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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 2026 Earnings Conference Call. After today's prepared remarks, we will host a question-and-answer session. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference 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 2026 earnings call. I am joined today by Kroger's Chief Executive Officer, Greg Foran; and Chief Financial Officer, David Kennerley.

Before we begin, I want to remind you that today's discussion will include forward-looking statements. We want to caution you that such statements are predictions and actual events or results can differ materially. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings. The Kroger Company assumes no obligation to update that information.

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

I will now turn the call over to Greg.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

Thank you, Rob, and good morning, everyone. I said it on day one and it's still true today, this is the best job in retail, full stop. I'm a believer in grocery, physical and digital. It's essential. It's resilient. People want fresh food. They want it close to home. And they want it at a price that works for them. And supermarkets, done well, is a fantastic business.

Now, Kroger. We've got terrific assets. We're outperforming many traditional grocery competitors and we're proud of that. But beating other grocers isn't the same as leading the industry. Customers today are shopping across more channels with more of their spend going outside of traditional grocery. But I don't see that as a problem, I see it as an opportunity. Right industry, right moment, right foundation. The runway in front of this business is significant.

We have what we need. Now we need to execute. Over my first 100 days, I've been in the business every week in stores, manufacturing plants, distribution centers and offices. I've spent time with associates, customers and suppliers, and with many of you. And I've walked our competitors, because you can't lead in this industry without understanding it from every angle. So let me give you my assessment.

First, our operating costs have been growing faster than our sales. That's not sustainable, and frankly, it's not acceptable. Taking costs out of this business is not optional. It's the starting point for everything else we want to do. Second, the way we operate behind the stores needs to improve. We need to move faster, make decisions more quickly, and get more out of the assets and the talent we already have.

Third, our execution in stores and online needs more consistency. When we operate well, we perform well. We attract households, grow sales and deliver strong earnings. But when execution slips, we fall short of our potential. And today, the gap between our best stores and the rest of the fleet needs to improve, and closing it is one of our biggest near-term opportunities.

On top of that, we've not been opening enough stores. Competitors have continued to grow their footprint while we stepped back. Our existing footprint is one of our strongest assets, but standing still in store growth means standing still in market share. The good news is we've started to ramp our pipeline thoughtfully, focused on the markets and formats that can generate the strongest returns.

And finally, we have opportunities to strengthen our price position and make it simpler. Customers are being more deliberate with their spending and at times shopping us selectively. We're getting too many promotional trips and not enough of the full basket. Our ambition is clear to be America's best grocer. We're going to lead with what we are, a great grocer focused on food, and we're going to win by doing it better than anyone else.

To become America's best grocer, there are five things we need to get right. Priorities that connect to every associate in every store, every day. This is what we call the [ph] Five Fs (00:04:51). Let's start with fresh. Fresh is the single biggest reason customers choose a grocer. If the produce isn't right, if the protein disappoints, if it doesn't last at home, we've lost them. We're raising our standards and measuring freshness the way customers experience it, not just on our shelves, but in their homes.

Fast. Customers are busy. When we're out of stock, when the checkout is slow, when the promotion is too complicated, that costs us trips. Fast applies just as much online as it does in our stores. Quick trips in store, fast delivery at home, a perfect order on time every time for you. We have more data and more customer insight than just about anyone in this industry. We need to use it better. Personalization our customers actually feel in the offers they get, in the experience they have, in the trip itself.

Friendly. Our associates are one of our biggest competitive advantages, and we're going to act like it. Friendly is a hard metric. When we measure it and manage to it, it improves the customer experience. That starts with how we invest in our associates, better training, simpler tools, and the support they need to do their best work.

Affordable. And yes, I know it doesn't start with an F, but it belongs on the list. We have opportunities to sharpen our pricing and make value simpler for customers. Over time, our promotions have gotten too complicated and our price position has not kept pace where it needed to.

Let me be clear on what this means. We do not need to be the lowest price retailer. We need to be more competitive, more consistent, and easier for customers to understand. When a customer is deciding where to shop, we want more of them choosing Kroger more often, because the value is clear, the experience is great and the trust is there.

To do this, we do not need a one-time reset. Every dollar we invest in customer value, we earn through cost savings and efficiency. That's a standard we're holding ourselves to. Over time, we'll move towards simpler, more consistent, everyday value. We will still be promotional. That is part of who we are. But sharper and easier for customers to understand. That requires discipline. And here's where we're pushing to fund that.

On cost of goods, we will press harder on supplier negotiations and lean further into direct sourcing. On goods not for resale, we will remove complexity and waste in addition to buying better. And we need to operate more

efficiently. That means fewer organizational layers, smarter ways of working, standing up our Kroger Capability Center, and applying AI across the business.

Let me turn to eCommerce and media, two businesses that are increasingly central to how we win and how we grow. Starting with eCommerce, most of the growth in grocery today is happening online. That's where the customer is moving, and that's where we have to lead. Our omni-channel customers spend nearly two-and-a-half times more with us than our in-store-only customers. The good news is that we have the right assets to do it, a strong store footprint, deep customer data, and a fresh offering that travels well into the digital basket.

Now, a strong eCommerce business does something else. It powers our media business. Kroger Precision Marketing is a high margin business built on first-party data that very few retailers can match. What sets us apart is the depth of our data. 95% of all transactions are tied to a loyalty card backed by over 20 years of history.

That means we can measure actual purchase behavior, not just intent. And that's increasingly valuable to brands and advertisers. The fundamentals of this industry are moving in our direction. We operate the technology layer closest to the customer, giving us a distinct advantage in how we engage and monetize those relationships.

As data and direct customer relationships become the most valuable currency in advertising, those with scale and trusted customer connections will be the long-term winners. And that gives us real confidence in our ability to lead. Over time, this will become an even more important driver of both growth and margin.

I want to spend a few moments on culture. None of this work happens without the right people moving at the right pace. Through my first 100 days, one thing has become clear, we need to move with more speed. We need to be more intentional and smarter about how we work at every level of this organization. And that starts with me. We are building a culture where the work is never done, where we improve the business every week.

Before I turn to the quarter, let me say a word about what you can expect from us this year. We are balancing two things at once, delivering results in the short term while making the changes required to improve the business long term. Both matter, and we intend to do both. We will be transparent with you every step of the way on what's working, what isn't, and what we're doing about it.

With that as the backdrop, let me turn to what we're seeing in the business, starting with the customer. The customer is under pressure. High gas prices and reduced SNAP benefits are squeezing budgets. Customers are managing spend carefully and shopping with real intent. That pressure is showing up in the market.

Food at home growth decelerated 100 basis points compared to the last quarter. The encouraging news is that our work on affordability is starting to resonate, and you can see it in the data. Traffic is up. Customers are coming through our doors more often, which tells me our value message is starting to land. And our loyal households have now grown for 17 consecutive quarters.

We've started to pull away from the middle of the pack, both in units and in dollars, and had our best performance against Circana's Rest of Market, a benchmark of traditional grocery competitors in over three years. That's a meaningful shift, and it tells me that the team is doing the right things in the right way. We delivered identical sales, excluding fuel of 1%, led by strong performance in eCommerce, Fresh and Our Brands, three areas I'm spending a lot of time on.

Our Brands continue to be a real strength. This quarter, Our Brands gained share and outpaced national brands by 175 basis points, even with the headwinds from deflation in dairy, with strong momentum in Simple Truth and

Private Selection. New items like the Private Selection Sparkling Mineral Water and our globally inspired Frozen Meals are resonating with customers.

As a business, we're changing our mindsets to think more like item-level merchants. Customers don't buy assortment, they buy items. The Garlic and Herb Rotisserie Chicken, the Black Diamond Watermelon, the Guatemalan Antigua Coffee. Every item has to earn its place on the shelf, and every item is an opportunity to delight a customer or lose one. That's a discipline we need to use in Our Brands, and frankly, across the entire store.

eCommerce also performed well, growing 19% led by delivery. We improved perfect order rates by 8% and attracted a record number of new households. And on the back of that progress, we hit a milestone we've been working toward for years. Our eCommerce business, including media, turned profitable this quarter. That's a real step-up, and we intend to keep building on it.

What gives me confidence this is sustainable is the work behind it, particularly our shift to more store-based fulfillment, which is improving the economics of the business as we scale. Our intent is to grow this business faster than the market over time.

On costs, we are moving with urgency. We delivered savings ahead of plan this quarter, and I can tell you we're just scratching the surface. There is more to come. Margin performance was solid. We balanced productivity and savings with investments to grow. We saw some unexpected pressure in transportation from higher diesel costs that wasn't built into our original expectations for the year, but it's a manageable headwind, and we're confident we can work through it.

Stepping back this quarter was a step in the right direction. We're making progress on the fundamentals. The strategy is coming into focus and the team is energized about what's ahead. We're building toward a clear long-term framework we plan to share at our Investor Update on October 20. Between now and then, we'll keep you posted on progress.

Let me leave you with this, right industry, right moment, right foundation. The opportunity is enormous, and we know the work. First, we break clear of the pack. Then, we close the gap to the leaders. I'm encouraged because the work is already underway, and we are seeing positive signs. But the work is never done, better every day, better every week. We have what we need, now we go execute.

We will now turn the call over to David.

David Kennerley

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

Thank you, Greg, and good morning, everyone. As you just heard, Greg is setting a clear strategic direction, and my job is to show you how the financial model supports it. And this quarter, it did. Kroger delivered a solid first quarter, reflecting continued progress in our core grocery business and strong growth in eCommerce. We are executing well in a dynamic environment. We are investing in price with discipline, fully funded through cost savings, while maintaining a strong focus on margin performance.

This quarter, we achieved identical sales growth without fuel of 1%. Sales growth was led by strong performance in eCommerce, Fresh and Our Brands. Importantly, grocery sales again represented a larger portion of our overall mix, reinforcing improving underlying trends in the core business.

Pharmacy sales were led by continued growth in GLP-1s and core scripts. That said, identical sales without fuel growth of 1% included a 130 basis point headwind to the total company from the Inflation Reduction Act and an additional 40 basis point headwinds to the total company from the accelerating shift from brand to generic prescriptions. Despite these top line pressures, Pharmacy profit grew ahead of expectations.

Food inflation came in at the low end of our expectations, down sequentially from the fourth quarter. Egg deflation was a meaningful headwind to identical sales without fuel, representing 64 basis points of pressure. Our first quarter results reflect improving underlying volumes relative to the market, partially offset by pressure from lower inflation and Pharmacy-related headwinds.

Looking ahead, we expect inflationary pressure to increase as the year progresses, reflecting the broader macro environment. Against this backdrop, our priority remains clear, delivering value for customers, working with suppliers to optimize costs, narrowing price gaps versus competitors, and managing our margins responsibly.

Our FIFO gross margin rate, excluding rent, depreciation and amortization, fuel and adjustment items, decreased 9 basis points in the first quarter compared to the same period last year. The change in rates was primarily driven by higher-than-expected transportation costs, the deflationary impacts from eggs, and planned pricing investments. These headwinds were partially offset by favorable mix in Pharmacy, improved eCommerce profitability, and sourcing benefits.

Transportation was an unexpected headwind, resulting in 15 basis points of pressure in the quarter, as higher oil prices impacted our fuel costs. We are managing this closely and expect some pressure to persist, while oil markets remain elevated. Despite these near-term pressures, we continue to expect our FIFO gross margin rate to be positive on a full year basis, with cost saving initiatives ramping up throughout the year.

Our operating, general and administrative rate, excluding fuel and adjustment items, increased 16 basis points in the first quarter, compared to the same period last year. The increase primarily reflects intentional investments in our associates, additional store hours, training, and new uniforms. These pressures were partially offset by lapping higher multi-employer pension contributions from a year ago and continued progress on our ongoing productivity initiatives. Our adjusted FIFO operating profit in the quarter was \$1.5 billion. Adjusted EPS was \$1.58, reflecting 6% growth compared to last year.

A core pillar of our long-term strategy is modernizing how we operate to move faster and create a more efficient cost structure that supports both margin performance and enables us to invest into more value for customers.

In the first quarter, we delivered COGS savings 30% ahead of our plan. We see meaningful runway ahead across both COGS and goods not for resale, with savings expected to build throughout the balance of year and accelerate beyond.

Combined with disciplined reinvestment, this positions us to drive margin expansion overtime. While we are committed to managing margins on an annual basis, quarterly results will fluctuate based on the timing of investments and savings initiatives. We look forward to sharing more specific long-term targets at our Investor Update this fall.

Fuel results were better than anticipated this quarter, reflecting favorable fuel margins driven by elevated volatility in global oil markets and strong volume performance relative to the industry. While our gallons were down slightly versus last year, our industry-leading fuel rewards program enabled us to outpace industry benchmarks by more than 400 basis points.

During the quarter, we expanded fuel reward promotions, helping customers save at the pump in an environment where value matters more than ever, while driving incremental traffic to our stores. As a result, fuel reward redemptions were up 10% compared to last year.

As noted earlier, we delivered a strong eCommerce performance in the quarter. Growth was led by convenience orders delivered in under an hour, which represented approximately 50% of our digital growth.

Our new third-party partnerships with DoorDash and Uber Eats allow us to leverage our store network, provide faster delivery and reach new customers. We gained share across every third-party platform where we operate, another proof point that we are beginning to pull away from traditional grocery.

As part of the continued evolution of our hybrid fulfillment model, we closed three fulfillment centers at the end of the last quarter. In markets where we have a store presence, we retained nearly all of those households and successfully converted them to store-based delivery and pickup.

These actions are already translating into better profitability. Our eCommerce business, including media, became profitable this quarter ahead of schedule. We expect profitability to accelerate through the remainder of this year and continue improving beyond 2026, as we scale store-based fulfillment, expand media and reduce our cost to serve. Together, these levers position eCommerce to become a larger contributor to margin expansion over time.

Our eCommerce results are also creating momentum for our media business, which delivered over 20% growth this quarter. This combination of Kroger's customer data, loyalty ecosystem, and expanded reach through partners is creating new opportunities for brands to engage customers in more targeted and effective ways.

Recently, we deepened several partnerships. With Google's Display & Video 360 platform, advertisers can now use KPM's retail signals to reach audiences across YouTube and YouTube TV, with SKU level conversion reporting available for the first time. We're also the first retail media network set to launch a self-service collaboration with TikTok, giving brands direct access to KPM audiences within one of today's most influential platforms.

Looking ahead, we are expanding our AI-powered capabilities to support real-time optimization, predictive budget allocation, and faster audience creation, positioning AI as a key enabler of both performance and scalability. We're encouraged by the progress we are seeing in media and believe we remain in the early stages of a long-term growth opportunity.

None of the progress we are making would be possible without our associates, who are at the heart of everything we do. A great customer experience begins with a motivated, engaged and well-supported team, which is why we continue to invest in our people.

Beyond competitive wages and benefits, this quarter, we invested in more store hours, additional training to better support our customers and new uniforms so our associates are easily recognizable on the floor, all to create a great shopping experience.

We are investing in better technology that helps our associates grow in their careers, work more efficiently, and spend more time on the value-added activities our customers notice most. These investments not only strengthen the experience we deliver in our stores and online, they also improve productivity and support the long-term growth of our business.

Now, turning 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 1.75x compared to our net total debt to adjusted EBITDA target ratio range of 2.3x to 2.5x. Over time, we expect to move back toward our target leverage ratio. We view this flexibility as a strategic asset. It gives us optionality to invest in high return opportunities, while maintaining our commitment to investment grade credit.

Our disciplined capital allocation continues to fuel our performance as we balance investments in growth opportunities, all while maintaining our strong financial foundation. Our capital allocation framework is grounded in a focus on improving ROIC, which is guiding every investment decision we make. We are confident that this focus will enable us to generate strong, long-term returns to our shareholders.

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 performance, which reflects continued momentum in our core grocery business and strong performance in eCommerce. Given our outlook for the remainder of the year, we are reaffirming our full year guidance.

Our confidence in the full year outlook is supported by continued progress on cost savings, improving eCommerce profitability, growth in media, and disciplined reinvestment in value.

For the second quarter, we expect identical sales without fuel to be roughly in line with the first quarter. This reflects continued Pharmacy headwinds from the accelerating shift from brand to generic prescriptions, as well as ongoing pressure on consumer spending. We expect adjusted net earnings per diluted share to be in line with last year in the second quarter, with growth accelerating in the back half as our cost saving initiatives continue to ramp.

In closing, we are setting a high bar for this business, and our financial model is built to support it. We are pleased with this quarter's results and we are confident in our plans. We look forward to laying out a broader financial framework at our Investor Update in October.

With that, I will turn the call back to the operator to begin the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: We'll now begin the question-and-answer session. Please limit yourself to one question. [Operator instructions] Your first question comes from the line of John Heinbockel from Guggenheim Securities. John, your line is now open.

John Heinbockel

Analyst, Guggenheim Partners

Q

Execution gap between really good stores and laggards. How do you think about closing that, and how impactful would that be, right, to market share? And then – and lastly, do you have – what's your thought on food volumes, and what is an acceptable food volume performance for this business?

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Good morning, John. It's Greg. I would say that I'm guessing over the last sort of about 15 weeks, 16 weeks, I've probably now got into well over 100 of our stores and many of our competitors. I would say that as a rough rule of thumb, I would say that two out of five, I would find in very good condition. Another two out of five that are in moderate condition, and there's generally one out of five where we could improve the performance. So, we just don't focus on that 20%. We look at actually the other two out of five where we can improve.

The way you fix that is by basically getting out into the business. You spend time with the Presidents in each division. You spend time with their Vice Presidents. You spend time with their district managers. You walk stores. You use the data that's available as well. We have some good data on stores. But basically, you're out there and you're seeing what's happening, and you're encouraging people and making sure that we stay on top of it.

It's interesting when you come across a store that has some challenges, and that's the nature of this business, and it's been like that in almost the 50 years that I've been doing it. It's amazing how quickly you can get it turned around and the impact it has on sales. I was in a store the other weekend, it wasn't in great shape. It had been running negative comp sales and in the space of basically some hard work over the day by the team, they turned it into some reasonably healthy positive comps. So it makes a difference when you run a good store.

You comment on volumes. Maybe I could just get a little bit more color on what you were after there?

John Heinbockel

Analyst, Guggenheim Partners

Q

[ph] You can (00:31:08) take out Pharmacy, food volumes, units, right?

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Sure.

John Heinbockel

Analyst, Guggenheim Partners

Q

I think most conventional food retailers run negative, right?

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

Yeah.

A

John Heinbockel

Analyst, Guggenheim Partners

And obviously, you certainly don't want to be there.

Q

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

Yeah. No, we don't. And we've made a comment in the script about starting to pull away from that traditional grocery set, something that they call Rest of Market. And what we're starting to see now is the beginnings of a meaningful break. And we're nowhere near where we want to be, but there's separation. That separation has been there now for a few months, and we're pleased with that, and we're focused on it. And at some point, we want those lines to cross and we want to get into the positive territory. But at this stage, there's a meaningful break, and I'm encouraged by that. We refer to it as green shoots in the business.

A

David Kennerley

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

I think the only thing I'd add, John, and agree with everything Greg said, the – in terms of the unit performance that we're seeing, if you look at the unit market share performance, actually was pretty good. It was about the best we've seen in two years to three years. So I think that's encouraging in the context of the market. But to Greg's point, our objective needs to be to get the units of the business to positive, and that is what we're focused on.

A

Operator: Thank you for your question. Your next question comes from the line of Simeon Gutman from Morgan Stanley. Your line is now open.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Hey, Greg. Hey, David. Kroger went out and did some big pricing investments, it was in the earlier part of the 2000s, a long time ago. And it took a couple of years for the sales needle to move pretty meaningfully. Can you give us a sense of the timeframe? Because it sounds like you're going to do this more surgically and have it funded. So think about what's the appropriate timeframe that we should expect a decent pickup in sales volumes? And if you're willing to frame, is the pricing opportunity or the value opportunity in the hundreds of millions or billions, just so we can understand how much needs to be funded over time?

Q

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

Yeah. Hi, Simeon. Good to chat again. Yes, I wasn't in the market when Kroger did it back in the 2000s, but I've certainly spoken to some of the team here at Kroger that were. So I have a sense of that. And obviously, from my time at another retailer, I've got a sense of how it plays out as well. Look, we'll provide a bit more color on what we're seeing and what we're learning in October 20. At this stage, too early to comment. I don't really want to get into details around that. And what's more, we're learning as we go. I appreciate this is not the same as that other retailer that I was at, so I have to understand some of the nuances that we will see around that. eCommerce has obviously changed from what it was back in 2014, 2015. So if you can just be patient with us, we'll give you some more color around October 20.

A

David Kennerley

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

A

Yeah. One thing to add, Simeon, I think, as you guys and obviously, we'll – Greg – as Greg said, we'll provide more color in the fall. The thing that you guys should be thinking about is, we've said it, we've got a very significant cost opportunity in the business to take cost out, yeah. And it's more than enough to be able to afford the price investments we need to make.

Operator: Thank you for your question. Your next question comes from the line of Tom Palmer from JPMorgan. Your line is now open.

Thomas Palmer

Analyst, JPMorgan Securities LLC

Q

Good morning, and thank you for the question. Maybe – and I appreciate there's more to come here in October, but I did want to maybe follow up on the price investments and at least understand how far along we might be at this point. I know it was cited as an item that contributed to the gross margin decline that we saw in the first quarter. Sounds like that's planned for throughout the year. So maybe just an update on kind of where we stand at this point in terms of price investments and how you're thinking about it in terms of, I think maybe more of a regional – region-by-region focus versus plans to go much broader than that? Thanks.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks. Thanks for the question, Tom. Look, we're being very thoughtful about how we do this, and just to build on David's point, we're funding it. So, as we dig into what we're doing with cost of goods, when we dig into goods not for resale, as we start to expand our importing capability, we build up deposits in our bank account. And as those deposits build, then we look at how we spend it.

The comment around some price investment in the first quarter is, once again, we've been very thoughtful as we go through our negotiations with suppliers, as we deal with some suppliers who want to get price up, how much of that we will pass on. And I would say I'm very, very pleased with the way that the team under Mary Ellen, [ph] Mike, and Carlo (00:36:56) have been managing that, managing where we want to sit with price, what we take, what we don't, and the rest of it. I'll just reiterate, just be patient. We'll get to the fall, and we'll have more to share with you at that point.

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

Krisztina Katai

Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Good morning, and thanks for taking the question. Greg, in your opening remarks, and even now in some of the answers to questions, obviously, you talked about operating costs growing faster than sales and that not being acceptable. Maybe can you talk about some of the areas of opportunity for the business that you see, perhaps sizing up the various buckets for us? I know that there's going to be more to come on October 20, but just how are you viewing the cost opportunities, especially in light of the operational and cultural improvements that you're seeking to achieve, and especially at the store level? Thank you.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks for your question, Krisztina. There's really no shortage of opportunities as I've sort of got around the business over the last sort of 14 weeks, 15 weeks. Some of those are above the gross margin line, and they can be sitting in things like shrinkage rates, sort of sitting in stores. They can be sitting in things like replenishment and how that's operating. And then some of them are sort of below the gross margin line and your traditional operational and general expenses, and it could be whether we've got the right number of people sitting in the right locations, what we're doing in terms of productivity in various parts of the business. So there is a reasonably long list of things that are going to add up over time, which will fund what we want to do. So it's pretty wide and varied. There are literally opportunities at every single part of the business.

David Kennerley

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

A

A couple of things to add. I mean, the work is underway. So you shouldn't think about this as this is work that hasn't started. If I use our work on cost of goods sold as an example in Q1, we're already ahead of the expectations that we had for ourselves. So about 30% ahead of where we're at. And through the balance of this year, we expect the savings that we'll get out of the initiatives that are broad-based, as Greg said, we expect them to ramp over the course of this year, and they will endure over a multi-year period. So we think this number's significant, and that's why we feel confident we can use that as a source of improving affordability for customers.

Operator: Thank you for your question. Your next question comes from the line of Michael Lasser from UBS. Your line is open.

Michael Lasser

Analyst, UBS Securities LLC

Q

Good morning. Thank you so much for taking my question. Greg, now that you've had a couple of months in the seat, it seems like your message is that Kroger can be the best version of itself without making any radical changes and achieve its long-term formula of 3% to 5% earnings growth over time. Someone on the other side might say, hey, that might be difficult to do in an environment where your competitors are using profit pools outside of grocery to invest in driving the traffic that this sector brings, and Kroger is – has to deal with the rigidity of its labor model at the same time that all of the growth is being driven by the grocery sector – excuse me, by the online grocery sector. How would you respond to that?

And as part of that, I don't know if you or David could note, what's going to change in the second half of the year as you're pointing to an inflection in your profitability given the updated comments that you provided around the second quarter? Thank you so much.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Thanks, Michael. Michael, I remain incredibly encouraged by what I see as I get around the business. We've got the right format, generally in the right locations with the right size, selling the right product. People need to buy food. We've seen how important stores are in terms of eCommerce. Is eCommerce going to grow? For sure. So, well-run Kroger has the right assets to be able to compete with anyone out there. And because of our scale, we can also compete in retail media. And David commented in his script about the performance of that, and I'll just layer in, it's actually going really well for us. I sat down yesterday with Christine, who looks after that business, and I finished that session with her even more encouraged by the results that she's getting of late, which just continue to accelerate.

So we've got the scale and we've got the assets to be able to compete. And we've got the format. There is no doubt that clubs are a powerful format and perform extremely well. But not everyone wants to go into a store that size and have to deal with pack sizes that big. I obviously understand the supercenter business, and we even have some ourselves. A lot of people prefer to get into a 50,000 square foot, 60,000 square foot store and do their shopping and get out again. And by the way, if you're picking groceries and you're picking them in a store that size, that can also be quite efficient.

So I like the fact we're in supermarkets. A good article about ALDI in the Financial Times today. But not everyone wants to go into a store with 2,500 to 3,000 own brand SKUs. They want to be able to buy national brands. We're well-positioned. We've got the assets. We've got enough scale. We can compete, whether it's in digitization and media and all those things that anyone else can. And we've got opportunity to grow. There are parts of this country where we're not operating at the moment. So I feel good about that.

David, do you want to pick up the second part?

David Kennerley

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

A

Yeah. I'll take the question about H2, Michael. So I think – listen, I just want to reiterate, I mean, we were, I think, pretty pleased with Q1, and I think particularly the share performance. So I think Q1 sort of broadly came in where we expected. Obviously, it's Q1, so it's still early in the year. So there's lots of unknowns as we head through the balance of the year. But I think a few things that for us give us confidence in H2, or the balance of the year and the outlook that we've got.

I think the first thing is the cost initiatives ramp-up. So that's going to give us fuel. What does that allow us to do? It allows us to continue sharpening value. It allows us to, as Greg talked about, focus on execution, focus on traffic. And that is building the unit momentum, continuing to accelerate our share performance. I think the third thing is the eComm business turned profitable in the quarter. And as that business continues to grow and accelerate, that will generate more profitable performance for us, which is a really good piece of good news for us.

And then the final thing is, again, and we'll still be within the range that we communicated in inflation, and we're going to keep working very diligently with suppliers. But I think as we get through the balance of the year, we will also continue to see some increased pressure on inflation as we head through the balance of the year. So I think we feel pretty good about how we've called it. And obviously, we'll keep you guys updated as we move through the year.

Operator: Thank you for your question. Your next question comes from the line of Leah Jordan from Goldman Sachs. Your line is now open.

Leah Jordan

Equity Research Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning. I just wanted to build off of that last question. I hear on the cost savings driving a lot of the profit improvement for the year, but your updated outlook for Q2 is really suggesting the ID sales guide will be more back half-weighted than maybe we thought last quarter. So just more detail around how you're thinking about inflation, volumes, and traffic as we move through the year? And ultimately, what I'm trying to get at is how much is that top line acceleration being driven by the macro versus your own initiatives underway, like the improvements on affordability? Thank you.

David Kennerley

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

A

Yeah. Leah, thanks for the question. I think a few things as we think about sort of Q2 and the year. I think as we reflect back on the plan that we built, I mean the plan was always going to be more H2 weighted. So I think that was the plan that we built for ourselves. And as you know, we don't guide to specific quarters, and what I'd say is, things are playing out broadly as we expected, with the exception of the fuel inflation that Greg touched on in his script.

I think as we head into Q2, I think a few things to think about. So the first is, we are expecting FIFO gross margins to be better. So we've got a number of things, the egg inflation or egg deflation, a very meaningful one, that will improve as we get into Q2. We are expecting our OG&A investments to be a little bit higher as we go through the year. Those are deliberate investments in the same things we've been talking about. Back to Greg talking about well-run stores, you need engaged associates, well-trained, right number of them in the store, right number of hours. So we're making deliberate choices about that.

I think the other thing about Q2 is whilst none of them are individually material enough to call out, collectively, we are lapping a collection of sort of what I would call one-time items, that cause some headwinds for Q2 specifically. And that's why you get the difference between what will ultimately be our H1 numbers and H2.

And to build on the points I said to Michael's question, listen, the cost savings ramp-up gives us more fuel to invest into the business. A little bit of inflationary pressure still within the range as we move through the balance of the year, and an eComm business and a media business that will continue to accelerate.

.....
Operator: Your next question comes from the line of Edward Kelly from Wells Fargo. Your line is now open.

Edward Kelly

Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Good morning, everyone, and thank you for taking my question. Greg, I wanted to ask you, you've mentioned the desire to move fast. I think last quarter, you said something about behind competition, but you want to catch up and then pass. And the strategy as it pertains to investing in price and funding it with cost saves, we have heard others talk about that as well. I think almost every company we cover this quarter has talked about investing in price.

My question is, how are you weighing the speed at which you want to move? So meaning slowly stepping on the accelerator and hoping the competition doesn't see you coming versus flooring it and really closing the gap. And the success of each of those sort of initiatives. I'm just kind of curious as to how you weigh the pace at which you're moving? And then maybe you could weave in, I know you're doing some price tests currently, what you're seeing in those price tests and how that might inform how this process sort of moves forward?

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks, Edward. As I said in the script, it's really about threading the needle, isn't it? You have to be pretty thoughtful here that what you're doing is you're balancing the short term with the longer term. And the other component that comes into play is the capability of the team to be able to execute. If you're going to start moving on price, you need to make sure that your stores are in good shape. So there are other things that have to come into play at the same time that you start to think about, well, gee, maybe I need to get a little bit more affordable on price.

If I can just tease out the price comment piece. The objective of Kroger, and if you go back to the 2000s, and I think it might have been Simeon or one of the others who raised it, last time, this was done in a meaningful way, I think. The objective actually is not to get down and be the same price as, if you like, some of the discounters in the marketplace. The objective here is to get to a situation where customers feel comfortable that the price that they're getting when they shop in a Kroger store or a Kroger brand is actually fair and reasonable.

And if you have a look at sort of what's been happening in Rest of Market, what's happened is those price gaps have widened over several years. And that's, I'm sure, one of the reasons why the share starts to move from Rest of Market to the other end of the market that's called MULO. So our objective here is not to go and price ourselves at a discount price. It's to actually get to a situation where the customer says, you know what? I have a choice of turning right or left when I leave my house, or I can swipe left or swipe right on my phone. And we want them to go, well, we're going to swipe to Kroger, or we're going to drive to Kroger, because it's a terrific grocery store. It's got a great range of fresh food. It's got a great range of brands, national brands, and Our Brands. It's affordable.

Or if I'm going to go online, it's got everything that I want in my basket. If I need to get it in 30 minutes, I can do that. If I need to get it same day, I can do that. And it's got some uniqueness about it in terms that they do fresh really well, they do convenience meals really well, and they've got a terrific selection of Own Brands.

So that's the position that we want to take, and we do that very carefully, surgically almost, by threading this needle. I am very, very conscious, as is David, that what we're doing here is going to be hard. We're not taking any dramatic, drastic actions. We're being very surgical, very thoughtful. I guess I've had the benefit of doing this before. Let's wait and see what happens from a competitive perspective. I can't judge that at this point. We'll know more, and we'll share more when we get to October 20. But it's sort of how I'm thinking about it. Anything you want to add to that, David?

David Kennerley

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

A

No. Maybe I don't know whether the price tests we're running this, and as you'd expect, we're running price tests.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. And we're not going to divulge the details of that at this point in time for obvious reasons. But we'll share a bit more when we get to October 20.

Operator: Thank you for your question. Your next question comes from the line of Seth Sigman from Barclays. Please go ahead.

Seth Sigman

Analyst, Barclays Capital, Inc.

Q

Hey. Good morning, everyone. As you think about the guidance for this year, it sounds like the investments are going to ramp, but the savings are also going to ramp. And previously, you'd targeted that \$400 million of savings from eCommerce. Is there a bigger, maybe more inclusive number for savings that's built into this guidance now that you can quantify to give investors some confidence in your ability to drive all of that change? Thanks so much.

David Kennerley

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

A

Yeah. Seth, let me take that one. I mean, we obviously communicated last year when we closed the Ocado sheds and included in our guidance the \$400 million improvement in eCommerce. I think what I'd say is that eCommerce profitability, which includes obviously that \$400 million improvement, is ahead of schedule and accelerating faster than we thought. So I think that is an additional tailwind. We – whilst I'm not going to put a number on it, we will share more in the fall about what we think the multi-year opportunity is.

The cost savings that we plan to realize through the balance of the year are more than sufficient for us to make the investments that we talked about. So I talked about OG&A likely to be an area of continued investment as we head through the year, offset with improvements in gross margin. So in summary to your question, the savings are bigger than the investments, and that's what gives us confidence in our ability to deliver the profit number for the year.

Operator: Thank you for your question. Your next question comes from the line of Rupesh Parikh. Your line is now open.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning, and thanks for taking my question. So on the Pharmacy business, I was curious how you're thinking about the headwind related to the Inflation Reduction Act and brand to generic for the balance of the year. And I also want to see if you can provide any color on [ph] quarter-to-date (00:55:23) trends? Thank you.

David Kennerley

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

A

Yeah. Let me take that one initially, Rupesh, and then I'll ask Greg to add any additional color. Lots of changes in the Pharmacy space this year. We obviously knew about the Inflation Reduction Act coming into the year. We estimated that to be about 130 basis point headwind for the year, and honestly, it's playing out exactly as we expected. Obviously, that's a headwind to sales. But given the way the rebates work, it's neutral from a profit perspective.

What we're also seeing, and it's an industry thing, is a sort of shift from branded drugs to generics impacted us by about 40 basis points on the total quarter, on total ID sales. On that one, even though it's a headwind to sales, it's actually profit positive, so helps improve the margin profile of the business. And again, hence why the sales headwind doesn't impact our profit guidance.

I think despite these pressures, honestly, the Pharmacy business continues to do well. If you look at core scripts, GLP-1 performance, we're winning share, and that's really the sort of yardstick that we use to measure the performance of the business, as well as the financial ones. And I think as you think about something like GLP-1s, that consumer who comes and fills their prescription in the store, not only are they filling their prescription, but they're also changing their eating habits. They want more fresh, higher protein. They're shopping Better For You categories.

So I think we feel that the overall Kroger ecosystem is very well-positioned to serve those customers. So I think, yes, some headwinds on the top line for the Pharmacy business. The industry facing much of the same. We're winning share, feel good about how we're doing.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

I think that's exactly right, David. I think a little bit like we're seeing in the rest of the business. There's some good underlying sort of foundational trends here that are coming through. As you said, we've picked up share, script counts is up. We're just rolling out delivery. So, like we're seeing in grocery, units are better, dollar share is getting better. So we feel good about Pharmacy.

Operator: Thank you for your question. Your next question comes from the line of Scott Marks from Jefferies. Your line is open.

Scott Marks

Analyst, Jefferies LLC

Q

Hey. Good morning, all. Thanks so much for taking the questions. In the prepared remarks, you made some comments about the consumer under pressure between higher gas prices, some of the changes to SNAP programs. Wondering if you can just give us a little bit more detail around what you're seeing from the consumer, specifically across different income cohorts, and what you're seeing just in terms of purchasing behaviors and habits? Thanks so much.

Gregory S. Foran

Chief Executive Officer & Director, The Kroger Co.

A

Yeah. Thanks, Scott. I would say that averages can always be a little bit misleading, so you need to get into the detail. SNAP, I would say, is most impacted across three states in particular, and we see a bit of that flow through. In terms of the price of fuel having an impact, when that price gets up to what it has, I think we see that some of the basket sizes, some of the items that people buy tend to be traded down a bit. I think that helps probably with Our Brands and how we're operating.

So, SNAP is varied across the country. Petrol is more widespread right across the country. We would say that based on the share data that we're seeing and the positive results that we're getting out of that, we're doing okay. We're managing through this. And I'll go back to the comment I made previously. I think we're threading the needle nicely between delivering the right level of profit and the right level of price.

Operator: Thank you for your question. Your last question comes from the line of Paul Lejuez from Citi. Your line is open.

Brandon Cheatham

Analyst, Citigroup Global Markets, Inc.

Q

Hey, everyone. This is Brandon Cheatham on for Paul. You all mentioned that freight costs were higher than you initially expected. I was just wondering if you could share the magnitude of that impact in 1Q, and the impact that had on eComm profitability? And then what have you contemplated for freight costs for the rest of the year? And if you could share any of the offsets that you're working through there?

David Kennerley

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

A

Yeah. So let me take that one, Paul (sic) [Brandon] (01:00:16). So as we'd said in the script, that – it cost us about 15 basis points on the gross margin line. So without that, the gross margin line would've been slightly positive. On eComm profit, whilst it cost us a bit, we're making really good progress on eComm profit. We turned profitable in

the quarter. And it wasn't just as a result of the closing of unprofitable Ocado sheds. We made progress really across the board. Great, I think it was the record level, or lowest level cost to serve that we've seen. Wait times were best ever, and I think we've got many more opportunities to improve that through the balance of the year.

Fuel prices are very hard to predict through the balance of the year. I'd love to be able to do that perfectly. Obviously, we can't. So we think we've made a sensible assumption in the guidance through the balance of the year. We think it's a manageable headwind. We think we've got enough in the tank to be able to deal with it. Obviously, we hope, like everybody else does, that the news coming out of the negotiations between the US and Iran alleviates some of those pressures. But we're prepared to deal with it regardless of what the outcome is.

Operator: We have reached the end of the Q&A session. This concludes today's call. Thank you for attending. You may now disconnect.

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