

KROGER CO  
Form 10-Q  
December 13, 2013

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

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the quarterly period ended November 9, 2013**

**OR**

☐ **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                                             | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer (do not check if a smaller reporting company) | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

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

There were 516,526,256 shares of Common Stock (\$1 par value) outstanding as of December 11, 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)

|                                                                                                                         | Third Quarter Ended |                     | Three Quarters Ended |                     |
|-------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|----------------------|---------------------|
|                                                                                                                         | November 9,<br>2013 | November 3,<br>2012 | November 9,<br>2013  | November 3,<br>2012 |
| Sales                                                                                                                   | \$ 22,505           | \$ 21,807           | \$ 75,270            | \$ 72,598           |
| Merchandise costs, including advertising,<br>warehousing, and transportation, excluding items<br>shown separately below | 17,889              | 17,383              | 59,832               | 57,757              |
| Operating, general and administrative                                                                                   | 3,549               | 3,305               | 11,664               | 11,161              |
| Rent                                                                                                                    | 138                 | 141                 | 466                  | 471                 |
| Depreciation                                                                                                            | 395                 | 382                 | 1,301                | 1,265               |
| Operating profit                                                                                                        | 534                 | 596                 | 2,007                | 1,944               |
| Interest expense                                                                                                        | 108                 | 103                 | 336                  | 350                 |
| Earnings before income tax expense                                                                                      | 426                 | 493                 | 1,671                | 1,594               |
| Income tax expense                                                                                                      | 125                 | 175                 | 567                  | 555                 |
| Net earnings including noncontrolling interests                                                                         | 301                 | 318                 | 1,104                | 1,039               |
| Net earnings attributable to noncontrolling<br>interests                                                                | 2                   | 1                   | 7                    | 4                   |
| Net earnings attributable to The Kroger Co.                                                                             | \$ 299              | \$ 317              | \$ 1,097             | \$ 1,035            |
| Net earnings attributable to The Kroger Co. per<br>basic common share                                                   | \$ 0.58             | \$ 0.61             | \$ 2.11              | \$ 1.90             |
| Average number of common shares used in basic<br>calculation                                                            | 515                 | 518                 | 515                  | 539                 |
| Net earnings attributable to The Kroger Co. per<br>diluted common share                                                 | \$ 0.57             | \$ 0.60             | \$ 2.09              | \$ 1.89             |
| Average number of common shares used in<br>diluted calculation                                                          | 521                 | 522                 | 521                  | 543                 |
| Dividends declared per common share                                                                                     | \$ 0.165            | \$ 0.150            | \$ 0.465             | \$ 0.380            |

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



## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions and unaudited)

|                                                                                                   | Third Quarter Ended |                     | Three Quarters Ended |                     |
|---------------------------------------------------------------------------------------------------|---------------------|---------------------|----------------------|---------------------|
|                                                                                                   | November 9,<br>2013 | November 3,<br>2012 | November 9,<br>2013  | November 3,<br>2012 |
| Net earnings including noncontrolling interests                                                   | \$ 301              | \$ 318              | \$ 1,104             | \$ 1,039            |
| Other comprehensive income                                                                        |                     |                     |                      |                     |
| Unrealized gain (loss) on available for sale securities, net of income tax(1)                     | (1)                 |                     | 3                    |                     |
| Amortization of amounts included in net periodic pension expense, net of income tax(2)            | 14                  | 13                  | 47                   | 44                  |
| Unrealized gains and losses on cash flow hedging activities, net of income tax(3)                 | (2)                 | 3                   | (11)                 | (11)                |
| Amortization of unrealized gains and losses on cash flow hedging activities, net of income tax(4) |                     | 1                   | 1                    | 3                   |
| Total other comprehensive income                                                                  | 11                  | 17                  | 40                   | 36                  |
| Comprehensive income                                                                              | 312                 | 335                 | 1,144                | 1,075               |
| Comprehensive income attributable to noncontrolling interests                                     | 2                   | 1                   | 7                    | 4                   |
| Comprehensive income attributable to The Kroger Co.                                               | \$ 310              | \$ 334              | \$ 1,137             | \$ 1,071            |

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

(2) Amount is net of tax of \$9 for the third quarter of 2013 and \$8 for the third quarter of 2012. Amount is net of tax of \$29 for the first three quarters of 2013 and \$27 for the first three quarters of 2012.

(3) Amount is net of tax of \$(3) for the third quarter of 2013 and \$2 for the third quarter of 2012. Amount is net of tax of \$(8) for the first three quarters of 2013 and \$(7) for the first three quarters of 2012.

(4) Amount is net of tax of \$1 for the third quarter and the first three quarters of 2013.

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)

|                                                                                                        | November 9,<br>2013 | February 2,<br>2013 |
|--------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| <b>ASSETS</b>                                                                                          |                     |                     |
| Current assets                                                                                         |                     |                     |
| Cash and temporary cash investments                                                                    | \$ 344              | \$ 238              |
| Store deposits in-transit                                                                              | 881                 | 955                 |
| Receivables                                                                                            | 1,044               | 1,051               |
| FIFO inventory                                                                                         | 6,768               | 6,244               |
| LIFO reserve                                                                                           | (1,140)             | (1,098)             |
| Prepaid and other current assets                                                                       | 315                 | 569                 |
| Total current assets                                                                                   | 8,212               | 7,959               |
| Property, plant and equipment, net                                                                     | 15,456              | 14,849              |
| Goodwill                                                                                               | 1,234               | 1,234               |
| Other assets                                                                                           | 578                 | 593                 |
| Total Assets                                                                                           | \$ 25,480           | \$ 24,635           |
| <b>LIABILITIES</b>                                                                                     |                     |                     |
| Current liabilities                                                                                    |                     |                     |
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 1,122            | \$ 2,734            |
| Trade accounts payable                                                                                 | 4,941               | 4,484               |
| Accrued salaries and wages                                                                             | 1,047               | 1,017               |
| Deferred income taxes                                                                                  | 284                 | 284                 |
| Other current liabilities                                                                              | 2,799               | 2,538               |
| Total current liabilities                                                                              | 10,193              | 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      | 7,148               | 6,141               |
| Adjustment to reflect fair-value interest rate hedges                                                  | —                   | 4                   |
| Long-term debt including obligations under capital leases and financing obligations                    | 7,148               | 6,145               |
| Deferred income taxes                                                                                  | 816                 | 800                 |
| Pension and postretirement benefit obligations                                                         | 1,207               | 1,291               |
| Other long-term liabilities                                                                            | 1,126               | 1,128               |
| Total Liabilities                                                                                      | 20,490              | 20,421              |
| Commitments and contingencies (see Note 8)                                                             |                     |                     |
| <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                                                                             | 3,513               | 3,451               |

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|                                                                 |           |           |
|-----------------------------------------------------------------|-----------|-----------|
| Accumulated other comprehensive loss                            | (713)     | (753)     |
| Accumulated earnings                                            | 10,651    | 9,787     |
| Common shares in treasury, at cost, 445 shares in 2013 and 2012 | (9,426)   | (9,237)   |
|                                                                 |           |           |
| Total Shareowners' Equity - The Kroger Co.                      | 4,984     | 4,207     |
| Noncontrolling interests                                        | 6         | 7         |
|                                                                 |           |           |
| Total Equity                                                    | 4,990     | 4,214     |
|                                                                 |           |           |
| Total Liabilities and Equity                                    | \$ 25,480 | \$ 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)

|                                                                                                                        | Three Quarters Ended |                     |
|------------------------------------------------------------------------------------------------------------------------|----------------------|---------------------|
|                                                                                                                        | November 9,<br>2013  | November 3,<br>2012 |
| Cash Flows from Operating Activities:                                                                                  |                      |                     |
| Net earnings including noncontrolling interests                                                                        | \$ 1,104             | \$ 1,039            |
| Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities: |                      |                     |
| Depreciation                                                                                                           | 1,301                | 1,265               |
| LIFO charge                                                                                                            | 42                   | 96                  |
| Stock-based employee compensation                                                                                      | 78                   | 61                  |
| Expense for Company-sponsored pension plans                                                                            | 57                   | 68                  |
| Deferred income taxes                                                                                                  | 21                   | 130                 |
| Other                                                                                                                  | 62                   | 37                  |
| Changes in operating assets and liabilities net of effects from acquisitions of businesses:                            |                      |                     |
| Store deposits in-transit                                                                                              | 74                   | (134)               |
| Receivables                                                                                                            | 5                    | (131)               |
| Inventories                                                                                                            | (524)                | (531)               |
| Prepaid expenses                                                                                                       | 262                  | (32)                |
| Trade accounts payable                                                                                                 | 402                  | 386                 |
| Accrued expenses                                                                                                       | 142                  | 57                  |
| Income taxes receivable and payable                                                                                    | 11                   | 115                 |
| Other                                                                                                                  | (120)                | (158)               |
| Net cash provided by operating activities                                                                              | 2,917                | 2,268               |
| Cash Flows from Investing Activities:                                                                                  |                      |                     |
| Payments for property and equipment, including payments for lease buyouts                                              | (1,786)              | (1,471)             |
| Proceeds from sale of assets                                                                                           | 15                   | 23                  |
| Payments for acquisitions                                                                                              | —                    | (12)                |
| Other                                                                                                                  | (47)                 | (28)                |
| Net cash used by investing activities                                                                                  | (1,818)              | (1,488)             |
| Cash Flows from Financing Activities:                                                                                  |                      |                     |
| Proceeds from issuance of long-term debt                                                                               | 1,025                | 850                 |
| Dividends paid                                                                                                         | (233)                | (189)               |
| Payments on long-term debt                                                                                             | (431)                | (921)               |
| Net (payments) borrowings on commercial paper                                                                          | (1,220)              | 744                 |
| Excess tax benefits on stock-based awards                                                                              | 24                   | 5                   |
| Proceeds from issuance of capital stock                                                                                | 186                  | 72                  |
| Treasury stock purchases                                                                                               | (384)                | (1,204)             |
| Net increase in book overdrafts                                                                                        | 56                   | 115                 |
| Other                                                                                                                  | (16)                 | (5)                 |
| Net cash used by financing activities                                                                                  | (993)                | (533)               |
| Net increase in cash and temporary cash investments                                                                    | 106                  | 247                 |
| Cash and temporary cash investments:                                                                                   |                      |                     |
| Beginning of year                                                                                                      | 238                  | 188                 |

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|                                                                           |    |         |    |         |
|---------------------------------------------------------------------------|----|---------|----|---------|
| End of quarter                                                            | \$ | 344     | \$ | 435     |
| Reconciliation of capital investments:                                    |    |         |    |         |
| Payments for property and equipment, including payments for lease buyouts | \$ | (1,786) | \$ | (1,471) |
| Payments for lease buyouts                                                |    | 108     |    | 24      |
| Changes in construction-in-progress payables                              |    | (110)   |    | (11)    |
| Total capital investments, excluding lease buyouts                        | \$ | (1,788) | \$ | (1,458) |
| Disclosure of cash flow information:                                      |    |         |    |         |
| Cash paid during the year for interest                                    | \$ | 308     | \$ | 320     |
| Cash paid during the year for income taxes                                | \$ | 489     | \$ | 334     |

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 Stock |        | Additional         | Treasury Stock |            | Accumulated<br>Other<br>Comprehensive |           | Accumulated | Noncontrolling |    | Total   |
|----------------------------------------------------|--------------|--------|--------------------|----------------|------------|---------------------------------------|-----------|-------------|----------------|----|---------|
|                                                    | Shares       | Amount | Paid-In<br>Capital | Shares         | Amount     | Gain (Loss)                           | Earnings  |             | Interest       |    |         |
| 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                            |              |        |                    | (4)            | 72         |                                       |           |             |                |    | 72      |
| Restricted stock issued                            |              |        | (57)               | (2)            | 38         |                                       |           |             |                |    | (19)    |
| Treasury stock activity:                           |              |        |                    |                |            |                                       |           |             |                |    |         |
| Treasury stock purchases, at cost                  |              |        |                    | 50             | (1,137)    |                                       |           |             |                |    | (1,137) |
| Stock options exchanged                            |              |        |                    | 3              | (67)       |                                       |           |             |                |    | (67)    |
| Share-based employee compensation                  |              |        | 61                 |                |            |                                       |           |             |                |    | 61      |
| Other comprehensive gain net of income tax of \$20 |              |        |                    |                |            | 36                                    |           |             |                |    | 36      |
| Other                                              |              |        | 3                  |                | (2)        |                                       |           |             | 12             |    | 13      |
| Cash dividends declared (\$0.38 per common share)  |              |        |                    |                |            |                                       | (202)     |             |                |    | (202)   |
| Net earnings including noncontrolling interests    |              |        |                    |                |            |                                       | 1,035     |             | 4              |    | 1,039   |
| Balances at November 3, 2012                       | 959          | \$ 959 | \$ 3,434           | 445            | \$ (9,228) | \$ (808)                              | \$ 9,404  | \$          | 1              | \$ | 3,762   |
| 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                            |              |        |                    | (8)            | 186        |                                       |           |             |                |    | 186     |
| Restricted stock issued                            |              |        | (58)               | (2)            | 26         |                                       |           |             |                |    | (32)    |
| Treasury stock activity:                           |              |        |                    |                |            |                                       |           |             |                |    |         |
| Treasury stock purchases, at cost                  |              |        |                    | 3              | (126)      |                                       |           |             |                |    | (126)   |
| Stock options exchanged                            |              |        |                    | 7              | (258)      |                                       |           |             |                |    | (258)   |
| Share-based employee compensation                  |              |        | 78                 |                |            |                                       |           |             |                |    | 78      |
| Other comprehensive gain net of income tax of \$24 |              |        |                    |                |            | 40                                    |           |             |                |    | 40      |
| Other                                              |              |        | 42                 |                | (17)       |                                       |           |             | (8)            |    | 17      |
| Cash dividends declared (\$0.465 per common share) |              |        |                    |                |            |                                       | (233)     |             |                |    | (233)   |
| Net earnings including noncontrolling interests    |              |        |                    |                |            |                                       | 1,097     |             | 7              |    | 1,104   |
| Balances at November 9, 2013                       | 959          | \$ 959 | \$ 3,513           | 445            | \$ (9,426) | \$ (713)                              | \$ 10,651 | \$          | 6              | \$ | 4,990   |

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

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

All amounts in the Notes to 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 third quarter and the three quarters ended November 9, 2013 and November 3, 2012, includes the results of operations of the Company for the 12 and 40-week periods then ended.

**2. STOCK OPTION PLANS**

The Company recognized total stock-based compensation of \$31 and \$20 in the third quarters ended November 9, 2013 and November 3, 2012, respectively. The Company recognized total stock-based compensation of \$78 and \$61 in the first three quarters of 2013 and 2012, respectively. These costs were recognized as operating, general and administrative costs in the Company's Consolidated Statements of Operations.

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The Company grants options for common shares ( stock options ) to employees, as well as to its non-employee directors, under various plans at an option price equal to the fair market value of the shares at the date of grant. In addition to stock options, the Company awards restricted stock to employees and its non-employee directors under various plans. Beginning in 2013, non-employee directors were awarded incentive shares in lieu of restricted stock and stock options. Equity awards may be made once each quarter on a predetermined date. It has been the Company's practice to make a general annual grant to employees, which occurred in the second quarter of 2013. Special grants may be made in the other three quarters. Grants to non-employee directors occur on the same date that the general annual grant to employees occurs.

Stock options granted in the first three quarters of 2013 expire 10 years from the date of grant and vest between one year and five years from the date of grant. Restricted stock awards granted in the first three quarters of 2013 have restrictions that lapse between one year and five years from the date of the awards. All grants and awards become immediately exercisable, in the case of options, and restrictions lapse, in the case of restricted stock, upon certain changes of control of the Company.

Changes in equity awards outstanding under the plans are summarized below.

*Stock Options*

|                               | Shares subject<br>to option |    | Weighted-average<br>exercise price |
|-------------------------------|-----------------------------|----|------------------------------------|
| Outstanding, February 2, 2013 | 26.5                        | \$ | 22.61                              |
| Granted                       | 4.2                         | \$ | 37.65                              |
| Exercised                     | (8.4)                       | \$ | 22.25                              |
| Canceled or Expired           | (0.2)                       | \$ | 24.81                              |
| Outstanding, November 9, 2013 | 22.1                        | \$ | 25.55                              |

*Restricted Stock*

|                               | Restricted shares<br>outstanding |    | Weighted-average<br>grant-date fair value |
|-------------------------------|----------------------------------|----|-------------------------------------------|
| Outstanding, February 2, 2013 | 4.3                              | \$ | 22.67                                     |
| Granted                       | 2.6                              | \$ | 37.62                                     |
| Vested                        | (2.5)                            | \$ | 22.90                                     |
| Forfeited                     | (0.1)                            | \$ | 26.01                                     |
| Outstanding, November 9, 2013 | 4.3                              | \$ | 31.47                                     |

The weighted-average grant date fair value of stock options granted during the first three quarters of 2013 and 2012, was \$8.97 and \$4.37, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option-pricing model, based on the assumptions shown in the table below. The Black-Scholes model utilizes extensive accounting judgment and financial estimates, including the term option holders are expected to retain their stock options before exercising them, the volatility of the Company's stock price over that expected term, the dividend yield over the term, and the number of awards expected to be forfeited before they vest. Using alternative assumptions in the calculation of fair value would produce fair values for stock option grants that could be different than those used to record stock-based compensation expense in the Consolidated Statements of Operations. The increase in the fair value of the stock options granted during the first three quarters of 2013, compared to the first three quarters of 2012, resulted primarily from an increase in the Company's share price, which decreased the expected dividend yield and an increase in the weighted average risk-free interest rate.

The following table reflects the weighted average assumptions used for grants awarded to option holders:

|                         | 2013      | 2012      |
|-------------------------|-----------|-----------|
| Risk-free interest rate | 1.87%     | 0.97%     |
| Expected dividend yield | 1.82%     | 2.49%     |
| Expected volatility     | 26.34%    | 26.49%    |
| Expected term           | 6.8 Years | 6.9 Years |



### 3. DEBT OBLIGATIONS

Long-term debt consists of:

|                                                                          | November 9,<br>2013 | February 2,<br>2013 |
|--------------------------------------------------------------------------|---------------------|---------------------|
| 2.20% to 8.00% Senior Notes due through 2043                             | \$ 7,186            | \$ 6,587            |
| 5.00% to 12.75% Mortgages due in varying amounts through 2034            | 82                  | 60                  |
| 0.28% to 0.45% Commercial paper borrowings due through November 2013     | 425                 | 1,645               |
| Other                                                                    | 185                 | 184                 |
| Total debt, excluding capital leases and financing obligations           | 7,878               | 8,476               |
| Less current portion                                                     | (1,087)             | (2,700)             |
| Total long-term debt, excluding capital leases and financing obligations | \$ 6,791            | \$ 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.

In the second quarter of 2013, the Company issued \$600 of senior notes due in fiscal year 2023 bearing an interest rate of 3.85% and \$400 of senior notes due in fiscal year 2043 bearing an interest rate of 5.15%.

In the first three quarters of 2013, the Company decreased the amount of commercial paper borrowings outstanding by \$1,220.

### 4. BENEFIT PLANS

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

|                                          | Third Quarter Ended |                     |                     |                     |
|------------------------------------------|---------------------|---------------------|---------------------|---------------------|
|                                          | Pension Benefits    |                     | Other Benefits      |                     |
|                                          | November 9,<br>2013 | November 3,<br>2012 | November 9,<br>2013 | November 3,<br>2012 |
| Components of net periodic benefit cost: |                     |                     |                     |                     |
| Service cost                             | \$ 10               | \$ 11               | \$ 4                | \$ 4                |
| Interest cost                            | 35                  | 36                  | 3                   | 3                   |
| Expected return on plan assets           | (52)                | (49)                |                     |                     |
| Amortization of:                         |                     |                     |                     |                     |
| Prior service cost                       |                     |                     | (1)                 | (1)                 |
| Actuarial loss                           | 24                  | 22                  |                     |                     |

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|                           |    |    |    |    |    |   |    |   |
|---------------------------|----|----|----|----|----|---|----|---|
| Net periodic benefit cost | \$ | 17 | \$ | 20 | \$ | 6 | \$ | 6 |
|---------------------------|----|----|----|----|----|---|----|---|

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

|                                          | Three Quarters Ended |                     |                     |                     |
|------------------------------------------|----------------------|---------------------|---------------------|---------------------|
|                                          | Pension Benefits     |                     | Other Benefits      |                     |
|                                          | November 9,<br>2013  | November 3,<br>2012 | November 9,<br>2013 | November 3,<br>2012 |
| Components of net periodic benefit cost: |                      |                     |                     |                     |
| Service cost                             | \$ 33                | \$ 36               | \$ 13               | \$ 13               |
| Interest cost                            | 118                  | 120                 | 12                  | 12                  |
| Expected return on plan assets           | (173)                | (162)               |                     |                     |
| Amortization of:                         |                      |                     |                     |                     |
| Prior service cost                       |                      |                     | (3)                 | (3)                 |
| Actuarial loss                           | 79                   | 74                  |                     |                     |
| Net periodic benefit cost                | \$ 57                | \$ 68               | \$ 22               | \$ 22               |

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

The Company contributed \$115 and \$110 to employee 401(k) retirement savings accounts in the first three 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.

## 5. 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:

|                                                                    | Third Quarter Ended<br>November 9, 2013 |                         |                     | Third Quarter Ended<br>November 3, 2012 |                         |                     |
|--------------------------------------------------------------------|-----------------------------------------|-------------------------|---------------------|-----------------------------------------|-------------------------|---------------------|
|                                                                    | Earnings<br>(Numerator)                 | Shares<br>(Denominator) | Per Share<br>Amount | Earnings<br>(Numerator)                 | Shares<br>(Denominator) | Per Share<br>Amount |
| Net earnings attributable to The Kroger Co. per basic common share | \$ 297                                  | 515                     | \$ 0.58             | \$ 314                                  | 518                     | \$ 0.61             |
| Dilutive effect of stock options                                   |                                         | 6                       |                     |                                         | 4                       |                     |

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|                                                                      |    |     |     |    |      |    |     |     |    |      |
|----------------------------------------------------------------------|----|-----|-----|----|------|----|-----|-----|----|------|
| Net earnings attributable to The Kroger Co. per diluted common share | \$ | 297 | 521 | \$ | 0.57 | \$ | 314 | 522 | \$ | 0.60 |
|----------------------------------------------------------------------|----|-----|-----|----|------|----|-----|-----|----|------|

|                                                                      | Three Quarters Ended<br>November 9, 2013 |                         |                     | Three Quarters Ended<br>November 3, 2012 |                         |                     |  |
|----------------------------------------------------------------------|------------------------------------------|-------------------------|---------------------|------------------------------------------|-------------------------|---------------------|--|
|                                                                      | Earnings<br>(Numerator)                  | Shares<br>(Denominator) | Per Share<br>Amount | Earnings<br>(Numerator)                  | Shares<br>(Denominator) | Per Share<br>Amount |  |
| Net earnings attributable to The Kroger Co. per basic common share   | \$ 1,088                                 | 515                     | \$ 2.11             | \$ 1,027                                 | 539                     | \$ 1.90             |  |
| Dilutive effect of stock options                                     |                                          | 6                       |                     |                                          | 4                       |                     |  |
| Net earnings attributable to The Kroger Co. per diluted common share | \$ 1,088                                 | 521                     | \$ 2.09             | \$ 1,027                                 | 543                     | \$ 1.89             |  |

The Company had combined undistributed and distributed earnings to participating securities totaling \$2 in the third quarter of 2013 and \$3 in the third quarter of 2012. For the first three quarters of 2013 and 2012, the Company had combined undistributed and distributed earnings to participating securities of \$9 and \$8, respectively.

The Company had options outstanding for approximately 4 and 14 shares during the third quarters of 2013 and 2012, respectively, which 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 2 shares in the first three quarters of 2013 and 12 shares in the first three quarters of 2012 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.

## **6. 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 11 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 9 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

## **7. RECENTLY ISSUED ACCOUNTING STANDARDS**

In July 2013, the FASB amended Accounting Standards Codification ( ASC ) 740, Income Taxes. The amendment provides guidance on the financial statement presentation of an unrecognized tax benefit, as either a reduction of a deferred tax asset or as a liability, when a net operating loss carryforward, similar tax loss, or a tax credit carryforward exists. The amendment will be effective for interim and annual periods beginning after December 15, 2013 and may be applied on a retrospective basis. Early adoption is permitted. The Company does not expect the adoption of this amendment to have a significant effect on the Company's consolidated financial position or results of operations.

## **8. COMMITMENTS AND CONTINGENCIES**

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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.

## **9. 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 November 9, 2013 and February 2, 2013.

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|                       | November 9, 2013 |       | February 2, 2013                     |       |
|-----------------------|------------------|-------|--------------------------------------|-------|
|                       | Pay              | Pay   | Pay                                  | Pay   |
|                       | Floating         | Fixed | Floating                             | Fixed |
| Notional amount       | \$ 100           | \$    | \$ 475                               | \$    |
| Number of contracts   | 2                |       | 6                                    |       |
| Duration in years     | 5.17             |       | 1.41                                 |       |
| Average variable rate | 5.84%            |       | 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 aggregating \$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 is recognized in current income as Interest expense. These gains and losses for the third quarters and first three quarters of 2013 and 2012 were as follows:

| Income Statement Classification | Third Quarter Ended  |                           |                      |                           |
|---------------------------------|----------------------|---------------------------|----------------------|---------------------------|
|                                 | November 9, 2013     | November 9, 2013          | November 3, 2012     | November 3, 2012          |
|                                 | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings |
| Interest Expense                | \$ 1                 | \$ (2)                    | \$ (4)               | \$ 4                      |

| Income Statement Classification | Three Quarters Ended |                           |                      |                           |
|---------------------------------|----------------------|---------------------------|----------------------|---------------------------|
|                                 | November 9, 2013     | November 9, 2013          | November 3, 2012     | November 3, 2012          |
|                                 | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings | Gain/(Loss) on Swaps | Gain/(Loss) on Borrowings |
| Interest Expense                | \$ (4)               | \$ 3                      | \$ (18)              | \$ 14                     |

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 | Asset Derivatives |                  |                                            |
|----------------------------------------------------------|-------------------|------------------|--------------------------------------------|
|                                                          | Fair Value        | Fair Value       | Balance Sheet Location                     |
|                                                          | November 9, 2013  | February 2, 2013 | (Other Long-Term Liabilities)/Other Assets |
| Interest Rate Hedges                                     | \$ (3)            | \$ 1             |                                            |

#### Cash Flow Forward-Starting Interest Rate Swaps

As of November 9, 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 November 9, 2013, the fair value of the interest rate swaps was recorded in other assets for \$18 and accumulated other comprehensive income (AOCI) for \$11 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 rate swaps was recorded in other assets 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.

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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 fixed-rate debt that the Company anticipated issuing at the time. As discussed in Note 3, the Company issued \$1,000 of senior notes in the second quarter of 2013. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$32, \$20 net of tax, is deferred in accumulated other comprehensive loss and will be amortized to earnings as interest payments are made on the related debt.

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

| Derivatives in Cash Flow Hedging Relationships    | Third Quarter Ended                                              |                  |                                                                              |                  | Location of Gain/(Loss) Reclassified into Income (Effective Portion) |
|---------------------------------------------------|------------------------------------------------------------------|------------------|------------------------------------------------------------------------------|------------------|----------------------------------------------------------------------|
|                                                   | Amount of Gain/(Loss) in AOCI on Derivatives (Effective Portion) |                  | Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion) |                  |                                                                      |
|                                                   | November 9, 2013                                                 | November 3, 2012 | November 9, 2013                                                             | November 3, 2012 |                                                                      |
| Forward-Starting Interest Rate Swaps, net of tax* | \$ (24)                                                          | \$ (39)          | \$                                                                           | \$ (1)           | Interest expense                                                     |

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

| Derivatives in Cash Flow Hedging Relationships    | Three Quarters Ended                                             |                  |                                                                              |                  | Location of Gain/(Loss) Reclassified into Income (Effective Portion) |
|---------------------------------------------------|------------------------------------------------------------------|------------------|------------------------------------------------------------------------------|------------------|----------------------------------------------------------------------|
|                                                   | Amount of Gain/(Loss) in AOCI on Derivatives (Effective Portion) |                  | Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion) |                  |                                                                      |
|                                                   | November 9, 2013                                                 | November 3, 2012 | November 9, 2013                                                             | November 3, 2012 |                                                                      |
| Forward-Starting Interest Rate Swaps, net of tax* | \$ (24)                                                          | \$ (39)          | \$ (1)                                                                       | \$ (3)           | Interest expense                                                     |

\*The amounts 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 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 November 9, 2013 and February 2, 2013, no cash collateral was received or pledged under the master netting agreements.

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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 November 9, 2013 and February 2, 2013:

| November 9, 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 | \$ 18                      | \$                                                                | \$ 18                                                                | \$                                                                                             | \$              | \$ 18      |
| <b>Liabilities</b>                      |                            |                                                                   |                                                                      |                                                                                                |                 |            |
| Fair Value Interest Rate<br>Swaps       | \$ 3                       | \$                                                                | \$ 3                                                                 | \$                                                                                             | \$              | \$ 3       |

| 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.

## 10. 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.

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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 November 9, 2013 and February 2, 2013:

## November 9, 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                      |                                                                            | 13                                                  |                                                    | 13    |
| Long-Lived Assets             |                                                                            |                                                     | 18                                                 | 18    |
| Interest Rate Hedges          |                                                                            | 15                                                  |                                                    | 15    |
| Total                         | \$ 33                                                                      | \$ 28                                               | \$ 18                                              | \$ 79 |

## 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     |
| 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 fair value of securities from a Level 3 asset to a Level 1 asset in the first quarter of 2013. In the first three quarters of 2013, unrealized gains on the Level 1 available-for-sale securities totaled \$5.

The Company values warrants using the Black-Scholes option-pricing model. The Black-Scholes 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 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

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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 three quarters of 2013, long-lived assets with a carrying amount of \$48 were written down to their fair value of \$18 resulting in an impairment charge of \$30. For the first three quarters of 2012, long-lived assets with a carrying amount of \$14 were written down to their fair value of \$4 resulting in an impairment charge of \$10.

**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 November 9, 2013, and February 2, 2013, which is a Level 3 measurement technique. At November 9, 2013, the fair value of total debt was \$8,440 compared to a carrying value of \$7,878. 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, Trade Accounts Payable, Accrued Salaries and Wages and Other Current Liabilities*

The carrying amounts of these items approximated fair value.

*Other Assets*

The fair values of these other assets were estimated based on quoted market prices for those or similar assets, or estimated cash flows, if appropriate. At November 9, 2013, and February 2, 2013, the carrying and fair value of other assets for which fair value is determinable was \$52 and \$44, respectively.

**11. OTHER COMPREHENSIVE INCOME (LOSS)**

The following table represents the changes in AOCI by component for the first three quarters 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)  |                                       | (11) |                                     | 3  |                                                              |       | (8)      |
| Amounts reclassified out of AOCI |                                       | 1    |                                     |    |                                                              | 47    | 48       |
| Net current-period OCI           |                                       | (10) |                                     | 3  |                                                              | 47    | 40       |
| Balance at November 9, 2013      | \$                                    | (24) | \$                                  | 10 | \$                                                           | (699) | \$ (713) |

(1) All amounts are net of tax.

(2) Net of tax of \$(8) and \$2 for cash flow hedging activities and available for sale securities, respectively.

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

|                                                                                | Third Quarter Ended<br>November 9, 2013 | Three Quarters Ended<br>November 9, 2013 |
|--------------------------------------------------------------------------------|-----------------------------------------|------------------------------------------|
| <b>Gains on cash flow hedging activities</b>                                   |                                         |                                          |
| Amortization of unrealized gains and losses on cash flow hedging activities(1) | \$ 1                                    | \$ 2                                     |
| Tax expense                                                                    | (1)                                     | (1)                                      |
| Net of tax                                                                     |                                         | 1                                        |
| <b>Pension and postretirement defined benefit plan items</b>                   |                                         |                                          |
| Amortization of amounts included in net periodic pension expense(2)            | 23                                      | 76                                       |
| Tax expense                                                                    | (9)                                     | (29)                                     |
| Net of tax                                                                     | 14                                      | 47                                       |
| Total reclassifications, net of tax                                            | \$ 14                                   | \$ 48                                    |

(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 4 to the Company's Consolidated Financial Statements for additional details).

## 12. INCOME TAXES

The effective income tax rate was 29.3% and 35.5% for the third quarters of 2013 and 2012, respectively. The effective income tax rate was 33.9% and 34.8% for the first three quarters of 2013 and 2012, respectively. The effective income tax rates for the third quarter and first three quarters of 2013 differed from the federal statutory rate primarily due to the benefit of certain tax items, offset partially by the effect of state income taxes. The effective tax rate for the third quarter of 2012 approximates the federal statutory rate. The effective income tax rate for the first three quarters of 2012 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.

On September 13, 2013, the U.S. Department of the Treasury and Internal Revenue Service released final tangible property regulations that provide guidance on the tax treatment regarding the deduction and capitalization of expenditures related to tangible property. These regulations are effective for tax years beginning on or after January 1, 2014. The Company is currently assessing these rules and their effect to its financial statements, and believes adoption of these regulations will not have an effect on net income and will not have a material effect on the reclassification between long-term deferred tax liabilities and current income tax liabilities.

## 13. POTENTIAL MERGER

During the second quarter, the Company announced that it had entered into a merger agreement with Harris Teeter Supermarkets, Inc. under which the Company will purchase all outstanding shares of Harris Teeter Supermarkets, Inc. for approximately \$2,500 in cash. In the second quarter of 2013, the Company also entered into an unsecured bridge loan agreement (the Bridge Loan Agreement) to provide an additional source of financing, if necessary, to fund a portion of the merger with Harris Teeter. The Bridge Loan Agreement provides the Company the

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ability to borrow, based on certain conditions, including the consummation of the Harris Teeter merger, up to \$850, and matures 364 days after closing. The Company expects to fund the merger through a combination of cash on hand and the issuance of short-term and long-term debt.

Borrowings under the Bridge Loan Agreement would bear interest at the three-month LIBOR rate plus an applicable margin determined by the Company's credit ratings, as determined by S&P and Moody's. The applicable margin will also increase by 25 basis points every 90 days after funding. The Company will also pay a funding fee to each lender equal to 0.5% of such lender's loan advance on the closing date of the financing, and duration fees on any loan amounts still outstanding of 0.5%, 0.75% and 1.0% on each of the 90th, 180th and 270th day, respectively, following the closing of the Harris Teeter merger. The Company also will pay an annual ticking fee of 0.15% of the amount the lenders have committed, regardless of whether any borrowings are made under the Bridge Loan Agreement. The Bridge Loan Agreement contains covenants, which, among other things, require the maintenance of a leverage ratio of not greater than 3.50:1.00 and a fixed charge coverage ratio of not less than 1.70:1.00. The covenants and representations and warranties in the Bridge Loan Agreement are substantially the same as those contained in the existing \$2,000 unsecured revolving credit facility.

The Company may repay borrowings under the Bridge Loan Agreement in whole or in part at any time without premium or penalty. The Bridge Loan Agreement is not guaranteed by the Company's subsidiaries.

The pending merger is expected to close during the fourth quarter of fiscal year 2013, subject to Federal Trade Commission review and certain customary closing conditions.

**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**

Third quarter 2013 total sales were \$22.5 billion compared with \$21.8 billion for the same period of 2012. This increase was attributable to identical supermarket sales increases, a shift in the calendar and increased fuel gallon sales, offset partially by a decrease in the average retail fuel price. Identical supermarket sales without fuel increased 3.5% in the third quarter of 2013, compared to the third quarter of 2012, primarily due to an increase in the number of households shopping with us, an increase in the average sale per customer and product cost inflation. Every supermarket store department, excluding fuel, and every operating division had positive identical sales. This marks positive identical supermarket sales growth for 40 consecutive quarters. The 53rd week in 2012 caused a one week shift in the fiscal year calendar when comparing fiscal year 2013 to fiscal year 2012. In the third quarter, the one week shift in the fiscal year calendar resulted in a high volume sales week being added to total sales for the third quarter of 2013 replacing a lower volume sales week in the third quarter of 2012.

Total sales for the first three quarters of 2013 were \$75.3 billion compared to \$72.6 billion for the same period of 2012. This increase was attributable to identical supermarket sales increases and increased fuel gallon sales, offset partially by a decrease in the average retail fuel price. Identical supermarket sales without fuel increased 3.4% in the first three quarters of 2013, compared to the same period in 2012, primarily due to an increase in the number of households shopping with us, an increase in the average sale per customer and product cost inflation. Our Customer 1st strategy continues to deliver solid results.

For the third quarter of 2013, net earnings totaled \$299 million, or \$0.57 per diluted share, compared to \$317 million, or \$0.60 per diluted share for the same period of 2012. The net earnings for the third quarter of 2013 include a net \$23 million adjustment for benefits from certain tax items (\$25 million), offset partially by an after-tax increase of \$2 million (\$1 million in interest and \$1 million in operating, general and administrative expenses) in expenses related to our pending merger with Harris Teeter (Third Quarter 2013 adjusted items). The net earnings for the third quarter of 2012 include a \$74 million after-tax reduction of operating, general and administrative expenses resulting from a settlement with Visa and MasterCard and a reduction in our obligation to fund the UFCW consolidated pension fund created in January 2012 (2012 adjusted items). Excluding the Third Quarter 2013 adjusted items, net earnings for third quarter 2013 totaled \$276 million, or \$0.53 per diluted share, compared to net earnings for the third quarter of 2012 of \$243 million, or \$0.46 per diluted share, which excludes the 2012 adjusted items. We believe the adjusted net earnings per diluted share figure presents a more accurate quarter-over-quarter and year-over-year comparison of our financial results because the adjusted items were not the result of our normal operations. The increase in adjusted net earnings for the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from an increase in non-fuel First-In, First Out (FIFO) operating profit and an increase in net earnings from our fuel operations, offset partially by an increase in income tax expense.

For the first three quarters of 2013, net earnings totaled \$1.1 billion, or \$2.09 per diluted share, compared to \$1.0 billion, or \$1.89 per diluted share for the same period of 2012. The net earnings for the first three quarters of 2013 include a net \$14 million adjustment for benefits from certain tax items (\$19 million), offset partially by the after-tax effect of \$5 million (including \$3 million in interest and \$2 million in operating, general and administrative expenses) in expenses related to our pending merger with Harris Teeter (2013 adjusted items). The 2013 adjusted items are less than the Third Quarter 2013 adjusted items due to an adjustment made during the third quarter of 2013 for certain tax items that relate to the expected tax rate for the full year of 2013, offset partially by the increase in the full year expenses related to the pending Harris Teeter merger. Excluding these adjustments, net earnings for the first three quarters of 2013 totaled \$1.1 billion, or \$2.06 per diluted share, which excludes the 2013 adjusted items, compared to adjusted net earnings for the first three quarters of 2012 of \$961 million, or \$1.76 per diluted share, which excludes the 2012 adjusted items. The increase in our adjusted net earnings for the first three quarters of 2013, compared to the same period in 2012, resulted primarily from an increase in non-fuel FIFO operating profit, a decrease in the Last-In, First-Out (LIFO)

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charge, an increase in net earnings from our fuel operations and a decrease in interest expense, offset partially by an increase in our effective tax rate.

Please refer to the Outlook section for information on our expectations for fiscal year 2013.

## RESULTS OF OPERATIONS

### *Net Earnings*

Net earnings totaled \$299 million for the third quarter of 2013, a decrease of 5.7% from net earnings of \$317 million for the third quarter of 2012. Adjusted net earnings for the third quarter of 2013 totaled \$276 million, excluding the Third Quarter adjusted items, an increase of 13.6% from adjusted net earnings of \$243 million for the third quarter of 2012, excluding the 2012 adjusted items. The increase in our adjusted net earnings for the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from an increase in non-fuel FIFO operating profit and an increase in net earnings from our fuel operations. The increase in non-fuel FIFO operating profit for the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from increased supermarket sales and improvements to operating, general and administrative expenses, rent and depreciation, as a percentage of sales, offset partially by continued investments in lower prices for our customers and increased shrink, as a percentage of sales. The increase in net earnings from our fuel operations for the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from an increase in the average margin per gallon of fuel sold and an increase in fuel gallons sold.

Net earnings totaled \$1.1 billion for the first three quarters of 2013, an increase of 6.0% from net earnings of \$1.0 billion for the first three quarters of 2012. Adjusted net earnings for the first three quarters of 2013 totaled \$1.1 billion, excluding the 2013 adjusted items, an increase of 12.7% from adjusted net earnings of \$961 million for the first three quarters of 2012, excluding the 2012 adjusted items. The increase in our adjusted net earnings for the first three quarters of 2013, compared to the same period in 2012, resulted primarily from an increase in non-fuel FIFO operating profit, a decrease in the LIFO charge, an increase in net earnings from our fuel operations and a decrease in interest expense, offset partially by an increase in our effective tax rate. The increase in non-fuel operating profit for the first three quarters of 2013, compared to the same period in 2012, resulted primarily from the benefit of increased supermarket sales and improvements to operating, general and administrative expenses, rent and depreciation, as a percentage of sales, partially offset by continued investments in lower prices for our customers and increased shrink, as a percentage of sales. The increase in net earnings from fuel operations for the first three quarters of 2013, compared to the first three quarters of 2012, resulted primarily from an increase in fuel gallons sold and an increase in average margin per gallon of fuel sold.

Net earnings of \$0.57 per diluted share for the third quarter of 2013 represented a decrease of 5.0% over net earnings of \$0.60 per diluted share for the third quarter of 2012. Adjusted net earnings for the third quarter of 2013 of \$0.53 per diluted share, excluding the Third Quarter 2013 adjusted items, represented an increase of 15.2% over adjusted net earnings of \$0.46 per diluted share for the third quarter of 2012, excluding the 2012 adjusted items. Adjusted net earnings per diluted share increased in the third quarter of 2013, compared to the third quarter of 2012, due to increased net earnings.

Net earnings of \$2.09 per diluted share for the first three quarters of 2013 represented an increase of 10.6% over net earnings of \$1.89 per diluted share for the first three quarters of 2012. Adjusted net earnings for the first three quarters of 2013 of \$2.06 per diluted share, excluding the 2013 adjusted items, represented an increase of 17.0% over adjusted net earnings of \$1.76 per diluted share for the first three quarters of 2012, excluding the 2012 adjusted items. Adjusted net earnings per diluted share increased in the first three quarters of 2013, compared to the first three quarters of 2012, due to increased net earnings and the repurchase of common shares over the past two years resulting in a lower weighted average number of shares outstanding.

Management believes adjusted net earnings (and adjusted net earnings per diluted share) are useful metrics to investors and analysts because they more accurately reflect our day-to-day business operations than do the generally accepted accounting principle ( GAAP ) measures of net earnings and net earnings per diluted share. Adjusted net earnings (and adjusted net earnings per diluted share) are non-generally accepted accounting principle ( non-GAAP ) financial measures and should not be considered alternatives to net earnings (and net earnings per diluted

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share) or any other GAAP measure of performance. Adjusted net earnings (and adjusted net earnings per diluted share) should not be reviewed in isolation or considered substitutes for our financial results as reported in accordance with GAAP. Management uses adjusted net earnings (and adjusted net earnings per diluted share) in evaluating our results of operations as it believes these measures are more meaningful indicators of operating performance since, as adjusted, those earnings relate more directly to our day-to-day operations. Management also uses adjusted earnings (and adjusted net earnings per diluted share) as a performance metric for management incentive programs, and to measure our progress against internal budgets and targets.

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The following table provides a reconciliation of net earnings attributable to The Kroger Co. to net earnings attributable to The Kroger Co. excluding the adjusted items and a reconciliation of net earnings attributable to The Kroger Co. per diluted common share to net earnings attributable to The Kroger Co. per diluted common share excluding the adjusted items, for the third quarters and first three quarters of 2013 and 2012:

|                                                                                                         | Third Quarter Ended |                     | Three Quarters Ended |                     |
|---------------------------------------------------------------------------------------------------------|---------------------|---------------------|----------------------|---------------------|
|                                                                                                         | November 9,<br>2013 | November 3,<br>2012 | November 9,<br>2013  | November 3,<br>2012 |
| Net earnings attributable to The Kroger Co.                                                             | \$ 299              | \$ 317              | \$ 1,097             | \$ 1,035            |
| Benefit from certain tax items offset by Harris                                                         |                     |                     |                      |                     |
| Teeter merger expenses(1)                                                                               | (23)                |                     | (14)                 |                     |
| Adjustments for the UFCW consolidated pension plan liability and credit card settlement(1)(2)           |                     | (74)                |                      | (74)                |
| Net earnings attributable to The Kroger Co. excluding the adjusted items above                          | \$ 276              | \$ 243              | \$ 1,083             | \$ 961              |
| Net earnings attributable to The Kroger Co. per diluted common share                                    | \$ 0.57             | \$ 0.60             | \$ 2.09              | \$ 1.89             |
| Benefit from certain tax items offset by Harris                                                         |                     |                     |                      |                     |
| Teeter merger expenses(3)                                                                               | (0.04)              |                     | (0.03)               |                     |
| Adjustments for the UFCW consolidated pension plan liability and credit card settlement(3)              |                     | (0.14)              |                      | (0.13)              |
| Net earnings attributable to The Kroger Co. per diluted common share excluding the adjusted items above | \$ 0.53             | \$ 0.46             | \$ 2.06              | \$ 1.76             |
| Average number of common shares used in diluted calculation                                             | 521                 | 522                 | 521                  | 543                 |

(1) The amounts presented represent the after-tax effect of each adjustment.

(2) The pre-tax adjustments for the UFCW consolidated pension plan liability and credit card settlement were \$115.

(3) The amounts presented represent the net earnings per diluted common share effect of each adjustment.

## Sales

### Total Sales

(in millions)

| Third Quarter Ended |                                      |                     |                           | Three Quarters Ended |                        |                     |                           |
|---------------------|--------------------------------------|---------------------|---------------------------|----------------------|------------------------|---------------------|---------------------------|
| November 9,<br>2013 | Percentage<br>Increase<br>(Decrease) | November 3,<br>2012 | Percentage<br>Increase(2) | November 9,<br>2013  | Percentage<br>Increase | November 3,<br>2012 | Percentage<br>Increase(3) |

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|                         |    |        |        |    |        |       |    |        |       |
|-------------------------|----|--------|--------|----|--------|-------|----|--------|-------|
| Total supermarket sales |    |        |        |    |        |       |    |        |       |
| without fuel            | \$ | 17,474 | 4.5%   | \$ | 16,716 | 3.6%  | \$ | 58,249 | 3.9%  |
| Fuel sales              |    | 4,404  | (2.6)% |    | 4,520  | 15.2% |    | 14,936 | 2.0%  |
| Other sales(1)          |    | 627    | 9.8%   |    | 571    | 6.3%  |    | 2,085  | 10.4% |
|                         |    |        |        |    |        |       |    | 1,889  | 5.3%  |
| Total sales             | \$ | 22,505 | 3.2%   | \$ | 21,807 | 5.9%  | \$ | 75,270 | 3.7%  |
|                         |    |        |        |    |        |       |    | 72,598 | 5.3%  |

(1) Other sales primarily relate to sales by 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 third quarter of 2012, compared to the third quarter of 2011.

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

The increase in total sales for the third quarter of 2013, compared to the third quarter of 2012, was primarily the result of our identical supermarket sales increase, excluding fuel, of 3.5% and a shift in the calendar, offset partially by a decrease in fuel sales of 2.6%. Identical supermarket sales, excluding fuel for the third quarter of 2013, compared to the third quarter of 2012, increased primarily due to an increase in the number of households shopping with us, an increase in the average sale per customer and product cost inflation. Total fuel sales decreased 2.6% in the third quarter of 2013, compared to the third quarter of 2012, due to a decrease in the average retail fuel price of 8.3%, offset partially by an increase in fuel gallons sold of 6.3%.

The increase in total sales for the first three quarters of 2013, compared to the same period of 2012, was primarily the result of our identical supermarket sales increase, excluding fuel, of 3.4% and an increase of fuel sales of 2.0%. Identical supermarket sales, excluding fuel for the first three quarters of 2013, compared to the first three quarters of 2012, increased primarily due to an increase in the number of households shopping with us, an increase in the average sale per customer and product cost inflation. Fuel sales increased 2.0% in the first three quarters of 2013, compared to the same period of 2012, due to an increase in fuel gallons sold of 5.4%, partially offset by a decrease in the average retail fuel price of 3.2%.

We define a supermarket as identical when it has been in operation without expansion or relocation for five full quarters. Although identical supermarket sales is a relatively standard term, numerous methods exist for calculating identical supermarket sales growth. As a result, the method used by our management to calculate identical supermarket sales may differ from methods other companies use to calculate identical supermarket sales. We urge you to understand the methods used by other companies to calculate identical supermarket sales before comparing our identical supermarket sales to those of other such companies. 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 third quarter and the first three quarters of 2013.

#### Identical Supermarket Sales

(\$ in millions)

|                        | Third Quarter       |                        |                     |                           |
|------------------------|---------------------|------------------------|---------------------|---------------------------|
|                        | November 9,<br>2013 | Percentage<br>Increase | November 3,<br>2012 | Percentage<br>Increase(1) |
| Including fuel centers | \$ 20,211           | 2.5%                   | \$ 19,714           | 5.2%                      |
| Excluding fuel centers | \$ 16,866           | 3.5%                   | \$ 16,294           | 3.2%                      |

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

#### Identical Supermarket Sales

(\$ in millions)

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|                        | November 9,<br>2013 | Three Quarters Ended<br>Percentage<br>Increase | November 3,<br>2012 | Percentage<br>Increase(1) |
|------------------------|---------------------|------------------------------------------------|---------------------|---------------------------|
| Including fuel centers | \$ 67,443           | 3.1%                                           | \$ 65,422           | 4.8%                      |
| Excluding fuel centers | \$ 56,125           | 3.4%                                           | \$ 54,304           | 3.7%                      |

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

*Gross Margin and FIFO Gross Margin*

Our gross margin rate was 20.51% for the third quarter of 2013, as compared to 20.29% for the third quarter of 2012. Our gross margin rate was 20.51% for the first three quarters of 2013, as compared to 20.44% for the first three quarters of 2012. The increase in the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from a decrease in fuel sales and an increase in the average margin per gallon of fuel sold, offset partially by continued investments in lower prices for our customers and increased shrink as a percentage of sales. The increase in the first three quarters of 2013, compared to the first three quarters of 2012, resulted primarily from an increase in the average margin per gallon of fuel sold, offset partially by continued investments in lower prices for our customers and increased shrink as a percentage of sales. A decrease in retail fuel sales increases our gross margin rate due to the very low gross margin on retail fuel sales as compared to non-fuel sales.

We calculate FIFO gross margin as sales minus merchandise costs, including advertising, warehousing, and transportation expenses, but excluding the LIFO charge. Our LIFO charge was \$13 million for the third quarter of 2013 and \$15 million for the third quarter of 2012, as discussed below. Our LIFO charge was \$42 million for the first three quarters of 2013 and \$96 million for the first three quarters of 2012. FIFO gross margin is a non-generally accepted accounting principle ( non-GAAP ) financial measure and should not be considered as an alternative to gross margin or any other generally accepted accounting principle ( 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 20.57% for the third quarter of 2013, as compared to 20.35% for the third quarter of 2012. Retail fuel sales lower our FIFO gross margin rate due to the very low FIFO gross margin on retail fuel sales as compared to non-fuel sales. Excluding the effect of retail fuel operations, our third quarter 2013 FIFO gross margin rate decreased 25 basis points, as a percentage of sales, compared to the third quarter of 2012. This decrease in the third quarter of 2013, compared to the third quarter of 2012, was primarily from continued investments in lower prices for our customers and increased shrink as a percentage of sales.

Our FIFO gross margin rate was 20.57% for the first three quarters of 2013, as compared to 20.58% for the first three quarters of 2012. Excluding the effect of retail fuel operations, as a percentage of sales, our FIFO gross margin rate decreased 17 basis points for the first three quarters of 2013, compared to the first three quarters of 2012. This decrease in the first three quarters of 2013, compared to the first three quarters of 2012, resulted primarily from continued investments in lower prices for our customers and increased shrink as a percentage of sales.

#### *LIFO Charge*

The LIFO charge was \$13 million in the third quarter of 2013 and \$15 million in the third quarter of 2012. The LIFO charge decreased in the third quarter of 2013, compared to the third quarter of 2012, due to our lower expected year-end product cost inflation in most major categories at the end of the third quarter of 2013 compared to the end of the third quarter of 2012.

The LIFO charge was \$42 million in the first three quarters of 2013 and \$96 million in the first three quarters of 2012. The LIFO charge decreased in the first three quarters of 2013, compared to the first three quarters of 2012, primarily due to our lower expected year-end product cost inflation in most major categories at the end of third quarter of 2013 compared to the end of third quarter of 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, increased 61 basis points to 15.77% for the third quarter of 2013 from 15.16% for the third quarter of 2012. The OG&A rate increased primarily due to the decrease in fuel sales, offset partially by the benefit of increased supermarket sales, effective cost controls and productivity improvements. A decrease in retail fuel sales increases our OG&A rate due to the very low OG&A rate,

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as a percentage of sales, of retail fuel sales compared to non-fuel sales. OG&A expenses were affected in the third quarter of 2013 by Harris Teeter merger expenses ( OG&A Merger Expenses ). The OG&A rate, excluding the OG&A Merger Expenses, increased eight basis points to 15.77% for the third quarter of 2013, from 15.69% for the third quarter of 2012, excluding the 2012 adjusted items. Adjusted OG&A expenses, as a percentage of sales, excluding OG&A Merger Expenses and fuel, decreased 19 basis points in the third quarter of 2013, compared to the third quarter of 2012, excluding the 2012 adjusted items. This decrease in our adjusted OG&A rate, as a percentage of sales excluding the effect of fuel, resulted primarily from increased supermarket sales, effective cost controls and productivity improvements.

OG&A expenses, as a percentage of sales, increased 13 basis points to 15.50% for the first three quarters of 2013 from 15.37% for the first three quarters of 2012. Adjusted OG&A expense, as a percentage of sales, decreased four basis points to 15.49% for the first three quarters of 2013, excluding the OG&A Merger Expenses, from 15.53% for the first three quarters of 2012, excluding the 2012 adjusted items. The reduction in adjusted OG&A rate resulted primarily from increased supermarket sales, effective cost controls and productivity improvements. Adjusted OG&A expenses, as a percentage of sales excluding fuel, decreased 15 basis points in the first three quarters of 2013 compared to the first three quarters of 2012. This decrease in our adjusted OG&A rate, as a percentage of sales excluding the effect of fuel, resulted primarily from increased supermarket sales, effective cost controls and productivity improvements.

#### *Rent Expense*

Rent expense was \$138 million, or 0.61% of sales, for the third quarter of 2013, compared to \$141 million, or 0.64% of sales, for the third quarter of 2012. For the first three quarters of 2013, rent expense was \$466 million, or 0.62% of sales, compared to \$471 million, or 0.65% of sales, in the first three quarters of 2012. Rent expense, as a percentage of sales excluding fuel, decreased five basis points in the third quarter of 2013 compared to the third quarter of 2012. Rent expense, as a percentage of sales excluding fuel, decreased 4 basis points in the first three quarters of 2013 compared to the first three quarters of 2012. These decreases in rent expense, as a percentage of sales both including and excluding fuel, primarily reflect our continued emphasis on owning rather than leasing, whenever possible, and the benefit of increased supermarket sales.

#### *Depreciation Expense*

Depreciation expense was \$395 million, or 1.75% of total sales, for the third quarter of 2013 compared to \$382 million, or 1.75% of total sales, for the third quarter of 2012. The increase in depreciation expense, in total dollars, was the result of additional depreciation on capital investments, including acquisitions and lease buyouts of \$2.5 billion, during the rolling four quarter period ending with the third quarter of 2013. Excluding the effect of retail fuel operations, depreciation, as a percentage of sales, decreased three basis points in the third quarter of 2013, compared to the same period of 2012.

Depreciation expense was \$1.3 billion, or 1.73% of total sales, for the first three quarters of 2013 compared to \$1.3 billion or 1.74% of total sales, for the first three quarters of 2012. The decrease in depreciation expense for the first three quarters of 2013, compared to the first three quarters of 2012, as a percentage of sales, was primarily due to the benefit of increased supermarket sales. Excluding the effect of retail fuel operations, depreciation, as a percentage of sales, decreased three basis points in the first three quarters of 2013, compared to the same period of 2012.

#### *Operating Profit and FIFO Operating Profit*

Operating profit was \$534 million, or 2.37% of sales, for the third quarter of 2013, compared to \$596 million, or 2.73% of sales, for the third quarter of 2012. Operating profit, as a percentage of sales, decreased 36 basis points in the third quarter of 2013, compared to the third quarter of 2012, primarily due to the 2012 adjusted items, continued investments in lower prices for our customers and increased shrink, as a percentage of sales, offset partially by increased supermarket identical sales, improvements in non-fuel operating, general and administrative expenses, rent and depreciation, as a percentage of sales, and an increase in fuel operating profit. Operating profit was \$2.0 billion, or 2.67% of sales, for the first three quarters of 2013, compared to \$1.9 billion, or 2.68% of sales, for the first three quarters of 2012. Operating profit, as a percentage of sales, decreased one basis point in the first three quarters of 2013, compared to the first three quarters of 2012, primarily due to the 2012 adjusted items, continued investments in lower prices for our customers and increased shrink, as a percentage of sales, offset partially by

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increased supermarket identical sales, improvements in non-fuel operating, general and administrative expenses, rent and depreciation, as a percentage of sales, a decrease in the LIFO charge and an increase in fuel operating profit.

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 merchandising and 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 non-fuel supermarket 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.

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FIFO operating profit was \$547 million, or 2.43% of sales, for the third quarter of 2013, compared to \$611 million, or 2.80% of sales, for the third 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. Adjusted FIFO operating profit, excluding fuel, was \$457 million or 2.52% of sales, for the third quarter of 2013, excluding the Third Quarter 2013 non-tax adjusted items, compared to \$432 million, or 2.50% of sales, for the third quarter of 2012, excluding the 2012 adjusted items. Adjusted FIFO operating profit, as a percentage of sales excluding fuel, increased two basis points in the third quarter of 2013, compared to the third quarter of 2012 primarily due to improvements in operating, general and administrative expenses, rent and depreciation, as a percentage of sales, offset partially by continued investments in lower prices for our customers and increased shrink as a percentage of sales.

FIFO operating profit was \$2.0 billion, or 2.72% of sales, for the first three quarters of 2013, compared to \$2.0 billion, or 2.81% of sales, for the first three quarters of 2012. Adjusted FIFO operating profit, excluding fuel, was \$1.9 billion, or 3.07% of sales, for the first three quarters of 2013, excluding the 2013 non-tax adjusted items, compared to \$1.7 billion, or 3.01% of sales, for the first three quarters of 2012, excluding the 2012 adjusted items. Adjusted FIFO operating profit, as a percentage of sales excluding fuel, increased six basis points in the first three quarters of 2013, compared to the first three quarters of 2012, primarily due to improvements in operating, general and administrative expenses, rent and depreciation, as a percentage of sales, offset by continued investments in lower prices for our customers and increased shrink as a percentage of sales.

The following table provides a reconciliation of operating profit to FIFO operating profit, FIFO operating profit, excluding fuel, and FIFO operating profit, excluding fuel and the non-tax adjusted items, for the third quarters and first three quarters of 2013 and 2012:

|                                                         | Third Quarter Ended<br>2013 |                        |                     |                        | Three Quarters Ended<br>2013 |                        |                     |                        |
|---------------------------------------------------------|-----------------------------|------------------------|---------------------|------------------------|------------------------------|------------------------|---------------------|------------------------|
|                                                         | November 9,<br>2013         | Percentage<br>of Sales | November 3,<br>2012 | Percentage<br>of Sales | November 9,<br>2013          | Percentage<br>of Sales | November 3,<br>2012 | Percentage<br>of Sales |
| Sales                                                   | \$ 22,505                   |                        | \$ 21,807           |                        | \$ 75,270                    |                        | \$ 72,598           |                        |
| Fuel sales                                              | 4,404                       |                        | 4,520               |                        | 14,936                       |                        | 14,643              |                        |
| Sales excluding fuel                                    | \$ 18,101                   |                        | \$ 17,287           |                        | \$ 60,334                    |                        | \$ 57,955           |                        |
| Operating profit                                        | \$ 534                      | 2.37%                  | \$ 596              | 2.73%                  | \$ 2,007                     | 2.67%                  | \$ 1,944            | 2.68%                  |
| LIFO charge                                             | 13                          | 0.06%                  | 15                  | 0.07%                  | 42                           | 0.06%                  | 96                  | 0.13%                  |
| FIFO operating profit                                   | 547                         | 2.43%                  | 611                 | 2.80%                  | 2,049                        | 2.72%                  | 2,040               | 2.81%                  |
| Fuel operating profit                                   | 92                          | 2.09%                  | 64                  | 1.42%                  | 203                          | 1.36%                  | 179                 | 1.22%                  |
| FIFO operating profit excluding fuel                    | 455                         | 2.51%                  | 547                 | 3.16%                  | 1,846                        | 3.06%                  | 1,861               | 3.21%                  |
| Non-tax Adjusted items                                  | 2                           |                        | 115                 |                        | 4                            |                        | 115                 |                        |
| FIFO operating profit excluding fuel and adjusted items | \$ 457                      | 2.52%                  | \$ 432              | 2.50%                  | \$ 1,850                     | 3.07%                  | \$ 1,746            | 3.01%                  |

Percentages may not sum due to rounding.

*Interest Expense*

Net interest expense was \$108 million, or 0.48% of total sales, in the third quarter of 2013 and \$103 million, or 0.47% of total sales, in the third quarter of 2012. For the first three quarters of 2013, net interest expense was \$336 million, or 0.45% of total sales, in 2013 and \$350 million, or 0.48% of total sales, in the first three quarters of 2012. The increase in net interest expense for the third quarter of 2013, compared to the third quarter of 2012, resulted primarily from a reduced benefit from interest rate swaps, expenses related to our pending merger with Harris Teeter and a higher weighted average interest rate, offset partially by a decrease in net total debt. The decrease in net interest expense for the first three quarters of 2013, when compared to the same period of 2012, resulted primarily from a decrease in net total debt, offset partially by a reduced benefit from interest rate swaps and expenses related to our pending merger with Harris Teeter.

*Income Taxes*

The effective income tax rate was 29.3% for the third quarter of 2013 and 35.5% for the third quarter of 2012. The effective income tax rate was 33.9% and 34.8% for the first three quarters of 2013 and 2012, respectively. The effective income tax rates for the third quarter and first three quarters of 2013 differed from the federal statutory rate primarily due to the benefit of certain tax items, offset partially by the effect of state income taxes. The effective tax rate for the third quarter of 2012 approximates the federal statutory rate. The effective income tax rate for the first three quarters of 2012 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.

On September 13, 2013, the U.S. Department of the Treasury and Internal Revenue Service released final tangible property regulations that provide guidance on the tax treatment regarding the deduction and capitalization of expenditures related to tangible property. The effective date to implement these regulations is for tax years beginning on or after January 1, 2014. We are currently assessing these rules and the effect on our financial statements, and we believe the adoption of these regulations will not have an effect on net income and will not have a material effect -on the reclassification between long-term deferred tax liabilities and current income tax liabilities.

**LIQUIDITY AND CAPITAL RESOURCES**

*Cash Flow Information*

Net cash provided by operating activities

We generated \$2.9 billion of cash from operating activities during the first three quarters of 2013, compared to \$2.3 billion in the first three quarters 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 \$372 million in the first three quarters of 2013, compared to a use of cash from working capital of \$270 million in the first three quarters of 2012. The increase in cash provided by changes in working capital for the first three quarters of 2013, compared to the first three quarters of 2012, was primarily due to a decrease in store deposits in-transit and prepaid expenses. Prepaid expenses decreased \$250 million from year-end 2012 in the first three quarters of 2013, reflecting a decrease in the prepayment balance of some employee benefits at year end.

Net cash used by investing activities

We used \$1.8 billion of cash for investing activities during the first three quarters of 2013 compared to \$1.5 billion during the first three quarters of 2012. The amount of cash used for investing activities increased in the first three quarters of 2013 versus 2012, primarily due to increased payments for capital investments.

Net cash used by financing activities

We used \$993 million of cash for financing activities in the first three quarters of 2013 compared to \$533 million in the first three quarters of 2012. The increase in the amount of cash used for financing activities for the first three quarters of 2013, compared to the first three quarters of 2012, was primarily related to the increase in net payments on commercial paper, partially offset by a reduction in treasury stock purchases and payments on long-term debt and an increase in proceeds from the issuance of long-term debt. Proceeds from the issuance of common shares resulted from exercises of employee stock options.

#### *Debt Management*

As of November 9, 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 November 9, 2013, we had no borrowings under our credit agreement or money market lines. As of November 9, 2013, we had \$425 million of outstanding commercial paper. The outstanding letters of credit that reduce funds available under our credit agreement totaled \$13 million as of November 9, 2013.

Our bank credit facility and the indentures underlying our publicly issued debt contain various restrictive covenants. As of November 9, 2013, we were in compliance with these financial covenants. Furthermore, management believes it is not reasonably likely that Kroger 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 \$589 million to \$8.3 billion as of the end of the third quarter of 2013, from \$8.9 billion as of the end of the third quarter of 2012. Total debt decreased \$609 million as of the end of the third quarter of 2013, from \$8.9 billion as of year-end 2012. The decrease as of the end of the third quarter of 2013, compared to the end of the third quarter of 2012, resulted primarily from the reduction in borrowings under the credit facility and outstanding commercial paper in the last four quarters of \$689 million. The decrease as of the end of the third quarter of 2013, compared to year-end 2012, resulted primarily from the reduction in commercial paper of \$1.2 billion and the payment of \$400 million of senior notes bearing an interest rate of 5.0%, partially offset by the issuance of \$600 million of senior notes bearing an interest rate of 3.85% and \$400 million of senior notes bearing an interest rate of 5.15% in July of 2013 ( July debt issuance ). The proceeds from the July debt issuance were primarily used for the payment of \$400 million of senior notes bearing an interest rate of 5.0% and payment on a portion of the outstanding commercial paper in the first three quarters of 2013. Additional payments on outstanding commercial paper were made using cash flow partially due to an increase in net cash provided by operating activities and not repurchasing as many common shares in the first three quarters of 2013, as we did in the first three quarters of 2012. Long-term debt for the first three quarters of 2013, compared to year-end 2012, increased by \$1 billion due to the July debt issuance. The current portion of long term debt for the first three quarters of 2013, compared to year-end 2012, decreased due to the reduction in commercial paper of \$1.2 billion and the payment of \$400 million of senior notes bearing an interest rate of 5.0%.

Over the next 12 months, we anticipate refinancing approximately \$600 million of debt maturing in the fourth quarter of fiscal year 2013, excluding any financing related to the pending Harris Teeter merger. 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.

#### *Common Share Repurchase Program*

During the third quarter of 2013, we invested \$148 million to repurchase 3.6 million Kroger common shares at an average price of \$41.25 per share. For the first three quarters of 2013, we invested \$384 million to repurchase 10.4 million Kroger common shares at an average price of \$36.78 per share. These shares were reacquired under two separate share 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 \$3.8 billion, excluding the potential merger with Harris Teeter Supermarkets, Inc. The estimated liquidity needs over the next twelve months of \$3.8 billion includes anticipated requirements for working capital, capital investments, interest payments and scheduled principal payments of debt, offset by cash and temporary cash investments on hand at the end of the third 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 \$600 million of debt maturing in the next twelve months, which is included in the \$3.8 billion in estimated liquidity needs. Based on the current market environment, we expect to refinance this debt on favorable terms. 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.

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During the second quarter of 2013, we entered into a bridge loan facility to provide additional funds, if necessary, for our merger with Harris Teeter Supermarkets, Inc. We expect to fund the merger through a combination of cash on hand and the issuance of short-term and long-term debt.

## CAPITAL INVESTMENTS

Capital investments, excluding the purchase of leased facilities, totaled \$641 million for the third quarter of 2013 compared to \$474 million for the third quarter of 2012. Capital investments, excluding acquisitions and the purchase of leased facilities, totaled \$1.8 billion in the first three quarters of 2013 and \$1.5 billion in the first three quarters of 2012. During the third quarter of 2013, capital investments for the purchase of leased facilities totaled \$89 million compared to \$6 million for the third quarter of 2012. During the first three quarters of 2013, capital expenditures for the purchase of leased facilities totaled \$108 million compared to \$24 million for the first three quarters of 2012. During the third quarter of 2013, we opened, acquired, expanded or relocated 13 food stores and also completed 71 minor and major within-the-wall remodels. During the first three quarters of 2013, we opened, acquired, expanded or relocated 32 food stores and also completed 132 minor and major within-the-wall remodels. Total food store square footage at the end of the third quarter of 2013 increased 0.4% from the end of the third quarter of 2012. Excluding acquisitions and operational closings, total food store square footage at the end of the third quarter of 2013 increased 1.3% over the end of the third 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 calculation of ROIC for the rolling four quarters on a 52 week basis ended November 9, 2013 and November 3, 2012 (\$ in millions):

|                                                                                         | Rolling Four Quarters Ended |                  |
|-----------------------------------------------------------------------------------------|-----------------------------|------------------|
|                                                                                         | November 9, 2013            | November 3, 2012 |
| Return on Invested Capital                                                              |                             |                  |
| Numerator                                                                               |                             |                  |
| Operating profit                                                                        | \$ 2,826                    | \$ 1,518         |
| 53rd week operating profit adjustment                                                   | (99)                        |                  |
| LIFO charge                                                                             | 1                           | 170              |
| Depreciation                                                                            | 1,687                       | 1,658            |
| Rent                                                                                    | 623                         | 614              |
| 53rd week rent adjustment                                                               | (12)                        |                  |
| UFCW pension plan consolidation charge                                                  |                             | 953              |
| Adjustments for the UFCW consolidated pension plan liability and credit card settlement |                             | (115)            |
| Other                                                                                   | 4                           |                  |
| Adjusted operating profit                                                               | \$ 5,030                    | \$ 4,798         |
| Denominator                                                                             |                             |                  |
| Average total assets                                                                    | \$ 25,057                   | \$ 24,286        |
| Average taxes receivable(1)                                                             |                             | (26)             |
| Average LIFO reserve                                                                    | 1,140                       | 1,054            |
| Average accumulated depreciation(2)                                                     | 14,812                      | 13,852           |
| Average trade accounts payable                                                          | (4,862)                     | (4,693)          |
| Average accrued salaries and wages                                                      | (998)                       | (977)            |
| Average other current liabilities(3)                                                    | (2,567)                     | (2,436)          |
| Rent x 8                                                                                | 4,888                       | 4,912            |
| Average invested capital                                                                | \$ 37,470                   | \$ 35,972        |
| Return on Invested Capital                                                              | 13.42%                      | 13.34%           |

(1) As of November 9, 2013, November 3, 2012 and November 5, 2011, taxes receivable were \$0, \$0 and \$53, respectively.

(2) As of November 9, 2013, November 3, 2012 and November 5, 2011, accumulated depreciation was \$15,310, \$14,314 and \$13,390, respectively.

(3) As of November 9, 2013, November 3, 2012 and November 5, 2011, other current liabilities included accrued income taxes of \$136, \$77 and \$0, 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 11 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 9 to the Company's Consolidated Financial Statements for the Company's new disclosures related to this amended standard.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2013, the FASB amended Accounting Standards Codification ( ASC ) 740, Income Taxes. . The amendments provide guidance on the financial statement presentation of an unrecognized tax benefit, as either a reduction of a deferred tax asset or as a liability, when a net operating loss carryforward, similar tax loss, or a tax credit carryforward exists. The amendments will be effective for interim and annual periods beginning after December 15, 2013 and may be applied on a retrospective basis. Early adoption is permitted. We do not expect the adoption of these amendments to have a significant effect on our consolidated financial position or results of operations.



## OUTLOOK

This discussion and analysis contains certain forward-looking statements about Kroger's future performance, excluding the potential merger with Harris Teeter Supermarkets, Inc. These statements are based on management's assumptions and beliefs in light of the information currently available. Such statements are indicated by words such as comfortable, committed, will, expect, goal, should, intend, target, believe, 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 fiscal year 2013, excluding certain tax items and the effect of the pending Harris Teeter merger.
- Looking forward to 2014, we expect net earnings per diluted share growth of 8 - 11%, excluding the effect of the pending Harris Teeter merger and tax items, which is consistent with our long-term growth strategy.
- We expect identical supermarket sales growth, excluding fuel sales, of 3.0%-3.5% for the fourth quarter of 2013.
- We expect FIFO non-fuel operating margin for 2013 to expand slightly compared to 2012, excluding the 53rd week in fiscal 2012 and the 2012 and 2013 adjusted items.
- For 2013, we expect our annualized LIFO charge to be approximately \$55 million.
- 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.
- We expect to obtain sales growth from new square footage, as well as from increased productivity from existing locations.

- We expect capital investments for 2013 to increase to approximately \$2.4 billion, excluding mergers, acquisitions and purchases of leased facilities. We also expect capital investments to increase incrementally \$200 million each year over the next few years, excluding mergers, 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 mergers, acquisitions and operational closings.
- We expect that our effective tax rate for the fourth quarter of 2013 will be approximately 35.5%, excluding the effect of the resolution of any tax issues and benefits from certain tax items.
- We do not anticipate goodwill impairments in 2013.

Various uncertainties and other factors could cause actual results to differ materially from those contained in the forward-looking statements. These include the specific risk factors identified in the Annual Report on Form 10-K for the fiscal year ended February 2, 2013 and any subsequent filings, as well as the following:

- 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.

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- Our ability to use cash flow to continue to maintain our investment grade debt rating and repurchase shares, pay dividends and fund capital investments, could be affected by unanticipated increases in net total debt, our inability to generate cash flow at the levels anticipated, and our failure to generate expected earnings.
- 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; natural disasters or adverse weather conditions; 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.
- 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.
- 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.
- 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.
- 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.

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 during the remainder of 2013.

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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. We undertake no obligation to update the forward-looking information contained in this filing.

**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 November 9, 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 November 9, 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> |
|----------------------------------------|-----------------------------------------|-------------------------------------|--------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| <b>First four weeks</b>                |                                         |                                     |                                                                                            |                                                                                                              |
| August 18, 2013 to September 14, 2013  | 157,300                                 | \$ 37.65                            | 157,300                                                                                    | \$ 446                                                                                                       |
| <b>Second four weeks</b>               |                                         |                                     |                                                                                            |                                                                                                              |
| September 15, 2013 to October 12, 2013 | 1,639,827                               | \$ 40.47                            | 1,639,827                                                                                  | \$ 446                                                                                                       |
| <b>Third four weeks</b>                |                                         |                                     |                                                                                            |                                                                                                              |
| October 13, 2013 to November 9, 2013   | 1,805,776                               | \$ 42.24                            | 1,805,776                                                                                  | \$ 405                                                                                                       |
| <b>Total</b>                           | <b>3,602,903</b>                        | <b>\$ 41.23</b>                     | <b>3,602,903</b>                                                                           | <b>\$ 341</b>                                                                                                |

(1) The reported periods conform to the Company's fiscal calendar composed of thirteen 28-day periods. The third quarter of 2013 contained three 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: December 13, 2013

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

Dated: December 13, 2013

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

**Exhibit Index**

|                   |                                                                                                                                                                                                                                                                                                                            |
|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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, filed with the SEC on June 28, 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, filed with the SEC on July 3, 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.                                                                                                                                                                                                                                                                    |