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The Kroger Co. (KR)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to The Kroger Co. First Quarter 2025 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

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

Rob Quast

Vice President-Investor Relations, The Kroger Co.

Good morning. Thank you for joining us for Kroger's first quarter 2025 earnings call. I am joined today by Kroger's Chairman and Chief Executive Officer, Ron Sargent; and Chief Financial Officer, David Kennerley.

Before we begin, 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 filings. The Kroger Company assumes no obligation to update that information.

After our prepared remarks, we look forward to taking your questions. In order to cover a broad range of topics from as many of you as we can, we ask that you please limit yourself to one question and one follow-up question, if necessary.

I will now turn the call over to Ron.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Thank you, Rob. Good morning, everyone. Thank you for joining our call today. Before jumping into the results, I wanted to share a few thoughts since I last spoke to you in March. After nearly four months as CEO, I've been very impressed with the many talented associates I've met across the company. Kroger has a strong bench of experienced operators and dedicated associates who can move our company forward.

After spending my career in retail, one thing's clear. Retail always starts with a customer. It's pretty simple. Our strategies, our focus, and our resources should be dedicated to how we can make the biggest impact on serving our customers. Grounded in these principles, my priorities in this role are to position Kroger for long-term growth, accelerate top line sales, and run great stores. We can do this by better focusing on our core business and by creating a growth culture in the company. Kroger has a long runway with many opportunities ahead, and I'm grateful to be part of the team, as we transition to our next phase of growth.

In the past few months, we've made a number of changes to move faster and put increased focus on our customer. We're directing investments toward projects that will grow our core business, including plans to accelerate new store openings. We are reassessing our capital allocation strategy to make sure we are spending our capital on projects that offer the highest returns. We are reviewing our non-core assets. We're aggressively looking for ways to reduce costs throughout the company, and we expect to reinvest those cost savings directly into lower prices and additional store hours for our associates so that they can better serve customers.

Finally, we've restructured our leadership team to ensure we have the right talent in place. We created a new eCommerce business unit, aligning all areas of the online customer experience under Yael Cosset, our Chief Digital Officer. We continue to elevate great leaders across the company by appointing Joe Kelley, as our Senior Vice President of Retail Divisions, as well as new division presidents in King Soopers, Food 4 Less, and Texas, where we consolidated two divisions just last week. These changes put talented executives in roles where they can support our stores and improve the customer experience.

We're making meaningful changes to the business to create a culture that benefits our customers and our associates, while improving long-term shareholder value. In the first quarter, we're beginning to see the benefits of many of these changes. This morning, we announced solid first quarter results with strong sales in Pharmacy, eCommerce and Fresh. Kroger identical sales, excluding fuel and adjustment items, increased 3.2% and adjusted net earnings per diluted share was $1.49 in the first quarter, which was an increase of 4%.

Now, let's take a closer look at the quarter. Strong performance in Fresh categories supported our identical sales without fuel results. Fresh identical sales were better than center store sales. We know our customers want healthier options and we are well positioned to deliver them across our Fresh departments.

Turning to Our Brands. As more customers search for value, we're excited about the potential for the Our Brands business. We are growing sales by offering high quality products to customers at all budget levels. This quarter, Our Brands grew faster than national brands for the seventh consecutive quarter. Simple Truth and Private Selection led our sales growth, highlighting that customers want premium products while also spending less.

Our Brands is also creating new products that support customers' healthier eating habits. For example, earlier this year, we identified protein as a major customer trend and soon Simple Truth will introduce 80 new protein products to our assortment. Targeted directly at this important trend, these products include everything from bars and powders to shakes, all from a natural and organic brand that customers trust. This is just one way that Kroger and Our Brands are innovating to stay ahead of what our customers want.

eCommerce continues to be a key part of our business, with 15% growth in the first quarter, driven by strong demand and delivery. To keep improving the customer experience, we're working to deliver more accurate orders faster and reduce pickup wait times. These improvements are attracting new households to eCommerce and giving our current households more reasons to shop with us. As our eCommerce business grows, it represents a bigger impact on our results. Our teams are committed to growing both eCommerce sales and improving profitability.

During the first quarter, we made good progress and delivered our best profit improvement yet on a quarter-over-quarter basis. To continue driving improvements, our team is reviewing all aspects of our strategy and operations to improve the customer experience, as well as the financial performance. David will share more on this topic later.

We know that our best customers shop with us through both eCommerce and in stores, which makes it important for us to continue building and running great stores. Today, we are on track to complete 30 major storing projects in 2025. And looking forward, we expect to accelerate new store openings in 2026 and beyond in high-growth geographies, growing our overall square footage and adding new jobs.

As I mentioned earlier, we're simplifying our business and reviewing areas that will not be meaningful to our future growth. Unfortunately, today, not all of our stores are delivering the sustainable results we need. It's also important to note, we paused our annual store review during the merger process. To position our company for future success, this morning, we announced plans to close approximately 60 stores over the next 18 months. We don't take these decisions lightly, but this will make the company more efficient, and Kroger will offer roles in other stores to all associates currently employed at affected stores.

To recap, our top priorities are clear. We're going to move with speed. We're going to concentrate on our core business and we're going to run great stores. This is how we'll position Kroger for long-term performance.

Before David gets into more detail on our financial results, I'd like to talk a little bit about our broader operating environment. Customers continue to spend cautiously in an uncertain economic environment. Many customers want more value, and as a result, they're buying more promotional products and more Our Brands products. They're also eating more meals at home.

Kroger is well positioned to support our customers changing shopping habits. We offer compelling promotions and fuel rewards, outstanding Our Brands products, and personalized promotions that offer families better savings on the products they use the most. We're simplifying our promotions to make it easier for customers to save and to see clear value at the shelf. In fact, we've lowered prices on more than 2,000 additional products so far this year.

As part of our work to keep prices low, we're also watching the changing environment around tariffs. Our business model is flexible to respond to those kinds of shifts. And as a domestic food retailer, we expect a smaller business impact than some of our competitors. Where we do see potential tariff impact, we are proactively looking for ways to avoid raising prices for our customers, and we consider price changes as a last resort. Tariffs have not had a material impact on our business so far. And given what we know today, we do not expect them to going forward.

I'd like to spend a moment talking about our associates. Our associates are the backbone of our company and are the people who create a great customer experience. One of our top operational priorities is improving in-stock levels, and we improved in-stock rates in every division this quarter. I appreciate our associates hard work every day to make this happen.

We continue to improve our associates' wages and benefits while investing in their development and well-being. These investments include hourly pay plus healthcare and pensions, as well as technology that makes work easier in our stores, including a virtual AI assistant that is improving associate productivity and engagement. This well-rounded approach is producing results, with both store and company retention rates reaching record levels this quarter. And when our associates stay longer, they learn more, take on additional responsibilities, and deliver a better customer experience, which leads to better sales.

With that, I'm happy to welcome David Kennerley, Kroger's Chief Financial Officer, to our earnings call today. We're excited to have David with us, and I'm confident he will help us accelerate our growth and improve our capabilities in a number of areas. As part of this role, I've asked David to lead initiatives across several areas, including cost optimization, efficiency and real estate so we can put more investment in our stores, as well as our customer experience.

Now, I'll turn it over to David, who will review our financial results in more detail. David?

David Kennerley

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

Thank you, Ron, and good morning, everyone. It's an honor to be here today for the first time as Kroger's Chief Financial Officer. Over the past few months, I've had the opportunity to meet teams all over Kroger, and I've been impressed by the breadth and depth of talent in this great organization. My immediate focus is to build upon

Kroger's existing momentum, leveraging our collection of unique assets and financial strength to accelerate our performance. To achieve this, I'll be concentrating initially on a few key priorities.

First, capital allocation. We'll be highly disciplined in how we deploy capital, ensuring we invest in projects that generate strong returns with a clear objective of improving ROIC over time. Second, cost optimization. We will focus on optimizing our cost structure, ensuring it aligns with and supports our long-term financial targets and drives operational efficiency. We're going to modernize operations and ways of working across the board, from corporate to our stores and supply chain, to work smarter and more efficiently.

Next, improving eCommerce profitability. While we've seen positive momentum here, my objective is to accelerate this improvement. As Ron said, we plan to review all aspects of our business to drive greater efficiency within our eCommerce cost structure and support growth for higher margin revenue.

Finally, growing market share. Kroger's collection of assets positions us well to win and grow share. My focus will be on ensuring we prioritize our resources to drive profitable market share growth, including an acceleration of storing projects and more competitive pricing. Kroger is a world-class retailer today and we are well positioned for long-term growth. My objective as CFO is to ensure we appropriately allocate our resources to where we have the best opportunity to grow and win, while delivering strong financial returns.

I'll now walk through our financial results for the quarter. We achieved identical sales without fuel growth of 3.2%, excluding adjustment items. Our sales growth was led by strong Pharmacy, eCommerce and Fresh sales. We are encouraged by organic script growth, including growth in non-GLP-1 prescriptions. Over recent quarters, we've seen improvement in grocery volumes, particularly in the perimeter of the store, which contributed to our sales growth this quarter. Volume improvement remains a key priority for us, and we expect sequential improvement throughout the year. We saw inflation slightly below 2% in the first quarter, in line with our expectations at the beginning of the year.

Our FIFO gross margin rate, excluding rent, depreciation and amortization, fuel and adjustment items, increased 79 basis points in the first quarter compared to the same period last year. The improvement in rate was primarily attributable to the sale of Kroger Specialty Pharmacy, lower shrink and lower supply chain costs, partially offset by the mix effect from growth in pharmacy sales, which has lower margins. After excluding the effect from the sale of Kroger Specialty Pharmacy, our FIFO gross margin rate improved by 33 basis points.

The operating, general and administrative rate, excluding fuel and adjustment items, increased 63 basis points in the first quarter compared to the same period last year. The increase in rate was primarily attributable to the sale of Kroger Specialty Pharmacy and an accelerated contribution to a multi-employer pension plan, partially offset by improved productivity.

Consistent with our approach to managing future obligations, we made a strategic pension contribution this quarter. This allows us to pre-fund future requirements and importantly, help secure long-term benefits for our associates. Multi-employer pension contributions drove a 29 basis point increase in our OG&A rate in the quarter. After adjusting for the effects from the sale of Kroger Specialty Pharmacy and the multi-employer pension contributions, our OG&A rate was relatively flat on an underlying basis.

As I mentioned earlier, cost optimization is one of my top priorities. We will look for new ways to modernize work and operate more efficiently, not only to fund investments in our customer experience, but also to deliver on our financial commitments.

Looking out for the balance of the year, we expect both our FIFO gross margin rate and OG&A rate on an underlying basis to remain relatively flat, as we balance price and wage investments with margin enhancement efforts. Our adjusted FIFO operating profit was $1.5 billion, and adjusted EPS was $1.49 in Q1.

Fuel is an important part of Kroger's strategy, and offers an important way to build loyalty with customers through the fuel rewards in our Kroger Plus program. Fuel results were behind expectations this quarter and a headwind to our results. Fuel sales were lower this quarter compared to last year, attributable to lower average retail price per gallon and fewer gallons sold. While gallons sold declined compared to last year, our gallon sales continue to outpace the industry. Fuel profitability was also behind the same period last year, as a result of fewer gallons sold. We expect fuel will be a headwind to our results for the remainder of the year.

As Ron shared earlier, our eCommerce business continued its strong performance. We grew eCommerce sales by 15% and increased a rate of profit improvement from our previous record improvement in the fourth quarter of 2024. We're pleased with our continued progress and confident we're on the right path, but our clear goal is to accelerate this momentum.

To that end, our new eCommerce structure unifies all teams, contributing to our eCommerce experience, with a clear mandate to enhance our eCommerce operations for both improved profitability and a superior customer experience. Their efforts will center on deploying new technology, improving density in our fulfillment operations, and accelerating the growth of our retail media platform. We expect these initiatives to be significant drivers of our eCommerce acceleration.

I'd also like to provide an update on recent developments concerning our contract with Ocado. Last week, Ocado drew down the entire $152 million from its letter of credit under our existing agreement. As mentioned earlier by Ron, we're undertaking a comprehensive review of our eCommerce operations and reviewing all aspects of the business to drive growth by improving the customer experience, while improving profitability.

I'd like to take a moment to provide a brief update on associate and labor relations. We made significant progress on agreements this quarter. Specifically, we ratified new labor agreements with more than 23,000 associates. Since Q1 closed, we've ratified a new collective bargaining agreement for store associates in our Mid-Atlantic division, and reached a fully recommended settlement for associates in Seattle. In total, this covers approximately 16,000 associates.

Kroger is working to reach an agreement with the UFCW for store associates at approximately 80 King Soopers store locations in Denver Metro, Pueblo, and Colorado Springs. Associates at these stores chose to strike for 14 days during the first quarter, and negotiations are ongoing. We respect our associates' right to collectively bargain.

As Ron said earlier, we continue to meaningfully improve wages and benefits. The company's investment in associate wages has increased the average hourly rate to more than $19.50. That figure grows to more than $25, with benefits like healthcare and pensions factored in that many of our competitors do not offer. We're proud to be a retailer, which offers fair wages and comprehensive benefits. Kroger's goal in every labor negotiation is to provide employees with stability and advancement opportunities, while working to reach a fair and balanced agreement that both rewards our associates and keeps groceries affordable for the millions of families we serve.

I'd now like to turn to capital allocation and financial strategy. Kroger generated strong adjusted free cash flow this quarter, driven by our operating results. Free cash flow is important to our model, providing liquidity to our operations and allowing us to maintain a strong balance sheet. At the end of the first quarter, Kroger's net total debt to adjusted EBITDA was 1.69x, compared to our net total debt to adjusted EBITDA target ratio range of 2.3x to 2.5x.

Our strong free cash flow and balance sheet provide us flexibility to invest in our business and other opportunities to enhance shareholder value. Our capital allocation priorities remain consistent and are designed to deliver total shareholder return of 8% to 11% over time. We are focused on investing in projects that will maximize return on invested capital over time, while remaining committed to maintaining a current investment-grade rating, growing our dividend subject to board approval, and returning excess capital to shareholders. A key priority for Kroger is to improve ROIC. We expect to do this by improving asset utilization and reallocating capital towards higher return projects, which will drive long-term shareholder value.

As Ron mentioned earlier, we've announced plans today to close roughly 60 underperforming stores across the country in an effort to optimize our store network. At the same time, we are actively investing for growth in new store projects. We expect to complete 30 major storing projects in 2025, focusing our investments in high growth areas. We will continue to prioritize new store growth and expect these to be a meaningful contributor to our long-term growth model.

We're delivering on our commitment to return excess capital to shareholders. We expect our $5 billion ASR program to be completed by no later than the third fiscal quarter of 2025. The ASR is being completed under Kroger's $7.5 billion share repurchase authorization. After completion of the ASR program, Kroger expects to resume open market share repurchases under the remaining $2.5 billion authorization. Kroger expects to complete these open market share repurchases by the end of the fiscal year, which is contemplated in full year guidance.

I would now like to provide some additional detail on our outlook for the rest of the year. We are pleased with our first quarter sales, which reflects strength in Pharmacy, eCommerce and Fresh. As a result, we are raising our identical sales without fuel guidance to a new range of 2.25% to 3.25%. We expect second quarter identical sales without fuel to be roughly at the midpoint of our full year guidance range.

With respect to the store closures discussed earlier, we anticipate these will occur over the next 18 months. There is a modest financial benefit to closing these stores. However, we intend to reinvest the efficiencies back into the customer experience and as a result, this will not impact our full year guidance. While first quarter sales and profitability exceeded our expectations, the macroeconomic environment remains uncertain and as a result, other elements of our guidance remain unchanged. As such, we are reaffirming our full year guidance for net operating profit and adjusted earnings per share.

I will now turn the call back to Ron.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Thanks, David. We're off to a solid start in 2025, and we are optimistic about the rest of the year. While the broader environment continues to be uncertain, we're focused on serving our customers with great stores. Kroger is operating from a position of strength, and our strategy is flexible enough to allow us to navigate this changing environment. We're narrowing our priorities, and we are moving with speed to deliver customers an even better experience. We're confident that by staying true to these priorities, we will generate long-term growth and attractive shareholder returns.

Before we open it up for questions, I wanted to provide a brief update on the ongoing CEO search. The board has a Search Committee in place and is working with a nationally recognized search firm. The board is fully engaged, but we have no specific updates at this time.

We'll now open it up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question for today comes from Ed Kelly of Wells Fargo.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Ed.

Operator: Your line is now open. Please go ahead.

Edward Kelly
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning, everyone. And David, welcome. I wanted to start just with a question around pricing and your value perception with customers. I think there's, it sounds like an increased focus around trying to improve the value perception. I was curious if you could maybe talk about how you're thinking about price gaps, the plan here going forward, what you're looking to accomplish? And then most importantly, can you do all this in a margin neutral sort of way going forward?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure. Let me take that one. David, I don't know if you have anything to add. But, overall, when you look at our competitive pricing environment, it remains very rational. As we mentioned in the comments, we do intend to continue to invest in lower prices. In fact, we lowered prices on an extra 2,000 items during the quarter. But this is much like we've done in prior years also. We're also working to make sure that our promotional offers are simpler, they're easier to access by all customers, and those promotional offers have to offer great value as well.

I can't comment on others, but I do believe that we were more competitive in Q1 than in Q4 versus our EDLP competitors. I think the positive news is that these pricing investments resulted in better sales, better gross margin and happier customers. So, I think this would be probably a good example of us continuing to invest in pricing while expanding our gross margin rate.

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

A

Yeah. Just maybe a couple of things to add, Ron. I think the other thing that we're focused on is making prices easier to get. So, rather than a customer having to get out their phone to get a digital coupon in store, we're trying to make the customer experience in-store much easier for them to access the good prices that Kroger has. And then just on the gross margin comment, I think this quarter is a good example. We've got decent gross margin performance. And as we look to improve our price perception through the balance of this year and beyond, we expect to do this on a margin-neutral basis.

Edward Kelly
Analyst, Wells Fargo Securities LLC

Q

Great. And then, just maybe a quick follow-up. Looks to be a bit more of a focus on eComm profitability and improving the impact on the P&L there. Could you just maybe provide a little bit more color around the road map? The size of the opportunity? I'm not sure how big the losses are at the moment in eComm, but any color there that you could share?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure. Let me try to provide a little more color. We have made good progress on eCommerce top line and bottom line during the quarter. As we mentioned in the notes, we combined all the elements of our eCommerce business under Yael Cosset. Yael's doing a great job. This allows us a lot better focus on our eCommerce business than we've had in the past. It also, very clearly, allows us to have ownership of the business. We're taking a look at every single aspect of our eCommerce strategy, as well as our eCommerce operations. We're looking at every market, every element, and we're working on a plan to address the performance in each one of those.

I think the good news is that we are seeing continued growth in the business, up 15% this quarter. Households and eCommerce are growing. Our customers are embracing the whole digital model of our business. And we are seeing improvements in profitability at an increasing rate. But to be clear on the profitability, we're not profitable at this point, and we must become profitable in our eCommerce business, and we got a lot of work to do. We will keep you updated throughout the year, but we don't disclose a specific profitability by sub-business segment.

Operator: Thank you.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Thanks, Ed.

Operator: Our next question comes from John Heinbockel of Guggenheim. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Hey, John.

John Heinbockel
Analyst, Guggenheim Partners

Q

Hey. So, I want to start with, Ron, what do you – how do you look at what is non-core? And that could be non-retail; it could be retail, I guess, could be – stores, obviously, the 60 stores. It could be retail divisions, I suppose. How do you look at that? And then on capital allocation, right, high return projects. Where do remodels sit in that prioritization relative to new stores?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. First of all, let me talk to core versus non-core. I mean, the core are the things that exist in our company that are dedicated to serving our customers. And it certainly includes stores. It would certainly include eCommerce. It would certainly include all the alternative revenue streams that those generate. That's how I would define core for The Kroger Company, and I think that's what we need to focus on going forward.

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

A

Hey. And John, let me just cover the capital allocation comment. Listen, as we think about where we spend capital, one of the reasons we've talked about investing in storing projects is that these projects typically offer higher returns than our average rate of return. And I would say, remodel sit somewhere in the middle of our average return rate.

John Heinbockel
Analyst, Guggenheim Partners

Q

All right. And then maybe as a follow-up, right, David, cost optimization, right? So, I think you've had eight years in a row of $1 billion of cost out. How are you attacking that this differently things you might be looking at processes versus what you've done over the past couple of years?

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

A

Yeah. I think, obviously, the advantage that Ron and I have is, is that it's bringing a fresh set of eyes to the business. And I think my conclusion from my first few months and I know Ron feels the same is, listen, I think we've got a really good foundation. So, I see this as operating from a position of strength, and I see this as about going from good to great. I think there are a lot of areas where we can improve from a cost perspective, whether that be on the direct costs, so our cost of goods sold; whether that be on, what I call, indirect costs or goods not for resale; whether that be on the G&A line and our corporate expenses. And I think we are looking to tackle this in a number of different ways than we've looked at in the past.

I think the other thing that will also contribute towards better cost performance is what I call kind of ways of working and process improvement. And I think there's a lot of opportunity here to kind of work smarter, more efficiently, more tech enabled. And we've already got some good proof points on that, but we're going to do more of that kind of work. So, I think that road map, John, I think we've got some things that we're going to look to get some early wins on the board. But I think this is a pretty significant medium-term opportunity.

Operator: Thank you. Our next question comes from Robert Ohmes of Bank of America. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Robby.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Hey. Good morning, David and Ron. Thanks for taking my question. I was hoping you guys could parse out more the sort of tailwinds to ID sales that you saw in the first quarter, and how we should think about some of those things for the rest of the year? So, I think some of the tailwinds, there was inflation, I think, obviously, in the first quarter. Can you parse out how much of that was driven by Fresh and what the inflation outlook is like? I think also the GLP-1 tailwind. Can you remind us what that tailwind is and does that continue, do you think, for the rest of the year? And then I think you guys did make some comments on volume. Sounds like Own Brands volume is pretty strong. Is national brands volume a negative for you guys? And is that a trend that continues as well?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.
A

Yeah. Let me start this. I'll give you some headlines, and David can fill in the blanks. As we said, identical sales were really driven by Pharmacy. They were driven by Fresh categories around the perimeter of our store, eCommerce, as well as Our Brands, and Our Brands continue to grow faster than the national brands. I think, our identical sales improvement also reflects some of the continued sales momentum in our core grocery business. We saw that beginning in Q4 and that continued in Q1.

And, finally, we should give some credit to the divisions. I mean, there was really strong execution on the part of our stores team to better serve our customers, and all of those things certainly help drive identicals as well. And given the increase in our identicals guidance, we expect to see continued improvement in grocery volumes throughout the year. And David, I don't know if you want to add anything?

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

Yeah. A couple of things to add. So, just on the inflation outlook. So, we saw inflation just under 2% for the quarter. We've guided to 1.5% to 2.5% for the year. So, we're well within the guidance range. And absent any major disruption, we expect to continue to be in that range. And then just on Pharmacy, just a couple of points, I think important to note that ESI had a very minimal impact to the quarter, less than 10 basis points, and we continue to see good growth from GLP-1s.

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

That's really helpful. And just a quick follow-up would be, $100,000-plus customer versus low income customer, anything you can share on what you're seeing there?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.
A

What we're seeing is different shopping behaviors, and different shopping patterns. For example, we are seeing, both I think shopping more at Kroger stores and grocery stores compared to eating away. They're making more frequent trips to the store. The average basket is less. When you look at the spend in total, I think it's been very stable. One factor is kind of interesting is that the inflation has been higher for food-away-from-home or restaurants. Inflation in restaurants have been higher for 27 consecutive months versus food consumed at home. I think both in high and low income levels, they're navigating a significant uncertainty. I think consumer confidence is down, customers are looking for value.

And I think, when you look at how we've responded to that, we're always looking for ways to deal with the environment and bring value to our customers and whether that's Our Brands, whether it's having the right promotions or having the right promotional pricing, we are kind of seeing a shift into larger pack sizes and increased use of coupons. We're seeing some discretionary spend. That's a little softer in areas like snacks and adult beverages, pet, general merchandise categories. So, I think, in terms of the consumer, we expect the consumer to remain cautious throughout the year, and we're responding to that with simpler promotions, coupons, lower prices, and a lot of Own Brand choices.

Operator: Thank you. Our next question comes from Simeon Gutman of Morgan Stanley. Your line is now open. Please go ahead.

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Q

Hey, guys. Good morning. A follow-up on sales and market share. Curious if you – when you look at market share, how you view at the performance in the quarter? Realize that the national data we see, it's not perfect, because it's national, but it did look like you inflected in the first quarter. You mentioned that ESI was pretty minimal. So, curious how you view it? What would be – what would you attribute to the inflection? And was it eCommerce and was it broad-based? Thanks.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Well, good morning, Simeon. I think I've known you long enough to – for you to understand that no good retailer is ever happy with their market share. It's really a critical metric in any retail business, and the goal has got to be to improve market share. The biggest driver of market share for us relates to opening new stores. We have seen very modest store growth over the last several years during the merger process. We did see significant improvements in Q1, and we saw market share gains in markets where we have added stores. Again, I don't want to discount the other driver in market share gain, and that's in-store experience, customer service getting better, competitive pricing getting better, simpler promotions, in-store conditions, and we're starting to see some progress there. And then, finally, when you're growing your eCommerce business at 15%, that will help your market share as well as accelerated growth in our Kroger Brands portfolio as well.

I don't know, anything else you want to add, David?

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

A

No, nothing to add. [ph] You covered it all (00:39:59).

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Q

Okay. A follow-up, different topic, eCommerce. I don't know if it's too early, but can you tell us, if you look at the investments that this company has made, do you think you need to step them up in order to scale quicker or accelerate growth, or they'll be funded? And you don't think that's a question. And then connected to it, I'm trying to understand the way you positioned the Ocado pulling down the revolver and then talking about how you need to evaluate what this looks like? So, thinking about how you deal with eCommerce over the next several years? Could there be another big step-up in investment to allow you to reduce cost to serve and accelerate speed, or you think you have the foundation in place today?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Well, I think we have a terrific foundation in place in our eCommerce business, and we have invested heavily in our eCommerce business over the last several years. We are, I think, offering a better customer experience.

We're improving things like wait times, we're delivering faster. The number of households is growing, particularly in the delivery side. And the nice thing about sales, it improves your density for your delivery routes. So, there is a lot of goodness coming, but I think it's a little early to say exactly what we're going to decide on each one of these. But the investments that we've made have been helpful. But going forward, we're going to look at every investment that we have made or will be making. I don't know, you want to talk about Ocado?

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

A

Yeah. Let me cover the Ocado question. So, the Ocado contracts had a clause in it on the seventh anniversary, they were able to draw down the remaining balance on the letter of credit that had been provided, and they chose to do that. So, I think it's a contractual thing and nothing more.

Operator: Thank you.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Thanks, Simeon.

Operator: Our next question comes from Paul Lejuez of Citigroup. Your line is now open. Please go ahead.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Thanks.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Paul.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, guys. Can you – good morning. Can you talk a little bit more about the Our Brands portfolio, the growth you saw in that segment of the business versus the rest of the store? And how the gap between the two are trending? And then I'm also curious if you could talk about any regional differences that you might have seen this past quarter, whether any certain regions stand out is getting more or less promotional or rational, however you want to frame it?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. I can start with Our Brands. As we noted, we had another strong quarter in Our Brands, I believe. And I'm an optimist, understand that, but I believe there is a big opportunity for Our Brand products that could accelerate this even further in the years ahead. The quality is terrific. It creates great value to our customers. It allows us to lead the pack, I think, in product innovation. And I referenced the Simple Truth protein line, but I think that's a great example of that. People are eating healthier, so we're going to jump on that trend. I think high protein products also ties into customers using GLP-1 medications. And the best part about Our Brands is that it differentiates us from our competitors. There is only one place you can get Kroger Brand or Simple Truth or [ph] Natural Selection (00:43:34), all of it just at Kroger.

In terms of regional differences, I really can't point to anything that jumps out at me that specifically different. I think we saw kind of good performance across the chain.

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

A

I mean, maybe the only thing you highlighted is we saw better share performance in those markets where we were building new stores.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

And I think this was asked earlier, but the higher income consumer, can you talk about the performance with your $100,000-plus customer? I'm not sure if you quantified where you're seeing the greater growth?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. I don't know that we did quantify specifically.

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

A

I think nothing other than to say that the higher income consumer continues to behave what we would call kind of rationally. I don't think any big disconnects versus previous quarters, continue to see premium wines, that kind of stuff, sort of increased spend on Fresh. Normal trends. I don't think anything unusual to note on the higher income consumer.

Operator: Thank you. Our next question comes from Michael Lasser of UBS. The line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Hey, Michael.

Michael Lasser
Analyst, UBS Securities LLC

Q

Good morning. Thank you so much. Good morning, Ron. Thank you so much for taking my question. If we put a picture of what Kroger is experiencing together, perhaps there is a case where the growth in eCommerce as well as the growth in Pharmacy are cannibalizing the center of the store. If this continues, is there a point at which the net result of this creates an overall challenge on ID sales? And to what degree is Kroger planning for that potential outcome today in the event that it happens in the future? Thank you.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. I don't know that we've spent a lot of time thinking about that. In fact, we're seeing improved grocery center store trends. We saw that certainly in the first quarter, and we expect to see that through the continue – every quarter this year. Yeah, I don't know there's a specific strategy around that other than running great stores and taking good care of our customers. I think we'll benefit, whether it's eCommerce, whether it's Pharmacy or whether it's the walk-in shopper. I don't – David, anything you want to add?

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

A

No, nothing to add. I agree.

Michael Lasser
Analyst, UBS Securities LLC

Q

I too. Thank you very much. And my follow-up question is, you stepped up price investments on the 2,000 items, [ph] yet (00:46:25) what sounds like the selling margin was positive. So, where are you finding the offsets within the selling margin to make the additional price investments, even as your gross margin – FIFO gross margin is positive? Thank you.

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

A

Yeah. Let me take that one, Michael. So, listen, I think we've got a number of levers that helped us with our gross margins. And I think these are the kind of things that we're going to try to do going forward. So, Our Brands mix obviously helps with that. And we also saw good performance from a sourcing savings perspective. So, I think that's just a couple of examples of positive contribution to our gross margin. I think we're going to have to – we're going – that's how we're going to deal with this going forward. So, we want to – so, I'd expect sort of a flat gross margin expectation for the balance of year as we look to balance those price investments with those positive contributors.

Operator: Thank you. Our next question comes from Leah Jordan of Goldman Sachs. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning.

Leah Jordan
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning. David, if you could provide more detail on the growth trends in retail media? How has engagement from partners trended given the dynamic macro backdrop? And just how should we think about the relative impact of profit as we move through the year versus what you realized in the first quarter?

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

A

Leah, let me take that one. So, I think a couple of things. So, first of all, I mean, we really like our offering in retail media. We've got a great suite of products that we see good engagement from brands on. And I think what we feel really good about that we think is differentiated for Kroger is our ability to do, what we call, kind of closed loop measurement, which is not only obviously understanding where we spend, but really tracking the measurement through to understand how that directly impacts sales and also customer behavior. So, we think we've got a good product.

And certainly, as you know, having spent, I spent a long time on the brands side, brands are wanting to understand how they get the best returns for their dollars. And so, for me, that is a very, very powerful set of tools. Now, I think what we talked about in Q4, we talked about some spend sort of pullback in CPG spending. We did see continued sort of similar trends in Q1 where CPGs are being cautious with their spending. But I want to reinforce the business continues to grow at a healthy rate. And we do expect to continue to see healthy growth in the business through the balance of the year.

Leah Jordan
Analyst, Goldman Sachs & Co. LLC

Q

That's very helpful. Thank you. I just want to have one follow-up on shrink. I mean, it continues to be a tailwind for several quarters and called out again this quarter. Could you talk about the magnitude of the impact to gross margin this quarter? What's the key driver for the shrink improvement and how much more opportunity do you see as we go throughout the year?

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

A

So, let me talk – I'll take that one. So, let me talk about shrink. Yeah, you're right. We've seen good progress, and we've seen good progress across both Fresh, and we've seen good progress on center store. And I think what we really attribute this to is we've made some investments in some AI-enabled technology and deployed new processes around that technology as well. And that's really allowing us to much – have much better visibility of the inventory we've got [ph] in-store, best-by dates (00:50:09) and allows us, therefore, to be much more sophisticated in the ordering that we're making. So, our expectation is we're going to continue to see good shrink performance through the balance of the year, and we'll continue to make investments in this space, provided we will continue to see the good returns that we're seeing.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

And just one addition is, sales help shrink, and more hours in stores help shrink, and more focused employees help shrink. So, I think there's a lot of things going on to improve our shrink results.

Operator: Thank you. Our next question comes from Rupesh Parikh of Oppenheimer. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Rupesh.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good morning, and thanks for taking my question. So, I guess, I just want to start with Express Scripts. I was curious how that ramp is going versus expectations? And then related to Express Scripts, just curious if you're actually building in benefits for the remaining quarters on the top line?.

David Kennerley

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

A

Yeah. Rupesh, let me take that one. So, as we said, ESI had a very minimal impact on the quarter. So, less than 10 basis point impact on sales. The reason we didn't include it in the guide for the year is because we knew it would be difficult to predict, because you've got these big commercial contracts, the timing of which they sort of come back on stream is difficult to predict. So, I'd say, we're on track, but specifically, the guide for the balance of the year continues to exclude ESI.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. And then maybe just one follow-up. Just on trends, just curious on quarter-to-date in terms of what you guys are seeing so far?

David Kennerley

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

A

Yeah. I would say that the – we're happy with the way the quarter started and it's in line with the guidance that we communicated in the prepared remarks.

Operator: Thank you. Our next question comes from Chuck Cerankosky of Northcoast Research. Your line is now open. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Chuck.

Chuck Cerankosky

Analyst, Northcoast Research Partners LLC

Q

Good morning, everyone. In looking at your storing strategy and investments in stores, could you give us sort of an overall view of what you're doing there in terms of what you're closing, where you're closing, where you're opening, what type of formats are you favoring? And in the context of other competitors changing their stores, [ph] not the least (00:52:43) of which are the drug chains, and also the use of pharmacy and fuel in this strategy? Thank you.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure. Let me start on store closures. As we noted, we plan to close roughly 60 stores, and we'll do that over the next 18 months. We usually evaluate individual store performance on an annual basis and we continue to do that. But we deferred closing any stores due to the merger process. So, we see this as an opportunity to move these closed store sales to other stores. And we think that we should improve profitability. There's really minimal financial impact on company results as a result of the store closures. The geography is spread really around the country. It's kind of ones and twos by division. And all the associates who are affected will be offered jobs in their other stores. And I'm not sure I got the second point of that.

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

A

Yeah. It was about the strategy, how we think about opening new stores?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. I mean, I think, obviously, new store openings are the biggest driver of market share gains. And we're continuing to look at that. And I think we'll be investing to accelerate store openings going forward. We don't have a number to share with you this morning. But it'll be north of the 30 that we open this year.

Chuck Cerankosky
Analyst, Northcoast Research Partners LLC

Q

Hey. Could you comment on the geography of those openings and the format you're favoring?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. As you know, it takes a while to open a big Kroger store. And we're looking at geography across the country. There's no specific area. We are probably going to favor areas of the country that are growing faster than others. We're going to look at where we have competitive opportunities or growth in – within cities that we operate in. But it's really scattered around the country. And there'll be a variety of store formats, although the marketplace store is a terrific format, and many of them will be marketplace stores.

Operator: Thank you. Our next question comes from Kelly Bania from BMO. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Kell.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Good morning. Thanks for taking our question. Good morning. Wondering if we could go back to digital sales and the nice acceleration there sequentially. I was just curious if you have any specific strategies or factors that you would attribute that to? And also, in that, you noted strong demand in delivery. And I was wondering if you could clarify how much of that is more same-day kind of Instacart-driven delivery versus Ocado-enabled delivery? And I just want to make sure if there's any consideration with respect to Ocado and any broader changes? Just want to make sure I understood that commentary clearly.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Yeah. I don't know if I can point to any specific strategy, and if I had a specific strategy, I probably wouldn't announce that publicly. But I think it is good growth really across the board. I think it's in all geography. It relates to the entire assortment of our product line. And they always say retail is detail, and this is really basically about chopping wood and doing all the little things. I think before we consolidated everything under Yael, there were a lot of different parts of our business that were trying to optimize. That doesn't work unless you have kind of one owner. And I think, structurally, that really helped our business, because somebody's got responsibility for not only the top line in total, but the bottom line in total, and every line in the – on the income statement in between.

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

Yeah. Maybe, Kelly, let me add a couple of things to Ron's comments. I mean, really our metrics on eCommerce were pretty good across the board. I mean, we grew households, we grew order volume, orders per household grew. So, I think we saw a number of the metrics that are important to eCommerce continue or really saw favorable performance. So, I thought we were very pleased with that.

On the Ocado thing, just to clarify just on your other question, listen, it's a contractual thing. We had a clause in the contract that said on the seventh anniversary of the signing of the contract, they were able to draw down the remainder of the letter of credit, and Ocado chose to do that.

Operator: Thank you. Our final question for today comes from Scott Marks of Jefferies. Your line is now open. Please go ahead.

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.
A

Good morning, Scott.

Scott Marks
Analyst, Jefferies LLC
Q

Hey. Good morning. Thanks so much. Good morning. Thanks so much for taking our questions. Wanted to just ask, you made some commentary around Our Brands kind of outperforming the national brands for, I believe, it was the seventh quarter in a row. Have you seen any change in strategy from your branded suppliers, whether it'd be promotional or otherwise?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.
A

I'm not the merchant here, but I think the answer is really not. I think the selling strategies of our suppliers continue like they have been for several quarters. We're not seeing them being more aggressive on pricing or promotion. I think it's kind of a bit of a steady-state with most of our CPG partners.

Scott Marks
Analyst, Jefferies LLC
Q

Got it. And then just as a follow-up. In light of some of the political backdrop with ban on some artificial food dyes and other potential regulatory changes down the pipe, wondering if you thought about how that might impact the center store part of your business especially, and any kind of discussions with some of those branded suppliers?

Ronald L. Sargent
Chairman & Interim Chief Executive Officer, The Kroger Co.
A

Well, I think there's certainly a trend going on in Washington to eliminate anything artificial and particular, in the area of dyes. I mean, I think many CPGs are reformulating their products to address that and deal with that. And certainly, we're all over that for Kroger Brands and Our Brands. I think, from a regulatory standpoint, I think we're spending a little more time on tariffs than we are on kind of artificial food ingredients, although our customers are looking to eat healthier and buy healthier products, and I think we are trying to respond to that. But in terms of tariffs, and the question hasn't come up, but we've really seen very minimal impact from tariffs. And where we do see impacts in areas like, I don't know, produce, flowers, we are working very hard to mitigate that impact. And we're pushing back on any suppliers who would like to pass along the additional cost. We're looking at some of the country of origin stuff, and we're even discontinuing some items where it doesn't make sense for our customers.

Operator: Thank you. I'll now turn it back to Ron for any further remarks.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Well, thanks, everybody. I appreciate all the questions today. As you know, before we conclude our earnings call, we would like to share a couple of comments with our associates listening in. To them, I say thank you. I thank you for all your efforts, which made our strong quarter possible. We still have a lot of work to do. And we appreciate your continued commitment to running great stores, and taking great care of our customers. So, thanks, everybody, for joining us on the call this morning. We look forward to speaking with all of you again soon, and we hope to see you all in our stores.

Operator: Thank you, all, for joining today's call. You may now disconnect your lines.