experience is built on three key areas: operational excellence, the associate experience and cost savings. First, operational excellence. Kroger is a leading operator and executes at a high level of service, both in-store and through seamless, which creates a compelling customer experience and puts us in a leadership position in Fresh. There have been a number of learnings with the pandemic that we are applying to take our execution to a higher level. Second, the associate experience. Kroger invests in our associates to attract and retain top talent, build retention and improve engagement because we know that the associate experience empowers the customer experience. And third, cost savings. Cost savings is a core competency with a proven track record. We continue to find ways to take costs out of business without sacrificing the customer experience, making it sustainable to continue to take cost out strategically to invest in our associates and fund growth for the future. And we are confident that these areas will help us elevate the customer experience, whether in-store, pickup or delivery, or however our customers choose to shop with us.

Key to our success is our strong competitive go to market strategy, and as a team, we are widening and deepening our competitive moats through productivity, technology and sustainability, and the stores as an asset remains essential to our ability to win. And then at the center, core to our strategy is the customer experience and the associate experience, keeping both the customer and the associate at the center of every decision that we make. Because customers have told us what's important to their experience and our strategy is built around just that. We're investing time and technology to meet our customers' expectations. Customers also tell us that the best customers' experiences are full, fresh and friendly experiences, meaning products are consistently in stock,

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fresh products of high quality and our associates are friendly. And Fresh is a differentiator for Kroger, and we are strengthening our leadership position in Fresh. . Kroger excels at Fresh with customers rating Kroger, the highest national retailer in fresh perception. This chart shows how we outperform national retailers. And as you can see that customers rank us the highest, and this year we had the highest all-time record in fresh perception.

So, while Fresh is already a competitive advantage, we strive to make it better every day. For example, using leading indicators to improve our in-store execution for things like days of freshness and validating product quality. We will continue to follow our strategy and lean into our leadership in the area of fresh because customers tell us that fresh is the leading category when choosing where to shop. And in fact, 70% of our customers choose where to shop based on fresh. So, Kroger is taking our Fresh competitive moat to the next level. We're strengthening the moat through enhanced operational processes, getting products to customers sooner so they last longer, and using technology and new ways to improve the fresh experience through all channels, from pickup, to in-store, to delivery for the Fresh's experience for all of our customers. And it's this end-to-end approach to freshness, that's the driver of being the retailer of choice.

Kroger continues to demonstrate operational excellence, keeping full, fresh and friendly at the forefront of how we measure our progress, and we are proud of our results in 2021 that we delivered an all-time best in both fresh and friendly categories. So, while the pandemic has presented challenges for the entire industry around in stocks with supply chain and product mobility constraints, we have responded with new applications such as our enhanced inventory management system, which integrates sophisticated data, science and automation to better predict the movement of goods. This application also streamlined the associate ordering and replenishment systems to better serve our customers and improve sales. And so moving forward, we've set up cross-functional and collaborative in-stock teams who are dedicated to solving supply chain issues, working with our supplier partners for detailed plans on constrained items and we've also increased vendor accountability in store with more data and visibility to service levels.

So, we've learned a lot through the pandemic and we're applying these learnings to make us even stronger in 2022. Data and technology are key to our mission to elevate the customer experience and grow sales. In 2021, we introduced a new fresh production, automated forecasting and ordering application using artificial intelligence. We also have real-time analytics available to coach associates to help them make better and faster decisions. And this is using both customer data for things like transactions and traffic data combined with operational data from our associates scheduling to both help our associates improve service and maintain productivity. And as our checkout experience continues to evolve, we want to give customers more options. So, one of the ways that we're making it easier for our customers is the introduction of our new smart cards, so customers are now able to do their shopping trip and bypass the traditional checkout line. And so, these are in different stages from test and learn to scale, all coming together to elevate the customer experience because our customers value their time and so do we, which is why having products consistently in-stock, fresh products of high-quality and associates friendly, are always important to our customers.

Operational excellence underscores every aspect of our business and every channel from the store to pickup to delivery and pickup and delivery is an important part of our growth strategy for Seamless. And it's more important to the customer experience than ever. Kroger is leveraging our more than 2,200 pickup locations as stores as an asset to further our seamless strategy. And we've expanded capacity in over 400 of our existing locations, creating more flexibility during peak times to capture customer demand. In 2021, we optimized the customer experience with enhanced online inventory visibility, improved digital experience and direct communication. And these applications have made it easier for customers to notify us when they're on their way, so we can have their orders ready faster. This is also a great example of improving productivity and the customer experience at the same time as not only did it improve the cost to serve, but our wait time improved by 20% as we got orders ready

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and improved the service and our customers love it. Cost to serve is improving using operational data and insights for process change as part of our pass-through growth claim.

New technology for selecting orders and streamlining of fully digital car site service improved a cost to serve again in 2021, achieving an all-time record. Our cost to serve has improved by 15% since 2019 and we are proud to be one of America's largest employers. Our culture of opportunity and advancement has created an environment where people from any walk of life can come for a job and stay for a career. Kroger has provided an incredible number of people with first time jobs, new beginnings and lifelong careers. And we take pride in our role as a leading employer in the United States because when it comes to the associate experience, enabling, supporting and empowering our associates is at the center of our priorities. We know that when our associates thrive, they are empowered to bring to life the customer experience in new ways. From first impressions to career growth to development, our people strategy is anchored around creating a culture where associates know that they can grow and contribute in meaningful ways. And this is why so many of our associates come to Kroger for a job and end up staying for a fulfilling career.

And when we talk about investing in our associates, it's more than just wages. Many associates start a career at Kroger because of our total package of wages, combined with comprehensive benefits, tailored training like the 24 hours of individualized training for associates that we give, teaching the customer experience that they can only get at Kroger and the tremendous advancement opportunities. 70% of our store leaders start out as part time clerks and we are always listening and incorporating feedback to simplify the associate experience because we know that our associates feel valued when we hear them and use their input. And it's this combination of training and experiences that build retention and engagement. And it's these investments, benefits and opportunities that apply to all of our associates and they're part of how we build strong relationships with all of our associates, both union and non-union.

Two thirds of our associates are part of collecting, bargaining agreements. We operate in an environment where collective bargaining negotiations occur on a regular basis, and they're part of our everyday business and we have a planning and communications process with goals in mind for our associates. And part of the strategy is investing our associates in meaningful ways, including the average hourly wage rate investments. We are committed to investing in our associates while keeping food affordable. Kroger has invested incrementally since 2017, increasing our average hourly rate, including comprehensive benefits from $17.56 to over $22 in 2021. We have been and we'll continue to invest in our associates as demonstrated by this nearly 26% increase in the average hourly rate over the past four years. And continuing this growing investment for our associates is a priority for 2022 and beyond, as looking forward we expect continued upward movement in the hourly wages in our business model.

Investing in our associates to build retention and engagement is part of our strategy in every area we operate. So, I've talked a lot about our associate experience. let's hear directly from some of our associates.

[Video Presentation] (57:42-58:44)

Our successful ability to find cost savings has allowed us to invest in our associates and our seamless ecosystem. And even with these investments, our cost savings have directly improved supermarket OG&A by a 131 basis points over the past four years without compromising the customer experience. Cost savings is a core competency for Kroger with a proven track record of delivering savings, delivering more than $4 billion in incremental cost savings since 2018 and expect to deliver another $1 billion in 2022 as we continue to elevate the customer experience, and these cost savings are sustainable as we continue to find ways to increase productivity, use data and technology and implement process change. And in many cases, that can mean streamlining

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automating tasks and with the objective of improving the overall customer and associate experience, leveraging technology and data analytics to streamline processes like the in-store replenishment and associate task management. And then also embedded in our cost savings is shrink reduction and using technology in new ways not only to improve shrink but also improve freshness and help us achieve our Zero Hunger | Zero Waste objectives.

ESG is increasingly important to our associates, to our customers and our shareholders, and Kroger is making it part of our everyday operations to achieve our goals in Zero Hunger | Zero Waste. We are proud to be a leader in this space with a focus on reducing waste and improving the well-being of communities across the country with our food donation program, reaching our food waste and sustainability goals will be an organizational effort and will rely on the teamwork of our amazing associates to achieve these ambitious goals.

So looking forward into 2022, we are excited about another year of strong results driven by operational excellence and elevating the customer experience. The associate experience, as we continue to invest in our associates, as we know that the associate experience empowers the customer experience. And cost savings, we will continue our impressive track record of cost savings, building on our achievements of the past four years.

And now I'd like to introduce Yael Cosset, our Chief Information Officer, for how our seamless strategy is solving for customer needs and accelerating growth. Yael?

Yael Cosset

Chief Information Officer & Senior Vice President, The Kroger Co.

Thank you. Mary Ellen. As Rodney mentioned yesterday and earlier today, oops – as Rodney mentioned yesterday and earlier this morning, we're focused on delivering a seamless experience that requires zero compromise by our customers.

Today, I'll provide more details on how our differentiated seamless experience solves for the customer's expectation and what zero compromise means for our customer. I will also provide an update on our two goals that we announced in 2021, our path to doubling digital sales by the end of 2023 and our path to doubling our profitability pass through rate leveraging of a seamless ecosystem, including the growth of our retail media.

We know customers want options and solutions without having to compromise, depending on the trip missions. customers will have different expectations what they want from the freshest produce to a simple yet high quality fresh meal solution, when they need it, whether they are doing their planned weekly shop or looking for an immediate solution for dinner 30 minutes from now. How they want to get it, go to a store, use pick up, get a delivery and all this has to come together without asking the customer to compromise on the value they get. While customers will turn to retailers with the most relevant solutions fulfilling all of their trip missions, retailers continue to ask customers to compromise on the experience, limiting the options or the value they get, which in turn impacts the retailer's overall growth potential. Or they compromise on the economic model, which is not sustainable long-term.

In an attempt to satisfy the customer needs, two different models have emerged with retailers typically focused on one approach over the other. The first model relies almost exclusively on stores, stores being an existing asset, our great option. They offer choice of assortment, including hot food meal solutions. They offer options on timing, including the quick trip leveraging their customer proximity. They also provide options on how customers choose to engage, come to a store, pick up a relevant time or get a delivery. However, with a store only model, there is a tipping point, where one would compromise on potential share growth due to capacity limitation or the unit economic headwind compared to dedicated facilities.

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The second model focuses on large, dedicated facilities and their leverage points. They provide great flexibility in assortment, sometimes potentially beyond what you can find in a store that deliver great customer experience with reliable fill rate, which can be challenging in a store. They provide great scale efficiency and allow us to reach new customers, and by leveraging technology, artificial intelligence, robotics and automations, they can deliver great unit economics, which in turn allows us to pass value back to our customers and our shareholders.

However, by being further away from the customer, it can compromise the ability to capture some of the customer trips, such as convenience, which has a higher expectation in terms of immediacy. Neither of which on a standalone basis can give us full growth potential or the unit economic leverage, on one hand, the store, offering a lot of options to the customer taking advantage of its proximity but limited scale. On the other hand, large facilities offering reliability, scale and efficiency, but limiting some of the trips we can capture. This is exactly why we have structured our ecosystem to leverage both, forming a dynamic network with our stores, our automated customer fulfillment centers to capture the full growth potential with the most relevant experience for our customers. This approach allows us to capture more trips from the planned weekly shop to the unexpected and time sensitive dinner, more customers, more occasions in existing and new geographies, zero compromise to our customers, capturing the full growth potential and no compromise for our shareholder delivering a sustainable economic model.

Looking back at 2021 we continued our journey. We focused on share gains long term, capturing new shopping trips and occasions and deepening the loyalty with our customers through our personalization platform, while we also progressed and invested in our ecosystem of assets to increase profitability.

Let me share a few examples of key 2021 accomplishments. Last year, we launched Kroger Delivery Now, solving for immediacy and convenience for the customers, capturing new trip missions, with a true no-compromise offering, a great Fresh assortment at a great value, to your door in as little as 30 minutes. By leveraging our existing assets, this new offering was profitable on day one after the first order. And that's at a time where many are struggling with a quick commerce model. We expanded our loyalty and personalization platform, which enables us to provide value that matters to each customers with over two trillion relevant recommendations to our customers, with 50% of items added to basket as a result of personalized search. Our omnichannel customers are the most exposed to our personalization and are showing 98% retention and spend two to four times what an average customer spends.

In 2021, we launched paid membership with Boost, as Stuart mentioned earlier, latest addition to our platform, driving repeat rate, frequency rate with over 50% of the members being new to delivery.

Switching to our ecosystem, in 2021, we launched our first large dedicated facilities, such as the one you'll see today, in Cincinnati, in Atlanta, bringing scale and efficiency, and also in Florida, where we are bringing our differentiated experience to over 20 million new consumers.

Lastly, completing our flywheel with retail media, we're fastest growing alternative profit business. Capitalizing on our assets, digital growth and personalization nearly doubled revenue per order over the course of last year. Each of these levers are positioning us to accelerate share gains in existing and new geographies while executing a sustainable economic model taking advantage of our assets, and retail media growth.

Looking ahead, we will grow our existing business by roughly $5 billion over the next couple years, growing baskets and share of total grocery and food spend. We will also generate significant growth capturing new shopping trips, reaching new customers and new geographies. Starting with our core business, here are a few

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examples. First, growing our baskets, personalization simplifies the experience, improves relevance and convenience which underpins how we grow share of wallet and improve the overall mix with our customers, which we will continue to amplify with a Boost paid membership program. Second, we are making it easier for customers. In 2022, we will continue to make it convenient for our customers to shop when and how it best suits them. We expect pick up, our largest e-commerce business today to grow by double-digit in 2022 alone, taking advantage of the store proximity, expanded capacity and availability when it really matters to the customer.

Last but not least, new trips and new customers. We will continue to leverage our stores for immediacy with Kroger Delivery Now to grow our share of the convenience trips. These occasions with our customers are highly incremental to our core business. Quick Commerce alone is a $1 billion plus growth opportunity for us over the next few years. Our growth will also come from the newly launched facilities and the ones we will be opening over the next 24 months, giving us access to new share and new customers in existing and new geographies, bringing amazing customer experience, reliability, scale and efficiencies, and reaching tens of millions of new customers.

We mentioned how convenience trips are incremental. I want to spend a minute on how our network of dedicated facilities drives growth and incrementality, how all the pieces fit together. This map is illustrative to help reflect opportunity in existing and new geographies. It shows our stores, some of the facilities we open and upcoming launches.

First, it starts with the quality of experience, fresh quality, reliable, fresh fill rate. Since we launched our seamless experience in Florida, for example, we have seen an amazing response from the families we serve and are achieving an industry leading Net Promoter Score. In existing geographies like Cincinnati and – Cincinnati is reflected illustratively in the insert – by opening up additional capacity we are driving growth of share of wallet from our existing customers. We are also reaching new customers who live further away from our stores or in less dense geographies. Moving away from existing geographies, we are building on the experience and learnings in Florida, and in 2021 we're entering new geographies, expanding in South Florida with smaller facilities to capture more trips and more customers.

We are also launching in Oklahoma City and Cleveland, which we've announced this week and announcing today in 2022 we are also launching in Austin, San Antonio, Birmingham, Alabama with more coming in 2023 and beyond. These new geographies alone are unlocking access to over 40 million new customers in 2022 and this doesn't include the Northeast and Southern California markets that we have announced, which we will launch later. Here is a full list of the sites we have announced so far, not going to go through all of them, but for your reference available as material. Our airports connecting our stores' large and small dedicated facilities creates a competitive advantage setting us up to accelerate share gain in a sustainable way, growing the core with larger baskets, improving the mix and deepening loyalty with our personalization platform, which will increase share of total spend and also capturing new shopping trips with offerings such as Kroger Delivery Now and new customers in existing and new geographies.

Now, looking at our path to increasing profitability moving forward, some retailers have chosen to rely exclusively on stores, while others have favored dedicated facilities. As I mentioned, we're building an ecosystem by combining the best of both worlds, without compromising on the customer experience and our technology and our data ties it all together to make it seamless to our customers. Let me share some color on the journey ahead.

First, our stores. Despite supply chain and labor availability challenges impacting our stores, as Mary Ellen shared, we continue to invest in technology to further improve the quality of the customer experience, the productivity from the assets and improve the cost to serve. Second, as we build our flexible network, we are connecting stores which provide the convenience and immediacy with dedicated facilities of various sizes which

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provide scale, reliability, reach with the efficiency of automation and our supply chain network providing the supporting infrastructure. When you complete the tour of our facility later today, we are confident you will recognize the impact such facilities have both on the customer experience and on the economic model.

Our CFCs use world-class technology where automation improves accuracy and reduces labor cost. We use data and artificial intelligence to reduce shrink and optimize inventory management. Simple things like the use of refrigerated trucks for our own fleet guarantees freshness quality from the fresh tomatoes to you, ice cream to your door, all contributing to the differentiated nature of our experience and its quality. And our customers are voting with a rapidly growing basket size, high repeat rate and high frequency rate. And it is what's live today. We continue to collaborate closely with Ocado who just a month ago shared some of their latest breakthrough innovation with impact on existing or future facilities. Two simple examples, the new generation bot, which is 5 times lighter than previous version, will reduce the cost and the time to build a facility, provide more flexibility and push the envelope on how we integrate automation in smaller facility such as the one we announced in South Florida.

Robotic picking, increasing the speed at which we pick an order and improving the unit economics by reducing labor cost. All these will contribute to further improve the unit economics, the flexibility and size of facilities, which is crucial to our model to fully capture the growth potential by capturing more trips and reaching new customers.

As we shared in the past, as we ramp up the utilization of the capacity in a facility, the density of a delivery route with batching, facilities typically reach the breakeven point within three years and compare or exceed store profitability pass-through rate beyond that.

Our dedicated facilities are a key part of our path to profitability while contributing to further growth potential by reaching new customers both in existing and in new geographies, a huge growth opportunity.

Third, our retail media growth, we are accelerating our retail media business growth, a key driver to doubling profit by 2023. Kroger Precision Marketing, our fastest growing alternative profit business is outpacing industry growth rate, an industry projected to exceed $50 billion by 2030. Our assets and platform serve to capitalize on this opportunity, leveraging proprietary artificial intelligence built on very granular first party data. For the fourth year in a row, our media platform received industry-wide endorsement from Path to Purchase Institute and industry experts recognizing the sophistication and value of precision, audience targeting and advanced measurements. Our media effectiveness realize double-digit improvement in 2021 alone driving our momentum which is extremely strong with our advertisers, agencies and publishers who represented close to two Southern brands in 2021.

Looking ahead in 2022 and 2023 our record growth revolve around the continued growth in our digital sales business. New capabilities such as shoppable content and also by unlocking access to new budgets. [ph] Merkel (1:19:56) published a study recently confirming that 95% of CPGs are investing in retail media dollars that are incremental to shopper or trade program dollars. And as advertisers shift more of their marketing dollars from less efficient platform, less efficient options, we will continue to increase our media revenue per monthly active users, which contributes to our flywheel and our path to doubling profitability by the end of [ph] 2023 (1:20:27).

As I wrap up, I want to reiterate a critical few points, our seamless ecosystem enables a differentiated customer experience, where our customers do not have to compromise on what they get, when they get it and how they get it, leading with fresh, leveraging personalization and an extensive set of shopping options. We are excited about the growth ahead, gaining more trips and winning new customers, zero compromise for our customers. And our approach will allow us to deliver this experience in a sustainable and profitable way, improving cost to serve from

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our stores, taking advantage of our network of dedicated facilities with industry leading experience and unit economics, accelerating the growth of our business. And last but not least, continuing to leverage our retail media business and its accelerated growth. All these will contribute to doubling digital sales and profitability rate by the end of 2023, creating a competitive and economic advantage through our assets and our flywheel.

Thanks for your time. I will now turn it over to Gary who will share a value creation model and our path forward. Gary?

Gary Millerchip

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

Thanks, Yael. Hi, good morning, everyone. It's great to see so many of you were able to make the trip to Florida and be here in person with us today. As you've heard from the team, we have made significant progress executing our strategy over the last three years and we see a clear path to growth ahead of us. I'll now share how the plans we've outlined today come together to deliver attractive and sustainable shareholder value for our investors. There are three key messages you should take away from my presentation.

First, Kroger has a proven value creation model, and we have [ph] developed (1:22:44) multiple levers within this model to ensure we deliver future earnings growth. Second, we have exceeded our TSR goals since the initial launch in 2019, driven by strong execution of our go to market strategy and structural changes that have occurred in food at home consumption. Looking forward, we believe we can continue to deliver TSR of 8% to 11% on a new higher base. And finally, we expect our business to generate strong free cash flow and see many opportunities to invest to drive future growth, while also continuing to return excess cash to shareholders. Let me start by highlighting how we are delivering on the commitments that we made back in 2019.

Our results in 2020 and 2021 and our guidance for 2022, highlight the significant momentum we have created in our business and provide a clear proof point of the strength of our go-to-market strategy. Over these three years, we expect to significantly exceed all elements of our TSR algorithm. As you can see within this table, our identical sales are expected to achieve a compounded annual growth rate of over 5%, almost two times the midpoint of our target range. And at the midpoint of our adjusted EPS guidance for 2022, we would deliver compounded annual EPS growth of over 20%, more than two times the top end of our TSR model.

Our 2022 guidance also reaffirms that we are creating a new higher base from which we expect to grow, some $900 million higher than the midpoint of our TSR model would have projected when we announced it back in 2019. Our guidance also highlights the flexibility and multiple levers that exist in our model today, which will allow us to deliver EPS growth in 2022 while cycling COVID-19 impacts and investing for future growth.

I'd like to take a step back for a few moments to recap Kroger's strong and durable value creation model, which is allowing us to deliver these exceptional results. The foundation of our model is our market leading omnichannel position in food retail. This is built on Kroger's unique assets, which combined with our competitive moats, deliver an unmatched value proposition for our customers. Looking forward, we are committed to continuing to widen and deepen our moats and expect to grow revenue at a faster rate than the food at home market. In addition, we are utilizing our customer traffic and unique data capture and analytical capabilities to deliver even greater value for customers, which in turn produces a high growth, high margin alternative profit streams.

The value we create from alternative profits, which wouldn't exist without the strength of our core food business, allows us to reinvest even more in the customer to drive additional traffic into our stores and digital channels, creating a flywheel effect in our value creation model. We are evolving from a traditional food retailer into a more diverse food first business that will consistently deliver net earnings growth of 3% to 5% in the future. We also

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expect to continue to generate strong free cash flow. We remain committed to growing our dividend over time and returning excess cash to shareholders via stock repurchases, resulting in a total shareholder return of between 8% and 11%.

One message that you've heard consistently from the Kroger team today is our focus on growth. Looking forward, we expect to grow sales by 2% to 4% annually. Stuart and Mary Ellen shared how we will do so by deepening our competitive moats, maximizing growth drivers and by delivering a great customer experience across our full friendly and fresh initiatives. Yael also shared how we will accelerate digital sales by improving the customer experience, expanding capacity and reaching new customers.

Our plans will be supported by continued investments in our customers, associates and our seamless ecosystem. At the same time, through process simplification and the investments in technology, we will take significant costs out of our business without impacting the quality of the customer experience. These productivity improvements combined with the gross margin levels that Stuart talked about and sustained growth in alternative profit streams provide us with a clear route map to expand operating margin by 1% to 2% over time.

Now, some of you will recall that when we originally announced our plans to grow alternative profits back in 2017, we shared some very ambitious goals and I'm delighted to say that we are very much on track with those goals. In 2021 alternative profit streams contributed over $1 billion in operating profit to Kroger, and we continue to see tremendous opportunities ahead of us for future growth.

At KPF, our plan is to focus on increasing customer penetration as only about one-third of Kroger shoppers currently use these services. We also see opportunities to innovate with new financial products at KPF. And while retail media has experienced phenomenal growth in the last two years, we still view this as a relatively immature revenue stream. As Yael shared earlier, CPG companies are investing billions of marketing dollars on digital platforms like Google and Facebook, and by leveraging our first-party data we have a huge opportunity to help our partners achieve a greater return on their investment.

As we continue to demonstrate the unique value of our media platform and grow digital customer engagement, we expect retail media will continue to grow share and expand at a rapid pace. Overall, we expect alternative profit will continue to grow at a double-digit rate for the foreseeable future. As this growth compounds on a larger base and is incremental to our core business, we would expect alternative profit to be a key driver in allowing us to reach an inflection point in our gross margin rate, excluding fuel. And by that I mean over time our gross margin rate should start to flatten and then show slight improvement.

I'd like to turn now to capital investments, as we shared yesterday we'll be increasing capital expenditures to $3.8 billion to $4 billion in 2022. This includes some catch up from lower than guidance spend over the last two years due to COVID-19 constraints. We are prioritizing the highest growth opportunities that will strengthen our competitive moats and deliver solid returns.

In addition to enabling our 2022 financial plan, these investments will support future growth outlined in our TSR model. In 2022, including our investments in CFCs, we will spend over $1 billion on accelerating our digital capabilities to drive profitable growth. We have also increased investments to drive operating margin expansion by $400 million over the last few years. This includes accelerating investments in technology to drive productivity and reduce waste across the enterprise. Beyond 2022, our TSR model contemplates capital expenditure of approximately $3.5 billion annually. And it's important to know that all of our capital investment programs, with the exception of maintenance projects, are expected to generate returns above our internal hurdle rate of return of 11% after tax.

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Our capital priorities for 2022 align directly with our value creation model and the plans outlined earlier today. To support sales growth, we remain committed to investing in our stores to improve the customer experience and to drive productivity. Our digital investments are focused on driving expanded capacity, improving the customer experience and developing new innovative propositions via our strategic partnerships, including Kroger Delivery Now with Instacart and also our CFCs powered by Ocado.

In addition, we will continue to invest in initiatives that deepen our competitive moats in Fresh, Our Brands and data and personalization. And these initiatives enable growth across both our stores and our digital channels. To support margin expansion, our capital priorities reflect technology investments that will enable $1 billion of incremental cost savings in 2022 and beyond, without again impacting the customer experience. This includes initiatives to drive lower digital fulfillment costs, increase store productivity and reduce shrink, as well as investments in supply chain that will expand capacity, improve product freshness and maximize productivity.

As Rob and Yael shared earlier, we are excited to have you here in Florida today to experience how our new customer fulfillment centers are helping transform our digital business through increased efficiency and the best-in-class e-commerce customer proposition. We also chose Florida, so you can see the unique opportunity CFC presents to grow new customers and expand in new geographies where we do not operate stores today.

I'd like to turn now to financial strategy. Our overall approach to capital allocation remains unchanged. And we will continue to be disciplined with our capital allocation decisions. Our first priority is to continue to invest in high return projects that support our strategy and drive earnings growth of 3% to 5%. We also remain committed to maintaining our current investment grade debt rating, growing our dividend over time and returning surplus cash to shareholders via stock buybacks achieving an expected payout ratio of between 5% and 6%. A key component of our financial model is the strength and resilience and consistency of our free cash flow, which has historically proven to be resilient throughout the economic cycle. Since 2018, Kroger has generated $11.6 billion in adjusted free cash flow and over the same time period returned $7.5 billion to shareholders, including growing our dividend at a compounded annual growth rate of 13.8%.

Over the last two years, we have meaningfully strengthened our balance sheet and liquidity, providing significant financial flexibility to invest in the business and drive future returns for our shareholders. Kroger's net total debt to adjusted EBITDA ratio is currently 1.63 compared to our target range of 2.3 to 2.5. Now, we are committed to being disciplined in deploying this flexibility, in accordance with our stated capital allocation priorities, and this can be evidenced by our recent decision to increase capital expenditure to support future growth. The 17% increase in dividend announced last June and an acceleration in share buybacks over the last six months. We will continue to look for attractive, high return organic and inorganic opportunities to invest in the business that enhance our moats and accelerate our growth strategy while at the same time, we remain committed to returning excess cash to shareholders.

Let me bring together everything you've heard from the team this morning. Kroger is operating from a position of strength. We are delivering today and investing for the future. We have a leading market position underpinned by our unique assets and competitive moats with exciting future growth opportunities. These opportunities, many of which you've heard about today, build on our strengths and allow us to serve customers in new and exciting ways. We have a proven value creation model underpinned by a strong balance sheet and resilient free cash flow, and our leadership team is energized by the opportunities in front of us. Our management incentive plans are designed to ensure the team is laser focused on delivering sustainable earnings growth and total shareholder returns of 8% to 11%.

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This concludes our presentations this morning. Thank you for listening. I'll now turn it over to Rob, who will introduce and facilitate the Q&A session. Rob?

Rob Quast

Director-Investor Relations, The Kroger Co.

Thank you, Gary. This concludes our presentations. We will now pause for a few minutes to assemble our management team as we prepare to take your questions.

Before we begin, I would like to briefly touch on how we will be handling Q&A. Kroger team members will be walking around the room with microphones to take your questions. Please raise your hand if you would like to ask a question. For all individuals asking a question, please state the name of the company you're with and your name at the start of your question. We ask that you please limit yourself to one question. We will begin the Q&A session at 10:15. Thank you.

[Break] (1:37:12-1:45:46)

QUESTION AND ANSWER SECTION

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, Rob Moskow, Credit Suisse. Nice to see everyone in person.

W. Rodney McMullen

Chairman & Chief Executive Officer, The Kroger Co.

A

Good morning.

Robert Moskow

Analyst, Credit Suisse Securities (USA) LLC

Q

I wanted to know, obviously going into Austin and these other markets, it demonstrates a lot of confidence in being able to enter markets without having a brick-and-mortar presence. I want to know if you could share a little bit about what kind of market penetration you expect to achieve in those markets and maybe an update on the progress so far in Orlando, is it based on penetration or is it just based on dollars in order to achieve success?

W. Rodney McMullen

Chairman & Chief Executive Officer, The Kroger Co.

A

You're looking at dollars and how broad a area do you need to get the dollars in. Obviously, it's incredibly high quality service that you're providing to the customer, and it's a unique experience that customers aren't able to get to other spots. So, it's a reasonably modest market share. We really don't feel the need to have physical stores, now in places where we do, obviously you leverage the physical store to accelerate the growth. If you look at Florida, as we said earlier, we're tracking real well against where we thought we would be at this point. The thing that we're especially proud of with our team here and I'm sure they'll talk about it later is our NPS scores. If you look at our Net Promoter Scores, it's up in the Apple type league. And for us when you think about a supermarket experience providing that kind of customer experience, we're so proud of our teams and that experience. And we believe as long as we continue to provide that kind of experience for our customers, the customers will reward us with their business. I don't know Gabrielle or Stuart or Yael, anything you want to add to that.

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Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

A

Yeah. One of the things that's interesting in Florida in particular is that the market is actually growing, so it's expanding. So, one of the opportunities that we've seen is with every customer that we actually serve with this great Promoter Score and that wide reach that our facilities have for example, one facility can actually go all the way to 180 miles and still deliver on same day and next day. You're covering quite a broad geography where you have a lot of customers with a great service assortment and fresh food. So, I think it depends on the market to your question. But to use the example of Groveland in Florida, that would be the key, the expansion, expansive nature.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

I might just add one thing to just to clarify, because I think the two examples you gave are slightly different too in terms of the level of capital investment in new markets and the level of business that you would need to be happy with the return on the investment. So with the Groveland CFC, of course that's a brand new sort of completely clear new opportunity for Kroger. And we have no stores in that market and we're going to market as a pure digital solution. When you think about some of the spokes that we talk about, many of those are building off of a CFC that's in an existing Kroger market. So we're often moving into contiguous locations that may be Kroger doesn't have stores, but it's allowed us to expand the capacity of the facility. So we're still servicing Kroger markets through the Dallas CFC. But it's enabling us to add some spokes, which are low capital intensive and we can bridge where obviously Kroger has very strong brand perception in neighboring markets, and you can then accelerate the growth by tapping into those contiguous areas.

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Q

Hi, Simeon Gutman, Morgan Stanley. I want to ask about capital allocation. It seems like you have only good choices to make from here. I wanted to ask about M&A. We were chatting Gary that maybe the economics could change since the advertising business is growing. Stores as an asset could you invest for longer term, but maybe sacrifice near-term returns just to get the store base in as good a shape and then buyback if margins are going up, that could be the best use. So how do you think about all those uses of capital from here?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

You want to start?

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Sure, yeah, I'll start and then Rodney I'm sure will add. Simeon, thanks for the question. Now, I think maybe to just come back a little bit first of all to my opening comments. We feel like obviously we're very confident in our financial model and the free cash flow that we generate. And we've already started to signal, I guess, if you think about the changes that we've made over the last 12 months, we're accelerating capital expenditure where we see opportunities to accelerate growth in the company. We increase the dividend last year and we increased the amount of buybacks in the last six months. So, we feel like we're being very disciplined of where are the opportunities to be able to deploy free cash flow.

All of that being said, we still believe we have significant flexibility within the model and we're really going to be disciplined, as I mentioned in my prepared comments, applying the capital allocation philosophy that we've talked

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about. We'll start with are there other opportunities where we can grow the company and we believe our TSR model will be delivered without the need for inorganic or M&A activity. But that doesn't mean that if we find the right M&A opportunities that can accelerate our capabilities, accelerate our growth and create shareholder value that we're always going to look at those opportunities alongside internal growth to say, where's the best way to accelerate our model and continue to grow Kroger at a faster pace.

Where we don't see those opportunities? Then of course, we're committed to returning cash to investors. We do think in the short-term – with all the uncertainty in the market right now and lots of global events that are happening, being in a strong position for liquidity and a strong balance sheet is actually, we think a good place to be because we want to be able to be opportunistic and take advantage of opportunities that may emerge as the future outlook becomes clearer. But we certainly are holding ourselves to a high standard to make sure that we're being really focused on where do we believe those opportunities are and we recognize that for our shareholders, it's important that we're clear about where the growth opportunities are and where we don't see those opportunities returning cash to investors.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah, I would just add a couple of things and Gary said it, but the discipline, obviously we have significant capacity and making sure that we're disciplined on how do we invest that capacity is critical and something we will do. If you look at the merger with Home Chef would be an example of where we really tried to find a company that had capabilities that we didn't. But you can leverage the assets they have within the Kroger infrastructure, plus help them accelerate their growth as well. And those are the types of things that we're looking at because it really does create a win, win, win and when we're able to do that, that's a great shareholder return as well. And capabilities are always important.

Michael Lasser
Analyst, UBS Securities LLC

Q

Good morning, it's Michael Lasser from UBS, thanks a lot for taking my question. It's a two-part question. First, how would you rank the order of importance to the goal of doubling your pass through profitability rate for your digital business in terms of gaining scale, reducing your cost of fulfillment and the advertising business or anything else?

And second is, part of that you haven't provided a lot of details around your economic relationship with Ocado. How would you refute the skeptical argument that Kroger was going to have to share in the profitability of its digital business, which could put it at a disadvantage amongst other large players like Amazon or Walmart, who don't have a similar type of relationship? Thank you.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yael, did you want to start on the first one?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Yeah, I was going to grab my pen to write it down. I think I don't know that I would necessarily rank them as in like one is bigger or more important. I think they all go hand in hand. As you scale the business, drive the growth, you improve the economic value of the unit economics on the facility, as we continue to grow as Mary Ellen shared this morning, we're also improving the cost to serve from the store. So scale helps drive the productivity of the

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asset, whether it's a facility or our stores and our teams in our stores. The fulfillment, obviously [indiscernible] (1:53:58) the advertising again, the scale of the business as the business – as the e-commerce business grows we're driving more traffic, whether it leads to transaction online or transaction in stores, but that traffic on our digital ecosystem, the app, the website is driving media revenue and ultimately contributes to that alternative profit growth. So, I don't know that I would necessarily put one above the other or rank them. I think they're all interconnected.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah, when you look at our partnership with Ocado, Yael talked about it. But if you look at our seamless ecosystem that we're designing overall, obviously Ocado is an important part of that overall ecosystem. But there's a lot of using our existing assets and new assets tying it all together. We would consider Ocado as a strategic partner. We have a very deep relationship with them in terms of sitting down and talking about things we need on future development, things to keep getting better. And when you look at Ocado, we believe there's enough opportunities there where Ocado will be strongly profitable because of our relationship and we will be as well. As you know, in the prepared remarks today and a year ago that we believe in – if you look out four years or so, the margins in that business won't be any different than the margins in the supermarket business.

The other thing about Ocado and Tim Steiner, who's one of the Co-Founders of Ocado, when we decided to do the original agreement, the thing that I shared with Tim is we're partnering with Ocado, who we think you will become, not who you are. And Ocado has an amazing set of software engineers and talent that's continuing to improve and develop on the things they have. And if you had a chance to watch their investor meeting a month or so ago and Yael shared some of the slides from it today, to me, it shows you the talent they have and the talent they have to keep getting better and better on reducing the cost, reduce – improving the speed and reducing the capital requirements to open up a facility as well. So we think there's enough opportunity where they'll have a good ROIC, we'll have a great ROIC and it's together we can create something that we can't individually. I don't know anything you'd want to add to that. The other thing I always like to remind people is, remember, Ocado has been in the business for 21 years and we get 21 years' worth of experience with that partnership. Yeah.

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Yeah. No, I think you said it well, Rodney. I think obviously the investment that Ocado is making as a technology company with 20 years' experience and the software engineers and the capability that brings, we believe we're getting great value for money in terms of that knowledge and that expertise that's hard to create in a retail business. And then, of course, we've heard Ocado talk about their retail business in the UK, which I believe they include their fees to their Ocado sort of technology company when they think about Ocado Retail and the Ocado Retail business in the UK has demonstrated they can achieve profitability rates that are higher than traditional food retailers in brick and mortar.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Hi. Karen Short from Barclays. So I wanted to just ask a question with respect to doubling the seamless ecosystem in 2023. Can you break down how much that will actually come from new markets versus existing? And then how are you contemplating cannibalization within that commentary? And then the second question I wanted to ask, sorry if you want to write it down. The second question I wanted to ask is, you talked about a larger FC, it used to be the equivalent of about 20 stores, so can you just update us on that and then what the equivalent of a smaller FC would be in terms of actual physical stores?

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Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

So rather than, I'm going to start with the last part because that's the easiest to remember and I'll come back. I may need you to re-ask. But I think the beauty of the capabilities that we have and are leveraging for our CFCs is that they are very flexible. So, there's kind of a standard model, the larger FCs, back to your point about 20-ish stores. But in reality, when you look into a market based on the approach, the density of population, the current e-commerce penetration, you can flex up or down the size of that facility and it's reflected in the facilities we have opened and, and others have opened globally. So, I would think about it as like a flexible model, and it ties to the first question we had, which is when you go into a given market, none of the facilities we are opening will saturate the market. They are a step and then you can look at it as like what is the expected market share, the e-commerce penetration in that geography. They vary greatly depending on where you look on the map I shared earlier. So, the e-commerce penetration, the market share you can gain will have an impact in our plan and our strategy on how quickly we can ramp up the capacity that we build in a given geography. So, it's hard to say the store equivalent because it will vary from one facility to another. The first part was how much will come from new markets versus existing. Is that...

Karen Short
Analyst, Barclays Capital, Inc.

Q

Yeah. And how you are factoring in cannibalization?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Yeah. So, the cannibalization part, we always look at both, right, which is, if there is growth in demand from the consumers to drive engagement online, we have to be present and we have to account for what is net incremental growth versus potentially a channel shift. I think the important learning and confirmation over the past two years, as the pandemic has greatly impacted the customer behavior, accelerating in some cases, pulling back when customers flocked back to the stores is that by having a seamless experience of what's available online and in-store, we are retaining the customer. Our retention rate, I shared, is over 98%. In fact when customers have decided to move from primarily online back to a little bit in-store or a lot in-store, depending on their personal preferences and also the context of their day, every single day. We retain over 99.9% of the customer spend even when they slow down their engagement online. And that was some of the performance and accomplishment that we've seen over the years by building that ecosystem and portfolio of experiences. So the cannibalization obviously is an important data point when you look at growth. But ultimately, we want to win the customer hearts and minds and we want to grow their share of wallets.

Now when you think about the first part of your first question, if I didn't miss it, about the share between existing and new geographies, if that's correct. As I mentioned earlier in my prepared remarks, we expect the growth coming from growing share of wallet by improving the product mix, by improving the quality of experience which drives that growth from our existing customers, but also leveraging personalization with membership, which also captures incremental share of spends. We expect that to represent roughly about $5 billion of growth between now and the end of 2023. The rest will come from either new customer in existing or new geographies as I pointed out on existing markets using Cincinnati as an example, there are customers we're able to reach in Cincinnati or in the tri-state area that we would not have been able to reach as easily because of the footprint of stores typically focuses on dense population area.

So the other half, if you will, roughly of our growth will come from new customers in existing market, new customers in new markets I think Florida 20 million consumers. You can do the math back to your point about the

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20 store equivalent. That is a lot of demand in e-commerce for us to go after both from a consumer perspective, and the new trips, I also pointed out the fact that existing customers and existing geographies also engaging with us in new ways, and with the launch of like quick commerce for convenience, we've seen huge, huge response and growth in that area, which will be another big contributing factor to our growth. So I hope I answered your three questions.

Mary Ellen Adcock
Senior Vice President - Operations, The Kroger Co.

A

Yeah, and just one thing to build on the point around, that's why we're so focused on the customer experience across all of the channels with their retention. Because having that experience, we know that customers are shopping all three and across, and having that experience also improves the retention that builds incrementality for that future growth.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah, an example of that is if you look at Kroger Delivery Now, almost 100% of this is incremental. So that was a customer that is actually loyal to us, but we really weren't giving them an offer to make it easy to shop with us. And what we are finding is the more engaged somebody becomes in our digital ecosystem or our whole ecosystem, we get a higher share of their total household spend. And you get an accelerating effect.

And one of the things that Tim Steiner always laughs at me because I – if you go back a year ago, Ocado basically had 700,000 households spending about $3.5 billion a year with them. And when you think about the deep penetration that you're getting into a household, when you get that kind of spend out of 700,000 by designing an overall ecosystem, we think there's a huge opportunity to get – to accelerate our share in each household and that's what Yael that was showing on his one slide.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

And maybe just one thing to add to around – the question around cannibalization too. So when we talk about our pass-through profitability on digital, we assume 50% of the transaction is cannibalizing in an existing market with an existing customer. And that's been actually we've tracked that for a long time. It's been pretty consistent even really since back to 2017 when we started to build the digital capabilities. So we – so when we talk about pass-through profitability, we're burdening the cost with the whole basket and we're only including the 50% incrementality as we're looking at the revenue and the value generated.

I think one of the interesting things with that will be, and Yael mentioned in is prepared comments is, we believe you hit a certain point in the store where you're probably impacting the store sales if you get beyond a certain level of fulfilling digital through a store. So as we use the CFC facility is powered by Ocado to start supporting those markets, we think there's a potential opportunity to see more incrementality because you can actually improve the experience in the store by having less of the shoppers around the store. We haven't built any of that into our modeling, but we think that's something that we believe we'll see over time as we get that ecosystem that Yael described across store and CFC is working together.

Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

A

Clearly, we're all pretty passionate about this one, but genuinely, if you take a look at it from a customer perspective, Karen, from a share of wallet perspective and engaging with the customer as Rodney likes to say

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across our seamless ecosystem, our share of wallet goes up significantly. So that's the first piece. The second piece is retention of that household then is significantly higher. So when we look at the total picture of what we're offering customers, Rodney's point on anything, anytime, anywhere, we can offer that increasing share of wallet and increasing retention. Now we've got true customer lens on the entire ecosystem and we love what we're seeing.

John Heinbockel
Analyst, Guggenheim Securities LLC

Q

John Heinbockel, Guggenheim. So two related questions and this may be overly simplistic, but if I take in all of the discrete P&L benefits, right, the cost reduction, alternative profit stream, et cetera, back out your EBIT improvement yearly, you get a delta, maybe about a $1.2 billion, $1.3 billion, when you think about that cost inflation, right, versus your proactive investments. So how do you think about those two buckets in that delta?

And then secondly, you think about the 4% comp, you'd normally think maybe the EBIT would grow a little faster than 5%. But is there a conscious effort to invest down so the priority is to be in that 3% to 5% no matter the comp environment, right, you'll move your investments around to create consistency as opposed to blowing that number away.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah, I'll let Gary answer the hard part of the question, but we are consciously – I mean, we're looking at the 8% to 11% TSR and making sure that we have a model where it's sustainable over time. And it's incredibly critical for us to continue our deepening our relationship with our customer because we think that's what makes it sustainable longer. And when you look at some of that investing, obviously we're making significant investments and our shared strategy going into new markets, we're also making significant investments on Fresh and making sure that we're accelerating our Fresh experience for our customers. So for us, it's really important to have the strong identicals but then take those strong identicals and invest part of that incremental in the customer and our associates because we think that's what makes it sustainable over time. Gary, I'll let you get into some of the...

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Yeah, well, I think it's a good question. John, I mean, I would probably have two different answers because if you think about in the short term, I'm not sure you can really separate inflation from strategic investments because in the current environment, investing in our associates is really important. Managing inflation and giving customers value where they – it makes the most sense, but while obviously managing margins effectively and sourcing effectively, all of that really is integrated in the short-term. So I don't know I would kind of separate them out in the short-term.

We think of it as how do we manage the business to deliver on our model and pull the right levers to navigate through what's been an interesting couple of years, and I'm sure it's going to continue to be interesting for the next 12 to 18 months. I think in the longer term model, as we shared in the guidance, we believe 2% to 4% is where we expect to be in terms of top line growth. And as you might imagine, if you're at the higher end of that range, you expect to be in the higher end of earnings growth or you're lower end it's going to be in the lower end unless we're pulling levers in a slightly different way in the short-term to manage that.

I think the important thing to remember is we're also aiming to grow total sales. So identical sales will create leverage, but as we're investing in some of these new markets and new opportunities, in the short-term that may

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not lead to accelerated earnings growth as you're building the business, but certainly over time if we can get more confident in those investments driving higher growth, then of course, over time they're likely to improve profitability as well.

Krisztina Katai
Analyst, Deutsche Bank Securities, Inc.

Q

Krisztina Katai, Deutsche Bank. Thank you for taking the question. You talked to the importance about Fresh. I just wanted to ask where you are in that end-to-end process journey, optimizing the supply chain, building these improvements, essentially building that also into your omni-channel. And then I think you've had a slide that said that your Fresh perception is the highest that it's ever been. So maybe can you just talk about what kind of a sales lift that you get, and how is that built into within your TSR 2% to 4% sales growth? Thank you.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah. I'll let Stuart to start out and then Gabriel and Mary Ellen add to, because when you look at Fresh, one of things that we're super proud of is it's really across all functions of the organization. So, it's the technology team in terms of being able to provide new approaches to technology to make it easy but it is literally all the way across.

And for us, it's critical. I don't know how, I've not asked our team how they feel relative to your question where we are in the process but I always think about things from a baseball game, I love baseball. And I think about things from an innings standpoint. We're still in the first inning. And it's nice that we start out at a competitive advantage and we've identified all kinds of things on how we can work together collaboratively to make it even better for our customers and make it easier for our associates.

So, Stuart, with that, I'm going to let you start getting into some of the more details and then everybody else can add on.

Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

A

And I'm not a baseball aficionado, so I'll talk football. No.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

But it's a different football for you.

Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

A

Exactly. Exactly. So, Rodney is spot on with respect to the number of departments that are involved, it truly is our entire organization, starting with the insights behind the quote you heard from Mary Ellen earlier and myself earlier on 70% of shoppers determining where to shop based on freshness. We have that ranked by every single department. Even within those departments, we have ranked what's most important to the consumer. So, from an insights perspective, we have that done. From a supplier perspective, we have in the produce department selected the suppliers who are able to deliver the quality that we expect and the supply that we need.

So we've gone through that process. Within my prepared remarks, I talked about the fact that from an in-store perspective and Mary Ellen can get into more of that in a moment. But from an in-store perspective, the stores that have completed the entire end-to-end process insights all the way through to execution at store level, which

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includes labor at the time when customers are shopping, we have seen very good numbers. We're excited by that. We will, because of the numbers we've seen, expand that in 2022 across produce.

And then as I mentioned right behind that we're working further upstream. And the insights piece and the supplier piece on meat right now and then from a dairy perspective, because we manufacture a large piece of the dairy side of things, we are a little bit further ahead on the dairy side as well. So that's where we are in the process. And to be honest, this is going to be a multi-year journey for us, but we're incredibly excited with where we are today.

Mary Ellen Adcock
Senior Vice President - Operations, The Kroger Co.

A

Yeah. So just building out, as we have mentioned, we know that Fresh is a leading indicator for the customer and we're starting from a competitive advantage there. However, we have plenty of opportunity which we see to continue to improve that all across and Stuart mentioned some on the upstream at the store level, it's also about using data and technology to enhance those operational processes and make them more sustainable. So for an example, we have introduced a new forecasting and ordering algorithm that makes it better predictive using the artificial intelligence, and also with the data and technology about improving the associate experience, which makes it easier for the associates, which is also how it makes it more sustainable, so we see that for the long-term.

And we're moving that into other aspects of the store across different elements. And this also, though combines with the total experience for full fresh and friendly because the customer also proves when they look at Fresh, in-stock is a part of that. So we've also used technology about how do we better predict the movement of goods to have them in-stock so that we improve that total experience because it all comes together and we know we use our leading indicators for the in-store execution and we see a tie to the business results on those leading indicators that – we know that when we have all those together it does improve the sales because the customer recognizes that total experience as well. Combining that with things that we're doing in the supply chain to go all the way upstream from where it starts with the customer.

Gabriel Arreaga
Senior Vice President-Supply Chain, The Kroger Co.

A

It's a great question because at the end, not everybody can do Fresh, and even when you look at in the market and see how everybody's infrastructure is completely different. I find that we are uniquely positioned to actually carry this out. So, I'll give you a couple of examples. We went out – we set out to actually reduce the days of stock that we had across our warehouses and our distribution centers. We've taken out about 30% of those days of stock, and that has created a lot of efficiencies, not only on the Fresh side, but also creates a lot of efficiencies on the cost side.

But there's clear examples when you think about differentiating factors, we have a logistics quarter that can actually put flowers that were cut in Colombia in our stores tomorrow and creating that ecosystem took a lot of years and actually it is now at the – I would say at the pinnacle where if you add, keep adding technology, you'll get even better and better and better. Another example is bringing things from California, pick them, it's a matter of two days before they're out of stores, which prolongs that freshness and reduces shrink to store. It creates a lot of great perception from the customer.

And you asked about how it works with our seamless ecosystem or how it works in our sheds. The sheds have the ability to actually curate a lot of the product that we're actually getting into the building. So we do a lot to actually make sure that every product that we actually sell to the customer has been cut, has been freshed,

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humidified and that is only possible if coming in the door you're supported by that large infrastructure that we have nationwide to be able to put that product on either the doorstep or on the shelf.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.
A

One other thing to me when you look across all the conversations, people and changing some of our people processes are part of what's allowing it to, and Tim you may want to talk about how your team is partnered with really all the teams...

Timothy A. Massa
Senior VP-Human Resources & Labor Relations, The Kroger Co.
A

Absolutely.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.
A

...on training, on retaining, hiring some of those things.

Timothy A. Massa
Senior VP-Human Resources & Labor Relations, The Kroger Co.
A

Thanks, Rodney. Good morning, everyone, Tim Massa, our Chief People Officer. Any time an associate starts in Fresh, the first thing they do is they have a Fresh Start app, it is powered by a company we partner with called Axonify and they were asked five questions to start their day, what their tasks are in that given department. We've expanded that now, and it's part of what Mary Ellen talked about, the associate experience, 24 hours of onboarding and training, their onboarding is also on the floor in any department that we're on.

So we started it in Fresh and have been able to transition it across all departments. And as we look at our wall-to-wall clerk being able in our contracts, to be able to work across the store, that's enabled us to train our folks faster and to be more knowledgeable to serve our customers. So that's been a big piece of our effort. And being clear on what is expected to serve a Fresh experience, Mary Ellen talked about that associate empowers that customer experience. They don't have a great experience if the associate is not able to serve their needs and exceed their expectations. We're seeing that play across all of our departments, really enabled and fueled by what we've been doing in Fresh.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.
A

Yeah. And your last part of your question on TSR, obviously, all these things together is what deepens the connection with the customer, that deepening connection with the customer is what helps our share and grows sales and that flows-through, and allows us to be able to continue to give nice raises to our associates, that allows us to give the great value for the customer and obviously creating value for shareholders as well.

Matt Fishbein
Analyst, Jefferies LLC
Q

Matt Fishbein from Jefferies. Thanks for the question. I wanted to talk about the $28 billion CPG brand, that is Our Brands, and really when I think about how it's similar and different to national brands, things that come to play are really that mix between manufactured products versus co-manufactured products, I know that that is something that could potentially morph over time as you invest more behind Our Brands. But other than that, just simply

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building the manufacturing capacity that you've had over the past couple of years kind of remaining flattish, what else can be done to Our Brands in terms of your investments in that going forward?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

Well, innovation will be a huge part. And Stuart, I'll let you start, and Gabriel, feel free to add anything.

Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

Very good.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

And by the way, when you go to the shed [ph] Yuan, who (2:19:24) we just recruited from the outside to run Our Brands program is here as well, so...

Stuart W. Aitken
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

Great. Thank you, Matt. So, from an innovation perspective, we see opportunity across the board. Earlier today, I talked about the $4 billion brands. There are others moving up that ladder relatively quickly as well. One example would be Murray's Cheese, which is growing at a tremendous rate. We've started putting them in our Harris Teeter stores, and they're doing incredibly well as well.

So finding those brands that really resonate with customers in the right way Home Chef, Rodney talked about the M&A opportunity we had with them, bringing them in-store and offering that home meal replacement, what's for dinner tonight, truly has transformed that brand for us as well.

From a manufacturing standpoint it's something Gabriel, Gary, Rodney and myself talk about all the time where those other opportunities are. I'll let Gabriel speak to that in a moment. But as we see opportunities across quality and supply, manufacturing really does allow us to – puts us in a lot more control, especially in the pandemic right now. So we're incredibly excited by our manufacturing opportunities.

Gabriel Arreaga
Senior Vice President-Supply Chain, The Kroger Co.

Yeah, it's a great question. I'll tell you I spent my life in the CPG room and anything from confectionery to with Unilever with foods, et cetera. And one thing that I've always known is the quality and the customer perception from Kroger brands is exceptionally high. Even when I made cookies, for example, I used to actually say, well, customers actually like – really like Kroger's cookies. And when I look at our assets today and how they're positioned across the US, we have a really unique opportunity to exploit those assets even further.

So I don't see us in the short-term actually having to open up more facilities, but reformulating what we already have. I'll give you an example in milk, we've been in the cutting edge of innovation in milk because of our dairies. So we have extended shelf life milk. We've actually gone into other diversified into what adds more value to the commoditized milk, which is a fascinating journey when you think about margin enhancement. But it also allows us to go into things like plant based milk, almond milk, soy milk, et cetera, which are trends that we can very clearly and very early determined that are about to take off in our shelves.

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So it's – I would define it like a kid in a candy store where you basically have a unique opportunity to have precision data to tell you where to go focus your manufacturing assets and scaling extremely quickly because you're on the shelf, coupled with that we just have a heritage of high quality and very, very good value in our products. And the other thing – because you talked about manufacturing versus core manufacturing, we always do that comparison. At the end of the day we've have a very good track record and continuous improvement in our factories that have actually lowered their prices quite a bit.

But we also have visibility on commodity prices, et cetera that allow us to actually procure and negotiate commodity prices, raw materials and packaging materials much better than usual CPG would actually do, that's not to say that we have an advantage on what the CPG cost is, but we do have a very good, good database of what that is. And that generates margin on an ongoing basis. So I would expect we look at it every day, how can we actually grow it faster? It's a complete, unique opportunity that we have.

Stuart W. Aitken A
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

Just building on Gabriel's point on quality. This notion of having a third party validate every one of our innovative new items that we're putting out there to be as good or better than the equivalent CPG brand, this is why you're hearing about things like cookies being as good as. And in fact, for the last three years, that's been the case and validated by the third-party. We want to put out the best quality product. Behind that, we're not going to put some marketing, behind that as well, so that the customer knows the value they're getting. And in the current economic environment, it's the best thing we can do.

Edward J. Kelly Q
Analyst, Wells Fargo Securities LLC

Hi, good morning, guys. This is Ed Kelly of Wells Fargo. It's good to see all of you live, by the way.

W. Rodney McMullen A
Chairman & Chief Executive Officer, The Kroger Co.

Thank you.

Edward J. Kelly Q
Analyst, Wells Fargo Securities LLC

So I wanted to ask you about labor. You gave some statistics on hourly pay, including benefits and it looked like if I took these numbers down correctly that the growth averaged about 4% from 2017 to 2020, but 2021 number was up a lot. It looked like 13% or something like that. So I guess what drove that and where does that go going forward? And then you gave some statistics on sort of cost to fill being down about 15%. I don't know if that was total company or if that was digital, but where is that going over time as well and how does all this sort of net out on the labor line? Thank you.

W. Rodney McMullen A
Chairman & Chief Executive Officer, The Kroger Co.

Tim, you want to start, we need to keep tight.

Timothy A. Massa A
Senior VP-Human Resources & Labor Relations, The Kroger Co.

Yeah.

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W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

There's still quite a few questions left in.

Timothy A. Massa
Senior VP-Human Resources & Labor Relations, The Kroger Co.

A

Yeah. I think, as Gary indicated, Ed yesterday, thank you for your question, yesterday, we have in our plan in the TSR model the increases in our wages. We needed to pull forward a bit as we saw salary increases going up across the industry, across the labor market over the past two years. And we had always projected in our – as you know, we have over 350 contracts. And as they played out and as the market increased, we found a need to accelerate some of that work in 2021 is part of why you saw that growth in 2021. Gary, if you agree with that.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Yeah, no, I think that's well said, Tim. And as you said, this is built into our model. We started out with a view and we built our long range sort of plans around TSR that we expected to be investing in wages. We know our associates are everything to the company. It's obviously our teams that make everything happen every day across our stores and our manufacturing and our supply chain facilities. So that was always the plan that we would be continue to invest. Tim said it well, we pulled forward in 2021 and we've pulled forward in 2022 as well, so we would expect that to continue as a higher investment in 2022 similar to what we saw in 2021.

The good news is it's pulling forward some things that we always anticipated that we would have in the plan. It speaks, I think, to Rodney's comment about. It's really critical that we keep innovating. We're taking cost out of the business. And when we made the decision to invest in [ph] Ali (2:26:32) right back in 2017, we also made the decision that we have to be committed to finding ways to take cost out without impacting the customer. And I think the good news there is that Mary Ellen said it, but we would never have guessed when we started that journey we'd have four years of identifying opportunities and we see as many opportunities ahead as we've had in the last four years. Mary Ellen mentioned again, but technology, there are many areas that we still believe we're investing in today that will allow us to continue to get more efficiency.

Mary Ellen Adcock
Senior Vice President - Operations, The Kroger Co.

A

Yeah, and I think that that is built into the model and we look forward, we know what we're looking at in terms of wages, but that's why we also have a full pipeline of ways to additionally take cost out of the business that do not impact the customer or the associate experience because we want to make it easier for both the associate and the customer. So we continue – so we can continue to invest in the associate, but also lower the cost through data, technology, automation and making it where we take work out, so that we can continue to invest in the associates and [indiscernible] (2:27:27) both attract and retain talent as we go forward. And we see additional opportunity to do that in our pipeline.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

We'll take this question, and then one final question.

Chuck Cerankosky
Analyst, Northcoast Research Partners LLC

Q

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Chuck Cerankosky, Northcoast Research. I want to go back to that $28 billion number for Our Brands. How aggressive do you want to be in accelerating that? And considering that so much of you Fresh product is unbranded and the customer relies on Kroger to ensure the quality of that, can Our Brands number be a lot bigger at the expense of the CPG brands? And are the digital offerings a way or platform is a way to accelerate that?

Stuart W. Aitken A
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

So, Our Brands without question can be significantly bigger. Obviously, with that comes margin expansion and keeping the customer within our ecosystem, which is critical. I wouldn't tell you it's at the expense of the CPG, for us it's customer choice. We, as Gabriel just talked about, want to offer the best quality and value. And if our CPGs can provide that same quality and value, fantastic, let the customer choose, that's our goal, that's our objective. We are looking at brands that offer unique differentiation, Natural and Organic being one, Simple Truth owning that space, the largest natural and organic brand in the US, private selection, having that upper tier premiumization there as well. So, for us, it's not about trading the CPG off. It's rather giving choice to the customer and us having the best quality and value for our customer.

W. Rodney McMullen A
Chairman & Chief Executive Officer, The Kroger Co.

Our brand has the same – has to go through the same things to keep on the shelf just like a CPG. So, we don't give it a leg up just because it's our brand and we think it's incredibly important that our team has to earn the right on the shelf just like a CPG has to earn the right on the shelf.

Gabriel Arreaga A
Senior Vice President-Supply Chain, The Kroger Co.

One thing very quickly because you asked about digital, what we have found in Florida as we've actually gained more – our larger customer base is that they prefer Our Brands quite a bit. And it's an interesting piece because it talks to the value, but also the quality of the product that in a region where Kroger is not present they're willing to actually make that choice.

Stuart W. Aitken A
SVP, Chief Merchant & Marketing Officer, The Kroger Co.

The index is higher in Florida, it's amazing, than in our Monroe facility, yes. Great news.

Ken Goldman Q
Analyst, JPMorgan Securities LLC

Hi. Ken Goldman, JPMorgan. Gary, you had talked about how the continued increase in alternative profits will over time hopefully flatten Kroger's gross margin progression and then potentially send it higher. I'm not trying to put you on the spot, but I wanted to get a sense of how far away that inflection is when the gross margin, again, ex-fuel I assume, can consistently start to get higher. Are we talking 3 years down the road, 10 years down the road just what's in your vision there for how we should start to think about that?

Gary Millerchip A
Chief Financial Officer & Senior Vice President, The Kroger Co.

Yeah. Thanks for the question, Ken. And I'd just reemphasize that our profit is one element in that journey because we will continue to invest in the customers we've shared and Stuart did a great job earlier of sharing some of the other levers that we're pulling around Our Brands. So, it's one component, as it gets bigger though

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becomes a bigger component. I deliberately didn't give a timeline just because as we kind of tried to I think convey through the broader discussion, we think about we're building this ecosystem with multiple levers to pull and we know that we have to win the customer.

So, we believe that what I shared is absolutely correct, that we will achieve it over time. But we don't put a timeline on it deliberately because we want to make sure we have the flexibility to make sure we're winning long-term customer loyalty and there are times, as you saw in the last year where we balanced OG&A and gross margin, we're committed to our TSR algorithm and believe that we're building even more levers to be able to achieve that, which is why I made the statement today. But I deliberately didn't put a time on because we want to make sure we're running the company for the customer and making those 5 and 10 year decisions that Rodney mentioned. But we absolutely believe that it's a path we expect to achieve based on all the work the team is doing and the plans that we're putting in place. I don't know if Rodney you want to add anything to that.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

The only thing I was going to add is what you added last, so.

Mary Ellen Adcock
Senior Vice President - Operations, The Kroger Co.

A

There you go.

Rob Quast
Director-Investor Relations, The Kroger Co.

A

That now concludes our Q&A session. We'll turn it over to Rodney for some closing remarks.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

Thanks, Rob, and thanks to everyone for joining us here today. And I think it's uniform. It's wonderful to be in person and being able to see everyone, and on behalf of our entire leadership team I hope you enjoyed the opportunity that we had to share with you, how we believe and strongly appreciate the positioning of Kroger and positioning Kroger to have an incredible future going forward.

The presentations you heard today really summarize why we believe Kroger is better positioned today than at any time in our history to drive sustainable growth. And as Gary mentioned at the end we really look at the commitment to the total shareholder return of 8% to 11%.

Stuart outlined our go-to-market strategies and how our competitive moats are widening and deepening, which is incredibly important. It's helping us differentiate our customer's experience. It helps us drive customer loyalty, and it helps us attract new customers. And one of the things that's incredibly exciting is if you look at the number of new customers we're getting, it's actually accelerated and that over time will be incredibly important as we help them move up the loyalty ladder.

Mary Ellen showed how we are leveraging our operational excellence and our associate experience and our cost saves to elevate that Kroger customer experience. You heard Yael, talk about how we've built everything into our seamless ecosystem, so that the customers have no compromise. For us, we want customers when they think food, they think Kroger. We also want to make sure that we have a delivery system, not just the delivery per se, but an overall ecosystem where the customer doesn't have to compromise anything.

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When you look at all those things together is what gives us confidence and commitment to our ability to double digital sales and double digital profitability. And you heard Gary talk about at the end on our overview on how our TSR model commitments over this year and the last couple of years where we've exceeded our TSR commitments and how we are committed to our TSR commitments going forward. As you look at long term sustainable growth of 8% to 11%.

So as we close the formal presentations, I'd like to reiterate Kroger's commitment, excitement and belief to be able to thrive and be able to thrive in a market that's changing so quickly. And we have the – the company in a position and our teams are in a position to be able to take advantage of that thriving. Our teams are focused on leading with fresh and accelerating with digital. Our associates are inspired to serve our customers to fulfill our purpose, which is to feed the human spirit.

Mary Ellen on the video the thing you saw, it's our associates. When you talk to our associates, why do you like doing what you do, it's to serve people. It's to help somebody have a better day. Those things together, as part of the magic of what creates Kroger, are making Kroger, Kroger. We continue to build on our nearly 140 year foundation of providing fresh food, providing affordable and healthy food and that is incredibly important too, because we want to make sure that we keep food affordable and being able to help people eat healthy.

We're investing in our associates as you saw and normally in the past, we've never shared the specific numbers, but we thought it would be important for you as investors to see the specific numbers of what we are investing in our associates and helping our associates come for job, stay for a career and we're taking all of that and building our new innovations that will match and support our evolving customer needs, so when they think food, they think Kroger.

All of this when you look at it together, is what enables us for our commitment to our shareholders of total shareholder return of 8% to 11%. I'm confident and excited about the vision, knowing that our people, our culture is fundamental to our success. It's what makes it special. So thanks again for joining us today. I hope you found today to get – together productive and understand why we are so excited about Kroger's future. And thanks again for everybody coming.

Timothy Steiner

Co-Founder, Chief Executive Officer and Director, Ocado Group

Good morning. I'm Tim Steiner, Founder and CEO of Ocado Group. I'm really happy to be able to join you today, albeit virtually as you get your first up-close and live view of Ocado's technology. You will have seen lots of footage of our tech online but there really is nothing like seeing in action firsthand to get a sense of the scale and sophistication of what we've achieved. This CFC and indeed Kroger's whole strategy across the state, it's one of the best examples in the world of the scale, flexibility and strategic breadth of the Ocado Smart Platform.

The ecosystem that we are building together in Florida will serve multiple customer missions across multiple lead times, leveraging scale fulfillment at Groveland and driving big efficiencies to a growing number of CSCs including micro fulfillment centers in the coming years. But this site is already driving a step change in the kind of service quality that Floridians can get online.

And as Kroger expands its network with Ocado across the state and indeed the whole USA the breadth and seamless nature of the Kroger Delivery service will just keep raising the bar higher for the online proposition that US grocery customers should expect. In January, I announced a Ocado Re:imagined, a wave of technology enhancements that are set to redefine even further what it means to offer a world leading online grocery service.

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Collectively, the mix of new robotics and software enhancements we unveiled will do a number of important things. Firstly, they will further drive down costs to serve the Kroger, radically improving their labor productivity in CFCs, and enabling them to serve a wider range of customer missions without incurring the higher costs historically associated with shorter lead times. They will also remove the historical tradeoff customers have faced between the available range they can choose from and shorter lead time deliveries.

So customers choosing faster delivery slots will no longer need to accept less product choice to do so. Customers themselves are increasingly aware of these tradeoffs as the number of more niche providers grows in the market, and Kroger has the tools to eliminate these trade-offs with Ocado. Overall, these announcements will bring significant new efficiencies to Kroger's live CFCs and those under construction. They will also drive down both the capital cost and construction time for future sites, meaning we can bring more capacity to bear more quickly and at lower cost. Collectively, we are again reimagining what it means to offer a mass market grocery online, at scale, at value and profit.

And I'm delighted that with these innovations, we are now moving to a phase of accelerated growth and expansion. Together with Kroger, when we announced our partnership in 2018, we were excited by Kroger's ambition to build the leading online grocery service across the whole of the USA. With a Ocado's technology, they've introduced a service that is delighting customers right from the start in both established Kroger communities, as well as entirely new geographies. We can't wait for you to see what's in store in the next phase of our partnership.

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