

KROGER CO  
Form 10-Q  
June 28, 2013

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended May 25, 2013**

**OR**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from        to**

**Commission file number 1-303**

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(Exact name of registrant as specified in its charter)

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**Ohio**  
(State or other jurisdiction of  
incorporation or organization)

**31-0345740**  
(I.R.S. Employer  
Identification No.)

**1014 Vine Street, Cincinnati, OH 45202**

(Address of principal executive offices)

(Zip Code)

**(513) 762-4000**

(Registrant's telephone number, including area code)

**Unchanged**

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer ☒ x

Accelerated filer ☐ o

Non-accelerated filer ☐ o  
(do not check if a smaller reporting company)

Smaller reporting company ☐ o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ o No ☒ x .

There were 518,243,041 shares of Common Stock (\$1 par value) outstanding as of June 21, 2013.

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****THE KROGER CO.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in millions, except per share amounts)

(unaudited)

|                                                                                                                   | <b>First Quarter Ended</b> |                         |
|-------------------------------------------------------------------------------------------------------------------|----------------------------|-------------------------|
|                                                                                                                   | <b>May 25,<br/>2013</b>    | <b>May 19,<br/>2012</b> |
| Sales                                                                                                             | \$ 30,043                  | \$ 29,065               |
| Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below | 23,856                     | 23,095                  |
| Operating, general and administrative                                                                             | 4,600                      | 4,464                   |
| Rent                                                                                                              | 189                        | 191                     |
| Depreciation and amortization                                                                                     | 519                        | 501                     |
| Operating profit                                                                                                  | 879                        | 814                     |
| Interest expense                                                                                                  | 129                        | 141                     |
| Earnings before income tax expense                                                                                | 750                        | 673                     |
| Income tax expense                                                                                                | 266                        | 232                     |
| Net earnings including noncontrolling interests                                                                   | 484                        | 441                     |
| Net earnings attributable to noncontrolling interests                                                             | 3                          | 2                       |
| Net earnings attributable to The Kroger Co.                                                                       | \$ 481                     | \$ 439                  |
| Net earnings attributable to The Kroger Co. per basic common share                                                | \$ 0.93                    | \$ 0.78                 |
| Average number of common shares used in basic calculation                                                         | 514                        | 556                     |
| Net earnings attributable to The Kroger Co. per diluted common share                                              | \$ 0.92                    | \$ 0.78                 |
| Average number of common shares used in diluted calculation                                                       | 520                        | 559                     |
| Dividends declared per common share                                                                               | \$ 0.150                   | \$ 0.115                |

The accompanying Notes are an integral part of the Consolidated Financial Statements.

**THE KROGER CO.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in millions and unaudited)

|                                                                                                | <b>First Quarter Ended</b> |                |
|------------------------------------------------------------------------------------------------|----------------------------|----------------|
|                                                                                                | <b>May 25,</b>             | <b>May 19,</b> |
|                                                                                                | <b>2013</b>                | <b>2012</b>    |
| Net earnings including noncontrolling interests                                                | \$ 484                     | \$ 441         |
| Other comprehensive income                                                                     |                            |                |
| Unrealized gain on available for sale securities, net of income tax(1)                         | 3                          |                |
| Amortization of amounts included in net periodic pension expense, net of income tax(2)         | 19                         | 18             |
| Unrealized loss on cash flow hedging activities, net of income tax(3)                          | (19)                       | (14)           |
| Amortization of unrealized gains and losses on cash flow hedging activities, net of income tax | 1                          | 2              |
| Total other comprehensive income                                                               | 4                          | 6              |
| Comprehensive income                                                                           | 488                        | 447            |
| Comprehensive income attributable to noncontrolling interests                                  | 3                          | 2              |
| Comprehensive income attributable to The Kroger Co.                                            | \$ 485                     | \$ 445         |

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(1) Amount is net of tax of \$2 for the first quarter of 2013.

(2) Amount is net of tax of \$11 for the first quarter of 2013 and \$12 for the first quarter of 2012.

(3) Amount is net of tax of \$(12) for the first quarter of 2013 and \$(9) for the first quarter of 2012.

The accompanying Notes are an integral part of the Consolidated Financial Statements.

## THE KROGER CO.

## CONSOLIDATED BALANCE SHEETS

(in millions, except per share amounts)

(unaudited)

|                                                                                                        | May 25,<br>2013 | February 2,<br>2013 |
|--------------------------------------------------------------------------------------------------------|-----------------|---------------------|
| <b>ASSETS</b>                                                                                          |                 |                     |
| Current assets                                                                                         |                 |                     |
| Cash and temporary cash investments                                                                    | \$ 247          | \$ 238              |
| Store deposits in-transit                                                                              | 851             | 955                 |
| Receivables                                                                                            | 961             | 1,051               |
| FIFO inventory                                                                                         | 6,191           | 6,244               |
| LIFO reserve                                                                                           | (1,115)         | (1,098)             |
| Prepaid and other current assets                                                                       | 299             | 569                 |
| Total current assets                                                                                   | 7,434           | 7,959               |
| Property, plant and equipment, net                                                                     | 14,967          | 14,849              |
| Goodwill                                                                                               | 1,234           | 1,234               |
| Other assets                                                                                           | 592             | 593                 |
| Total Assets                                                                                           | \$ 24,227       | \$ 24,635           |
| <b>LIABILITIES</b>                                                                                     |                 |                     |
| Current liabilities                                                                                    |                 |                     |
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 1,784        | \$ 2,734            |
| Trade accounts payable                                                                                 | 4,855           | 4,484               |
| Accrued salaries and wages                                                                             | 957             | 1,017               |
| Deferred income taxes                                                                                  | 284             | 284                 |
| Other current liabilities                                                                              | 2,487           | 2,538               |
| Total current liabilities                                                                              | 10,367          | 11,057              |
| Long-term debt including obligations under capital leases and financing obligations                    |                 |                     |
| Face-value of long-term debt including obligations under capital leases and financing obligations      | 6,161           | 6,141               |
| Adjustment to reflect fair-value interest rate hedges                                                  | 1               | 4                   |
| Long-term debt including obligations under capital leases and financing obligations                    | 6,162           | 6,145               |
| Deferred income taxes                                                                                  | 776             | 800                 |
| Pension and postretirement benefit obligations                                                         | 1,199           | 1,291               |
| Other long-term liabilities                                                                            | 1,127           | 1,128               |
| Total Liabilities                                                                                      | 19,631          | 20,421              |
| Commitments and contingencies (see Note 6)                                                             |                 |                     |
| <b>SHAREOWNERS EQUITY</b>                                                                              |                 |                     |
| Preferred shares, \$100 per share, 5 shares authorized and unissued                                    | —               | —                   |
| Common shares, \$1 par per share, 1,000 shares authorized; 959 shares issued in 2013 and 2012          | 959             | 959                 |
| Additional paid-in capital                                                                             | 3,483           | 3,451               |
| Accumulated other comprehensive loss                                                                   | (749)           | (753)               |
| Accumulated earnings                                                                                   | 10,190          | 9,787               |
| Common shares in treasury, at cost, 445 shares in 2013 and 2012                                        | (9,293)         | (9,237)             |

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|                                            |           |           |
|--------------------------------------------|-----------|-----------|
| Total Shareowners' Equity - The Kroger Co. | 4,590     | 4,207     |
| Noncontrolling interests                   | 6         | 7         |
| Total Equity                               | 4,596     | 4,214     |
| Total Liabilities and Equity               | \$ 24,227 | \$ 24,635 |

The accompanying Notes are an integral part of the Consolidated Financial Statements.

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions and unaudited)

|                                                                                                                        | Quarter Ended   |                 |
|------------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
|                                                                                                                        | May 25,<br>2013 | May 19,<br>2012 |
| Cash Flows from Operating Activities:                                                                                  |                 |                 |
| Net earnings including noncontrolling interests                                                                        | \$ 484          | \$ 441          |
| Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities: |                 |                 |
| Depreciation and amortization                                                                                          | 519             | 501             |
| LIFO charge                                                                                                            | 17              | 46              |
| Stock-based employee compensation                                                                                      | 24              | 24              |
| Expense for Company-sponsored pension plans                                                                            | 25              | 31              |
| Deferred income taxes                                                                                                  | (14)            | 58              |
| Other                                                                                                                  | 38              | (3)             |
| Changes in operating assets and liabilities net of effects from acquisitions of businesses:                            |                 |                 |
| Store deposits in-transit                                                                                              | 104             | (53)            |
| Receivables                                                                                                            | 88              | 3               |
| Inventories                                                                                                            | 53              | 91              |
| Prepaid expenses                                                                                                       | 276             | (56)            |
| Trade accounts payable                                                                                                 | 279             | 214             |
| Accrued expenses                                                                                                       | (226)           | (49)            |
| Income taxes receivable and payable                                                                                    | 89              | 94              |
| Other                                                                                                                  | (139)           | (43)            |
| Net cash provided by operating activities                                                                              | 1,617           | 1,299           |
| Cash Flows from Investing Activities:                                                                                  |                 |                 |
| Payments for capital investments                                                                                       | (618)           | (542)           |
| Proceeds from sale of assets                                                                                           | 6               | 9               |
| Other                                                                                                                  | (14)            | 6               |
| Net cash used by investing activities                                                                                  | (626)           | (527)           |
| Cash Flows from Financing Activities:                                                                                  |                 |                 |
| Proceeds from issuance of long-term debt                                                                               | 2               | 846             |
| Dividends paid                                                                                                         | (78)            | (65)            |
| Payments on long-term debt                                                                                             | (409)           | (527)           |
| Net payments on commercial paper                                                                                       | (545)           | (370)           |
| Excess tax benefits on stock-based awards                                                                              | 7               | 1               |
| Proceeds from issuance of capital shares                                                                               | 95              | 38              |
| Treasury stock purchases                                                                                               | (146)           | (345)           |
| Increase (decrease) in book overdrafts                                                                                 | 93              | (19)            |
| Other                                                                                                                  | (1)             | (8)             |
| Net cash used by financing activities                                                                                  | (982)           | (449)           |
| Net increase in cash and temporary cash investments                                                                    | 9               | 323             |
| Cash and temporary cash investments:                                                                                   |                 |                 |
| Beginning of year                                                                                                      | 238             | 188             |
| End of quarter                                                                                                         | \$ 247          | \$ 511          |



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## Reconciliation of capital investments:

|                                              |    |       |    |       |
|----------------------------------------------|----|-------|----|-------|
| Payments for capital investments             | \$ | (618) | \$ | (542) |
| Changes in construction-in-progress payables |    | (28)  |    | (15)  |
| Total capital investments                    | \$ | (646) | \$ | (557) |

## Disclosure of cash flow information:

|                                               |    |     |    |     |
|-----------------------------------------------|----|-----|----|-----|
| Cash paid during the quarter for interest     | \$ | 114 | \$ | 113 |
| Cash paid during the quarter for income taxes | \$ | 181 | \$ | 94  |

The accompanying Notes are an integral part of the Consolidated Financial Statements.

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

(in millions, except per share amounts)

(unaudited)

|                                                    | Common<br>Shares | Stock<br>Amount | Additional<br>Paid-In<br>Capital | Treasury<br>Shares | Stock<br>Amount | Accumulated<br>Other<br>Comprehensive<br>Gain (Loss) | Accumulated<br>Earnings | Noncontrolling<br>Interest | Total    |
|----------------------------------------------------|------------------|-----------------|----------------------------------|--------------------|-----------------|------------------------------------------------------|-------------------------|----------------------------|----------|
| Balances at January 28, 2012                       | 959              | \$ 959          | \$ 3,427                         | 398                | \$ (8,132)      | \$ (844)                                             | \$ 8,571                | \$ (15)                    | \$ 3,966 |
| Issuance of common stock:                          |                  |                 |                                  |                    |                 |                                                      |                         |                            |          |
| Stock options exercised                            |                  |                 |                                  | (2)                | 38              |                                                      |                         |                            | 38       |
| Restricted stock issued                            |                  |                 | (2)                              |                    | 1               |                                                      |                         |                            | (1)      |
| Treasury stock activity:                           |                  |                 |                                  |                    |                 |                                                      |                         |                            |          |
| Treasury stock purchases, at cost                  |                  |                 |                                  | 13                 | (302)           |                                                      |                         |                            | (302)    |
| Stock options exchanged                            |                  |                 |                                  | 1                  | (43)            |                                                      |                         |                            | (43)     |
| Share-based employee compensation                  |                  |                 | 24                               |                    |                 |                                                      |                         |                            | 24       |
| Other comprehensive gain net of income tax of \$3  |                  |                 |                                  |                    |                 | 6                                                    |                         |                            | 6        |
| Other                                              |                  |                 | 5                                |                    | (2)             |                                                      |                         |                            | 3        |
| Cash dividends declared (\$0.115 per common share) |                  |                 |                                  |                    |                 |                                                      | (65)                    |                            | (65)     |
| Net earnings including noncontrolling interests    |                  |                 |                                  |                    |                 |                                                      | 439                     | 2                          | 441      |
| Balances at May 19, 2012                           | 959              | \$ 959          | \$ 3,454                         | 410                | \$ (8,440)      | \$ (838)                                             | \$ 8,945                | \$ (13)                    | \$ 4,067 |
| Balances at February 2, 2013                       | 959              | \$ 959          | \$ 3,451                         | 445                | \$ (9,237)      | \$ (753)                                             | \$ 9,787                | \$ 7                       | \$ 4,214 |
| Issuance of common stock:                          |                  |                 |                                  |                    |                 |                                                      |                         |                            |          |
| Stock options exercised                            |                  |                 |                                  | (4)                | 95              |                                                      |                         |                            | 95       |
| Restricted stock issued                            |                  |                 | (3)                              |                    | 1               |                                                      |                         |                            | (2)      |
| Treasury stock activity:                           |                  |                 |                                  |                    |                 |                                                      |                         |                            |          |
| Treasury stock purchases, at cost                  |                  |                 |                                  |                    | (19)            |                                                      |                         |                            | (19)     |
| Stock options exchanged                            |                  |                 |                                  | 4                  | (127)           |                                                      |                         |                            | (127)    |
| Share-based employee compensation                  |                  |                 | 24                               |                    |                 |                                                      |                         |                            | 24       |
| Other comprehensive gain net of income tax of \$1  |                  |                 |                                  |                    |                 | 4                                                    |                         |                            | 4        |
| Other                                              |                  |                 | 11                               |                    | (6)             |                                                      |                         | (4)                        | 1        |
| Cash dividends declared (\$0.150 per common share) |                  |                 |                                  |                    |                 |                                                      | (78)                    |                            | (78)     |
| Net earnings including noncontrolling interests    |                  |                 |                                  |                    |                 |                                                      | 481                     | 3                          | 484      |
| Balances at May 25, 2013                           | 959              | \$ 959          | \$ 3,483                         | 445                | \$ (9,293)      | \$ (749)                                             | \$ 10,190               | \$ 6                       | \$ 4,596 |

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The accompanying Notes are an integral part of the Consolidated Financial Statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

All amounts in the Notes to the Consolidated Financial Statements are in millions except per share amounts.

Certain prior-year amounts have been reclassified to conform to current-year presentation.

**1. ACCOUNTING POLICIES**

*Basis of Presentation and Principles of Consolidation*

The accompanying financial statements include the consolidated accounts of The Kroger Co., its wholly-owned subsidiaries, and the Variable Interest Entities ( VIEs ) in which the Company is the primary beneficiary. The February 2, 2013 balance sheet was derived from audited financial statements and, due to its summary nature, does not include all disclosures required by generally accepted accounting principles ( GAAP ). Significant intercompany transactions and balances have been eliminated. References to the Company in these Consolidated Financial Statements mean the consolidated company.

In the opinion of management, the accompanying unaudited Consolidated Financial Statements include all normal, recurring adjustments that are necessary for a fair presentation of results of operations for such periods but should not be considered as indicative of results for a full year. The financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted, pursuant to SEC regulations. Accordingly, the accompanying Consolidated Financial Statements should be read in conjunction with the financial statements in the Annual Report on Form 10-K of The Kroger Co. for the fiscal year ended February 2, 2013.

The unaudited information in the Consolidated Financial Statements for the first quarters ended May 25, 2013 and May 19, 2012, includes the results of operations of the Company for the 16-week periods then ended.

**2. DEBT OBLIGATIONS**

Long-term debt consists of:

|                                                               | May 25,<br>2013 | February 2,<br>2013 |
|---------------------------------------------------------------|-----------------|---------------------|
| 2.20% to 8.00% Senior Notes due through 2042                  | \$ 6,188        | \$ 6,587            |
| 5.00% to 12.75% Mortgages due in varying amounts through 2034 | 61              | 60                  |

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|                                                                          |          |          |
|--------------------------------------------------------------------------|----------|----------|
| 0.40% to 0.45% Commercial paper borrowings due through July 2013         | 1,100    | 1,645    |
| Other                                                                    | 185      | 184      |
| Total debt, excluding capital leases and financing obligations           | 7,534    | 8,476    |
| Less current portion                                                     | (1,748)  | (2,700)  |
| Total long-term debt, excluding capital leases and financing obligations | \$ 5,786 | \$ 5,776 |

In the first quarter of 2013, the Company repaid \$400 of senior notes bearing an interest rate of 5.00% upon their maturity.

### 3. BENEFIT PLANS

The following table provides the components of net periodic benefit costs for the Company-sponsored pension plans and other post-retirement benefits for the first quarters of 2013 and 2012.

|                                          | Pension Benefits |       | First Quarter |      | Other Benefits |      |
|------------------------------------------|------------------|-------|---------------|------|----------------|------|
|                                          | 2013             | 2012  | 2013          | 2012 | 2013           | 2012 |
| Components of net periodic benefit cost: |                  |       |               |      |                |      |
| Service cost                             | \$ 15            | \$ 16 | \$ 5          | \$ 5 |                |      |
| Interest cost                            | 48               | 49    | 5             | 5    |                |      |
| Expected return on plan assets           | (69)             | (65)  |               |      |                |      |
| Amortization of:                         |                  |       |               |      |                |      |
| Prior service cost                       |                  |       |               |      | (1)            | (1)  |
| Actuarial loss                           | 31               | 31    |               |      |                |      |
| Net periodic benefit expense             | \$ 25            | \$ 31 | \$ 9          | \$ 9 |                |      |

The Company contributed \$100 to its Company-sponsored defined benefit pension plans in the first quarter of 2013 and does not expect to make any additional contributions in 2013.

The Company contributed \$48 and \$44 to employee 401(k) retirement savings accounts in the first quarters of 2013 and 2012, respectively.

The Company also contributes to various multi-employer pension plans based on obligations arising from most of its collective bargaining agreements. These plans provide retirement benefits to participants based on their service to contributing employers. The Company recognizes expense in connection with these plans as contributions are funded.

### 4. EARNINGS PER COMMON SHARE

Net earnings attributable to The Kroger Co. per basic common share equal net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted average number of common shares outstanding. Net earnings attributable to The Kroger Co. per diluted common share equal net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted average number of common shares outstanding, after giving effect to dilutive stock options. The following table provides a reconciliation of net earnings attributable to The Kroger Co. and shares used in calculating net earnings attributable to The Kroger Co. per basic common share to those used in calculating net earnings attributable to The Kroger Co. per diluted common share:

| Earnings<br>(Numerator) | First Quarter Ended<br>May 25, 2013<br>Shares<br>(Denominator) | Per Share<br>Amount | Earnings<br>(Numerator) | First Quarter Ended<br>May 19, 2012<br>Shares<br>(Denominator) | Per Share<br>Amount |
|-------------------------|----------------------------------------------------------------|---------------------|-------------------------|----------------------------------------------------------------|---------------------|
|                         |                                                                |                     |                         |                                                                |                     |

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|                                                                      |    |     |     |    |      |    |     |     |    |      |
|----------------------------------------------------------------------|----|-----|-----|----|------|----|-----|-----|----|------|
| Net earnings attributable to The Kroger Co. per basic common share   | \$ | 477 | 514 | \$ | 0.93 | \$ | 436 | 556 | \$ | 0.78 |
| Dilutive effect of stock options                                     |    |     | 6   |    |      |    |     | 3   |    |      |
| Net earnings attributable to The Kroger Co. per diluted common share | \$ | 477 | 520 | \$ | 0.92 | \$ | 436 | 559 | \$ | 0.78 |

The Company had undistributed and distributed earnings to participating securities totaling \$4 and \$3 in each of the first quarters of 2013 and 2012, respectively.

In the first quarter of 2013, the Company did not have any options outstanding that were excluded from the computations of earnings per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share. The Company had options outstanding for approximately 10 shares during the first quarter of 2012 that were excluded from the computation of earnings per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share.

## 5. RECENTLY ADOPTED ACCOUNTING STANDARDS

In February 2013, the Financial Accounting Standards Board ( FASB ) amended its standards on comprehensive income by requiring disclosure of information about amounts reclassified out of accumulated other comprehensive income ( AOCI ) by component. Specifically, the amendment requires disclosure of the effect of significant reclassifications out of AOCI on the respective line items in net income in which the item was reclassified if the amount being reclassified is required to be reclassified to net income in its entirety in the same reporting period. It requires cross reference to other disclosures that provide additional detail for amounts that are not required to be reclassified in their entirety in the same reporting period. This new disclosure became effective for the Company beginning February 3, 2013, and is being adopted prospectively in accordance with the standard. See Note 9 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

In December 2011, the FASB amended its standards related to offsetting assets and liabilities. This amendment requires entities to disclose both gross and net information about certain instruments and transactions eligible for offset in the statement of financial position and certain instruments and transactions subject to an agreement similar to a master netting agreement. This information is intended to enable users of the financial statements to understand the effect of these arrangements on the Company's financial position. The new rules became effective for the Company on February 3, 2013. In January 2013, the FASB further amended this standard to limit its scope to derivatives, repurchase and reverse repurchase agreements, securities borrowings and lending transactions. See Note 7 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

## 6. COMMITMENTS AND CONTINGENCIES

The Company continuously evaluates contingencies based upon the best available evidence.

The Company believes that allowances for loss have been provided to the extent necessary and that its assessment of contingencies is reasonable. To the extent that resolution of contingencies results in amounts that vary from the Company's estimates, future earnings will be charged or credited.

*Litigation* Various claims and lawsuits arising in the normal course of business, including suits charging violations of certain antitrust, wage and hour, or civil rights laws, are pending against the Company. Some of these suits purport or have been determined to be class actions and/or seek substantial damages. Any damages that may be awarded in antitrust cases will be automatically trebled. Although it is not possible at this time to evaluate the merits of all of these claims and lawsuits, nor their likelihood of success, the Company is of the belief that any resulting liability will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made provisions where it is reasonably possible to estimate and where an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involve substantial uncertainties. Management currently believes that the aggregate range of loss for the Company's exposure is not material to the Company. It remains possible that despite management's current belief, material differences in actual outcomes or changes in management's evaluation or predictions could arise that could have a material adverse effect on the Company's financial condition, results of operations, or cash flows.



**7. DERIVATIVE FINANCIAL INSTRUMENTS**

GAAP defines derivatives, requires that derivatives be carried at fair value on the balance sheet, and provides for hedge accounting when certain conditions are met. The Company's derivative financial instruments are recognized on the balance sheet at fair value. Changes in the fair value of derivative instruments designated as cash flow hedges, to the extent the hedges are highly effective, are recorded in other comprehensive income, net of tax effects. Ineffective portions of cash flow hedges, if any, are recognized in current period earnings. Other comprehensive income or loss is reclassified into current period earnings when the hedged transaction affects earnings. Changes in the fair value of derivative instruments designated as fair value hedges, along with corresponding changes in the fair value of the hedged assets or liabilities, are recorded in current period earnings. Ineffective portions of fair value hedges, if any, are recognized in current period earnings.

The Company assesses, both at the inception of the hedge and on an ongoing basis, whether derivatives used as hedging instruments are highly effective in offsetting the changes in the fair value or cash flow of the hedged items. If it is determined that a derivative is not highly effective as a hedge or ceases to be highly effective, the Company discontinues hedge accounting prospectively.

*Interest Rate Risk Management*

The Company is exposed to market risk from fluctuations in interest rates. The Company manages its exposure to interest rate fluctuations through the use of interest rate swaps (fair value hedges) and forward-starting interest rate swaps (cash flow hedges). The Company's current program relative to interest rate protection contemplates hedging the exposure to changes in the fair value of fixed-rate debt attributable to changes in interest rates. To do this, the Company uses the following guidelines: (i) use average daily outstanding borrowings to determine annual debt amounts subject to interest rate exposure, (ii) limit the average annual amount subject to interest rate reset and the amount of floating rate debt to a combined total of \$2,500 or less, (iii) include no leveraged products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status.

Annually, the Company reviews with the Financial Policy Committee of the Board of Directors compliance with these guidelines. These guidelines may change as the Company's needs dictate.

Fair Value Interest Rate Swaps

The table below summarizes the outstanding interest rate swaps designated as fair value hedges as of May 25, 2013 and February 2, 2013.

|                       | May 25, 2013  |           | February 2, 2013                     |           |
|-----------------------|---------------|-----------|--------------------------------------|-----------|
|                       | Pay Floating  | Pay Fixed | Pay Floating                         | Pay Fixed |
| Notional amount       | \$ 100        | \$        | \$ 475                               | \$        |
| Number of contracts   | 2             |           | 6                                    |           |
| Duration in years     | 5.64          |           | 1.41                                 |           |
| Average variable rate | 5.87%         |           | 3.29%                                |           |
| Average fixed rate    | 6.80%         |           | 5.38%                                |           |
| Maturity              | December 2018 |           | Between April 2013 and December 2018 |           |

During the first quarter of 2013, four of the Company's fair value swaps, with a notional amount of \$375, matured.

The gain or loss on these derivative instruments as well as the offsetting gain or loss on the hedged items attributable to the hedged risk are recognized in current income as Interest expense. These gains and losses for the first quarters of 2013 and 2012 were as follows:

| Income Statement Classification | First Quarter Ended  |                           |                      |                           |
|---------------------------------|----------------------|---------------------------|----------------------|---------------------------|
|                                 | May 25, 2013         |                           | May 19, 2012         |                           |
|                                 | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings |
| Interest Expense                | \$ (2)               | \$ 3                      | \$ (10)              | \$ 8                      |

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The following table summarizes the location and fair value of derivative instruments designated as fair value hedges on the Company's Consolidated Balance Sheets:

| Derivatives Designated as Fair Value Hedging Instruments | Fair Value      |     | Asset Derivatives   |   | Balance Sheet Location<br>(Other Long-Term<br>Liabilities)/Other Assets |
|----------------------------------------------------------|-----------------|-----|---------------------|---|-------------------------------------------------------------------------|
|                                                          | May 25,<br>2013 |     | February 2,<br>2013 |   |                                                                         |
| Interest Rate Hedges                                     | \$              | (1) | \$                  | 1 |                                                                         |

Cash Flow Forward-Starting Interest Rate Swaps

As of May 25, 2013, the Company had 5 forward-starting interest rate swap agreements with maturity dates of January 2014 with an aggregate notional amount totaling \$250. A forward-starting interest rate swap is an agreement that effectively hedges the variability in future benchmark interest payments attributable to changes in interest rates on the forecasted issuance of fixed-rate debt. The Company entered into these forward-starting interest rate swaps in order to lock in fixed interest rates on its forecasted issuances of debt in fiscal year 2013. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of May 25, 2013, the fair value of the interest rates swaps was recorded in other investments for \$6 and AOCI for \$4 net of tax.

As of February 2, 2013, the Company had 17 forward-starting interest rate swap agreements with maturity dates between April 2013 and January 2014 with an aggregate notional amount totaling \$850. In 2012, the Company entered into 7 of these forward-starting interest rate swap agreements with an aggregate notional amount totaling \$350. The Company entered into the forward-starting interest rate swaps in order to lock in fixed interest rates on its forecasted issuances of debt in fiscal year 2013. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of February 2, 2013, the fair value of the interest rates swaps was recorded in other investments and other long-term liabilities for \$14 and \$9, respectively, and AOCI and accumulated other comprehensive loss for \$9 net of tax and \$6 net of tax, respectively.

During the first quarter of 2013, the Company terminated 12 forward-starting interest rate swap agreements with maturity dates of April 2013 with an aggregate notional amount totaling \$600. In addition, in the first quarter of 2013, the Company entered into and terminated 7 forward-starting interest rate swap agreements with an aggregate notional amount totaling \$600. These 19 forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on \$600 of expected issuance of fixed rate debt. The Company continues to believe the prospective issuance of debt related to forward starting swap agreements is probable. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$32 has been deferred net of tax of \$20 in accumulated other comprehensive loss and will be amortized to earnings as the payment of interest to which the hedge relates are made.

The following tables summarize the effect of the Company's derivative instruments designated as cash flow hedges for the first quarter of 2013 and 2012:

| Derivatives in Cash Flow Hedging Relationships    | First Quarter Ended                                              |              |                                                                              |              |                                                                      |  |
|---------------------------------------------------|------------------------------------------------------------------|--------------|------------------------------------------------------------------------------|--------------|----------------------------------------------------------------------|--|
|                                                   | Amount of Gain/(Loss) in AOCI on Derivatives (Effective Portion) |              | Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion) |              | Location of Gain/(Loss) Reclassified into Income (Effective Portion) |  |
|                                                   | May 25, 2013                                                     | May 19, 2012 | May 25, 2013                                                                 | May 19, 2012 |                                                                      |  |
| Forward-Starting Interest Rate Swaps, net of tax* | \$ (32)                                                          | \$ (42)      | \$ (1)                                                                       | \$ (2)       | Interest expense                                                     |  |

\*The amount of Gain/(Loss) in AOCI on derivatives include unamortized proceeds and payments from forward-starting interest rate swaps once classified as cash flow hedges.

For the above fair value and cash flow interest rate swaps, the Company has entered into International Swaps and Derivatives Association master netting agreements that permit the net settlement of amounts owed under their respective derivative contracts. Under these master netting agreements, net settlement generally permits the Company or the counterparty to determine the net amount payable for contracts due on the

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same date and in the same currency for similar types of derivative transactions. These master netting agreements generally also provide for net settlement of all outstanding contracts with a counterparty in the case of an event of default or a termination event.

Collateral is generally not required of the counterparties or of the Company under these master netting agreements. As of May 25, 2013 and February 2, 2013, no cash collateral was received or pledged under the master netting agreements.

The effect of the net settlement provisions of these master netting agreements on the Company's derivative balances upon an event of default or termination event is as follows as of May 25, 2013 and February 2, 2013:

### May 25, 2013

|                                         | Gross Amount<br>Recognized | Gross Amounts Offset<br>in the Statement of<br>Financial Position | Net Amount<br>Presented in the<br>Statement of<br>Financial Position | Gross Amounts Not Offset in the<br>Statement of Financial Position<br>Financial<br>Instruments | Cash Collateral | Net Amount |
|-----------------------------------------|----------------------------|-------------------------------------------------------------------|----------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-----------------|------------|
| <b>Assets</b>                           |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Cash Flow                               |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Forward-Starting Interest<br>Rate Swaps | \$ 6                       | \$                                                                | \$ 6                                                                 | \$                                                                                             | \$              | \$ 6       |
| <b>Liabilities</b>                      |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Fair Value Interest Rate<br>Swaps       | \$ 1                       | \$                                                                | \$ 1                                                                 | \$                                                                                             | \$              | \$ 1       |

### February 2, 2013

|                                         | Gross Amount<br>Recognized | Gross Amounts Offset<br>in the Statement of<br>Financial Position | Net Amount<br>Presented in the<br>Statement of<br>Financial Position | Gross Amounts Not Offset in the<br>Statement of Financial Position<br>Financial<br>Instruments | Cash Collateral | Net Amount |
|-----------------------------------------|----------------------------|-------------------------------------------------------------------|----------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-----------------|------------|
| <b>Assets</b>                           |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Cash Flow                               |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Forward-Starting Interest<br>Rate Swaps | \$ 16                      | \$ (2)                                                            | \$ 14                                                                | \$                                                                                             | \$              | \$ 14      |
| Fair Value Interest Rate<br>Swaps       | 1                          |                                                                   | 1                                                                    |                                                                                                |                 | 1          |
| Total                                   | \$ 17                      | \$ (2)                                                            | \$ 15                                                                | \$                                                                                             | \$              | \$ 15      |
| <b>Liabilities</b>                      |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Cash Flow                               |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Forward-Starting Interest<br>Rate Swaps | \$ 11                      | \$ (2)                                                            | \$ 9                                                                 | \$                                                                                             | \$              | \$ 9       |

### Commodity Price Protection

The Company enters into purchase commitments for various resources, including raw materials utilized in its manufacturing facilities and energy to be used in its stores, warehouses, manufacturing facilities and administrative offices. The Company enters into commitments expecting to take delivery of and to utilize those resources in the conduct of normal business. Those commitments for which the Company expects to utilize or take delivery in a reasonable amount of time in the normal course of business qualify as normal purchases and normal sales.



**8. FAIR VALUE MEASUREMENTS**

GAAP establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy defined in the standards are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities;

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable;

Level 3 Unobservable pricing inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing an asset or liability.

For items carried at (or adjusted to) fair value in the consolidated financial statements, the following tables summarize the fair value of these instruments at May 25, 2013 and February 2, 2013:

**May 25, 2013 Fair Value Measurements Using**

|                               | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) |    | Significant Other<br>Observable Inputs<br>(Level 2) |    | Significant<br>Unobservable<br>Inputs<br>(Level 3) |   | Total |
|-------------------------------|----------------------------------------------------------------------------|----|-----------------------------------------------------|----|----------------------------------------------------|---|-------|
| Available-for-Sale Securities | \$                                                                         | 33 | \$                                                  |    | \$                                                 |   | 33    |
| Warrants                      |                                                                            |    |                                                     | 11 |                                                    |   | 11    |
| Long-Lived Assets             |                                                                            |    |                                                     |    |                                                    | 9 | 9     |
| Interest Rate Hedges          |                                                                            |    |                                                     | 5  |                                                    |   | 5     |
| Total                         | \$                                                                         | 33 | \$                                                  | 16 | \$                                                 | 9 | \$ 58 |

**February 2, 2013 Fair Value Measurements Using**

|                               | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) |   | Significant Other<br>Observable Inputs<br>(Level 2) |   | Significant<br>Unobservable<br>Inputs<br>(Level 3) |    | Total |
|-------------------------------|----------------------------------------------------------------------------|---|-----------------------------------------------------|---|----------------------------------------------------|----|-------|
| Available-for-Sale Securities | \$                                                                         | 8 | \$                                                  |   | \$                                                 | 20 | \$ 28 |
| Long-Lived Assets             |                                                                            |   |                                                     |   |                                                    | 8  | 8     |
| Interest Rate Hedges          |                                                                            |   |                                                     | 6 |                                                    |    | 6     |



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|       |    |   |    |   |    |    |    |    |
|-------|----|---|----|---|----|----|----|----|
| Total | \$ | 8 | \$ | 6 | \$ | 28 | \$ | 42 |
|-------|----|---|----|---|----|----|----|----|

In the first quarter of 2013, one of the Company's available-for-sale securities began trading in an active market. Because of this, the Company transferred the \$20 from a Level 3 asset to a Level 1 asset in the first quarter of 2013. In the first quarter of 2013, unrealized gains on the Level 1 available-for-sale securities totaled \$5.

The Company values warrants using the Black-Sholes option-pricing model. The Black-Sholes option-pricing model is classified as a Level 2 input.

The Company values interest rate hedges using observable forward yield curves. These forward yield curves are classified as Level 2 inputs.

Fair value measurements of non-financial assets and non-financial liabilities are primarily used in the impairment analysis of goodwill, other intangible assets, and long-lived assets, and in the valuation of store lease exit costs. The Company reviews goodwill and other intangible assets for impairment annually, during the fourth quarter of each fiscal year, and as circumstances indicate the possibility of impairment. See Note 2 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2013 for further discussion related to the Company's carrying value of goodwill. Long-lived assets and store lease exit costs were measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. See Note 1 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended February 2, 2013 for further discussion of the Company's policies regarding the valuation of long-lived assets and store lease exit costs. For the first quarter of 2013, long-lived assets with a carrying amount of \$28 were written down to their fair value of \$9 resulting in an impairment charge of \$19. For the first quarter of 2012, long-lived assets with a carrying amount of \$3 were written down to their fair value of \$1 resulting in an impairment charge of \$2.

### **Fair Value of Other Financial Instruments**

#### *Current and Long-term Debt*

The fair value of the Company's long-term debt, including current maturities, was estimated based on the quoted market prices for the same or similar issues adjusted for illiquidity based on available market evidence. If quoted market prices were not available, the fair value was based on the net present value of the future cash flow using the forward interest rate yield curve in effect at May 25, 2013, and February 2, 2013, which is a Level 3 measurement technique. At May 25, 2013, the fair value of total debt was \$8,437 compared to a carrying value of \$7,534. At February 2, 2013, the fair value of total debt was \$9,339 compared to a carrying value of \$8,476.

#### *Cash and Temporary Cash Investments, Store Deposits In-Transit, Receivables, Prepaid and Other Current Assets, Accounts Payable, Accrued Salaries and Wages and Other Current Liabilities*

The carrying amounts of these items approximated fair value.

#### *Long-term Investments*

The fair values of these investments were estimated based on quoted market prices for those or similar investments, or estimated cash flows, if appropriate. At May 25, 2013, and February 2, 2013, the carrying and fair value of long-term investments for which fair value is determinable was \$42 and \$44, respectively.

## 9. OTHER COMPREHENSIVE INCOME (LOSS)

The following table represents the changes in AOCI by component for the first quarter of 2013:

|                                  | Cash Flow<br>Hedging<br>Activities(1) |      | Available for sale<br>Securities(1) |    | Pension and<br>Postretirement<br>Defined Benefit<br>Plans(1) |       | Total(1) |
|----------------------------------|---------------------------------------|------|-------------------------------------|----|--------------------------------------------------------------|-------|----------|
| Balance at February 2, 2013      | \$                                    | (14) | \$                                  | 7  | \$                                                           | (746) | \$ (753) |
| OCI before reclassifications(2)  |                                       | (19) |                                     | 3  |                                                              |       | (16)     |
| Amounts reclassified out of AOCI |                                       | 1    |                                     |    |                                                              | 19    | 20       |
| Net current-period OCI           |                                       | (18) |                                     | 3  |                                                              | 19    | 4        |
| Balance at May 25, 2013          | \$                                    | (32) | \$                                  | 10 | \$                                                           | (727) | \$ (749) |

(1) All amounts are net of tax.

(2) Net of tax of \$(12) and \$2 for cash flow hedging activities and available for sale securities, respectively.

The following table represents the items reclassified out of AOCI and the related tax effects for the first quarter of 2013:

|                                                                                | Three Months Ended<br>May 25, 2013 |
|--------------------------------------------------------------------------------|------------------------------------|
| Gains on cash flow hedging activities                                          |                                    |
| Amortization of unrealized gains and losses on cash flow hedging activities(1) | \$ 1                               |
| Tax (expense) / benefit                                                        |                                    |
| Net of tax                                                                     | 1                                  |
| Pension and postretirement defined benefit plan items                          |                                    |
| Amortization of amounts included in net periodic pension expense(2)            | 30                                 |
| Tax expense                                                                    | (11)                               |
| Net of tax                                                                     | 19                                 |
| Total reclassifications, net of tax                                            | \$ 20                              |

(1) Reclassified from AOCI into interest expense.

(2) Reclassified from AOCI into merchandise costs and operating, general and administrative expense. These components are included in the computation of net periodic pension expense (see Note 3 to the Company's Consolidated Financial Statements for additional details).

## 10. INCOME TAXES

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The effective income tax rate was 35.5% and 34.5% for the first quarters of 2013 and 2012, respectively. The 2013 effective income tax rate differed from the federal statutory rate primarily due to the effect of state income taxes. The 2012 effective income tax rate differed from the federal statutory rate primarily due to the favorable resolution of certain tax issues, partially offset by the effect of state income taxes.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following analysis should be read in conjunction with the Consolidated Financial Statements.

### OVERVIEW

First quarter 2013 total sales were \$30.0 billion compared with \$29.1 billion for the same period of 2012. This increase was attributable to identical supermarket sales increases and increased fuel sales, offset partially by a decrease in the average retail fuel price. Identical supermarket sales without fuel increased 3.3% in the first quarter of 2013, compared to the first quarter of 2012, primarily due to product cost inflation and an increase in transaction count. Identical supermarket sales without fuel and pharmacy increased 4.0% in the first quarter of 2013, compared to the first quarter of 2012. Our identical supermarket sales were positive in each of our supermarket operating divisions. This continues our trend of positive identical supermarket sales growth for 38 consecutive quarters. Our Customer 1st strategy continues to deliver solid results.

For the first quarter of 2013, net earnings totaled \$481 million, or \$0.92 per diluted share, compared to \$439 million, or \$0.78 per diluted share for the same period of 2012. The increase in net earnings for the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from an increase in non-fuel FIFO operating profit and a decrease in the LIFO charge, partially offset by a higher effective tax rate and a decrease in earnings from our fuel operations. The increase in non-fuel operating profit for the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from the benefit of increased supermarket sales, productivity improvements and effective cost controls, partially offset by continued investments in lower prices for our customers and increases in our credit card fees and health care costs.

Based on the strength of our results for the first quarter of 2013, we have increased both the lower and upper ranges of our guidance for net earnings per diluted share for fiscal year 2013. Please refer to the Outlook section for more information on our expectations. Our Customer 1st strategy continues to increase customer loyalty, identical supermarket sales and market share. As a result, we are rewarding shareholders through net earnings per diluted share growth, by increasing dividends over time and through share buybacks.

### RESULTS OF OPERATIONS

#### *Net Earnings*

Net earnings totaled \$481 million for the first quarter of 2013, an increase of 9.6% from net earnings of \$439 million for the first quarter of 2012. The increase in our net earnings for the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from an increase in non-fuel FIFO operating profit and a decrease in the LIFO charge, partially offset by a higher effective tax rate and a decrease in earnings from our fuel operations. The increase in non-fuel operating profit for the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from the benefit of increased supermarket sales, productivity improvements and effective cost controls partially offset by continued investments in lower prices for our customers and increases in our credit card fees and health care costs.

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Net earnings of \$0.92 per diluted share for the first quarter of 2013 represented an increase of 17.9% over net earnings of \$0.78 per diluted share for the first quarter of 2012. Net earnings per diluted share increased in the first quarter of 2013, compared to the first quarter of 2012, due to increased net earnings and the repurchase of 45 million common shares over the past four quarters resulting in lower weighted average shares outstanding.

## Sales

**Total Sales**

(\$ in millions)

|                                      |                  |                               | <b>First Quarter</b> |                               |  |
|--------------------------------------|------------------|-------------------------------|----------------------|-------------------------------|--|
|                                      | <b>2013</b>      | <b>Percentage Increase(2)</b> | <b>2012</b>          | <b>Percentage Increase(3)</b> |  |
| Total supermarket sales without fuel | \$ 23,272        | 3.6%                          | \$ 22,460            | 4.3%                          |  |
| Fuel Sales                           | 5,967            | 1.6%                          | 5,873                | 12.2%                         |  |
| Other Sales(1)                       | 804              | 9.8%                          | 732                  | 5.9%                          |  |
| <b>Total sales</b>                   | <b>\$ 30,043</b> | <b>3.4%</b>                   | <b>\$ 29,065</b>     | <b>5.8%</b>                   |  |

(1) Other sales primarily relate to sales at convenience stores, excluding fuel; jewelry stores; manufacturing plants to outside customers; variable interest entities; a specialty pharmacy; and in-store health clinics.

(2) This column represents the percentage increase in the first quarter of 2013, compared to the first quarter of 2012.

(3) This column represents the percentage increase in the first quarter of 2012, compared to the first quarter of 2011.

The increase in total sales and total supermarket sales without fuel for the first quarter of 2013, compared to the first quarter of 2012, was primarily due to our identical supermarket sales increase, excluding fuel, of 3.3% and, excluding fuel and pharmacy, of 4.0%. Total fuel sales increased slightly in the first quarter of 2013, compared to the first quarter of 2012, primarily due to an increase in fuel gallons sold of 5.1% offset by a decrease in the average retail fuel price of 3.3%. The decrease in the average retail fuel price was caused by a decrease in the product cost of fuel. Identical supermarket sales, excluding fuel, increased primarily due to inflation and an increase in transaction count, offset partially by the effect of several branded prescription drugs coming off patent. When branded prescription drugs come off patent and are sold as generics, sales are reduced because generic equivalents have lower retail prices than branded drugs.

We define a supermarket as identical when it has been in operation without expansion or relocation for five full quarters. Fuel discounts received at our fuel centers and earned based on in-store purchases are included in all of the identical supermarket sales results calculations illustrated below and reduce our identical supermarket sales results. Differences between total supermarket sales and identical supermarket sales primarily relate to changes in supermarket square footage. Identical supermarket sales include sales from all departments at identical Fred Meyer multi-department stores. Our identical supermarket sales results are summarized in the table below. We used the identical supermarket dollar figures presented below to calculate percentage changes for the first quarter of 2013.

**Identical Supermarket Sales**

(\$ in millions)

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|                        | 2013 |        | First Quarter<br>Percentage<br>Increase(1) | 2012 |        | Percentage<br>Increase(2) |
|------------------------|------|--------|--------------------------------------------|------|--------|---------------------------|
| Including fuel centers | \$   | 26,945 | 2.9%                                       | \$   | 26,196 | 5.5%                      |
| Excluding fuel centers | \$   | 22,412 | 3.3%                                       | \$   | 21,700 | 4.2%                      |

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(1) This column represents the percentage increase in identical supermarket sales in the first quarter of 2013, compared to the first quarter of 2012.

(2) This column represents the percentage increase in identical supermarket sales in the first quarter of 2012, compared to the first quarter of 2011.



*Gross Margin and FIFO Gross Margin*

Our gross margin rate, as a percentage of sales, was 20.59% for the first quarter of 2013, as compared to 20.54% for the first quarter of 2012. The increase in the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from a decrease in the Last-In, First-Out ( LIFO ) charge and the effect of several branded prescription drugs coming off patent, offset by an increase in retail fuel sales, continued investments in lower prices for our customers and increased shrink, warehouse and advertising costs as a percentage of sales. When branded prescription drugs come off patent and are sold as generics, our gross margin rate, as a percentage of sales, increases. Our gross margin rate, as a percentage of sales, increases because the generic equivalents have lower retail prices than branded drugs with approximately the same gross margin. Retail fuel sales lower our gross margin rate due to the very low gross margin on retail fuel sales as compared to non-fuel sales.

We calculate First-In, First-Out ( FIFO ) gross margin as sales minus merchandise costs, including advertising, warehousing, and transportation expenses, but excluding the LIFO charge. Merchandise costs exclude depreciation and rent expenses. Our LIFO charge was \$17 million for the first quarter of 2013 and \$46 million for the first quarter of 2012. FIFO gross margin is a non-GAAP financial measure and should not be considered as an alternative to gross margin or any other GAAP measure of performance. FIFO gross margin should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. FIFO gross margin is an important measure used by management to evaluate merchandising and operational effectiveness. Management believes FIFO gross margin is a useful metric to investors and analysts because it measures our day-to-day merchandising and operational effectiveness.

Our FIFO gross margin rate was 20.65% for the first quarter of 2013, as compared to 20.70% for the first quarter of 2012. Retail fuel sales lower our FIFO gross margin rate due to the very low FIFO gross margin rate on retail fuel sales as compared to non-fuel sales. Excluding the effect of retail fuel operations, our first quarter 2013 FIFO gross margin rate decreased 15 basis points, as a percentage of sales, compared to the first quarter of 2012. This decrease in the first quarter of 2013, compared to the first quarter of 2012, as a percentage of sales, resulted primarily from continued investments in lower prices for our customers and increased shrink, warehouse and advertising costs, partially offset by the effect of several branded prescription drugs coming off patent.

*LIFO Charge*

The LIFO charge was \$17 million in the first quarter of 2013 and \$46 million in the first quarter of 2012. The LIFO charge decreased in the first quarter of 2013, compared to the first quarter of 2012, primarily due to our lower expected year end product cost of inflation in most major categories for 2013 compared to 2012.

*Operating, General and Administrative Expenses*

Operating, general and administrative ( OG&A ) expenses consist primarily of employee-related costs such as wages, health care benefit costs and retirement plan costs, utilities, and credit card fees. Rent expense, depreciation and amortization expense, and interest expense are not included in OG&A.

OG&A expenses, as a percentage of sales, decreased 5 basis points to 15.31% for the first quarter of 2013 from 15.36% for the first quarter of 2012, primarily due to the benefit of increased supermarket sales and fuel sales, productivity improvements and effective cost controls. Retail

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fuel sales lower our OG&A rate due to the very low OG&A rate, as a percentage of sales, of retail fuel sales compared to non-fuel sales. OG&A expenses, as a percentage of sales excluding fuel, decreased 16 basis points in the first quarter of 2013, compared to the first quarter of 2012. This decrease in our OG&A rate, as a percentage of sales excluding the effect of fuel, resulted primarily from the benefit of increased supermarket sales, productivity improvements and effective cost controls.

### *Rent Expense*

Rent expense was \$189 million in the first quarter of 2013 compared to \$191 million in the first quarter of 2012. Rent expense, as a percentage of sales, was 0.63% in the first quarter of 2013, compared to 0.66% in the first quarter of 2012. Rent expense, as a percentage of sales excluding fuel, decreased 3 basis points in the first quarter of 2013 compared to the first quarter of 2012. The decrease in rent expense, as a percentage of sales excluding fuel, reflects our continued emphasis on owning rather than leasing, whenever possible, and the benefit of increased supermarket sales.

### Depreciation Expense

Depreciation expense was \$519 million, or 1.73% of total sales, for the first quarter of 2013 compared to \$501 million, or 1.72% of total sales, for the first quarter of 2012. The increase in our depreciation expense for the first quarter of 2013, compared to the first quarter of 2012, as a percentage of sales, is primarily due to our fuel operations. The depreciation expense for our fuel operations for the first quarter of 2013, as a percentage of sales, compared to the first quarter of 2012, increased. This increase was primarily attributable to the decrease in the average retail fuel price. Excluding the effect of retail fuel operations, depreciation, as a percentage of sales, decreased 1 basis point in the first quarter of 2013, compared to the same period of 2012.

### Operating Profit and FIFO Operating Profit

Operating profit was \$879 million, or 2.93% of sales, for the first quarter of 2013, compared to \$814 million, or 2.80% of sales, for the first quarter of 2012. Operating profit, as a percentage of sales, increased 13 basis points in the first quarter of 2013, compared to the first quarter of 2012, primarily due to improvements in operating, general and administrative expenses and rent and a decreased LIFO charge in the first quarter of 2013, compared to the first quarter of 2012, offset partially by continued investments in lower prices for our customers, increased shrink, warehouse and advertising costs.

We calculate FIFO operating profit as operating profit excluding the LIFO charge. FIFO operating profit is a non-GAAP financial measure and should not be considered as an alternative to operating profit or any other GAAP measure of performance. FIFO operating profit should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. FIFO operating profit is an important measure used by management to evaluate operational effectiveness. Management believes FIFO operating profit is a useful metric to investors and analysts because it measures our day-to-day operational effectiveness. Since fuel discounts are earned based on in-store purchases, fuel operating profit does not include fuel discounts, which are allocated to our in-store supermarket location departments. We also derive operating, general and administrative expenses, rent and depreciation and amortization through the use of estimated allocations in the calculation of fuel operating profit.

FIFO operating profit was \$896 million, or 2.98% of sales, for the first quarter of 2013, compared to \$860 million, or 2.96% of sales, for the first quarter of 2012. Retail fuel sales lower our FIFO operating profit rate due to the very low FIFO operating profit rate, as a percentage of sales, of retail fuel sales compared to non-fuel sales. FIFO operating profit, excluding fuel, was \$872 million, or 3.62% of sales, for the first quarter of 2013, compared to \$825 million, or 3.56% of sales, for the first quarter of 2012. FIFO operating profit, as a percentage of sales excluding fuel, increased 6 basis points in the first quarter of 2013, compared to the first quarter of 2012 primarily due to improvements in operating, general and administrative expenses and rent, offset partially by continued investments in lower prices for our customers and increased shrink, warehouse and advertising costs.

The following table provides a reconciliation of operating profit to FIFO operating profit and FIFO operating profit, excluding fuel, for the first quarters of 2013 and 2012 (\$ in millions):

|       | First Quarter Ended |                          | 2012 Percentage |                          |
|-------|---------------------|--------------------------|-----------------|--------------------------|
|       | May 25, 2013        | 2013 Percentage of Sales | May 19, 2012    | 2012 Percentage of Sales |
| Sales | \$ 30,043           |                          | \$ 29,065       |                          |

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|                                      |    |        |       |       |        |
|--------------------------------------|----|--------|-------|-------|--------|
| Fuel sales                           |    | 5,967  |       | 5,873 |        |
| Sales excluding fuel                 | \$ | 24,076 |       | \$    | 23,192 |
| Operating profit                     | \$ | 879    | 2.93% | \$    | 814    |
| LIFO charge                          |    | 17     | 0.06% |       | 46     |
| FIFO operating profit                |    | 896    | 2.98% |       | 860    |
| Fuel operating profit                |    | 24     | 0.40% |       | 35     |
| FIFO operating profit excluding fuel | \$ | 872    | 3.62% | \$    | 825    |

Percentages may not sum due to rounding.

*Interest Expense*

Net interest expense was \$129 million, or 0.43% of total sales, for the first quarter of 2013 compared to \$141 million, or 0.48% of total sales, for the first quarter of 2012. The decrease in net interest expense for the first quarter of 2013, compared to the first quarter of 2012, resulted primarily from a lower weighted average interest rate due to utilizing our commercial paper facility.

*Income Taxes*

Our effective income tax rate was 35.5% for the first quarter of 2013 and 34.5% for the first quarter of 2012. The 2013 effective income tax rate differed from the federal statutory rate primarily due to the effect of state income taxes. The 2012 effective income tax rate differed from the federal statutory rate primarily due to the favorable resolution of certain tax issues, partially offset by the effect of state income taxes.

**LIQUIDITY AND CAPITAL RESOURCES**

*Cash Flow Information*

Net cash provided by operating activities

We generated \$1.6 billion of cash from operating activities during the first quarter of 2013, compared to \$1.3 billion in the first quarter of 2012. The cash provided by operating activities came from net earnings including noncontrolling interests, adjusted for non-cash expenses, and changes in working capital. Changes in working capital provided cash from operating activities of \$663 million in the first quarter of 2013 and \$244 million in the first quarter of 2012. Prepaid expenses decreased \$250 million from year end 2012 in the first quarter of 2013, reflecting a decrease in the prepayment balance of some employee benefits at year end. The increase in cash provided by changes in working capital for the first quarter of 2013, compared to the first quarter of 2012, was primarily due to decreases in store deposits in-transit and prepaid expenses, offset partially by a decrease in accrued expenses.

The amount of cash paid for income taxes increased in the first quarter of 2013, compared to the first quarter of 2012, primarily due to an overpayment of 2011 taxes applied to 2012.

Net cash used by investing activities

We used \$626 million of cash for investing activities during the first quarter of 2013 compared to \$527 million during the first quarter of 2012. The amount of cash used for investing activities increased in the first quarter of 2013 versus 2012, primarily due to increased cash payments for capital investments.

Net cash used by financing activities

We used \$982 million of cash for financing activities in the first quarter of 2013 compared to \$449 million in the first quarter of 2012. The increase in the amount of cash used for financing activities for the first quarter of 2013, compared to the first quarter of 2012, was primarily related to a decrease in the proceeds received from the issuance of long-term debt, offset partially by a decrease in treasury stock purchases. Proceeds from the issuance of common shares resulted from exercises of employee stock options.

*Debt Management*

As of May 25, 2013, we maintained a \$2 billion (with the ability to increase by \$500 million), unsecured revolving credit facility that, unless extended, terminates on January 25, 2017. Outstanding borrowings under the credit agreement and commercial paper borrowings, and some outstanding letters of credit, reduce funds available under the credit agreement. In addition to the credit agreement, we maintained two uncommitted money market lines totaling \$75 million in the aggregate. The money market lines allow us to borrow from banks at mutually agreed upon rates, usually at rates below the rates offered under the credit agreement. As of May 25, 2013, we had no borrowings under our credit agreement and money market lines. As of May 25, 2013, we had \$1.1 billion of outstanding commercial paper. The outstanding letters of credit that reduce funds available under our credit agreement totaled \$13 million as of May 25, 2013.

Our bank credit facility and the indentures underlying our publicly issued debt contain various restrictive covenants. As of May 25, 2013, we were in compliance with these financial covenants. Furthermore, management believes it is not reasonably likely that we will fail to comply with these financial covenants in the foreseeable future.

Total debt, including both the current and long-term portions of capital leases and lease-financing obligations, decreased \$160 million to \$7.9 billion as of the end of the first quarter of 2013, from \$8.1 billion as of the end of the first quarter of 2012. Total debt decreased \$933 million as of the end of the first quarter of 2013, from \$8.9 billion as of year-end 2012. The decrease as of the end of the first quarter of 2013, compared to the end of the first quarter of 2012, resulted from the payment at maturity in the last four quarters of \$346 million of senior notes bearing an interest rate of 6.2%, \$500 million of senior notes bearing an interest rate of 5.5% and \$400 million of senior notes bearing an interest rate of 5.0%, offset partially by the issuance of commercial paper in the last four quarters of \$1.1 billion. The decrease as of the end of the first quarter of 2013, compared to year-end 2012, resulted primarily from the payment at maturity of \$400 million of senior notes bearing an interest rate of 5.0% and the decrease in the amount of commercial paper outstanding.

Over the next twelve months, we expect to refinance approximately \$1.5 billion of debt by issuing additional senior notes to replace our debt that matured in the fourth quarter of 2012 and the first quarter of 2013, and that will mature in the fourth quarter of 2013. We may use our commercial paper program to fund debt maturities throughout 2013 but do not currently expect to use the program permanently to fund debt maturities. The debt that matured in the fourth quarter of 2012 and the first quarter of 2013 was previously refinanced with cash flows from operating activities and commercial paper. We currently have \$250 million notional amount of forward starting interest rate swaps to effectively hedge the changes in future benchmark interest rates on a portion of our expected issuances of fixed rate debt. In the first quarter of 2013, we terminated additional forward starting swaps that were entered into to effectively hedge the changes in future benchmark interest rates on \$600 million of our expected issuance of fixed rate debt. The unamortized loss of \$32 million related to these terminated forward starting swaps will be amortized to earnings as the payments of interest to which the hedge relates are made.

#### *Common Stock Repurchase Program*

During the first quarter of 2013, we invested \$146 million to repurchase 4.5 million Kroger common shares at an average price of \$32.44 per share. These shares were reacquired under two separate stock repurchase programs. The first is a \$500 million repurchase program that was authorized by Kroger's Board of Directors on October 16, 2012. The second is a program that uses the cash proceeds from the exercises of stock options by participants in Kroger's stock option and long-term incentive plans as well as the associated tax benefits.

#### *Liquidity Needs*

We estimate our liquidity needs over the next twelve-month period to be approximately \$4.1 billion, which includes anticipated requirements for working capital, capital expenditures, interest payments and scheduled principal payments of debt and commercial paper, offset by cash and temporary cash investments on hand at the end of the first quarter of 2013. Based on current operating trends, we believe that cash flows from operating activities and other sources of liquidity, including borrowings under our commercial paper program and bank credit facility, will be adequate to meet our liquidity needs for the next twelve months and for the foreseeable future beyond the next twelve months. We have approximately \$1.1 billion of commercial paper and \$600 million of senior notes maturing in the next twelve months, which is included in the \$4.1 billion in estimated liquidity needs. The commercial paper matures in the second quarter of 2013 and the \$600 million of senior notes mature in the fourth quarter of 2013. Over the next twelve months, we anticipate repaying or refinancing this \$1.7 billion through cash flows from operating activities and by issuing approximately \$1.5 billion of additional senior notes. The amount of commercial paper outstanding at the end of the first quarter of 2013 decreased by \$545 million to \$1.1 billion, compared to \$1.6 billion at the end of the fourth quarter of 2012. This decrease was primarily due to our not repurchasing as many common shares in the first quarter of 2013 compared to our average quarterly rolling four quarter repurchases. We may use our commercial paper program to fund debt maturities throughout 2013 but do not currently expect to use the program permanently to fund debt maturities. We believe we have adequate coverage of our debt covenants to continue to maintain our current debt ratings and to respond effectively to competitive conditions.

#### **CAPITAL INVESTMENTS**

Capital investments totaled \$646 million for the first quarter of 2013, compared to \$557 million for the first quarter of 2012. During the first quarter of 2013, we opened, acquired, expanded, or relocated 8 food stores and also completed 21 within-the-wall remodels. Total food store square footage at the end of the first quarter of 2013 increased 0.6% from the end of the first quarter of 2012. Excluding acquisitions and operational closings, total food store square footage at the end of the first quarter of 2013 increased 1.4% over the end of the first quarter of 2012.



## RETURN ON INVESTED CAPITAL

We calculate return on invested capital ( ROIC ) by dividing adjusted operating profit for the prior four quarters by the average invested capital. Adjusted operating profit is calculated by excluding certain items included in operating profit, and adding back our LIFO charge, depreciation and amortization and rent. Average invested capital is calculated as the sum of (i) the average of our total assets, (ii) the average LIFO reserve, (iii) the average accumulated depreciation and amortization and (iv) a rent factor equal to total rent for the last four quarters multiplied by a factor of eight; minus (i) the average taxes receivable, (ii) the average trade accounts payable, (iii) the average accrued salaries and wages and (iv) the average other current liabilities. Averages are calculated for return on invested capital by adding the beginning balance of the first quarter and the ending balance of the fourth quarter, of the last four quarters, and dividing by two. We use a factor of eight for our total rent as we believe this is a common factor used by our investors, analysts and rating agencies. ROIC is a non-GAAP financial measure of performance. ROIC should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. ROIC is an important measure used by management to evaluate our investment returns on capital. Management believes ROIC is a useful metric to investors and analysts because it measures how effectively we are deploying our assets. All items included in the calculation of ROIC are GAAP measures, excluding certain adjustments to operating income.

Although ROIC is a relatively standard financial term, numerous methods exist for calculating a company's ROIC. As a result, the method used by our management to calculate ROIC may differ from methods other companies use to calculate their ROIC. We urge you to understand the methods used by other companies to calculate their ROIC before comparing our ROIC to that of such other companies.

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The following table provides a reconciliation of ROIC for the rolling four quarters on a 52 week basis ended May 25, 2013 and May 19, 2012 (\$ in millions):

|                                                                                 | Rolling Four Quarters Ended |              |
|---------------------------------------------------------------------------------|-----------------------------|--------------|
|                                                                                 | May 25, 2013                | May 19, 2012 |
| <b>Return on Invested Capital</b>                                               |                             |              |
| <b>Numerator</b>                                                                |                             |              |
| Operating profit                                                                | \$ 2,829                    | \$ 1,281     |
| 53rd week operating profit adjustment                                           | (99)                        |              |
| LIFO charge                                                                     | 26                          | 216          |
| Depreciation and amortization                                                   | 1,670                       | 1,640        |
| Rent on a 53 week basis                                                         | 626                         | 618          |
| 53rd week rent adjustment                                                       | (12)                        |              |
| UFCW pension plan consolidation charge                                          |                             | 953          |
| UFCW consolidated pension plan liability and credit card settlement adjustments | (115)                       |              |
| Adjusted operating profit                                                       | \$ 4,925                    | \$ 4,708     |
| <b>Denominator</b>                                                              |                             |              |
| Average total assets                                                            | \$ 24,018                   | \$ 23,451    |
| Average taxes receivable(1)                                                     | (9)                         | (12)         |
| Average LIFO reserve                                                            | 1,102                       | 981          |
| Average accumulated depreciation and amortization(2)                            | 14,430                      | 13,412       |
| Average trade accounts payable                                                  | (4,665)                     | (4,325)      |
| Average accrued salaries and wages                                              | (948)                       | (940)        |
| Average other current liabilities(3)                                            | (2,309)                     | (2,263)      |
| Rent x 8                                                                        | 4,912                       | 4,944        |
| Average invested capital                                                        | \$ 36,531                   | \$ 35,248    |
| Return on Invested Capital                                                      | 13.48%                      | 13.36%       |

(1) As of May 19, 2012 and May 21, 2011, taxes receivable were \$17 and \$7, respectively. As of May 25, 2013, the Company did not have any taxes receivable.

(2) As of May 25, 2013, May 19, 2012 and May 21, 2011, accumulated depreciation and amortization was \$14,906, \$13,954 and \$12,870, respectively.

(3) As of May 25, 2013, May 19, 2012 and May 21, 2011, other current liabilities included accrued income taxes of \$217, \$68 and \$221, respectively. Accrued income taxes are removed from other current liabilities in the calculation of average invested capital.

## CRITICAL ACCOUNTING POLICIES

We have chosen accounting policies that we believe are appropriate to report accurately and fairly our operating results and financial position, and we apply those accounting policies in a consistent manner. Except as noted below, our critical accounting policies are summarized in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and other factors we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could vary from those estimates.

#### **RECENTLY ADOPTED ACCOUNTING STANDARDS**

In February 2013, the FASB amended its standards on comprehensive income by requiring disclosure of information about amounts reclassified out of accumulated other comprehensive income ( AOCI ) by component. Specifically, the amendment requires disclosure of the effect of significant reclassifications out of AOCI on the respective line items in net income in which the item was reclassified if the amount being reclassified is required to be reclassified to net income in its entirety in the same reporting period. It requires cross reference to other disclosures that provide additional detail for amounts that are not required to be reclassified in their entirety in the same reporting period. This new disclosure became effective for us beginning February 3, 2013, and is being adopted prospectively in accordance with the standard. See Note 9 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

In December 2011, the FASB amended its standards related to offsetting assets and liabilities. This amendment requires entities to disclose both gross and net information about certain instruments and transactions eligible for offset in the statement of financial position and certain instruments and transactions subject to an agreement similar to a master netting agreement. This information is intended to enable users of the financial statements to understand the effect of these arrangements on our financial position. The new rules became effective for us on February 3, 2013. In January 2013, the FASB further amended this standard to limit its scope to derivatives, repurchase and reverse repurchase agreements, securities borrowings and lending transactions. See Note 7 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

## OUTLOOK

This discussion and analysis contains certain forward-looking statements about Kroger's future performance. These statements are based on management's assumptions and beliefs in light of the information currently available. Such statements relate to, among other things: projected changes in net earnings attributable to The Kroger Co.; identical supermarket sales growth; expected product cost; expected pension plan contributions; our ability to generate operating cash flows; projected capital expenditures; square footage growth; opportunities to reduce costs; cash flow requirements; and our operating plan for the future; and are indicated by words such as "comfortable," "committed," "will," "expect," "goal," "should," "intend," "target," "believe," "anticipate," "plan," and similar words or phrases. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially.

Statements elsewhere in this report and below regarding our expectations, projections, beliefs, intentions or strategies are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. While we believe that the statements are accurate, uncertainties about the general economy, our labor relations, our ability to execute our plans on a timely basis and other uncertainties described below could cause actual results to differ materially.

- We expect net earnings per diluted share in the range of \$2.73-\$2.80 for 2013. This range reflects the strength of our first quarter results. This equates to our long-term growth rate of 8% to 11% from our adjusted fiscal 2012 net earnings per diluted share of \$2.52, which excludes the UFCW consolidated pension accrual and credit card settlement adjustments in the third quarter of 2012 and the extra week in the fourth quarter of 2012. We expect the second and third quarter net earnings per diluted share growth rate for 2013 to be at the high end of the 8% to 11% range or above the range primarily because we expect inflation in the second and third quarters of 2013, to be comparable to the second and third quarters of 2012. We also expect the fourth quarter net earnings per diluted share on a 12-week to 12-week basis to be lower than prior year primarily due to a budgeted LIFO charge of \$13 million compared to a LIFO credit of \$41 million in the fourth quarter of 2012.
- We expect identical supermarket sales growth, excluding fuel sales, of 2.5%-3.5% in 2013.
- Our long-term business model seeks to produce annual earnings per diluted share growth averaging 8.0%-11.0%, plus an increased dividend over time that will further enhance shareholder return.
- For 2013, we intend to continue to focus on improving sales growth, in accordance with our Customer 1st strategy, by making investments in gross margin and the customer shopping experience. We expect to finance these investments primarily with operating cost reductions. We expect FIFO non-fuel operating margins for 2013 to expand slightly compared to 2012, excluding the UFCW consolidated pension plan accrual and the credit card settlement adjustments in 2012.
- For 2013, we expect our annualized LIFO charge to be approximately \$55 million. This forecast is based on estimated cost changes for products in our inventory.
- For 2013, we expect interest expense to be approximately \$430 million.

- We plan to use cash flow primarily for capital investments, to maintain our current debt coverage ratios, to pay cash dividends, and to repurchase stock. As market conditions change, we may re-evaluate these uses of cash flow.

- We expect to obtain sales growth from new square footage, as well as from increased productivity from existing locations.

- Capital investments reflect our strategy of growth through expansion, filling in targeted existing markets, entering a new market and focusing on productivity increases from our existing store base through remodels. In addition, we intend to continue our emphasis on self-development and ownership of real estate, and logistics and technology improvements. Our continued capital spending on technology is focused on improving store operations, logistics, manufacturing procurement, category management, merchandising and buying practices, and is expected to reduce merchandising costs. We intend to continue using cash flow from operations to finance capital expenditure requirements. We expect capital investments for 2013 to increase to the range of \$2.1-\$2.4 billion, excluding acquisitions and purchases of leased facilities. We also expect capital investments to increase incrementally \$200 million each year over the next few years, excluding acquisitions and purchases of leased facilities, to accomplish our strategy. We expect total food store square footage for 2013 to grow approximately 1.5% before acquisitions and operational closings.

- Based on current operating trends, we believe that cash flow from operations and other sources of liquidity, including borrowings under our commercial paper program and bank credit facility, will be adequate to meet anticipated requirements for working capital, capital expenditures, interest payments and scheduled principal payments for the foreseeable future. We also believe we have adequate coverage under our debt covenants to continue to respond effectively to competitive conditions.

- We believe we have adequate sources of cash, if needed, under our credit facility and other borrowing sources for the next twelve months and for the foreseeable future beyond the next twelve months.

- We expect that our OG&A results will be affected by increased costs, such as higher employee benefit costs and credit card fees, offset by improved productivity from process changes and leverage gained through sales increases.

- We expect that our effective tax rate for 2013 will be approximately 35.5%, excluding the effect of the resolution of any tax issues.

- We expect rent expense, as a percentage of total sales and excluding closed-store activity, will decrease due to the emphasis our current strategy places on ownership of real estate.

- We believe that in 2013 there will be opportunities to reduce our operating costs in such areas as administration, productivity improvements, shrink, warehousing and transportation. We intend to invest most of these savings in our core business to drive profitable sales growth and offer improved value and shopping experiences for our customers.

- In February 2013, we contributed \$100 million to the Company-sponsored defined benefit pension plans and do not expect to make any additional contributions in 2013. We expect contributions made during 2013 will decrease our required contributions in future years. Among other things, investment performance of plan assets, the interest rates required to be used to calculate the pension obligations, and future changes in legislation, will determine the amounts of additional contributions. We expect 2013 expense for Company-sponsored defined benefit pension plans to be approximately \$80 million. In addition, we expect 401(k) Retirement Savings Account Plan cash contributions and expense from automatic and matching contributions to participants to increase slightly in 2013, compared to 2012.

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- We expect to contribute approximately \$225 million to multi-employer pension plans in 2013, subject to collective bargaining. In addition, excluding all payments to the UFCW consolidated pension plan and the pension plans that were consolidated into the UFCW consolidated pension plan, we expect increases in expense as a result of increases in multi-employer pension plan contributions over the next few years.
- We do not anticipate additional goodwill impairments in 2013.
- Over the next twelve months, we expect to refinance approximately \$1.5 billion of debt by issuing additional senior notes to replace our debt that matured in the fourth quarter of 2012 and the first quarter of 2013, and that will mature in the fourth quarter of 2013. We may use our commercial paper program to fund debt maturities throughout 2013 but do not currently expect to use the program permanently to fund debt maturities.

- We have various labor agreements that will be renegotiated in 2013, covering store employees in Dallas, Seattle, Roanoke and Cincinnati. Upon the expiration of our collective bargaining agreements, work stoppages by the affected workers could occur if we are unable to negotiate new contracts with labor unions. A prolonged work stoppage affecting a substantial number of locations could have a material adverse effect on our results. In all of these contracts, rising health care and pension costs will continue to be an important issue in negotiations.

Various uncertainties and other factors could cause us to fail to achieve our goals. These include:

- The extent to which our sources of liquidity are sufficient to meet our requirements may be affected by the state of the financial markets and the effect that such condition has on our ability to issue commercial paper at acceptable rates. Our ability to borrow under our committed lines of credit, including our bank credit facilities, could be impaired if one or more of our lenders under those lines is unwilling or unable to honor its contractual obligation to lend to us, or in the event that natural disasters or weather conditions interfere with the ability of our lenders to lend to us. Our ability to refinance maturing debt may be affected by the state of the financial markets.
- Our ability to achieve sales, earnings and cash flow goals may be affected by: labor negotiations or disputes; changes in the types and numbers of businesses that compete with us; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition; our response to these actions; the state of the economy, including interest rates, the inflationary and deflationary trends in certain commodities, and the unemployment rate; the effect that fuel costs have on consumer spending; changes in government-funded benefit programs; manufacturing commodity costs; diesel fuel costs related to our logistics operations; trends in consumer spending; the extent to which our customers exercise caution in their purchasing in response to economic conditions; the inconsistent pace of the economic recovery; changes in inflation or deflation in product and operating costs; stock repurchases; the effect of brand prescription drugs going off patent; our ability to retain additional pharmacy sales from third party payors; our results of operations; and the success of our future growth plans. The extent to which the adjustments we are making to our strategy create value for our shareholders will depend primarily on the reaction of our customers and our competitors to these adjustments, as well as operating conditions, including inflation or deflation, increased competitive activity, and cautious spending behavior of our customers. Our ability to achieve sales and earnings goals may also be affected by our ability to manage the factors identified above.
- Our product cost inflation could vary from our estimate due to general economic conditions, weather, availability of raw materials and ingredients in the products that we sell and their packaging, and other factors beyond our control.
- Our ability to pass on product cost increases will depend on the reactions of our customers and competitors to those increases.
- Our ability to use free cash flow to continue to maintain our debt coverage and to reward our shareholders could be affected by unanticipated increases in net total debt, our inability to generate free cash flow at the levels anticipated, and our failure to generate expected earnings.
- During the first three quarters of the year, our LIFO charge and the recognition of LIFO expense will be affected primarily by estimated year-end changes in product costs. Our LIFO charge for the year will be affected primarily by changes in product costs at year-end.



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- If actual results differ significantly from anticipated future results for certain reporting units including variable interest entities, an impairment loss for any excess of the carrying value of the reporting units' goodwill over the implied fair value would have to be recognized.
- In addition to the factors identified above, our identical store sales growth could be affected by increases in Kroger private label sales, the effect of our 'sister stores' (new stores opened in close proximity to an existing store) and reductions in retail pricing.
- Our operating margins, without fuel, could decline or fail to meet expectations if we are unable to pass on any cost increases, if we fail to deliver the cost savings contemplated or if changes in the cost of our inventory and the timing of those changes differ from our expectations.

- We have estimated our exposure to the claims and litigation arising in the normal course of business, as well as to the material litigation facing Kroger, and believe we have made provisions where it is reasonably possible to estimate and where an adverse outcome is probable. Unexpected outcomes in these matters, however, could result in an adverse effect on our earnings.
- Changes in the types and numbers of businesses that compete with us are likely to continue and the effects on our business, either favorable or unfavorable, cannot be foreseen.
- Rent expense, which includes subtenant rental income, could be adversely affected by the state of the economy, increased store closure activity and future consolidation.
- Depreciation expense, which includes the amortization of assets recorded under capital leases, is computed principally using the straight-line method over the estimated useful lives of individual assets, or the remaining terms of leases. Use of the straight-line method of depreciation creates a risk that future asset write-offs or potential impairment charges related to store closings would be larger than if an accelerated method of depreciation were followed.
- Our effective tax rate may differ from the expected rate due to changes in laws, the status of pending items with various taxing authorities, and the deductibility of certain expenses.
- The actual amount of automatic and matching cash contributions to our 401(k) Retirement Savings Account Plan will depend on the number of participants, savings rate, compensation as defined by the plan, and length of service of participants.
- The amounts of our contributions and recorded expense related to multi-employer pension funds could vary from the amounts that we expect, and could increase more than anticipated. Should asset values in these funds deteriorate, if employers withdraw from these funds without providing for their share of the liability, or should our estimates prove to be understated, our contributions could increase more rapidly than we have anticipated.
- If the investment performance of our pension plan assets does not meet expectations due to poor performance of the financial markets or for other reasons, our contributions to Company-sponsored defined benefit pension plans could increase more than anticipated in future periods.
- Changes in laws or regulations, including changes in accounting standards, taxation requirements and environmental laws may have a material effect on our financial statements.

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- Changes in the general business and economic conditions in our operating regions may affect the shopping habits of our customers, which could affect sales and earnings.
- Changes in our product mix may negatively affect certain financial indicators. For example, we continue to add supermarket fuel centers to our store base. Since gasoline generates low profit margins, we expect to see our FIFO gross profit margins decline as gasoline sales increase. Although this negatively affects our FIFO gross margin, gasoline sales provide a positive effect on OG&A expense as a percentage of sales.
- Our capital investments, expected square footage growth, and number of store projects completed over the next fiscal year could differ from our estimate if we are unsuccessful in acquiring suitable sites for new stores, if development costs vary from those budgeted, if our logistics and technology or store projects are not completed on budget or within the time frame projected, or if economic conditions fail to improve, or worsen.
- Interest expense could be adversely affected by the interest rate environment, changes in our credit ratings, fluctuations in the amount of outstanding debt, decisions to incur prepayment penalties on the early redemption of debt and any factor that adversely affects our operations and results in an increase in debt.
- Impairment losses, including goodwill, could be affected by changes in our assumptions of future cash flows, market values or business valuations in the market. Our cash flow projections include several years of projected cash flows which would be affected by changes in the economic environment, real estate market values, competitive activity, inflation and customer behavior.

- Our estimated expense and obligation for Kroger-sponsored pension plans and other post-retirement benefits could be affected by changes in the assumptions used in calculating those amounts. These assumptions include, among others, the discount rate, the expected long-term rate of return on plan assets, average life expectancy and the rate of increases in compensation and health care costs.
- Adverse weather conditions could increase the cost our suppliers charge for their products, or may decrease customer demand for certain products. Increases in demand for certain commodities could also increase the cost our suppliers charge for their products. Additionally, increases in the cost of inputs, such as utility costs or raw material costs, could negatively affect financial ratios and earnings.
- Although we presently operate only in the United States, civil unrest in foreign countries in which our suppliers do business may affect the prices we are charged for imported goods. If we are unable to pass on these increases to our customers, our FIFO gross margin and net earnings would suffer.
- Earnings and sales also may be affected by natural disasters or adverse weather conditions, particularly to the extent that they disrupt our operations or those of our suppliers; create shortages in the availability or increases in the cost of products that we sell in our stores or materials and ingredients we use in our manufacturing facilities; or raise the cost of supplying energy to our various operations, including the cost of transportation.

We cannot fully foresee the effects of changes in economic conditions on Kroger's business. We have assumed economic and competitive situations will not change significantly in 2013.

Other factors and assumptions not identified above could also cause actual results to differ materially from those set forth in the forward-looking information. Accordingly, actual events and results may vary significantly from those included in, contemplated or implied by forward-looking statements made by us or our representatives.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There have been no material changes in our exposure to market risk from the information provided in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013.

**Item 4. Controls and Procedures.**

The Chief Executive Officer and the Chief Financial Officer, together with a disclosure review committee appointed by the Chief Executive Officer, evaluated Kroger's disclosure controls and procedures as of the quarter ended May 25, 2013, the end of the period covered by this report. Based on that evaluation, Kroger's Chief Executive Officer and Chief Financial Officer concluded that Kroger's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15(d)-15(e) of the Exchange Act) were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In connection with the evaluation described above, there was no change in Kroger's internal control over financial reporting during the quarter ended May 25, 2013, that has materially affected, or is reasonably likely to materially affect, Kroger's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Various claims and lawsuits arising in the normal course of business, including suits charging violations of certain antitrust, wage and hour, or civil rights laws, as well as product liability cases, are pending against the Company. Some of these suits purport or have been determined to be class actions and/or seek substantial damages. Any damages that may be awarded in antitrust cases will be automatically trebled. Although it is not possible at this time to evaluate the merits of all of these claims and lawsuits, nor their likelihood of success, the Company is of the belief that any resulting liability will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made provisions where it is reasonably possible to estimate and where an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involve substantial uncertainties. It remains possible that despite management's current belief, material differences in actual outcomes or changes in management's evaluation or predictions could arise that could have a material adverse impact on the Company's financial condition, results of operations, or cash flows.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(c)

**ISSUER PURCHASES OF EQUITY SECURITIES**

| <b>Period(1)</b>                                      | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)</b> | <b>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(3) (in millions)</b> |
|-------------------------------------------------------|-----------------------------------------|-------------------------------------|--------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| First four weeks<br>February 3, 2013 to March 2, 2013 | 51                                      | \$ 27.86                            | 51                                                                                         | \$ 466                                                                                                       |
| Third four weeks<br>March 31, 2013 to April 27, 2013  | 2,890,635                               | \$ 32.81                            | 2,890,635                                                                                  | \$ 448                                                                                                       |
| <b>Total</b>                                          | <b>4,541,261</b>                        | <b>\$ 32.44</b>                     | <b>4,541,261</b>                                                                           | <b>\$ 448</b>                                                                                                |

(1) The reported periods conform to the Company's fiscal calendar composed of thirteen 28-day periods. The first quarter of 2013 contained four 28-day periods.

(2) Shares were repurchased under (i) a \$500 million share repurchase program, authorized by the Board of Directors and announced on October 16, 2012 and (ii) a program announced on December 6, 1999 to repurchase common shares to reduce dilution resulting from our employee stock option and long-term incentive plans, which program is limited to proceeds received from exercises of stock options and the tax benefits associated therewith. The programs have no expiration date but may be terminated by the Board of Directors at any time. Total shares purchased include shares that were surrendered to the Company by participants under the Company's long-term incentive plans to pay for taxes on restricted stock awards.

(3) The amounts shown in this column reflect amounts remaining under the \$500 million share repurchase program referenced in clause (i) of Note 2 above. Amounts to be invested under the program utilizing option exercise proceeds are dependent upon option exercise activity.

**Item 6. Exhibits.**

- EXHIBIT 3.1 - Amended Articles of Incorporation are hereby incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 22, 2010.
- EXHIBIT 3.2 - The Company's regulations are hereby incorporated by reference to Exhibit 3.2 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 26, 2007.
- EXHIBIT 4.1 - Instruments defining the rights of holders of long-term debt of the Company and its subsidiaries are not filed as Exhibits because the amount of debt under each instrument is less than 10% of the consolidated assets of the Company. The Company undertakes to file these instruments with the Commission upon request.
- EXHIBIT 31.1 - Rule 13a-14(a) / 15d-14(a) Certifications Chief Executive Officer.
- EXHIBIT 31.2 - Rule 13a-14(a) / 15d-14(a) Certifications Chief Financial Officer.
- EXHIBIT 32.1 - Section 1350 Certifications.
- EXHIBIT 99.1 - Additional Exhibits Statement of Computation of Ratio of Earnings to Fixed Charges.
- EXHIBIT 101.INS - XBRL Instance Document.
- EXHIBIT 101.SCH - XBRL Taxonomy Extension Schema Document.
- EXHIBIT 101.CAL - XBRL Taxonomy Extension Calculation Linkbase Document.
- EXHIBIT 101.DEF - XBRL Taxonomy Extension Definition Linkbase Document.
- EXHIBIT 101.LAB - XBRL Taxonomy Extension Label Linkbase Document.
- EXHIBIT 101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**THE KROGER CO.**

Dated: June 28, 2013

By: /s/ David B. Dillon  
David B. Dillon  
Chairman of the Board and Chief Executive Officer

Dated: June 28, 2013

By: /s/ J. Michael Schlotman  
J. Michael Schlotman  
Senior Vice President and Chief Financial Officer

**Exhibit Index**

|                   |                                                                                                                                                                                                                                                                                                                            |
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