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The Kroger Co. (KR)

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MANAGEMENT DISCUSSION SECTION

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

I would 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 third quarter 2025 earnings call. I am joined today by Kroger's Chairman and Chief Executive Officer (sic) [Interim Chief Executive Officer] (00:00:33), 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 Co. 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, and good morning, everybody. Thank you for joining our call today. We're happy to deliver another quarter of strong results, reflecting meaningful progress on our strategic priorities. This quarter, we continue to focus on what matters most, serving our customers, running great stores and strengthening our core business. These efforts are improving the customer experience and creating a strong foundation for long-term growth.

Today, we're going to talk about the things we got done this quarter, the proof points of our progress and the ways we're positioning Kroger for continued success. I'd like to start with sharing the results of our eCommerce strategic review. It marks an important step in how we're evolving our business to meet customer needs and also to improve profitability.

In today's world, having a strong eCommerce offering is key to delivering a differentiated customer experience, and also represents an important growth driver for our business. We've made good progress, building a more than \$14 billion business and achieving six consecutive quarters of double-digit sales growth. Earlier this year, we formed our new eCommerce team headed by Yael Cosset designed to align all of the teams who contribute to the online customer experience.

By bringing these teams together, we've created a more integrated structure to support our strategy. Building on that foundation, we conducted a comprehensive review of our entire eCommerce model. This review helped us to identify where we can be more efficient and better meet customer demand.

Customers increasingly value speed, flexibility and convenience, and better leveraging store-based fulfillment helps us meet those expectations. As a result, we're evolving our hybrid fulfillment model by using automated fulfillment in geographies where customer demand supports it and also leveraging store-based fulfillment through our pickup business and relationships with well-established third-party delivery partners. These changes are fully consistent with our broader organizational goals to improve operational efficiency, to drive profitability and to more effectively utilize our stores.

We will make these changes to our network through a phased approach, ensuring we maintain flexibility to adjust our plans, while minimizing operational and customer disruption.

In recognition of this shift, we announced the closure of three automated fulfillment centers that haven't met operational and financial expectations. We expect these fulfillment centers to close by the end of January 2026.

Based on our customer and store level analysis, in those geographies where we will close sites but continue to operate stores, we expect to retain most of our customers and their eCommerce spend through store-based fulfillment and in-store shopping. We expect these closures to have a neutral impact on identical sales without fuel.

With more fulfillment occurring in stores, we recently expanded our relationships with third-party delivery providers, Instacart, DoorDash and Uber Eats. By using our store network, we're improving both geographic coverage and speed with delivery in as little as 30 minutes.

Each of our delivery partners brings unique strengths and specific benefits to our customers. They will also create new opportunities for our media business, both on our platform and on theirs, something David will cover later.

So in summary, this refreshed hybrid model helps us to attract new customers, improve delivery speeds and leverages our growing store network. We expect these decisions to contribute approximately \$400 million in eCommerce profitability improvements in 2026, making our eCommerce business profitable in 2026.

Turning now to store operations, running great stores and delivering an exceptional customer experience are central to our strategy. Our internal composite scores, which measure key metrics such as in-stocks, fresh quality and customer service, continue to show steady improvement.

We're also investing in experiences that matter most to our customers, including adding store hours to improve checkout speed, increase service and improve in-stocks. These investments are delivering tangible results, including significant year-over-year reductions in wait times for our customers.

To support these changes, we're utilizing an AI-powered workforce management platform, which enables better coverage during peak periods and gives associates greater flexibility. This tool combines real-time labor insights with intelligent scheduling, allowing store leaders to proactively fill open shifts and ensure the right staffing at the right time, especially during high demand periods like weekends and holidays.

Finally, as part of our commitment to simplifying our business, we are making good progress in reviewing all non-core assets to determine their ongoing contribution and role within the company. All of these actions strengthen our business and position Kroger for long-term growth.

Before I talk about the results, I want to take a moment to just share what we're seeing from customers and how that's shaping our approach going forward. Macroeconomic uncertainty continues to influence customer behavior, and we're seeing a split across income groups.

Spending from higher income households continue strong, while middle income customers are feeling increased pressure, similar to what we've seen from lower income households over the past several quarters. They're making smaller, more frequent trips to manage budgets and they are cutting back on discretionary purchases.

Food spend has been more resilient than non-food spend. Categories like natural and organics continue to perform well, reflecting continued interest in healthy and premium options. At the same time, customers are turning to promotions and Our Brands as smart ways to save without sacrificing quality. Ready-to-eat and other meal solutions are providing another way for households to get quality and convenience at a great value.

Inflation and uncertainty around government funding, combined with the pause in SNAP benefits during the final weeks of the quarter, added incremental pressure to our third quarter identical sales without fuel. These trends reinforce the importance of delivering value through lower prices, affordable quality in Our Brands products, and more promotions for customers to save.

Turning to our third quarter results. Identical sales, without fuel, grew 2.6% year-over-year and accelerated on a two-year stack basis, up 4.9%. Sales growth was led by pharmacy and eCommerce. Gaining market share continues to be a top priority. In a challenging macroeconomic environment, we delivered share trend improvement again this quarter after adjusting for closed stores, reflecting the progress we're making in strengthening our competitive position.

We also increased our price investments this quarter. Toward the end of the quarter, when SNAP benefits were held up, we increased promotions to help customers save. We are disciplined in those investments, balancing our gross margin rate to ensure we deliver value in a sustainable way. Our Brands had another strong quarter with sales outpacing national brands. Customers continue to choose these products because they deliver high quality at a great value.

Our premium lines, Simple Truth and Private Selection were the strongest performers again this quarter. Our Brands products carry a more favorable margin profile and also improved profitability during the quarter. These results highlight the strategic importance of Our Brands, driving sales, building loyalty, and improving profitability.

eCommerce sales were strong again this quarter, growing 17%, led by delivery. We also improved eComm profitability with both pickup and delivery showing strong quarter-over-quarter improvement.

We're encouraged by the early results from our DoorDash relationship. In its first month alone, we fulfilled 1 million orders, bringing new customers and incremental meal occasions to Kroger. As we evolve our hybrid model, we expect to continue to ramp up both sales and profitability. This quarter's results show the progress we're making. We also know we have more to do.

Looking toward the future, as we've shared previously, we're accelerating expansion of our store footprint. We expect to break ground on 14 new stores in the fourth quarter, marking a meaningful acceleration in activity.

Earlier this quarter, we announced expansion plans for Harris Teeter, one of our strongest and most successful banners. These plans include opening additional new stores in the Southeast and entering Jacksonville, Florida, which is an important adjacent geography that positions us to grow households and gain share.

Looking ahead, we plan to accelerate capital investment in new stores beyond 2025 to strengthen our competitive position, expand into high-potential geographies, and support long-term growth.

As we expand our footprint, our approach to site selection and store format starts with the customer, then prioritizes improving ROIC with a focus on delivering greater shareholder value.

We also see significant opportunity to continue taking costs out of our business, starting with procurement, both cost of goods sold and goods not for resale are areas with significant potential for savings and we are acting to capture those benefits.

At the same time, we are rethinking how we work. This includes leveraging technology and artificial intelligence to simplify task and operate more efficiently, putting talent closer to the customer and building a more streamlined organization.

As part of this effort, we are returning to in-office work five days a week to strengthen collaboration, accelerate decision-making, and better support our stores. Working together also creates a better environment for our associates to learn and develop. These changes will allow us to move faster and lead to a more efficient organization. We're also looking to emerging technologies, such as agentic AI to enhance the customer experience. We plan to introduce new agentic shopping capabilities, starting with Instacart's AI-powered Cart Assistant on the Kroger website and mobile app in the first quarter of 2026.

The Cart Assistant will help customers shop more effortlessly by making it easier to build personalized baskets, find meal ideas and save time. We'll embrace this technology while making sure it complements what differentiates Kroger today, fresh products, unique Our Brands products and an industry-leading loyalty program. While the landscape continues to evolve, we're confident we'll be able to use technology to improve the customer experience.

Finally, we're continuing the foundational work towards refreshing our go-to-market strategy with the customer of the future in mind. This includes a deep dive into customer data and a rigorous assessment of our competitive positioning. This work is shaping the foundation for our next phase of growth.

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. Kroger delivered another strong set of results this quarter, driven by solid execution in our core grocery business and continued growth in eCommerce and pharmacy. In a challenging environment, marked with cautious consumer spending, the government shutdown and a pause in SNAP distributions, we improved market share trends, excluding the impact of store closures by delivering meaningful value to customers. We delivered these results while continuing to balance the right investments for the customer with disciplined margin management.

I'll now walk through our financial results for the third quarter. We achieved identical sales without fuel growth of 2.6%, moderating slightly from last quarter as we cycle the impact of last year's Hurricane Helene and port strike, as well as the pause in SNAP distributions during our final week of the quarter.

On a two-year stack basis, identical sales without fuel accelerated by 20 basis points to 4.9%, reflecting continued strength in our business. Our identical sales without fuel growth was again led by strong pharmacy and eCommerce results. Food inflation increased moderately compared to the prior quarter with notable inflation in certain commodities, particularly beef.

Our pharmacy business delivered another strong quarter fueled by growth in both core pharmacy scripts and GLP-1s. While the strong growth in pharmacy sales impacts our margin rates, it contributes positive gross profit dollar growth and supports our overall operating profit.

Our FIFO gross margin rate, excluding rent, depreciation and amortization and fuel increased 49 basis points in the third quarter compared to the same period last year. The improvement in rate was primarily attributable to the sale of Kroger Specialty Pharmacy, Our Brands performance, lower supply chain costs and lower shrink, partially offset by the mix effect from growth in pharmacy sales, which has lower margins and price investments.

After excluding the effect from the sale of Kroger Specialty Pharmacy, our FIFO gross margin rate increased 24 basis points. As we communicated last quarter, we expect our gross margin rate for the full year on an underlying basis to be relatively flat as we balance the impact of pharmacy mix, margin enhancement initiatives and price investments.

The operating, general and administrative rate, excluding fuel and adjustment items, increased 27 basis points in the third quarter, compared to the same period last year. The increase in rate was primarily attributable to the sale of Kroger Specialty Pharmacy and investments in associate wages and benefits, partially offset by lower incentive plan costs and improved productivity.

After adjusting for the sale of Kroger Specialty Pharmacy, our adjusted OG&A rate increased 9 basis points on an underlying basis. As we did in the first quarter this year, we took the opportunity to make an accelerated pension contribution in Q3, which was worth 8 basis points on our OG&A rate. This reflects a proactive approach to reducing future liabilities and, most importantly, help secure long-term benefits for our associates.

Our LIFO charge for the quarter was \$44 million, compared to a LIFO charge of \$4 million last year, resulting in a \$0.04 headwind to EPS this quarter. Our adjusted FIFO operating profit in the quarter was \$1.1 billion, and adjusted EPS was \$1.05, both reflecting 7% growth compared to last year. Fuel is an important part of Kroger's strategy and builds loyalty with customers through our Kroger Plus fuel rewards program.

Fuel sales were lower this quarter compared to last year, attributable to fewer gallons sold. Fuel profitability was in line with expectations, just slightly ahead of the same period last year. We expect gallons sold to remain lower on a year-over-year basis for the fourth quarter.

Turning now to eCommerce. Our eCommerce business delivered 17% growth this quarter, driven by an increase in both households and order frequency. Orders delivered within two hours or less grew by more than 30%, reflecting the growing immediacy demand.

Building on what Ron shared earlier, the recent update to our eCommerce strategy reflects a thoughtful evolution of how we serve our customers and drive sustainable growth. Our refreshed hybrid fulfillment model allows us to

leverage the strength in both automation and store-based fulfillment to meet evolving customer expectations. This also allows us to optimize the performance and use of automated fulfillment centers when the right conditions exist and utilize third-party partners for faster delivery, while reaching new customers and incremental trips. Our new model positions us for both strong, sustainable growth and improved flexibility.

From a financial perspective, we're significantly accelerating the profitability of our eCommerce business, closing three fulfillment centers and increasing store-based delivery will deliver approximately \$400 million in incremental eCommerce operating profit in 2026. As a result, we now expect our eCommerce business to be profitable in 2026.

The benefits from these decisions will be primarily used to reinvest in our business to increase value for customers and improve the shopping experience as we look to accelerate sales. We also remain focused on expanding operating margins and a portion of these benefits will be used to increase shareholder value.

Given the financial performance of our automated fulfillment network and the closure of specific sites and, as previously announced, we recorded an impairment and related charges of \$2.6 billion in the third quarter. We will continue to monitor our retained sites with a focus on improving operating efficiency and strengthening financial performance.

Our updated hybrid model also creates new opportunities for our media business. Our broad reach and unmatched food retail capabilities are attractive to delivery partners, and we structured these relationships to benefit our media business. For example, our unique approach to collaboration with Instacart, DoorDash and Uber unlocks new media opportunities across both platforms, and we're already seeing strong interest from several large CPG brands.

By integrating our customer data and loyalty insights with third-party platforms, we can bring more targeted and innovative media campaigns to reach new customer segments and create additional monetization opportunities.

Our media business had a strong quarter with double-digit growth and continues to be a meaningful contributor to profitability. We're encouraged by the momentum and believe we have an opportunity to accelerate growth even further as we leverage new capabilities and improve coordination between our media and merchandising teams.

I'd now like to turn to capital allocation and financial strategy. Kroger delivered strong adjusted free cash flow this quarter, which reflects the strength of our operating performance. Free cash flow is important to our model, providing liquidity for our operations and strengthening our balance sheet.

At quarter end, our net total debt to adjusted EBITDA ratio was 1.73, which is below our target ratio range of 2.3 to 2.5. This provides us with financial flexibility to pursue growth investments and other opportunities to enhance shareholder value. We expect to return to our target leverage ratio over time, and we'll share more details about our plans for 2026 next quarter.

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 our current investment-grade rating, growing our dividend subject to board approval and returning excess capital to shareholders.

During the third quarter, we completed our \$5 billion ASR program under Kroger's \$7.5 billion share repurchase authorization. We are currently executing open market repurchases and expect to complete the remaining \$2.5 billion under the authorization by the end of the fiscal year, which is contemplated in full year guidance.

Improving ROIC is a key priority. As we shared earlier, we expect our updated hybrid eCommerce model and investments in new storing to drive stronger returns going forward. Building on that, we continue to sharpen our focus on cost structure. We've made meaningful progress so far, but we see greater opportunities ahead by modernizing operations and ways of working across our organization from stores to support centers. We also see opportunities to improve procurement to unlock additional cost savings. The combination of disciplined cost management and capital deployment positions Kroger to deliver stronger returns and create more shareholder value.

I would now like to provide some additional detail on our outlook for the rest of the year. We are pleased with the continued momentum in our business, supported by strong performances in pharmacy and eCommerce. Given our year-to-date results and outlook for the remainder of the year, we are narrowing our range for identical sales without fuel growth to a new range of 2.8% to 3% and raising the lower end of our adjusted earnings per share guidance to a new range of \$4.75 to \$4.80.

This includes the impact of LIFO which is now expected to be a \$0.07 headwind compared to what we expected at the start of the year. As we move into Q4, we expect a slight improvement in our OG&A rate to help mitigate the impact of a slight decline in FIFO gross margin rate.

One additional factor to note is the impact of the Inflation Reduction Act on our pharmacy business. Beginning on January 1, this legislation is expected to reduce Medicare drug prices on 10 highly utilized medications. Sales on these medications will be recorded at the new reduced prices.

Kroger will continue purchasing these drugs at current acquisition costs and manufacturers will fully reimburse Kroger for the difference through rebates, which will then be recorded as an offset to cost of goods sold. As a result, we expect that this will lower Q4 identical sales without fuel by approximately 30 basis points to 40 basis points, but will have no impact on our earnings. This is reflected in our updated guidance.

I will now turn the call back to Ron.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Thank you, David. In closing, we're encouraged by the progress we're making. Our priorities are clear and we're executing with greater speed and discipline. We're strengthening our core business and investing in areas that will contribute to long-term growth. We're taking decisive actions today that will make Kroger stronger now and in the future and deliver greater value for our shareholders over time.

Before we move into Q&A, I want to provide a brief update on the CEO search. Our board remains actively engaged and is making good progress. While we don't have a specific timeline to announce today, we're engaged in a thorough process and expect to appoint a new CEO during the first quarter of 2026.

We'll now open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question goes to John Heinbockel of Guggenheim. John, please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Hey, good morning, John.

John Heinbockel

Analyst, Guggenheim Partners

Hey, Ron, can you talk to – hey, good morning. The accelerated storing program, right? Maybe talk about that cadence. And then when you think about, you've got obviously a fairly far-flung network. How do you think about concentrating that? And as part of this – I know the digital review is different. When you think about the portfolio that you currently have, is there – are there opportunities? Are you looking to – do you exit some places? Do you double down in others as part of the storing effort?

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Sure. Let me kind of try to answer several of those questions. First of all, we're pretty excited about kind of the new investments in storing because that drives a lot of goodness from the top line and the same store sales line. And we think we've got a great long runway to grow stores. I think when you think about the things that go into making stores successful, obviously, the right location, the right market, you've got to have great operational infrastructure as well as talent. And obviously, you're not going to open a store unless you think it's going to deliver a terrific return.

In the fourth quarter, we're going to complete about – or in the fourth quarter, we plan to complete about four major store projects. We're going to break ground on another 14 stores. And when you look at 2026, we expect to increase new store builds by 30%.

In terms of – and I guess the other thing I should just mention is how excited we are about our entry into Jacksonville with Harris Teeter. Harris Teeter runs a great business. They already operate in Florida in Amelia Island, which is about 40 miles from Jacksonville. Florida itself is a large state. It's a growing state. We expect to do very well there. I think Jacksonville is the tenth largest city in the United States, and I think it's the largest city in Florida.

And I think that's kind of an indication of we're going to continue to expand in adjacent markets. I think we also have opportunities to grow through acquisition, and we haven't ruled that out despite our last few years with the Albertsons. And I think when you look at our long-term aspiration, we expect and plan to be a national retailer.

So I'm not sure that answers all your questions. Concentration is important. We'll certainly fill up Jacksonville before we move to adjacent markets. But we think we've got great opportunities to grow stores. And I think, frankly, that's been one of our biggest challenges over the last few years is we haven't allocated enough capital to growing stores because we have allocated a lot of capital in other areas like fulfillment centers.

John Heinbockel

Analyst, Guggenheim Partners

Q

Great. And maybe just a follow-up, totally unrelated. The CEO search has been one of the longest, right? I think we've seen it in a while. I'm curious, you and the board, what are you looking for, maybe characteristic-wise, capability-wise? And what does the business need from that person?

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure, yeah. I think, as you know, we've been pretty deliberate in the process. We've also been very thorough in the process. We're working with an executive search firm, and we have identified and engaged with really several very highly qualified candidates. I think we have announced publicly that our next CEO will be external. And I think we expect them to bring in fresh perspectives to the organization and also to complement the culture that we have today, which is pretty strong at Kroger as well.

In terms of what we're looking for, we want a deep understanding of retail transformation. We want somebody who is very close to the customer. We want somebody who has demonstrated success operating at scale, who knows how to operate and frankly, cultural fit and an alignment with Kroger values is critical as well. And like I said, we're getting closer, we're making good progress, and we expect that decision will be announced in the first quarter.

John Heinbockel

Analyst, Guggenheim Partners

Q

Thank you.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Thanks, John.

Operator: The next question goes to Ed Kelly of Wells Fargo. Ed, please go ahead. Your line is open.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Ed.

Edward Kelly

Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Good morning, everyone. Thank you for taking my question. I wanted to – maybe, first, Ron, could you just kind of step back and maybe talk about how you're feeling about the current grocery ID trend? It seems like you want that to be better. The competitive environment, it seems like, it may be picking up a bit.

And you did mention some investment in price towards the end of the quarter. How should we think about all of that in the context of maintaining underlying gross margin stability going forward? And I think what you are implying for next year based upon what you're talking about eComm is EBIT, at least maybe some EBIT margin expansion.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure, yeah. Let me just talk a little bit about sales. I think this morning, we announced that sales came in a little lighter than we expected, and that was primarily later in the quarter. And that's due to a combination of factors. We saw increased caution and uncertainty among consumers, particularly in October and November due to the concerns about the government shutdown. Also the pause in SNAP benefit distributions created some headwinds at the end of the quarter. I think consumers are becoming more selective. They're buying more on promotion. They're reducing the discretionary purchases, things like general merchandise. General merchandise comped negative during the quarter.

And also, we had a tougher ID comparison in Q3 from the prior year. Despite all that, our two-year stacked identical sales were up 20 basis points, and I think that might have been one of the higher quarters of the year. But I think what we're doing going forward is our focus remains on value and serving customers during a pretty uncertain time. If you look at Q4, well, Q4 to-date, we're feeling pretty good about our quarter-to-date sales. We're slightly ahead of our guidance that we provided this morning. But we don't anticipate any meaningful improvement in the consumer environment in Q4.

Also, when you do the math, looking at the top line, we're also going to lap harder comparisons in Q4. Last year, we benefited from some weather and maybe, we'll have weather again this year. Also, we benefited from egg inflation last year that we won't see this year. And then finally, and I think David mentioned this one is we'll see some headwinds relating to the Inflation Reduction Act in pharmacy, and that will hit us in January to the tune of about 30 basis points in overall ID sales. You asked about competition. Yeah, I think the environment remains very competitive as it always is in the retail world.

I think especially true today when consumers are looking for great value. Frankly, our focus is just running the Kroger playbook. We want to run great stores. We want to drive eCommerce business. We want to grow alternative profits. We continue to lower prices. We took down another 1,000 items in Q3. And I think we will continue to ramp up promotions during the holidays to drive traffic as well as basket sizes. The good news is that vendor funding continues to be strong to support our initiatives.

Maybe I'll give you one example of that, the Thanksgiving meal bundle that we announced a few weeks ago. We lowered the price this year over last year. And we did not cut the menu to do so. I think the bundle fed 10 people for less than \$5 per person. So an answer to your question, yeah, the environment remains competitive, and we expect that to continue.

David Kennerley

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

A

Hey. Just a couple of things to build on Ron's comments. I think also important to note that in the quarter, our share trends improved. So despite the impacts on sales from the things that Ron talked about, we saw sequential improvement in our share trends, which was good. And then in terms of gross margin, I think Q3 shows that we manage gross margin in a very, very responsible way. And I think despite what we've guided to for Q4, you guys should think about us continuing to do that in a responsible way.

If you look at actually the breakdown of gross margin, selling gross itself actually declined as we invested in pricing, but we were able to offset that with mix on Our Brands, good sourcing improvements, shrink and other supply chain costs. And I think I'd expect a similar dynamic to what we saw in Q3 going forward.

Operator: Great. Thank you. The next question goes to Michael Montani of Evercore ISI. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Good morning, Michael.

A

Michael David Montani

Analyst, Evercore Group LLC

Q

Yes. Hi. Good morning. Thanks for taking the question. I guess one thing that I was going to ask about was when you look at the pharmacy drug pricing headwind, should we anticipate that that annualizes closer to 100 bps for next year? That was part one. And then part two is just, can you parse out some of the tailwinds you might have to offset when you think about Express Scripts impact? Where is that now? How does that mature DoorDash and Uber Eats? Just trying to see what there might be there as offsets.

David Kennerley

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

A

Hey. Thanks for the question. It's David here. So obviously, we're not getting into 2026 guidance today. We'll obviously get into more details on that in our next quarterly earnings. But let me just add a little bit more color on the Inflation Reduction Act impacts that we'll see this quarter. And then how you might think about some of the tailwinds that we've got.

So I think to provide a little bit more detail. So starting January 1, Medicare will pay 60% to 70% less for the first 10 negotiated drugs. And I think important to stress this is really only Medicare. Those lower reimbursements will translate into lower sales, i.e., the price at which we sell and that creates the headwind that we've talked about.

I think also important to note that manufacturers will offer rebates to us to offset that, so this will have no margin impact in the quarter and no earnings impact, and we expect that dynamic to continue on an ongoing basis. As we think about the tailwinds that we have to maintain really good performance in our ID sales, our long-term trends are – we're seeing units improve in our core business. We've got expecting to continue to invest in making sure our price gaps. We've got headroom on Our Brands. We've got, I think, a whole range of different initiatives to keep core momentum in our business moving along strongly to offset some of the impacts from what we're going to see going forward on our pharmacy business.

Operator: Thank you. The next question goes to Kelly Bania of BMO. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Good morning, Kelly.

A

Operator: Kelly, your line is open.

Kelly Bania

Analyst, BMO Capital Markets Corp.

Q

There we go. Thanks for taking our question. Can you just maybe help parse out more specifically the impact of pharmacy on the quarter? It sounds like you're estimating some slight market share improvements. But I think a

lot of investors are really just trying to understand what's happening with the core grocery business with inflation and units and market share? Any color you can give there?

And then also, just going back to the reinvestment of the eCommerce losses. Maybe can you talk about how much you're planning there? How much is planning to go towards price versus store standards and maybe just your assessment of those two key factors on where your price positioning is and your store standards? Is this going to be a broad-based investment across many stores, more targeted in certain areas? Any color on how we should think about that and what that might do for next year?

David Kennerley

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

A

Kelly, let me take that initially, and then I'll turn over to Ron. So I think pharmacy in the quarter, I would think of the impact of pharmacy business similar to what we've been seeing over recent quarters. So I don't think there's a material change in what we've seen from a pharmacy performance this quarter.

I think your second question was around units and what we're seeing on the core business. We did see a slight deceleration in our unit trends in Q3. If you sort of dissect where that's coming from, actually discretionary categories were probably the most impacted. We also saw some impacts in our meat business due to the higher inflation that we've been seeing.

But I think it's also important to say that actually unit trends improved or held up in a number of areas. We saw good improvement in the deli. And actually, natural and organic foods held up really, really well. I think these trends changed given some of the broader dynamics that Ron talked about at the beginning, SNAP and the sort of broader macro consumer environment.

In terms of the tailwind that we have next year from our eCommerce business, we haven't yet declared how we're going to split that money up. Obviously, we'll provide more details when we get into 2026 guidance. But as we've said, we expect to use some of the money to reinvest back into pricing to make ourselves even more competitive.

We've got a whole range of different opportunities to invest to improve the customer and in-store experience, which we believe will also help improve composite scores, but we're also committed on an ongoing basis, as we've said, to improve the operating margins of the business, and we expect to do that next year as well.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

And David, the only area I would add would be kind of technology. I think we've got some technology spend that is in the pipeline that we want to make sure that we can continue to grow not only our retail business but also our eCommerce business, which is rapidly evolving.

Operator: The next question goes to Michael Lasser of UBS. Michael, please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Good morning, Michael.

Michael Lasser

Analyst, UBS Securities LLC

Q

Good morning. Thank you so much for taking my question. Good morning, Ron. Two-part unrelated question. The first is, as you went through your eCommerce review, how did you think about the risk of leaning so heavily on third-party providers to fulfill a core competency, which is to interact with the customer at the point of delivery versus having that key function more in-house?

And also, as part of the eCommerce review, you mentioned that it's going to be profitable next year. Is that simply a function of the \$400 million of losses going away? Or are there other factors that we should consider to drive that profitability?

And just one last unrelated point. As you think about 2026, do you expect the rate of growth for the grocery industry just to be more sluggish overall given this 100 basis point headwind from the pharmacy change along with what could be a headwind from SNAP next year? Thank you very much.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Sure. I'll start and then I'll turn it over to David. In terms of – you asked the question about the providers that are going to be doing some more of our delivery; one, we're really excited about the connection. I think each of those partners really brings distinct customer – serves distinct customer needs as well as, as occasions. Some are full basket stock-up delivery companies and some are really more about immediate convenience.

I think we're looking at these incremental – as these partners as incremental sales opportunities and customer opportunities. The vast majority of our eComm sales come from the Kroger website and we feel like they give us operational flexibility as well as strategic flexibility.

If you think about Instacart, which is our largest partner, they deliver broad geographic reach. They've got great scale. They can handle very large basket sizes. They also – we also can offer agentic shopping capability on Kroger's iOS platform.

Uber Eats, that leverages Uber's existing customer base and the Uber app. And I think the benefits here are add-on economics, customers can order grocery items and do with the restaurant orders. And that certainly appeals to younger customers who want more speed, more convenience. And I think those are – represent new and younger customers for the company.

And then DoorDash, David talked about how successful that launch has been. And there, again, we're focusing on speed. We're focusing on convenience. It is ideal for quick small basket needs and again, it appeals to younger customers.

In terms of the \$400 million, I'll ask David to weigh in on that one.

David Kennerley

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

A

Yeah. So, Michael, the way I think about eCommerce profitability is, I mean, as we've been saying, we're already making good improvements in profitability on the business that as it exists today. In fact, in quarter three, we actually cut the losses that we've been making in half. So, we're making really, really good quarter-over-quarter improvements in profitability, and I expect that to continue into next year.

You then take the \$400 million that we've talked about, which is from closing the automated fulfillment centers. You then add in the business that we believe is highly incremental from the new third-parties that we're working with, so DoorDash and Uber Eats as well as continued growth from our Instacart business.

You've got the media business that we expect to continue to grow. And importantly, the media sharing opportunities that we have with our new partners and when you put all that together, that allows us to expect that we will make money in eCommerce next year.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

And Michael, your third question. I'm not sure I'm qualified to speak for the rate of – the grocery industry growth rate for 2026. And I certainly don't want to get into any guidance at this point. We'll do that next quarter. But I don't know that there's any reason why there should be this dramatic slowdown in the grocery industry and certainly, not for us, we've got new store growth coming. We're closing kind of unproductive and low-performing stores.

eCommerce has been – has had a great year and continues to accelerate. It seems like every month more and more. So, the mix might change a bit there because eCommerce will grow faster than physical stores. But we've got a lot going on in fresh categories. Our Brands continues to grow faster than the house. And then finally, we want to continue to execute very well in our stores and customer service matters. And I'm not sure that I see a slowdown for 2026.

Operator: Thank you. The next question goes to Jacob Aiken-Phillips of Melius Research. Jacob, please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

A

Hey, good morning, Jacob.

Jacob Aiken-Phillips

Analyst, Melius Research LLC

Q

Hi. Good morning. So on the last call, you talked about how you're kind of working on how you discuss the retail media business with vendors or across the organization. And today, you highlighted some new opportunities with the 3P partnerships. I'm just curious like as more [ph] emissions (00:47:34) originate on the partner platforms, how are you structuring the relationship so that you have the right level of first-party data? And should we think of the economics as comparable first-party versus third-party for retail media?

David Kennerley

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

A

Jacob, let me take that one. It was a little hard to hear your question, your line is breaking up. But hopefully, I got the gist of it. So we're seeing good performance from our retail media business today. So in Q3, we saw another quarter of double-digit growth, and we think we've got good plans for Q4 and our plans lead us to believe actually that that business will accelerate into Q4.

And obviously, we'll share more specific guidance as we get into next year. And I think the foundation of this is great tools with best-in-class capabilities for the brands that choose to operate on the platforms.

Now as we think about the new partnerships that we've got going forward, the really important thing that was important for us as we structured those relationships is to make sure that we got to participate in the media opportunities that exist and that may originate on their platform rather than our platform.

Obviously, I don't want to get into the details of the specifics of how we've structured those agreements. But we've structured them in a way that we benefit what I would call a [ph] appropriately (00:48:58) from that in a way that's very favorable to our economics.

Operator: The next question goes to Seth Sigman of Barclays. Please go ahead. Your line is open.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Hi, Seth.

A

Seth Sigman

Analyst, Barclays Capital, Inc.

Hey, good morning, everyone. I think there was a comment that you feel good about quarter-to-date. I'm not sure if that implies trends have improved or not. But is there anything more you can share about that and what may be driving that if it is improving? And you mentioned price investments. I'm just curious, is that playing a role? And then a bigger picture question on price investments. You were doing a lot of testing this year. Is there anything else you can share about what is working versus what is not working? Thank you.

Q

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Yeah. I think it's a little early to kind of opine about the fourth quarter. We're just three or four weeks into the quarter. Just to be clear, I said that quarter-to-date, we are trending ahead of our guidance that we shared with you this morning.

A

In terms of price investments, it's a little hard to know those in real-time. We continue to make price investments. We will continue to do that throughout the quarter. I think what we're seeing with our promotional kind of environment out there is that customers are responding to promotion and we will continue to do that. I don't know, David?

David Kennerley

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

Yeah. Just sorry, one slight clarification just to make sure the point on Q4 is crystal clear. We're trending, quarter-to-date, slightly above the midpoint of our Q4 guidance.

A

Seth Sigman

Analyst, Barclays Capital, Inc.

Thank you.

Q

David Kennerley

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

Yeah, and Ron, do you want to cover price investments. So let me take that one. So I think there was a second question on there, Seth, about price investments. Listen, we continue to make sure that we offer great value for

A

the consumer. As Ron talked about, a great example was towards the end of the quarter when we knew consumers were struggling given SNAP benefits being withheld, we invested in what believe was an appropriate way and also a very responsible way with our margins to bring the cost of the Thanksgiving dinner down, as well as lower prices through promotions on a number of critical items for households. And I think we'll continue to do that. Value is at the foundation of what we do, and we'll continue to do that in a responsible way.

Operator: Great. Thank you. The next question goes to Simeon Gutman of Morgan Stanley. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Good morning, Simeon.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Hey, Ron. Hi, David. Good morning. Two questions. The first, eCommerce, now that you'll be in the green next year, can you talk about the scalability or maybe incremental margins? Does it move quicker or it's still a long evolution?

And part two, since you've been in your role Ron, there's been some significant change, strategic change, tactical change. Today's call sounded a little more urgent with some pricing folks coming back to work, etcetera. I don't know if that's a fair read or not. Can you say if it is? And I guess new CEO should be very little interruption as far as execution goes because it sounds like the plans are all being built today. Thanks.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Let me ask David to cover the first and then I'll cover the second.

David Kennerley

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

Yeah, let me take the first one. So, obviously, the economics, our eCommerce business with the outcome of the strategic review have changed. So we now move from a business that was in the red to a business that's now in the green. We've had a really good growing business now for many quarters. And I think with the new partnerships that we've signed, with the stores that we're building, with the strong growth that we're really seeing across all elements of our eCommerce business. I think what that allows us to do is continue to scale the business in a way that we now make money.

So I think as you think about that going forward, I'm not sure we see a dramatic change in the growth rate, but I'd expect us to see continued strong double-digit growth from the eCommerce business going forward with the change being that, that business is now profitable.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

And Simeon, just to get into the second point, I've been here. I think this is my 10th month. And my only objective is to set up the company for future success. We got to do the right things, and we're going to do the right things even if some of the decisions are hard. And you ask about urgency. I'm not sure there's any more urgency. I'm always urgent about everything. And I think going fast needs to be a key element of our culture. I think being

willing to make the tough decisions needs to be a key part of our culture and to the support, we've gotten great support. The board has been very supportive of those things that we need to do to set the company up for future success.

And frankly, our management team has really embraced the speed, the decisions, the focus on the customer, the focus on kind of moving some of the influence from our corporate office to our divisions where our customers are. And then five days a week, it's frankly just a function of the fact that that's just retail.

I mean, we need to be here, we need to collaborate, we need to be able to respond quickly. And we need to be able to support our stores that operate seven days a week as long as our – as well as our manufacturing facilities and our distribution facilities. So I wouldn't say there's more urgency, but I would say that there's plenty of urgency.

Operator: Thank you. The next question goes to Thomas Palmer of JPMorgan. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Hi, Tom.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Good morning. Thanks for the question. In the release discussing the fulfillment center closures, there was the mention, right, of the \$400 million in savings. To maybe get a little bit of a breakdown of where these savings will be seen, I think some of it might be depreciation, some of it other operating costs. And then when we're thinking about the reinvestment, how much of this is investment that you probably would have undertaken anyway, and this just gives you kind of better ammo to fund it versus things that might not have occurred if the closures had not occurred?

David Kennerley

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

Yeah. Let me take that one. So as you think about the \$400 million, you're right, that splits across what I would call kind of operating profit, kind of EBITDA, kind of more cash-related items. And then, of course, there's a component of it that relates to depreciation. So it is split across both.

In terms of investments, the way I would think about that, obviously, and we'll get more into that in terms of – when we get into guidance for next year, it's a combination. Clearly, it gives us fuel to be able to make investments that we were likely already going to make, but it also gives us incremental flexibility to invest in things that perhaps we were not going to be able to make. So we'll get into more details on that as we get into 2026 guidance, but hopefully, that gives you sufficient color.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

And just to add, I mean, the key of eCommerce, it's our – one of our fastest-growing businesses, and that will continue. In fact, it continues to accelerate. It's 11% of our sales. The focus is we got to make money on a business that's growing that fast. And it was all about we got to get profitable. We got to get profitable fast because that eCommerce is a key part of our future here.

Operator: Thank you. The next question goes to Rupesh Parikh of Oppenheimer. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Good morning, Rupesh.

A

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Good morning. Thanks for taking my question. So just going back, I guess, just to CapEx. So going forward, more aggressive store openings, obviously, a change in your eCommerce strategy. Does anything change in terms of how to think about the baseline CapEx spending for the business?

Q

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

CapEx?

A

David Kennerley

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

I don't think anything changes in the immediate term about the CapEx. I think what we're doing is prioritizing the mix differently. So we're reallocating more into our storing program and less into other areas of the business. We think this is good for the ROIC of the company and the returns on our capital as we get good returns from major storing programs. So think of it more as a mix shift.

A

Operator: Thank you. The final question goes to Chuck Cerankosky of Northcoast Research. Please go ahead.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Hey, good morning, Chuck.

A

Chuck Cerankosky

Analyst, Northcoast Research Partners LLC

Good morning, everyone. In looking at your store development, well, let me back up a bit. It sounds like you talked about the mid-tier customer pulling back some more in line with the lower income customers. Is that a change which you saw during the quarter? And in looking at store development, anything going on at Fred Meyer that you might want to talk about? And could you perhaps talk about how it's a larger exposure to general merchandise as you're thinking about that banner? Thank you.

Q

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Sure. Yeah, I can give you some big picture kind of comments about the – what we're seeing on the consumer side. As you've been reading, consumer sentiment has declined a lot over the last four months. And there's a lot of reasons behind that, whether it's a slowing job market or the government shutdown, the SNAP benefits, concern about inflation and categories like beef and coffee and chocolate, I just think customers are managing their budgets carefully, and they're making more trips. They're making smaller trips.

A

The idea of stocking up is declining a bit. And we're seeing this economy where high income premium shoppers, they continue to spend while lower income customers are pulling back more aggressively.

In terms of that middle bucket, I would guess, again, they're also looking for value. And the best indicator of that is our Q3 was softer in the later parts of the quarter because of the pause in SNAP benefits. So that would be kind of – I think going forward, I think the consumer is going to remain cautious. I think there's going to be more focus on food items and less on discretionary categories.

Does that impact Fred Meyer? I think it probably does from their mix of higher mix of discretionary and GM merchandise. But it's also – we're seeing it in adult beverages, snacks, I think the good news is that we're seeing this continued shift from restaurant purchases to food at home purchases, which should be good for our business.

And then I think the other big trend we're seeing is eCommerce continues to grow a lot faster than physical stores. Fred Meyer, I don't want to point out a specific division, but Fred Meyer continues to perform well. We got Todd out there, President, Todd Kammeyer, running it. And I was out there a few months ago, and I'm feeling pretty good about Fred Meyer.

David Kennerley

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

A

Yeah, I think maybe just one thing just to add on stores and store formats as to how we think about that. We'll continue to build kind of large stores around the 123,000 square foot. We've also got a 99,000 square foot format that we're going to continue to build. And I think as we think about the future, we're going to continue to experiment to make sure that we have the right array of store formats to cater consumers wherever they may be located.

Operator: Thank you. That concludes today's question-and-answer. I will now hand back to Ron Sargent, Chairman and Chief Executive Officer (sic) [Interim Chief Executive Officer] (01:01:37) for any closing comments.

Ronald L. Sargent

Chairman & Interim Chief Executive Officer, The Kroger Co.

Okay. Well, thanks, everybody. Thanks. We had a lot of great questions today. Before we conclude our earnings call, we'd like to share a few comments with our associates who are listening in. The progress we've made and the strong results we share today reflect your hard work and your commitment. This year, we focused on running great stores, delivering a strong customer experience and strengthening our core business really priorities that are essential to our success going forward. Your efforts are creating a strong foundation for Kroger's long-term growth.

We're very proud of what we've accomplished so far, and we're excited for the work ahead. So thanks for everything you do and for your hard work during a really busy holiday season. Thanks, everybody, for joining us on the call this morning. We look forward to speaking with all of you again soon. I hope to see you in our stores, and Happy Holidays, everybody.

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

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