



Notice of 2018 Annual Meeting of Shareholders  
2018 Proxy Statement  
and  
2017 Annual Report



# Family of Companies

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## Supermarkets




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## Price-Impact Stores



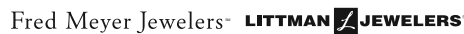

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## Multi-Department Stores




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## Jewelry Stores




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## Specialty Retailers




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## Services



Fellow Shareholders:

FOOD IS MORE EXCITING than ever before. A majority of Americans identify as “foodies.” Customers have a virtually-unlimited number of options when you combine all the tastes, flavors and types of meals available today. And more shoppers plan to purchase food online this year than ever before.

Kroger’s vision is to serve America through food inspiration and uplift. We are uniquely positioned to be the partner our customers turn to for their needs because meals have been our expertise for 135 years and – every day since day one – we place the customer at the center of everything we do.

Every day, we serve more than nine million customers who walk through our doors, savor (and save with!) their favorite *Our Brands* products, search Kroger.com for recipes or digital savings, pick up their ClickList order or receive a home delivery. We have the scale, data, physical assets and human connection to win with our customers today and into the future. We are energetically creating a seamless digital experience for our customers and providing personalized inspiration to help America decide what’s for dinner. As we pursue our *Restock Kroger* plan, Kroger will change the way America eats.

Reflecting on 2017, there was much to celebrate. Kroger’s total sales reached \$122.7 billion. We grew digital sales by more than 90%, expanded ClickList to more than 1,000 locations, and now offer a seamless experience to more than two-thirds of our 60 million customers. We gained market share for the 13<sup>th</sup> consecutive year. Kroger’s Board of Directors raised the quarterly dividend for the 11<sup>th</sup> consecutive year. Our quarterly dividend has grown at a compound annual growth rate of 13.0% since we reinstated the dividend in 2006. We achieved \$17 billion in natural and organic sales, including \$2 billion in Simple Truth<sup>®</sup> sales. We created more than 10,000 new American jobs in our supermarkets across the country, demonstrating the essential role our industry plays in generating economic activity and opportunity in our communities. And we launched Zero Hunger | Zero Waste, our ambitious commitment to end hunger in the places we call home and eliminate waste across our business by 2025.

At our investor conference in October, we discussed the need for retail companies to constantly reinvent themselves to remain relevant. Kroger is right in the middle of such a reinvention. We are proactively addressing customer changes and we’re making strategic investments to create the future of retail: a seamless digital experience, customer-centric technology solutions, an enhanced associate experience, space-optimized stores and smart-priced products.

These efforts came together in the four drivers of *Restock Kroger: Redefine the Grocery Customer Experience, Partner for Customer Value, Develop Talent* and *Live Our Purpose*. Executing against these four drivers will create meaningful shareholder value. We expect *Restock Kroger* to generate \$6.5 billion of free cash flow before dividends and \$400 million in incremental FIFO operating profit over the next three years. Our long-term strategy and annual business plan are reviewed and approved by Kroger’s engaged Board of Directors.

What’s exciting about *Restock Kroger* are several aggressive plays that we haven’t run before:

**We are redeploying capital to prioritize the digital experience and a seamless shopping experience** for all customers so they can choose how, where and when they want to shop with us.

**We are forming strategic partnerships to grow alternative revenue streams.** For example, last year we launched *Kroger Precision Marketing, powered by 84.51°*, to monetize the media opportunity to reach the more than nine million sets of eyes in our stores and on our digital properties every day.

**We are redoubling our efforts to expand our world-class data and personalization work with 84.51°**, including using data insights to optimize space in our stores for the future.

**We are investing in our associates more than ever before**, starting with a half-billion-dollar investment in wages for many store associates announced as a part of *Restock Kroger*.

The federal Tax Cuts and Jobs Act is an important catalyst as it is enabling us to accelerate these *Restock Kroger* investments. We’re taking a balanced approach to ensure tax reform benefits our shareholders, customers and associates alike. Shareholders will benefit from approximately a third of the tax savings flowing through to net earnings per diluted share. Another third of our tax savings is being re-invested in *Redefining the Grocery Customer Experience* through lower prices, better service and added convenience. The final third is being invested to *Develop Talent* for the long term.

We applaud the many companies who share our enthusiasm for tax reform and announced significant bonuses for employees. At Kroger, we wanted to take a slightly different approach. Instead of a one-time award, we want to create an associate benefit that lasts. So we’ve increased the company’s 401(k) contribution match to help associates retire with more money in their pockets, plus expanded associate discounts to keep more money in their pockets today.

But what I'm most excited about is our offer of up to \$3,500 in annual tuition assistance to any associate who wants to attend classes to build a better future for themselves. Whether they are interested in a GED or undergraduate degree, an MBA or a professional certification, associates can take advantage of up to \$21,000 in total assistance as long as they've been with us for at least six months on a full or even part-time basis.

We're calling Kroger's new industry-leading education benefit **Feed Your Future**. Under the new benefit, we expect to increase by five times Kroger's total annual investment in associate education.

As someone who got his start stocking shelves on the night shift at Kroger in 1978, I can attest to education's life-changing power. I worked my way through college, and upon graduation I was so proud to accept a full-time job with Kroger. I've been here ever since.

Kroger has always been a place where people can 'come for a job and stay for a career.' We believe that making education benefits available to more associates and at more generous levels than ever before is the best way to support their future career growth. These investments support *Restock Kroger*, which means we fully expect a strong return.

All of these efforts are built on the foundation of operational excellence and everyday productivity improvements that have long-defined the Kroger way. We won't leave a penny on the table as we seek to reinvest savings to grow our business. Today more than ever, I am optimistic and confident about Kroger's future. I encourage you to keep up to date on our *Restock Kroger* progress by regularly visiting [ir.kroger.com](http://ir.kroger.com).

**Kroger is also rising to the call from investors, customers and associates alike to live our purpose, To Feed the Human Spirit™.**

Our stakeholders increasingly want to understand and participate in shaping companies' environmental and social sustainability commitments – and they are choosing to support companies with shared values and clarity of purpose.

One of Kroger's differentiating strengths is our physical presence in our communities. We are part of the fabric of the neighborhoods we serve, and 135 years in the grocery business have taught us a few things about people and about food. We know that meals matter. Families that share meals together have children who do better in all aspects of their lives. Throughout our history, Kroger has always provided the food and nourishment people need to live their best lives. Last year, in fact, Kroger donated more than 325 million meals to feed hungry families through our partnership with local *Feeding America* food banks. Yet there is a fundamental absurdity in the U.S. food system – 40% of the food produced here goes to waste, while 1 in 8 Americans struggle with hunger. In fact, 1 in 6 children go hungry every day. That just doesn't make sense.

We must do something about this, and we believe we can address this absurdity – perhaps better than anyone. Kroger has the tremendous scale – the physical assets, the technology, the resources, the people and the passion – combined with the local connection to our communities to tackle this challenge head on. Our plan is called Zero Hunger | Zero Waste and our aim is to end hunger in the communities we call home and eliminate waste across the company by 2025.

We are setting big goals, leveraging The Kroger Co. Foundation and company-wide community investment efforts, and asking our trusted partners to join us on the journey – especially *Feeding America* and the *World Wildlife Fund* – because we can't do it alone. We'll tell our story along the way to inspire and encourage our associates, customers and all of our stakeholders to join us on our 'moonshot' mission to transform Kroger communities and improve the health of millions of Americans by 2025.

This journey is just beginning, and we welcome you to join us, too. You can follow along at [www.thekrogerco.com](http://www.thekrogerco.com) or [#zerohungerzerowaste](https://twitter.com/zerohungerzerowaste).

Kroger has successfully competed in an ever-changing retail landscape throughout our history. We know that our success in the future will depend on our ability to see where the customer is going and to proactively address their changing preferences. *Restock Kroger* is our plan to do just that. We know we can accomplish *Restock Kroger* because it is built on a foundation of our strengths, including:

- Kroger has more data than any of our competitors, which leads to deep customer knowledge and unparalleled personalization. We use this data to improve our customers' experience.
- We have incredibly convenient locations and platforms for pickup and delivery within one-to-two miles of our customers.
- We have a leadership team that combines deep experience with creative new talent.

- We have the scale to win with more than 60 million households shopping with us annually. We're regularly named America's most loved grocery store.
- We have a proven track record of consistently returning capital to shareholders through an increasing dividend and share buyback program.
- And, we have an abiding commitment to uplift and improve the lives of our associates, customers and communities.

Kroger's fundamentals are strong. Associates are inspired by Kroger's purpose and our vision to serve America through food inspiration and uplift. Our *Restock Kroger* plan creates an exciting ecosystem for those who want to develop, test and scale the innovative solutions that will fundamentally redefine the food and grocery customer experience. Enhanced associate benefits like **Feed your Future** will support individual growth and development and help to retain great talent who will in turn serve our customers. All of this will allow us to deliver for our shareholders, not only through selling groceries but through alternate sources of revenue as well.

We believe this is cause for optimism and we continue to believe our best days are ahead of us.

\* \* \*

For our associates: Thank you for what you do every day, for our customers and each other.

For our shareholders and other stakeholders: On behalf of all of us, thank you for your continued confidence in Kroger.

Sincerely,



Rodney McMullen  
Chairman and CEO

#### *Kroger Safe Harbor Statement*

*This letter contains "forward-looking statements" within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995 about future performance of Kroger, including with respect to Kroger's ability to achieve short- and long-term sales and earnings goals, sustainable long-term shareholder value, ability to execute on our growth strategy and business plan, ability to execute on Restock Kroger, ability to increase dividends, ability to grow market share, and ability to develop new brands and implement new technologies, among other statements. These statements are based on management's assumptions and beliefs in light of the information currently available to it. These statements are indicated by words such as "expect," "believe," "plan," "goal," "mission," "vision," "aim," "will," "seek," and "continue." These statements are subject to known and unknown risks, uncertainties and other important factors that could cause actual results and outcomes to differ materially from those contained in the forward-looking statements. These include the specific risk factors identified in "Risk Factors" and "Outlook" in Kroger's Annual Report on Form 10-K and any subsequent filings with the Securities and Exchange Commission.*

## 2017 Zero Hunger | Zero Waste Champion Award

Congratulations to The Kroger Co. Zero Hunger | Zero Waste Champions for 2017:

<u>Division</u>	<u>Recipient</u>
Atlanta	Store #670
Central	Michael Pastirik
Cincinnati	Danny Baker
Columbus	Sandra Dargahi
Dallas	Patricia Grafton
Delta	Store #478
Dillon Stores	Kenya Walker
Food 4 Less	Rita Yamada
Fred Meyer	Donna King
Fry's	Gwen Wood
Houston	Aaron Calvert
King Soopers/City Market	Tony Romero
Louisville	John Gatton
Mariano's	Amanda Puck
Michigan	Christine Ferland
Mid-Atlantic	Jeanie Tolbert
Nashville	Elizabeth Farar
QFC	James Subocz
Ralphs	Nikki Sims-Allen
Roundy's	Heidi Abegglen
Ruler	Julius Thomas
Smith's	Store #183
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Anderson Bakery	John Haymond
Winchester Farms Dairy	Darrell Lacy
Westover Dairy	Keith Wendland
Kroger Mountain View Foods	Phung Le
Pontiac Foods	Roberta McKelvin
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Logistics	Armando Bolanos
Kroger Technology	Christy Foxbower
Fred Meyer Jewelers	Jennifer Burke
84.51°	Cindia Wren



## Notice of 2018 Annual Meeting of Shareholders

### Fellow Kroger Shareholders:

It is our pleasure to invite you to join our Board of Directors, senior leadership, and other Kroger associates at The Kroger Co. Annual Meeting of Shareholders.

**When:** Thursday, June 28, 2018, at 11:00 a.m. eastern time.

**Where:** Music Hall  
Music Hall Ballroom  
1241 Elm Street  
Cincinnati, OH 45202

**Items of Business:**

1. To elect 11 director nominees.
2. To approve our executive compensation, on an advisory basis.
3. To approve an amendment to our Regulations to adopt proxy access.
4. To approve an amendment to our Regulations to permit Board amendments in accordance with Ohio law.
5. To ratify the selection of our independent auditor for fiscal year 2018.
6. To vote on three shareholder proposals, if properly presented at the meeting.
7. To transact other business as may properly come before the meeting.

**Who can Vote:** Holders of Kroger common shares at the close of business on the record date May 2, 2018 are entitled to notice of and to vote at the meeting.

**How to Vote:** Your vote is important! Please vote your proxy in one of the following ways:

1. *Via the internet*, by visiting [www.proxyvote.com](http://www.proxyvote.com).
2. *By telephone*, by calling the number on your proxy card, voting instruction form or notice.
3. *By mail*, by marking, signing, dating and mailing your proxy card if you requested printed materials, or your voting instruction form. No postage is required if mailed in the United States.
4. *In person*, by attending the meeting in Cincinnati.

**Attending the Meeting:** Shareholders holding shares at the close of business on the record date, or their duly appointed proxies, may attend the meeting. If you plan to attend the meeting, you must bring either: (1) the notice of meeting that was separately mailed to you or (2) the top portion of your proxy card, either of which will be your admission ticket. You must also bring valid photo identification, such as a driver's license or passport. We reserve the right to exclude any person who cannot provide an admission ticket and valid photo identification.

**Webcast of the Meeting:** If you are unable to attend the meeting, you may listen to a live webcast of the meeting by visiting [ir.kroger.com](http://ir.kroger.com) at 11:00 a.m. eastern time on June 28, 2018.

We appreciate your continued confidence in Kroger, and we look forward to seeing you at the meeting.

May 15, 2018  
Cincinnati, Ohio

By Order of the Board of Directors,  
Christine S. Wheatley, Secretary



## Proxy Statement

May 15, 2018

We are providing this notice, proxy statement and annual report to the shareholders of The Kroger Co. (“Kroger”, “we”, “us”, “our”) in connection with the solicitation of proxies by the Board of Directors of Kroger (the “Board”) for use at the Annual Meeting of Shareholders to be held on June 28, 2018, at 11:00 a.m. eastern time, at the Music Hall Ballroom, Music Hall, 1241 Elm St., Cincinnati, Ohio 45202, and at any adjournments thereof.

Our principal executive offices are located at 1014 Vine Street, Cincinnati, Ohio 45202-1100. Our telephone number is 513-762-4000. This notice, proxy statement and annual report, and the accompanying proxy card were first furnished to shareholders on May 15, 2018.

### Who can vote?

You can vote if, as of the close of business on May 2, 2018, you were a shareholder of record of Kroger common shares.

### Who is asking for my vote, and who pays for this proxy solicitation?

Your proxy is being solicited by Kroger’s Board of Directors. Kroger is paying the cost of solicitation. We have hired D.F. King & Co., Inc., 48 Wall Street, New York, New York, a proxy solicitation firm, to assist us in soliciting proxies and we will pay them a fee estimated not to exceed \$17,500.

We also will reimburse banks, brokers, nominees, and other fiduciaries for postage and reasonable expenses incurred by them in forwarding the proxy material to beneficial owners of our common shares.

Proxies may be solicited personally, by telephone, electronically via the Internet, or by mail.

### Who are the members of the Proxy Committee?

Robert D. Beyer, W. Rodney McMullen, and Ronald L. Sargent, all Kroger Directors, are the members of the Proxy Committee for our 2018 Annual Meeting.

### How do I vote my proxy?

You can vote your proxy in one of the following ways:

1. *Via the internet*, by visiting [www.proxyvote.com](http://www.proxyvote.com).
2. *By telephone*, by calling the number on your proxy card, voting instruction form, or notice.
3. *By mail*, by marking, signing, dating and mailing your proxy card if you requested printed materials, or your voting instruction form. No postage is required if mailed in the United States.
4. *In person*, by attending the meeting in Cincinnati.

### What do I need to attend the meeting in person in Cincinnati?

If you plan to attend the meeting, you must bring either: (1) the notice of meeting that was separately mailed to you or (2) the top portion of your proxy card, either of which will be your admission ticket. You must also bring valid photo identification, such as a driver’s license or passport. We reserve the right to exclude any person who cannot provide an admission ticket and valid photo identification.

### Can I change or revoke my proxy?

The common shares represented by each proxy will be voted in the manner you specified unless your proxy is revoked before it is exercised. You may change or revoke your proxy by providing written notice to Kroger’s Secretary at 1014 Vine Street, Cincinnati, Ohio 45202, in person at the meeting or by executing and sending us a subsequent proxy.

### How many shares are outstanding?

As of the close of business on May 2, 2018, the record date, our outstanding voting securities consisted of 812,841,516 common shares.\*



## How many votes per share?

Each common share outstanding on the record date will be entitled to one vote on each of the 11 director nominees and one vote on each other proposal. Shareholders may not cumulate votes in the election of directors.

## What voting instructions can I provide?

You may instruct the proxies to vote "For" or "Against" each proposal, or you may instruct the proxies to "Abstain" from voting.

## What happens if proxy cards or voting instruction forms are returned without instructions?

If you are a registered shareholder and you return your proxy card without instructions, the Proxy Committee will vote in accordance with the recommendations of the Board.

If you hold shares in street name and do not provide your broker with specific voting instructions on proposals 1, 2, 3, 4, 6, 7, or 8, which are considered non-routine matters, your broker does not have the authority to vote on those proposals. This is generally referred to as a "broker non-vote." Proposal 5, ratification of auditors, is considered a routine matter and, therefore, your broker may vote your shares according to your broker's discretion.

The vote required, including the effect of broker non-votes and abstentions for each of the matters presented for shareholder vote, is set forth below.

## What are the voting requirements for each of the proposals?

**Proposal No. 1 Election of Directors** – An affirmative vote of the majority of the total number of votes cast "For" or "Against" a director nominee is required for the election of a director in an uncontested election. A majority of votes cast means that the number of shares voted "For" a director nominee must exceed the number of votes "Against" such director. Broker non-votes and abstentions will have no effect on this proposal.

**Proposal No. 2 Advisory Vote to Approve Executive Compensation** – Advisory approval by shareholders of executive compensation requires the affirmative vote of the majority of shares participating in the voting. Broker non-votes and abstentions will have no effect on this proposal.

**Proposal No. 3 Vote to Approve Amendment to Regulations to Permit Proxy Access** – An affirmative vote of the majority of the outstanding shares is required to amend the Regulations to permit proxy access. Broker non-votes and abstentions will have the same effect as a vote against this proposal.

**Proposal No. 4 Vote to Approve Amendment to Regulations to Permit Board Amendments in Accordance with Ohio Law** – An affirmative vote of 75% of the outstanding shares is required to amend the Regulations to permit Board amendments of certain provisions. Broker non-votes and abstentions will have the same effect as a vote against this proposal.

**Proposal No. 5 Ratification of Independent Auditors** – Ratification by shareholders of the selection of independent public accountants requires the affirmative vote of the majority of shares participating in the voting. Abstentions will have no effect on this proposal.

**Proposal Nos. 6, 7, and 8 Shareholder Proposals** – The affirmative vote of the majority of shares participating in the voting on a shareholder proposal is required for such proposal to pass. Accordingly, broker non-votes and abstentions will have no effect on these proposals.

**How does the Board of Directors recommend that I vote?**

<b>Proposal</b>	<b>For More Information</b>	<b>Board Recommendation</b>
Item No. 1 Election of Directors	See page 5	<b>FOR</b>
Item No. 2 Advisory Vote to Approve Executive Compensation	See page 50	<b>FOR</b>
Item No. 3 Amendment to Regulations to Permit Proxy Access	See page 50	<b>FOR</b>
Item No. 4 Amendment to Regulations to Permit Board Amendments in Accordance with Ohio Law	See page 53	<b>FOR</b>
Item No. 5 Ratification of Independent Auditors	See page 54	<b>FOR</b>
Item Nos. 6, 7, and 8 Shareholder Proposals	See page 57	<b>AGAINST</b>

**Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to be Held on June 28, 2018**

The Notice of 2018 Annual Meeting, Proxy Statement and 2017 Annual Report and the means to vote by internet are available at [www.proxyvote.com](http://www.proxyvote.com).

- \* This version replaces the proxy statement originally filed on Form DEF 14A on May 15, 2018 and reflects the corrected number of outstanding common shares as reported in our supplement to the proxy statement filed on Form DEFA 14A on May 15, 2018.

## **Kroger's Corporate Governance Practices**

Kroger is committed to strong corporate governance. We believe that strong governance builds trust and promotes the long-term interests of our shareholders. Highlights of our corporate governance practices include the following:

### **Board Governance Practices**

- ✓ Strong Board oversight of enterprise risk.
- ✓ All director nominees are independent, except for the CEO.
- ✓ All five Board committees are fully independent.
- ✓ Robust code of ethics.
- ✓ Annual evaluation of the Chairman and CEO by the independent directors, led by the independent Lead Director.
- ✓ Annual Board and committee self-assessments.
- ✓ Commitment to Board refreshment and diversity.
- ✓ Regular executive sessions of the independent directors, at the Board and committee level.
- ✓ Strong independent Lead Director with clearly defined role and responsibilities.
- ✓ High degree of Board interaction with management to ensure successful oversight and succession planning.

### **Shareholder Rights**

- ✓ All directors are elected annually with a simple majority standard for all uncontested director elections and by plurality in contested director elections.
- ✓ No poison pill (shareholder rights plan).
- ✓ Shareholders have the right to call a special meeting.
- ✓ Regular engagement with shareholders to understand their perspectives and concerns on a broad array of topics, including corporate governance matters.
- ✓ Responsive to shareholder feedback.

### **Compensation Governance**

- ✓ Pay program tied to performance and business strategy.
- ✓ Majority of pay is long-term and at-risk with no guaranteed bonuses or salary increases.
- ✓ Stock ownership guidelines align executive and director interests with those of shareholders.
- ✓ Prohibition on all hedging, pledging and short sales of Kroger securities by directors and executive officers.
- ✓ No tax gross-up payments to executives.

## Proposals to Shareholders

### Item No. 1. Election of Directors

**You are being asked to elect 11 director nominees for a one-year term. The Board of Directors recommends that you vote FOR the election of all director nominees.**

As of the date of this proxy statement, Kroger's Board of Directors consists of 11 members. All nominees, if elected at the 2018 Annual Meeting, will serve until the annual meeting in 2019, or until their successors have been elected by the shareholders or by the Board pursuant to Kroger's Regulations, and qualified.

Kroger's Articles of Incorporation provide that the vote required for election of a director nominee by the shareholders, except in a contested election or when cumulative voting is in effect, is the affirmative vote of a majority of the votes cast for or against the election of a nominee.

The experience, qualifications, attributes, and skills that led the Corporate Governance Committee and the Board to conclude that the following individuals should serve as directors are set forth opposite each individual's name. The committee memberships stated below are those in effect as of the date of this proxy statement.

#### Nominees for Directors for Terms of Office Continuing until 2019

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<b>Nora A. Aufreiter</b> Age 58 Director Since 2014 <i>Committees:</i> Financial Policy Public Responsibilities	<p>Ms. Aufreiter is a Director Emeritus of McKinsey &amp; Company, a global management consulting firm. She retired in June 2014 after more than 27 years with McKinsey, most recently as a director and senior partner. During that time, she worked extensively in the U.S., Canada, and internationally with major retailers, financial institutions and other consumer-facing companies. Before joining McKinsey, Ms. Aufreiter spent three years in financial services working in corporate finance and investment banking. She is a member of the Board of Directors of The Bank of Nova Scotia, The Neiman Marcus Group, and Cadillac Fairview, one of North America's largest owners, operators and developers of commercial real estate. Ms. Aufreiter also serves on the boards of St. Michael's Hospital and the Canadian Opera Company, and is a member of the Dean's Advisory Board for the Ivey Business School in Ontario, Canada.</p> <p>Ms. Aufreiter has over 30 years of broad business experience in a variety of retail sectors. Her vast experience in leading McKinsey's North American Retail Practice, North American Branding service line and the Consumer Digital and Omnichannel service line is of particular value to the Board. She also brings to the Board valuable insight on commercial real estate.</p>
<b>Robert D. Beyer</b> <i>Lead Director</i> Age 58 Director Since 1999 <i>Committees:</i> Corporate Governance* Financial Policy	<p>Mr. Beyer is Chairman of Chaparral Investments LLC, a private investment firm and holding company that he founded in 2009. From 2005 to 2009, Mr. Beyer served as Chief Executive Officer of The TCW Group, Inc., a global investment management firm. From 2000 to 2005, he served as President and Chief Investment Officer of Trust Company of the West, the principal operating subsidiary of TCW. Mr. Beyer is a member of the Board of Directors of Leucadia National Corporation. In the past five years he also served as a director of The Allstate Corporation.</p> <p>Mr. Beyer brings to Kroger his experience as CEO of TCW, a global investment management firm serving many of the largest institutional investors in the U.S. He has exceptional insight into Kroger's financial strategy, and his experience qualifies him to serve as a member of the Board. While at TCW, he also conceived and developed the firm's risk management infrastructure, an experience that is useful to Kroger's Board in performing its risk management oversight functions. His abilities and service as a director were recognized by his peers, who selected Mr. Beyer as an Outstanding Director in 2008 as part of the Outstanding Directors Program of the Financial Times. His strong insights into corporate governance form the foundation of his leadership role as Lead Director on the Board.</p>

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<p><b>Anne Gates</b> Age 58 Director Since 2015 <i>Committees:</i> Audit Public Responsibilities</p>	<p>Ms. Gates was President of MGA Entertainment, Inc., a privately-held developer, manufacturer and marketer of toy and entertainment products for children, from 2014 until her retirement in 2017. Ms. Gates held roles of increasing responsibility with The Walt Disney Company from 1991-2012. Her roles included executive vice president, chief financial officer for Disney Consumer Products, managing director for Disney Consumer Products Europe and Emerging Markets, and senior vice president of operations, planning and analysis. Prior to joining Disney, Ms. Gates worked for PepsiCo and Bear Stearns. She is currently a director of Tapestry, Inc. (formerly known as Coach, Inc.) and Raymond James Financial, Inc.</p> <p>Ms. Gates has over 25 years of experience in the retail and consumer products industry. She brings to Kroger financial expertise gained while serving as President of MGA and CFO of a division of The Walt Disney Company. Ms. Gates has a broad business background in finance, marketing, strategy and business development, including international business. Her expertise in toy and entertainment products is of particular value to the Board. Ms. Gates has been designated an Audit Committee financial expert.</p>
<p><b>Susan J. Kropf</b> Age 69 Director Since 2007 <i>Committees:</i> Compensation Corporate Governance</p>	<p>Ms. Kropf was President and Chief Operating Officer of Avon Products Inc., a manufacturer and marketer of beauty care products, from 2001 until her retirement in January 2007. She joined Avon in 1970 and, during her tenure at Avon, Ms. Kropf also served as Executive Vice President and Chief Operating Officer, Avon North America and Global Business Operations from 1998 to 2000 and President, Avon U.S. from 1997 to 1998. Ms. Kropf was a member of Avon's Board of Directors from 1998 to 2006. She currently is a director of Avon Products, Inc., Tapestry, Inc. (formerly known as Coach, Inc.), and Sherwin Williams Company. In the past five years she also served as a director of MeadWestvaco Corporation.</p> <p>Ms. Kropf has unique and valuable consumer insight, having led a major, publicly-traded retailer of beauty and related consumer products. She has extensive experience in manufacturing, marketing, supply chain operations, customer service, and product development, all of which assist her in her role as a member of Kroger's Board. Ms. Kropf has a strong financial background, and has significant boardroom experience through her service on the boards of various public companies, including experience serving on compensation, audit, and corporate governance committees. She was inducted into the YWCA Academy of Women Achievers. Ms. Kropf received recognition from the National Association of Corporate Directors as an NACD Directorship 100 "Class of 2016" member.</p>
<p><b>W. Rodney McMullen</b> <i>Chairman and Chief Executive Officer</i> Age 57 Director Since 2003</p>	<p>Mr. McMullen was elected Chairman of the Board in January 2015 and Chief Executive Officer of Kroger in January 2014. Mr. McMullen served as Kroger's President and Chief Operating Officer from August 2009 to December 2013. Prior to that role, Mr. McMullen was elected to various roles at Kroger including Vice Chairman in 2003, Executive Vice President in 1999 and Senior Vice President in 1997. Mr. McMullen is a director of Cincinnati Financial Corporation and VF Corporation.</p> <p>Mr. McMullen has broad experience in the supermarket business, having spent his career spanning over 38 years with Kroger. He has a strong background in finance, operations, and strategic partnerships, having served in a variety of roles with Kroger, including as our CFO, COO and Vice Chair. His service on the compensation, executive, and investment committees of Cincinnati Financial Corporation and the audit and nominating and governance committees of VF Corporation adds depth to his extensive retail experience.</p>
<p><b>Jorge P. Montoya</b> Age 71 Director Since 2007 <i>Committees:</i> Compensation Public Responsibilities*</p>	<p>Mr. Montoya was President of The Procter &amp; Gamble Company's Global Snacks &amp; Beverage division, and President of Procter &amp; Gamble Latin America, from 1999 until his retirement in 2004. Prior to that, he was an Executive Vice President of Procter &amp; Gamble, a provider of branded consumer packaged goods, from 1995 to 1999. Mr. Montoya is a director of The Gap, Inc.</p> <p>Mr. Montoya brings to Kroger's Board over 30 years of leadership experience at a premier consumer products company. He has a deep knowledge of the Hispanic market, as well as consumer products and retail operations. Mr. Montoya has vast experience in marketing and general management, including international business. He was named among the 50 most important Hispanics in Business &amp; Technology, in <i>Hispanic Engineer &amp; Information Technology Magazine</i>.</p>

<p><b>Clyde R. Moore</b> Age 64 Director Since 1997</p> <p><i>Committees:</i> Compensation* Corporate Governance</p>	<p>Mr. Moore was the Chairman of First Service Networks, a national provider of facility and maintenance repair services, until his retirement in 2015. Prior to his retirement, he was Chairman and Chief Executive Officer of First Service Networks from 2000 to 2014.</p> <p>Mr. Moore has over 30 years of general management experience in public and private companies. He has sound experience as a corporate leader overseeing all aspects of a facilities management firm and numerous manufacturing companies. Mr. Moore's expertise broadens the scope of the Board's experience to provide oversight to Kroger's facilities, digital and manufacturing businesses. Additionally, his expertise and leadership as Chair of the Compensation and Talent Development Committee is of particular value to the Board.</p>
<p><b>James A. Runde</b> Age 71 Director Since 2006</p> <p><i>Committees:</i> Compensation Financial Policy*</p>	<p>Mr. Runde is a special advisor and a former Vice Chairman of Morgan Stanley, a financial services provider, where he was employed from 1974 until his retirement in 2015. He was a member of the Board of Directors of Burlington Resources, Inc. prior to its acquisition by ConocoPhillips in 2006. Mr. Runde serves as a Trustee Emeritus of Marquette University and the Pierpont Morgan Library.</p> <p>Mr. Runde brings to Kroger's Board a strong financial background, having led a major financial services provider. He also has served on the compensation committee of a major corporation.</p>
<p><b>Ronald L. Sargent</b> Age 62 Director Since 2006</p> <p><i>Committees:</i> Audit* Public Responsibilities</p>	<p>Mr. Sargent is the former Chairman and Chief Executive Officer of Staples, Inc., a business products retailer, where he was employed from 1989 until his retirement in January 2017. Prior to joining Staples, Mr. Sargent spent 10 years with Kroger in various positions. He is a director of Five Below, Inc. and Wells Fargo &amp; Company. In the past five years he was a director of Staples, Inc.</p> <p>Mr. Sargent has over 35 years of retail experience, first with Kroger and then with increasing levels of responsibility and leadership at Staples, Inc. His efforts helped carve out a new market niche for the international retailer. His understanding of retail operations, consumer insights, and e-commerce are of particular value to the Board. Mr. Sargent has been designated an Audit Committee financial expert.</p>
<p><b>Bobby S. Shackouls</b> Age 67 Director Since 1999</p> <p><i>Committees:</i> Audit Corporate Governance</p>	<p>Mr. Shackouls was Chairman of the Board of Burlington Resources Inc., a natural resources business, from July 1997 until its merger with ConocoPhillips in 2006 and its President and Chief Executive Officer from December 1995 until 2006. Mr. Shackouls was also the President and Chief Executive Officer of Burlington Resources Oil and Gas Company (formerly known as Meridian Oil Inc.), a wholly-owned subsidiary of Burlington Resources, from 1994 to 1995. Mr. Shackouls is a director of Plains GP Holdings, LLC and Oasis Petroleum Inc. In the past five years, Mr. Shackouls was a director of PNGS GP LLC, the general partner of PAA Natural Gas Storage, L.P. Mr. Shackouls previously served as Kroger's Lead Director.</p> <p>Mr. Shackouls brings to the Board the critical thinking that comes with a chemical engineering background, as well as his experience leading a major natural resources company, coupled with his corporate governance expertise.</p>



<p><b>Mark S. Sutton</b></p> <p>Age 56</p> <p>Director Since 2017</p> <p><i>Committees:</i></p> <p>Audit</p> <p>Public Responsibilities</p>	<p>Mr. Sutton is Chairman and Chief Executive Officer of International Paper, a leading global producer of renewable fiber-based packaging, pulp and paper products. Prior to becoming CEO, he served as President and Chief Operating Officer with responsibility for running the company’s global business. Mr. Sutton joined International Paper in 1984 as an electrical engineer. He held roles of increasing responsibility throughout his career, including mill manager, Vice President of corrugated packaging operations across Europe, the Middle East and Africa, Vice President of corporate strategic planning, and Senior Vice President of several business units, including global supply chain, before being named CEO in 2014. He serves on the boards of the American Forest &amp; Paper Association, the Business Roundtable, the International Advisory Board of the Moscow School of Management — Skolkovo, Memphis Tomorrow and the New Memphis Institute.</p> <p>Mr. Sutton has over thirty years of leadership experience with increasing levels of responsibility and leadership at International Paper. He brings to the Board the critical thinking that comes with an electrical engineering background as well as his experience leading a global company. His strong strategic planning background and supply chain experience are of particular value to the Board. Mr. Sutton has been designated an Audit Committee financial expert.</p>
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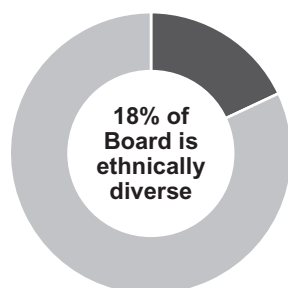
**The Board of Directors Recommends a Vote For Each Director Nominee.**

**Diversity of Background**

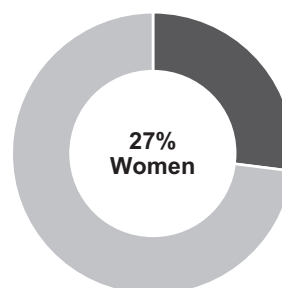
Our director nominees possess relevant experience, skills and qualifications that contribute to a well-functioning Board that effectively oversees the Company’s strategy and management. Listed below are the skills and experience that we consider important for our directors in light of our current business, strategy and structure:

	Nora Aufreiter	Robert Beyer	Anne Gates	Susan Kropf	Rodney McMullen	Jorge Montoya	Clyde Moore	James Runde	Ronald Sargent	Bobby Shackouls	Mark Sutton	Total (of 11)
Business Management	●	●	●	●	●	●	●	●	●	●	●	11
Retail	●		●	●	●	●			●			6
Consumer	●		●	●	●	●			●			6
Financial Expertise		●	●	●	●		●	●	●	●	●	9
Risk Management		●			●			●	●	●	●	6
Operations & Technology	●		●	●	●	●	●		●	●	●	9
Sustainability	●		●	●		●			●		●	6
Manufacturing			●	●			●				●	4

**Ethnic Diversity**



**Gender Diversity**





## Information Concerning the Board of Directors

### Board Leadership Structure and Lead Independent Director

The Board is currently composed of ten independent non-employee directors and one management director, Mr. McMullen, the Chairman and CEO. Kroger has a governance structure in which independent directors exercise meaningful and vigorous oversight.

As provided in Kroger's *Guidelines on Issues of Corporate Governance* (the "Guidelines"), the Board has designated one of the independent directors as Lead Director. The Lead Director works with the Chairman to share governance responsibilities, facilitate the development of Kroger's strategy and grow shareholder value. The Lead Director serves a variety of roles, consistent with current best practices, including:

- reviewing and approving Board meeting agendas, materials and schedules to confirm that the appropriate topics are reviewed, with sufficient information provided to directors on each topic and appropriate time is allocated to each;
- serving as the principal liaison between the Chairman, management and the independent directors;
- presiding at the executive sessions of independent directors and at all other meetings of the Board at which the Chairman is not present;
- calling meetings of independent directors at any time; and
- serving as the Board's representative for any consultation and direct communication, following a request, with major shareholders.

The Lead Director carries out these responsibilities in numerous ways, including:

- facilitating communication and collegiality among the Board;
- soliciting direct feedback from non-employee directors;
- overseeing the succession process, including site visits and meeting with a wide range of employees including corporate and division management associates;
- meeting with the CEO frequently to discuss strategy;
- serving as a sounding board and advisor to the CEO; and
- discussing Company matters with other directors between meetings.

Unless otherwise determined by the independent members of the Board, the Chair of the Corporate Governance Committee is designated as the Lead Director. Robert D. Beyer, an independent director and the Chair of the Corporate Governance Committee, is currently the Lead Director. Mr. Beyer is an effective Lead Director for Kroger due to, among other things:

- his independence;
- his deep strategic and operational understanding of Kroger obtained while serving as a Kroger director;
- his insight into corporate governance, his experience as the CEO of a global investment management firm;
- his experience on the boards of other large publicly traded companies; and
- his engagement and commitment to carrying out the role and responsibilities of the Lead Director.

With respect to the roles of Chairman and CEO, the *Guidelines* provide that the Board will determine whether it is in the best interests of Kroger and our shareholders for the roles to be combined. The Board exercises this judgment as it deems appropriate in light of prevailing circumstances. Upon retirement of our former Chairman, David B. Dillon, on December 31, 2014, the Board determined that it is in the best interests of Kroger and our shareholders for one person to serve as the Chairman and CEO, as was the case from 2004 through 2013, with another individual serving as independent Lead Director. The Board believes that this leadership structure improves the Board's ability to focus on key policy and operational issues and helps the Company operate in the long-term interest of shareholders. Additionally, this structure provides an effective balance between strong Company leadership and appropriate safeguards and oversight by independent directors. The Board believes that the structure of the Chairman and independent Lead Director position should continue to be considered as part of the succession planning process.

## Annual Board Evaluation Process

The Board and each of its committees conduct an annual self-evaluation to determine whether the Board is functioning effectively both at the Board and at the committee levels. As part of this annual self-evaluation, the Board assesses whether the current leadership structure and function continues to be appropriate for Kroger and its shareholders. The *Guidelines* provide the flexibility for the Board to modify our leadership structure in the future as appropriate. We believe that Kroger, like many U.S. companies, is well-served by this flexible leadership structure.

The Board recognizes that a robust evaluation process is an essential component of strong corporate governance practices and promoting Board effectiveness. The Corporate Governance Committee oversees an annual evaluation process led by the Lead Independent Director (who also serves as Chair of the Corporate Governance Committee).

Each director completes an annual self-evaluation of the Board and the committees on which he or she serves. These self-evaluations are designed to help assess the skills, qualifications, and experience represented on the Board and its committees, and to determine whether the Board and its committees are functioning effectively. The results of this annual self-evaluation are discussed by the full Board and each committee, as applicable, and changes to the Board's and its committees' practices are implemented as appropriate.

## Committees of the Board of Directors

To assist the Board in undertaking its responsibilities, and to allow deeper engagement in certain areas of company oversight, the Board has established five standing committees: Audit, Compensation and Talent Development ("Compensation"), Corporate Governance, Financial Policy and Public Responsibilities. All committees are composed exclusively of independent directors, as determined under the NYSE listing standards. The current charter of each Board committee is available on our website at [ir.kroger.com](http://ir.kroger.com) under Investors — Governance — Committee Composition.

Name of Committee, Number of Meetings, and Current Members	Committee Functions
<p><b>Audit Committee</b></p> <p><b>Meetings in 2017: 5</b></p> <p><b>Members:</b>            Ronald L. Sargent, <i>Chair</i>            Anne Gates            Bobby S. Shackouls            Mark S. Sutton</p>	<ul style="list-style-type: none"> <li>• Oversees the Company's financial reporting and accounting matters, including review of the Company's financial statements and the audit thereof, the Company's financial reporting and accounting process, and the Company's systems of internal control over financial reporting</li> <li>• Selects, evaluates and oversees the compensation and work of the independent registered public accounting firm and reviews its performance, qualifications, and independence</li> <li>• Oversees and evaluates the Company's internal audit function, including review of its audit plan, policies and procedures and significant findings</li> <li>• Oversees risk assessment and risk management, including review of cybersecurity risks as well as legal or regulatory matters that could have a significant effect on the Company</li> <li>• Reviews and monitors the Company's compliance programs, including the whistleblower program</li> </ul>
<p><b>Compensation Committee</b></p> <p><b>Meetings in 2017: 5</b></p> <p><b>Members:</b>            Clyde R. Moore, <i>Chair</i>            Susan J. Kropf            Jorge P. Montoya            James A. Runde</p>	<ul style="list-style-type: none"> <li>• Recommends for approval by the independent directors the compensation of the CEO, and approves the compensation of other senior management</li> <li>• Administers the Company's executive compensation policies and programs, including determining grants of equity awards under the plans</li> <li>• Has sole authority to retain and direct the committee's compensation consultant</li> <li>• Assists the full Board with senior management succession planning</li> </ul>

Name of Committee, Number of Meetings, and Current Members	Committee Functions
<p><b>Corporate Governance Committee</b></p> <p><b>Meetings in 2017: 2</b></p> <p><b>Members:</b>            Robert D. Beyer, <i>Chair</i>            Susan J. Kropf            Clyde R. Moore            Bobby S. Shackouls</p>	<ul style="list-style-type: none"> <li>• Oversees the Company's corporate governance policies and procedures</li> <li>• Develops criteria for selecting and retaining directors, including identifying and recommending qualified candidates to be director nominees</li> <li>• Designates membership and Chairs of Board committees</li> <li>• Reviews the Board's performance and director independence</li> <li>• Establishes and reviews the practices and procedures by which the Board performs its functions</li> </ul>
<p><b>Financial Policy Committee</b></p> <p><b>Meetings in 2017: 2</b></p> <p><b>Members:</b>            James A. Runde, <i>Chair</i>            Nora A. Aufreiter            Robert D. Beyer</p>	<ul style="list-style-type: none"> <li>• Reviews and recommends financial policies and practices</li> <li>• Oversees management of the Company's financial resources</li> <li>• Reviews the Company's annual financial plan, significant capital investments, plans for major acquisitions or sales, issuance of new common or preferred stock, dividend policy, creation of additional debt and other capital structure considerations including additional leverage or dilution in ownership</li> <li>• Monitors the investment management of assets held in pension and profit sharing plans administered by the Company</li> </ul>
<p><b>Public Responsibilities Committee</b></p> <p><b>Meetings in 2017: 2</b></p> <p><b>Members:</b>            Jorge P. Montoya, <i>Chair</i>            Nora A. Aufreiter            Anne Gates            Ronald L. Sargent            Mark S. Sutton</p>	<ul style="list-style-type: none"> <li>• Reviews the Company's policies and practices affecting its social and public responsibility as a corporate citizen, including: community relations, charitable giving, supplier diversity, sustainability, government relations, political action, consumer and media relations, food and pharmacy safety and the safety of customers and employees</li> <li>• Reviews and examines the Company's evaluation of and response to changing public expectations and public issues affecting the business</li> </ul>

### Director Nominee Selection Process

The Corporate Governance Committee is responsible for recommending to the Board a slate of nominees for election at each annual meeting of shareholders. The Corporate Governance Committee recruits candidates for Board membership through its own efforts and through recommendations from other directors and shareholders. In addition, the Corporate Governance Committee has retained an independent search firm to assist in identifying and recruiting director candidates who meet the criteria established by the Corporate Governance Committee.

These criteria are:

- demonstrated ability in fields considered to be of value to the Board in the deliberation and long-term planning of the Board and Kroger, including business management, public service, education, technology, law and government;
- highest standards of personal character and conduct;
- willingness to fulfill the obligations of directors and to make the contribution of which he or she is capable, including regular attendance and participation at Board and committee meetings, and preparation for all meetings, including review of all meeting materials provided in advance of the meeting; and
- ability to understand the perspectives of Kroger's customers, taking into consideration the diversity of our customers, including regional and geographic differences.

The Corporate Governance Committee also considers the specific experience and abilities of director candidates in light of our current business, strategy and structure and the current or expected needs of the Board in its identification and recruitment of director candidates.

## **Board Diversity and Succession Planning**

Our director nominees reflect a wide array of experience, skills and backgrounds. Each director is individually qualified to make unique and substantial contributions to Kroger. Collectively, our directors' diverse viewpoints and independent-mindedness enhance the quality and effectiveness of Board deliberations and decision making. Our Board is a dynamic group of new and experienced members, providing an appropriate balance of institutional knowledge and fresh perspectives about Kroger due to the varied length of tenure on the Board. This blend of qualifications, attributes and tenure results in highly effective board leadership.

The Corporate Governance Committee considers racial, ethnic and gender diversity to be important elements in promoting full, open and balanced deliberations of issues presented to the Board. The Corporate Governance Committee considers director candidates that help the Board reflect the diversity of our shareholders, associates, customers and the communities in which we operate. Some consideration also is given to the geographic location of director candidates in order to provide a reasonable distribution of members from Kroger's operating areas.

Board succession planning is an ongoing, year-round process. The Corporate Governance Committee recognizes the importance of thoughtful Board refreshment, and engages in a continuing process of identifying attributes sought for future Board members. The Corporate Governance Committee takes into account the Board and committee evaluations regarding the specific qualities, skills, and experiences that would contribute to overall Board and committee effectiveness, as well as the future needs of the Board and its committees in light of Kroger's current and long-term business strategies, and the skills and qualifications of directors who are expected to retire in the future.

## **Shareholder Engagement**

Maintaining ongoing relationships with our shareholders, and understanding our shareholders' views, is a priority for both our Board and management team. We have a longstanding history of engaging with our shareholders through our investor relations team's year-round outreach program. At the direction of our Board, we expanded our shareholder engagement program in 2016 to include outreach to our largest shareholders' governance teams. In 2017, we requested meetings with shareholders representing nearly 40% of our outstanding shares and ultimately engaged with shareholders representing over a third of our outstanding shares.

During these engagements, we discussed and solicited feedback on a range of topics, including business strategy, corporate governance, executive compensation and sustainability. In addition, we attended industry events to further engage with shareholders and subject matter experts. These conversations provided valuable insights into our shareholders' perspectives and their feedback was shared with, and considered by, our full Board.

## **Candidates Nominated by Shareholders**

The Corporate Governance Committee will consider shareholder recommendations for director nominees for election to the Board. If shareholders wish to nominate a person or persons for election to the Board at our 2019 annual meeting, written notice must be submitted to Kroger's Secretary, and received at our executive offices, in accordance with Kroger's Regulations, not later than March 31, 2019. Such notice should include the name, age, business address and residence address of such person, the principal occupation or employment of such person, the number of Kroger common shares owned of record or beneficially by such person and any other information relating to the person that would be required to be included in a proxy statement relating to the election of directors. The Secretary will forward the information to the Corporate Governance Committee for its consideration. The Corporate Governance Committee will use the same criteria in evaluating candidates submitted by shareholders as it uses in evaluating candidates identified by the Corporate Governance Committee, as described above. See "Director Nominee Selection Process."

If Item No. 3 on proxy access is approved by the requisite vote at the 2018 Annual Meeting, eligible shareholders will have the ability to submit director nominees for inclusion in our proxy statement for the 2019 annual meeting of shareholders. As described in more detail in Item No. 3, to be eligible, shareholders must have owned at least 3% of our common shares for at least three years. Up to 20 shareholders will be able to aggregate for this purpose. Nominations must be submitted to our Corporate Secretary at our principal executive offices no earlier than December 16, 2018 and no later than January 15, 2019.

## **Corporate Governance Guidelines**

The Board has adopted the *Guidelines on Issues of Corporate Governance*, which includes copies of the current charters for each of the five standing committees of the Board. The *Guidelines* are available on our website

at [ir.kroger.com](http://ir.kroger.com) under Investors – Governance – Guidelines on Issues of Corporate Governance. Shareholders may also obtain a copy of the *Guidelines* by making a written request to Kroger’s Secretary at our executive offices.

## **Independence**

The Board has determined that all of the non-employee directors have no material relationships with Kroger and satisfy the criteria for independence set forth in Rule 303A.02 of the New York Stock Exchange Listed Company Manual. Therefore, all non-employee directors are independent for purposes of the NYSE listing standards. The Board made its determination based on information furnished by all members regarding their relationships with Kroger and its management, and other relevant information. The Board considered, among other things, that

- the value of any business transactions between Kroger and entities with which the directors are affiliated falls below the thresholds identified by the NYSE listing standards, and
- none had any material relationships with Kroger other than serving on our Board.

## **Audit Committee Expertise**

The Board has determined that Anne Gates, Ronald L. Sargent and Mark S. Sutton, independent directors who are members of the Audit Committee, are “audit committee financial experts” as defined by applicable SEC regulations and that all members of the Audit Committee are “financially literate” as that term is used in the NYSE listing standards and are independent in accordance with Rule 10A-3 of the Securities Exchange Act of 1934.

## **Code of Ethics**

The Board has adopted *The Kroger Co. Policy on Business Ethics*, applicable to all officers, employees and directors, including Kroger’s principal executive, financial and accounting officers. The *Policy* is available on our website at [ir.kroger.com](http://ir.kroger.com) under Investors – Governance – Policy on Business Ethics. Shareholders may also obtain a copy of the *Policy* by making a written request to Kroger’s Secretary at our executive offices.

## **Communications with the Board**

The Board has established two separate mechanisms for shareholders and interested parties to communicate with the Board. Any shareholder or interested party who has concerns regarding accounting, improper use of Kroger assets or ethical improprieties may report these concerns via the toll-free hotline (800-689-4609) or email address ([helpline@kroger.com](mailto:helpline@kroger.com)) established by the Board’s Audit Committee. The concerns are investigated by Kroger’s Vice President, Chief Ethics and Compliance Officer and the Vice President of Internal Audit and reported to the Audit Committee as deemed appropriate.

Shareholders or interested parties also may communicate with the Board in writing directed to Kroger’s Secretary at our executive offices. Communications relating to personnel issues or our ordinary business operations, or seeking to do business with us, will be forwarded to the business unit of Kroger that the Secretary deems appropriate. All other communications will be forwarded to the Chair of the Corporate Governance Committee for further consideration. The Chair of the Corporate Governance Committee will take such action as he or she deems appropriate, which may include referral to the full Corporate Governance Committee or the entire Board.

## **Attendance**

The Board held six meetings in fiscal year 2017. During fiscal 2017, all incumbent directors attended at least 75% of the aggregate number of meetings of the Board and committees on which that director served. Members of the Board are expected to use their best efforts to attend all annual meetings of shareholders. All 11 members attended last year’s annual meeting.

## **Independent Compensation Consultants**

The Compensation Committee directly engages a compensation consultant to advise the Compensation Committee in the design of Kroger’s executive compensation. The Committee retained a consultant from Mercer Human Resource Consulting (“Mercer”) from 2001 through December 2017. Retained by and reporting directly to the Compensation Committee, Mercer provided the Committee with assistance in evaluating Kroger’s executive compensation programs and policies.



In fiscal 2017, Kroger paid Mercer \$361,147 for work performed for the Compensation Committee. Kroger, on management's recommendation, retained the parent and affiliated companies of Mercer to provide other services for Kroger in fiscal 2017, for which Kroger paid \$8,394,369. These other services primarily related to insurance claims (for which Kroger was reimbursed by insurance carriers as claims were adjusted), insurance brokerage and bonding commissions provided by Marsh USA Inc., and pension plan compliance and actuary services provided by Mercer Inc. Kroger also made payments to affiliated companies for insurance premiums that were collected by the affiliated companies of Mercer on behalf of insurance carriers, but these amounts are not included in the totals referenced above, as the amounts were paid over to insurance carriers for services provided by those carriers. Neither the Compensation Committee nor the Board expressly approved the other services provided by Mercer. After taking into consideration the NYSE's independence standards and the SEC rules, the Compensation Committee determined that the Mercer consultant was independent and Mercer's work has not raised any conflict of interest because:

- the Mercer consultant was first engaged by the Compensation Committee before he became associated with Mercer;
- the Mercer consultant works exclusively for the Compensation Committee and not for our management;
- the Mercer consultant does not benefit from the other work that Mercer's parent and affiliated companies perform for Kroger; and
- neither the Mercer consultant nor the Mercer consultant's team perform any other services for Kroger.

In July 2017, the Committee invited proposals from other executive compensation consulting firms. Following consideration of several firms, in December 2017, the Committee engaged Korn Ferry Hay Group ("Korn Ferry") as its executive compensation consultant. Due to the timing of the engagement, Korn Ferry did not have an opportunity to assist the Committee with the design and development of the executive compensation programs for fiscal 2017, other than assisting in the final determination of fiscal 2017 payouts.

After taking into consideration the NYSE's independence standards and the SEC rules, the Compensation Committee determined that the Korn Ferry consultant was independent and Korn Ferry's work has not raised any conflict of interest.

The Compensation Committee may engage an additional compensation consultant from time to time as it deems advisable.

### **Compensation Committee Interlocks and Insider Participation**

No member of the Compensation Committee was an officer or employee of Kroger during fiscal 2017, and no member of the Compensation Committee is a former officer of Kroger or was a party to any related person transaction involving Kroger required to be disclosed under Item 404 of Regulation S-K. During fiscal 2017, none of our executive officers served on the board of directors or on the compensation committee of any other entity that has or had executive officers serving as a member of Kroger's Board of Directors or Compensation Committee of the Board.

### **Board Oversight of Enterprise Risk**

While risk management is primarily the responsibility of Kroger's management team, the Board is responsible for strategic planning and overall supervision of our risk management activities. The Board's oversight of the material risks faced by Kroger occurs at both the full Board level and at the committee level.

The Board receives presentations throughout the year from various department and business unit leaders that include discussion of significant risks as necessary. At each Board meeting, the Chairman and CEO addresses matters of particular importance or concern, including any significant areas of risk that require Board attention. Additionally, through dedicated sessions focusing entirely on corporate strategy, the full Board reviews in detail Kroger's short- and long-term strategies, including consideration of significant risks facing Kroger and their potential impact. The independent directors, in executive sessions led by the Lead Director, address matters of particular concern, including significant areas of risk, that warrant further discussion or consideration outside the presence of Kroger employees. At the committee level, reports are given by management subject matter experts to each committee on risks within the scope of their charters.

The Audit Committee has oversight responsibility not only for financial reporting of Kroger's major financial exposures and the steps management has taken to monitor and control those exposures, but also for the

effectiveness of management's processes that monitor and manage key business risks facing Kroger, as well as the major areas of risk exposure, and management's efforts to monitor and control the major areas of risk exposure including cybersecurity risk. The Audit Committee incorporates its risk oversight function into its regular reports to the Board and also discusses with management its policies with respect to risk assessment and risk management.

Management provides regular updates throughout the year to the respective Board committees regarding management of the risks they oversee. For example, our Vice President, Chief Ethics and Compliance Officer provides regular updates to the Audit Committee on our compliance risks and actions taken to mitigate that risk; and our Executive Vice President and Chief Information Officer and our Chief Information Security Officer provide regular updates on our cybersecurity risks and actions taken to mitigate that risk to the Audit Committee. The Audit Committee reports on risk to the full Board at each regular meeting of the Board.

We believe that our approach to risk oversight, as described above, optimizes our ability to assess inter-relationships among the various risks, make informed cost-benefit decisions, and approach emerging risks in a proactive manner for Kroger. We also believe that our risk structure complements our current Board leadership structure, as it allows our independent directors, through the five fully independent Board committees, and in executive sessions of independent directors led by the Lead Director, to exercise effective oversight of the actions of management, led by Mr. McMullen as Chairman and CEO, in identifying risks and implementing effective risk management policies and controls.



## Director Compensation

### 2017 Director Compensation

The following table describes the 2017 compensation for non-employee directors. Mr. McMullen does not receive compensation for his Board service.

Name	Fees Earned or Paid in Cash	Stock Awards <sup>(1)</sup>	Option Awards <sup>(2)</sup>	Change in Pension Value And Nonqualified Deferred Compensation Earnings <sup>(3)</sup>	Total
Nora A. Aufreiter	\$ 86,371	\$165,872	—	—	\$ 252,243
Robert D. Beyer	\$ 127,016	\$165,872	—	\$10,185	\$ 303,073
Anne Gates	\$ 96,532	\$165,872	—	—	\$ 262,404
Susan J. Kropf	\$ 88,062	\$165,872	—	—	\$ 253,934
Jorge P. Montoya	\$ 101,613	\$165,872	—	—	\$ 267,485
Clyde R. Moore	\$ 106,694	\$165,872	—	\$149,496	\$ 422,062
Susan M. Phillips <sup>(4)</sup>	\$ 40,351	\$ —	—	\$3,277	\$ 43,628
James A. Runde	\$ 101,613	\$165,872	—	—	\$ 267,485
Ronald L. Sargent	\$ 116,855	\$165,872	—	\$3,360	\$ 286,087
Bobby S. Shackouls	\$ 96,532	\$165,872	—	—	\$ 262,404
Mark S. Sutton	\$ 93,678	\$165,872	—	—	\$ 259,550

- (1) Amounts reported in the Stock Awards column represent the aggregate grant date fair value of the annual incentive share award, computed in accordance with FASB ASC Topic 718. On July 12, 2017, each non-employee director then serving received 7,237 incentive shares with a grant date fair value of \$165,872.
- (2) Options are no longer granted to non-employee directors. The aggregate number of previously granted stock options that remained unexercised and outstanding at fiscal year-end for directors then serving was as follows: Mr. Shackouls held 7,800 options and Messrs. Beyer, Montoya, Moore, Runde and Sargent and Ms. Kropf each held 65,000 options.
- (3) The amounts reported for Mr. Beyer, Dr. Phillips, and Mr. Sargent represent preferential earnings on nonqualified deferred compensation. For a complete explanation of preferential earnings, please refer to footnote 5 to the Summary Compensation Table. The amount reported for Mr. Moore represents the change in actuarial present value of his accumulated benefit under the pension plan for non-employee directors. Pension values may fluctuate significantly from year to year depending on a number of factors, including age, average annual earnings, and the assumptions used to determine the present value, such as the discount rate. The increase in the actuarial present value of his accumulated pension benefit for 2017 is primarily due to a lower discount rate and an increase in projected yearly benefit payments.
- (4) Dr. Phillips retired from the Board at the 2017 annual meeting. Accordingly, she received prorated cash retainers.

### Annual Compensation

Each non-employee director receives an annual cash retainer of \$85,000. The Chairs of each of the Audit Committee and the Compensation Committee receive an additional annual cash retainer of \$20,000. The Chair of each of the other committees receives an additional annual cash retainer of \$15,000. Each member of the Audit Committee receives an additional annual cash retainer of \$10,000. The director designated as the Lead Director receives an additional annual cash retainer of \$25,000. Each non-employee director also receives incentive shares (Kroger common shares) with a value of approximately \$165,000.

The Board has determined that compensation of non-employee directors must be competitive on an ongoing basis to attract and retain directors who meet the qualifications for service on the Board. Non-employee director compensation will be reviewed from time to time as the Corporate Governance Committee deems appropriate.

## **Pension Plan**

Non-employee directors first elected prior to July 17, 1997 receive an unfunded retirement benefit equal to the average cash compensation for the five calendar years preceding retirement. Only Mr. Moore is eligible for this benefit. Benefits begin at the later of actual retirement or age 65.

## **Nonqualified Deferred Compensation**

We also maintain a deferred compensation plan for non-employee directors. Participants may defer up to 100% of their cash compensation and/or the receipt of all (and not less than all) of the annual award of incentive shares.

### ***Cash Deferrals***

Cash deferrals are credited to a participant's deferred compensation account. Participants may elect from either or both of the following two alternative methods of determining benefits:

- interest accrues until paid out at the rate of interest determined prior to the beginning of the deferral year to represent Kroger's cost of ten-year debt; and/or
- amounts are credited in "phantom" stock accounts and the amounts in those accounts fluctuate with the price of Kroger common shares.

In both cases, deferred amounts are paid out only in cash, based on deferral options selected by the participant at the time the deferral elections are made. Participants can elect to have distributions made in a lump sum or in quarterly installments, and may make comparable elections for designated beneficiaries who receive benefits in the event that deferred compensation is not completely paid out upon the death of the participant.

### ***Incentive Share Deferrals***

Participants may also defer the receipt of all (and not less than all) of the annual award of incentive shares. Distributions will be made by delivery of Kroger common shares within 30 days after the date which is 6 months after the participant's separation of service.

## Beneficial Ownership of Common Stock

The following table sets forth the common shares beneficially owned as of April 1, 2018 by Kroger's directors, the NEOs, and the directors and executive officers as a group. The percentage of ownership is based on 854,098,314 of Kroger common shares outstanding on April 1, 2018. Shares reported as beneficially owned include shares held indirectly through Kroger's defined contribution plans and other shares held indirectly, as well as shares subject to stock options exercisable on or before May 31, 2018. Except as otherwise noted, each beneficial owner listed in the table has sole voting and investment power with regard to the common shares beneficially owned by such owner.

Name	Amount and Nature of Beneficial Ownership <sup>(1)</sup> (a)	Options Exercisable on or before May 31, 2018 – included in column (a) (b)
Stuart W. Aitken <sup>(2)</sup>	105,293	15,895
Nora A. Aufreiter <sup>(3)</sup>	19,442	—
Robert D. Beyer <sup>(3)</sup>	315,361	65,000
Michael J. Donnelly	563,728	282,692
Anne Gates	14,145	—
Christopher T. Hjelm	506,918	260,536
Susan J. Kropf	146,910	65,000
W. Rodney McMullen	3,854,390	1,279,448
Jorge P. Montoya <sup>(4)</sup>	107,316	65,000
Clyde R. Moore	165,310	65,000
James A. Runde	163,910	65,000
Ronald L. Sargent <sup>(3)</sup>	165,232	65,000
J. Michael Schlotman	736,329	456,203
Bobby S. Shackouls <sup>(3)</sup>	81,102	7,800
Mark S. Sutton	9,691	—
Directors and executive officers as a group (28 persons, including those named above)	9,162,150	3,649,733

- (1) No director or officer owned as much as 1% of Kroger common shares. The directors and executive officers as a group beneficially owned less than 1% of Kroger common shares.
- (2) This amount includes 3,018 shares held by Mr. Aitken's wife. He disclaims beneficial ownership of these shares.
- (3) This amount includes incentive share awards that were deferred under the deferred compensation plan for independent directors in the following amounts: Ms. Aufreiter, 9,049; Mr. Beyer, 7,062; Mr. Sargent, 23,457; Mr. Shackouls, 23,457.
- (4) This amount includes 22,000 shares held in Mr. Montoya's trust. He disclaims beneficial ownership of these shares.

The following table sets forth information regarding the beneficial owners of more than five percent of Kroger common shares as of April 1, 2018 based on reports on Schedule 13G filed with the SEC.

Name	Address	Amount and Nature of Ownership	Percentage of Class
BlackRock, Inc.	55 East 52 <sup>nd</sup> St. New York, NY 10055	64,312,967 <sup>(1)</sup>	7.53%
Vanguard Group Inc.	100 Vanguard Blvd. Malvern, PA 19355	69,066,614 <sup>(2)</sup>	8.09%

- (1) Reflects beneficial ownership by BlackRock Inc., as of December 31, 2017, as reported on Amendment No. 8 to Schedule 13G filed with the SEC on February 8, 2018, reporting sole voting power with respect to 55,885,209 common shares, and sole dispositive power with regard to 64,312,967 common shares.
- (2) Reflects beneficial ownership by Vanguard Group Inc. as of December 31, 2017, as reported on Amendment No. 3 to Schedule 13G filed with the SEC on February 9, 2018, reporting sole voting power with respect to 1,262,195 common shares, shared voting power with respect to 214,353 common shares, sole dispositive power of 67,622,556 common shares, and shared dispositive power of 1,444,058 common shares.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and certain persons who own more than 10% of our outstanding common shares, to file reports of ownership and changes in ownership with the SEC and to furnish us with copies of those reports.

Based solely on our review of the copies of Forms 3, 4 and 5 received by Kroger, and written representations from certain reporting persons that no Form 5 was required for that person, we believe that during 2017 all filing requirements applicable to our executive officers, directors and 10% beneficial owners were timely satisfied.

### **Related Person Transactions**

The Board has adopted a written policy requiring that any Related Person Transaction may be consummated or continue only if the Audit Committee approves or ratifies the transaction in accordance with the policy. A "Related Person Transaction" is one (a) involving Kroger, (b) in which one of our directors, nominees for director, executive officers, or greater than five percent shareholders, or their immediate family members, have a direct or indirect material interest; and (c) the amount involved exceeds \$120,000 in a fiscal year.

The Audit Committee will approve only those Related Person Transactions that are in, or not inconsistent with, the best interests of Kroger and its shareholders, as determined by the Audit Committee in good faith in accordance with its business judgment. No director may participate in any review, approval or ratification of any transaction if he or she, or an immediate family member, has a direct or indirect material interest in the transaction.

Where a Related Person Transaction will be ongoing, the Audit Committee may establish guidelines for management to follow in its ongoing dealings with the related person and the Audit Committee will review and assess the relationship on an annual basis to ensure it complies with such guidelines and that the Related Person Transaction remains appropriate.

## Compensation Discussion and Analysis

### Executive Summary

#### Named Executive Officers

This Compensation Discussion and Analysis provides a discussion and analysis of our compensation program for our named executive officers (“NEOs”). For the 2017 fiscal year ended February 3, 2018, the NEOs were:

Name	Title
W. Rodney McMullen	Chairman and Chief Executive Officer
J. Michael Schlotman	Executive Vice President and Chief Financial Officer
Michael J. Donnelly	Executive Vice President and Chief Operating Officer
Christopher T. Hjelm	Executive Vice President and Chief Information Officer
Stuart W. Aitken	Group Vice President

#### Summary of Key Compensation Practices

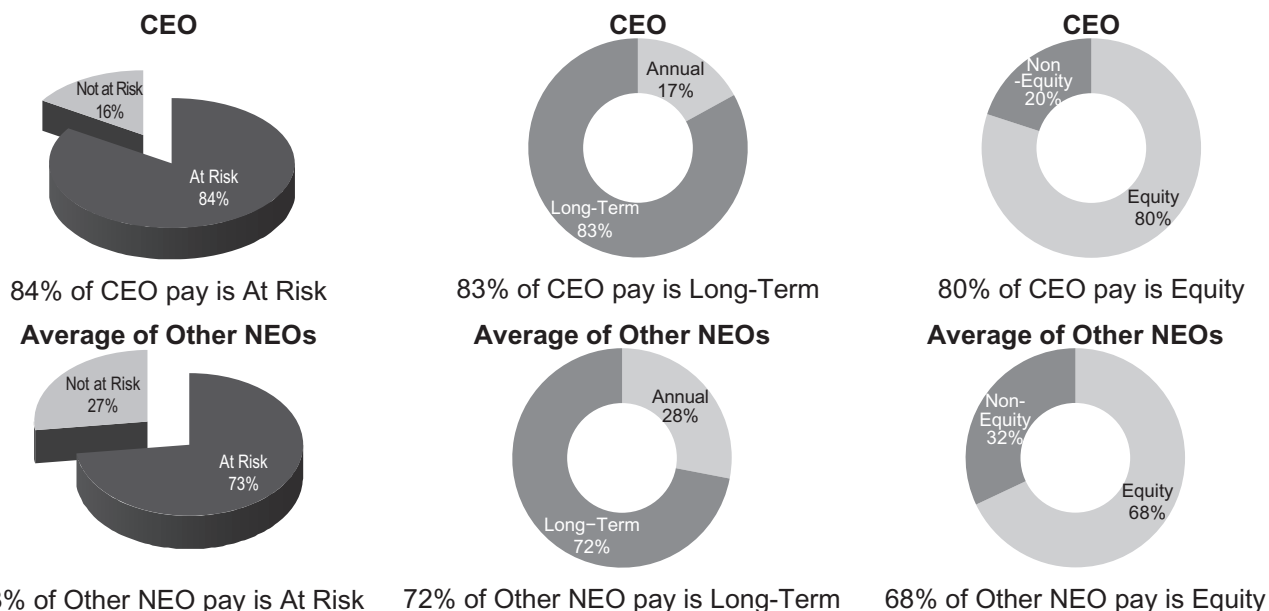
What we do:	What we do not do:
<ul style="list-style-type: none"> <li>✓ Align pay and performance</li> <li>✓ Significant share ownership guidelines of 5x salary for our CEO</li> <li>✓ Multiple performance metrics under our short- and long-term performance-based plans discourage excessive risk taking</li> <li>✓ Balance between short-term and long-term compensation to discourage short-term risk taking at the expense of long-term results</li> <li>✓ Engagement of an independent compensation consultant</li> <li>✓ Robust clawback policy</li> <li>✓ Ban on hedging, pledging and short sales of Kroger securities</li> <li>✓ Limited perquisites</li> </ul>	<ul style="list-style-type: none"> <li>✗ No employment contracts with executives</li> <li>✗ No special severance or change of control programs applicable only to executive officers</li> <li>✗ No tax gross-up payments for executives</li> <li>✗ No re-pricing or backdating of options</li> <li>✗ No guaranteed salary increases or bonuses</li> <li>✗ No payment of dividends or dividend equivalents until performance units are earned</li> <li>✗ No single-trigger cash severance benefits upon a change in control</li> </ul>

## Summary of Fixed and At-Risk Pay Elements

The fixed and at-risk pay elements of NEO compensation are reflected in the following table and charts.

	Element	Form	Description	
ANNUAL / SHORT-TERM INCENTIVE	Base Salary	Cash	<ul style="list-style-type: none"> <li>Attract, incentivize, retain talented executives</li> <li>Benchmarked to peer group</li> <li>Fixed cash component</li> </ul>	FIXED
	Other Benefits	Retirement & Limited Perquisites	<ul style="list-style-type: none"> <li>Kroger maintains several defined benefit and defined contribution retirement plans for its employees, in addition to an executive deferred compensation plan and The Kroger Co. Employee Protection Plan</li> <li>Executives receive limited perquisites because the Compensation Committee does not believe it is necessary for the attraction or retention of executive talent</li> </ul>	
	Annual Incentive Plan	Cash Bonus	<ul style="list-style-type: none"> <li>Metrics and targets align with annual business goals; payout depends on actual performance against each goal</li> <li>Rewards and incentivizes Kroger employees, including NEOs, for annual performance on key financial and operational measures</li> <li>Benchmarked to peer group median</li> </ul>	
LONG-TERM INCENTIVE	Long-Term Incentive Plan	Performance Units	<ul style="list-style-type: none"> <li>Drive profitability and growth, create shareholder value, foster executive retention, and align executive and shareholder interests</li> <li>All components paid in performance-based long-term cash bonuses and performance units to align executive and shareholder interests; vesting over a 3-year period</li> <li>Rewards and incentivizes approximately 170 key employees, including NEOs, for long-term performance on key financial and operational measures</li> </ul>	VARIABLE / AT-RISK
		Long-Term Cash Bonus		
	Time-Based Awards	<ul style="list-style-type: none"> <li>Restricted Stock</li> <li>Stock Options</li> </ul>	<ul style="list-style-type: none"> <li>Stock options and restricted stock for NEOs vest over 5 years; exercise price of stock options is closing price on day of grant</li> <li>Provides direct alignment to stock price appreciation and rewards executives for the achievement of long-term business objectives and providing incentives for the creation of shareholder value</li> </ul>	

The amounts used in the charts below are based on the amounts reported in the Summary Compensation Table for 2017, excluding the Change in Pension Value and Nonqualified Deferred Compensation Earnings column.



## Looking Ahead – Realignment of Performance-Based Pay to Restock Kroger for 2018 and Beyond

### Restock Kroger

In October 2017, we announced *Restock Kroger*, our plan to redefine the food and grocery customer experience in America and to create value for our shareholders. We developed the plan because, though we are proud of our long history of success and our strengths, we recognize that what got us here will not get us where we want to be in the future. *Restock Kroger* has four main drivers:

1. **Redefine the Food and Grocery Customer Experience:** Focus on data and personalization, digital, space optimization, Our Brands, and smart pricing

2. **Expand Partnerships to Create Customer Value:** Focus on front end transformation, technology innovation, cost reduction and alternative revenue streams
3. **Develop Talent:** Accelerate high-performance leadership culture through future talent development, training, and a rebalancing of pay and benefits
4. **Live Kroger's Purpose:** Meet Zero Hunger | Zero Waste targets and achieve 2020 sustainability goals

The three-year *Restock Kroger* plan is fueled by capital investments, cost savings and free cash flow. As a result of our plan, over the next three years (2018 – 2020), we expect to generate:

- \$400 million in incremental FIFO operating profit, and
- \$6.5 billion of free cash flow before dividends (double the performance of the previous three years).

We have prioritized our estimated \$9 billion in capital investments to support *Restock Kroger* over the next three years. We are looking first for sales-driving and cost-savings opportunities across both brick-and-mortar and digital platforms; followed by investments in logistics and technology platforms; and finally capital for storing activity.\*

#### *Our Compensation Committee is Focused on Pay for Performance*

The Compensation Committee has long maintained a strong pay for performance philosophy. Compensation must align the interests of our NEOs with the interests of our shareholders and must create incentives to achieve the annual business plan targets and longer term company objectives.

We implemented a long-term performance based bonus program for NEOs more than ten years ago, and the metrics were tailored to our long-term measures at that time. As our business objectives have shifted, the Compensation Committee is focused on ensuring performance metrics are aligned with our long-term strategy.

#### *Our Long-Term Compensation Program: Align with Restock Kroger*

We have made new commitments to shareholders on a three-year time horizon under *Restock Kroger*. We believe that the success of *Restock Kroger* depends on the focused attention of our leadership team and associates on the goals of *Restock Kroger* and that it is essential to implement new performance metrics that mirror these new commitments. We are describing our approach for developing our 2018 LTIP program, even though it is still a work in progress, to be transparent about how we are planning to make changes to our program to align with *Restock Kroger*.

Our 2018 three-year long-term plan (2018 – 2020) will have performance metrics tied to *Restock Kroger* goals: free cash flow and cost savings included in FIFO operating profit growth, with a return on invested capital modifier. We are implementing a metric based on the cost savings imbedded in the achievement of operating profit growth, because cost savings is essential to fund the strategic projects that will produce the operating profit growth. We believe it is a more meaningful metric than operating profit growth itself, because it forces us to focus on the savings that we need to support sustainable incremental operating profit growth.

Since we grant a new three-year long-term incentive plan each year, at any one time, there are three outstanding plans. As we are mid-cycle in the 2016 – 2018 and 2017 – 2019 long-term plans, we feel strongly that we should focus on *Restock Kroger* metrics rather than having competing priorities. As a result, the Compensation Committee has determined that the metrics of the mid-cycle plans should be modified to align with *Restock Kroger*.

For the outstanding 2016 – 2018 long-term plan, fiscal year 2016 and 2017 performance will be measured on the existing plan metrics and will be applied to two-thirds of the previously granted cash and performance unit bonus target amounts. Fiscal year 2018 performance will be measured on the *Restock Kroger* metrics of free cash flow and savings included in FIFO operating profit growth, and will be applied to one-third of the previously granted cash and performance unit bonus target amounts.

Similarly, for the outstanding 2017 – 2019 long-term plan, fiscal year 2017 performance will be measured on the existing plan metrics and will be applied to one-third of the previously granted cash and performance unit bonus target amounts. Fiscal year 2018 and 2019 performance will be measured on the *Restock Kroger* metrics of free cash flow and cost savings included in FIFO operating profit growth, and will be applied to two-thirds of the previously granted cash and performance unit bonus target amounts.

\* For important risk, uncertainties and other factors relating to these forward-looking statements, see the Risk Factors in our Annual Report on Form 10-K that accompanies this proxy statement.



With respect to the mid-cycle plans, we are not adjusting cash bonus potentials or re-issuing previously issued performance unit grants and we are not allowing NEOs to re-earn cash and performance units that were not earned in the completed year(s) of the outstanding plans. We did not change the timing of the payout under the outstanding plans. These plan updates are illustrated below.

		2016	2017	2018	2019	2020
<b>LTIP PERFORMANCE PERIODS</b>	<b>2016 – 2018</b>	2/3 Existing Plan Metrics		1/3 Restock Kroger Metrics		
	<b>2017 – 2019</b>		1/3 Existing Plan Metrics	2/3 Restock Kroger Metrics		
	<b>2018 - 2020</b>			100% Restock Kroger Metrics		
<b>METRICS</b>		<b>EXISTING PLAN METRICS</b>		<b>RESTOCK KROGER METRICS</b>		
		<ul style="list-style-type: none"> <li>• Customer 1<sup>st</sup> Strategy</li> <li>• Improvement in Associate Engagement</li> <li>• Reduction in Operating Cost as a Percentage of Sales, ex. Fuel</li> <li>• Return on Invested Capital</li> </ul>		<ul style="list-style-type: none"> <li>• Free Cash Flow</li> <li>• Savings Included in Net Operating Profit Growth</li> <li>• Return on Invested Capital (2018 – 2020 Plan only)</li> </ul>		

#### *Our Annual Cash Bonus Program: Based on Meeting Financial Goals*

We have also redesigned the performance-based annual cash bonus plan to better align with our financial goals of *Restock Kroger* and to simplify the way we reward our associates. The 2018 annual plan has the following metrics:

1. ID sales
2. Earnings per share
3. Strategic business plans that support *Restock Kroger*

To further support the cost saving focus of *Restock Kroger*, for any payout under the strategic business plans metric, the Company must have met its cost savings goals for 2018.

#### **Our Compensation Philosophy and Objectives**

As one of the largest retailers in the world, our executive compensation philosophy is to attract and retain the best management talent as well as motivate these employees to achieve our business and financial goals. Kroger's incentive plans are designed to reward the actions that lead to long-term value creation. The Compensation Committee believes that there is a strong link between our business strategy, the performance metrics in our short-term and long-term incentive programs, and the business results that drive shareholder value.

We believe our strategy creates value for shareholders in a manner consistent with our core values: honesty, integrity, respect, inclusion, diversity and safety.

To achieve our objectives, the Compensation Committee seeks to ensure that compensation is competitive and that there is a direct link between pay and performance. To do so, it is guided by the following principles:

- A significant portion of pay should be performance-based, with the percentage of total pay tied to performance increasing proportionally with an NEO's level of responsibility.

- Compensation should include incentive-based pay to drive performance, providing superior pay for superior performance, including both a short- and long-term focus.
- Compensation policies should include an opportunity for, and a requirement of, equity ownership to align the interests of NEOs and shareholders.
- Components of compensation should be tied to an evaluation of business and individual performance measured against metrics that directly drive our business strategy.

The Compensation Committee has three related objectives regarding compensation:

- First, the Compensation Committee believes that compensation must be designed to attract and retain those individuals who are best suited to be an officer at Kroger.
- Second, a majority of compensation should help align the interests of our NEOs with the interests of our shareholders.
- Third, compensation should create strong incentives for the NEOs to achieve the annual business plan targets established by the Board, and to achieve Kroger's long-term strategic objectives.

### **Components of Executive Compensation at Kroger**

Compensation for our NEOs is comprised of the following:

- Annual Compensation:
  - Salary
  - Performance-Based Annual Cash Bonus
- Long-Term Compensation:
  - Performance-Based Long-Term Incentive Plan (consisting of a long-term cash bonus and performance units)
  - Non-qualified stock options
  - Restricted stock
- Retirement and other benefits
- Limited perquisites

The annual and long-term performance-based compensation awards described herein were made pursuant to our 2014 Long-Term Incentive and Cash Bonus Plan, which was approved by our shareholders in 2014.

### ***Annual Compensation – Salary***

Our philosophy with respect to salary is to provide a sufficient and stable source of fixed cash compensation. All of our compensation cannot be at-risk or long-term. It is important to provide a meaningful annual salary to attract and retain a high caliber leadership team, and to have an appropriate level of cash compensation that is not variable.

Salaries for the NEOs (with the exception of the CEO) are established each year by the Compensation Committee, in consultation with the CEO. The CEO's salary is established by all of the independent directors. Salaries for the NEOs are reviewed annually in June.

The amount of each NEO's salary is influenced by numerous factors including:

- An assessment of individual contribution in the judgment of the CEO and the Compensation Committee (or, in the case of the CEO, of the Compensation Committee and the independent directors);
- Benchmarking with comparable positions at peer group companies;
- Tenure in role; and
- Relationship to other Kroger executives' salaries.

The assessment of individual contribution is a qualitative determination, based on the following factors:

- Leadership;
- Contribution to the officer group;
- Achievement of established objectives;
- Decision-making abilities;
- Performance of the areas or groups directly reporting to the NEO;
- Increased responsibilities;
- Strategic thinking; and
- Furtherance of Kroger's core values.

### ***Annual Compensation – Performance-Based Annual Cash Bonus***

The NEOs participate in a performance-based annual cash bonus plan. The amount of annual cash bonus that the NEOs earn each year is based upon Kroger's performance compared to goals established by the Compensation Committee and the independent directors based on the business plan adopted by the Board of Directors. A minimum level of performance must be achieved before any payouts are earned, while a payout of up to 200% of target bonus potential can be achieved for superior performance. There are no guaranteed or minimum payouts; if none of the performance goals are achieved, then none of the bonus is earned and no payout is made.

The annual cash bonus plan is designed to encourage decisions and behavior that drive the annual operating results and the long-term success of the Company. Kroger's success is based on a combination of factors, and accordingly the Compensation Committee believes that it is important to encourage behavior that supports multiple elements of our business strategy.

### ***Establishing Annual Cash Bonus Potentials***

The Compensation Committee establishes annual cash bonus potentials for each NEO, other than the CEO, whose annual cash bonus potential is established by the independent directors. Actual payouts represent the extent to which performance meets or exceeds the goals established by the Compensation Committee. Actual payouts may be as low as zero if performance does not meet the goals established by the Compensation Committee or as high as 200% of the potential bonus amount if the performance far exceeds these pre-established goals.

The Compensation Committee considers multiple factors in making its determination or recommendation as to annual cash bonus potentials:

- The individual's level within the organization, as the Compensation Committee believes that more senior executives should have a more substantial part of their compensation dependent upon Kroger's performance;
- The individual's salary, as the Compensation Committee believes that a significant portion of an NEO's total cash compensation should be dependent upon Kroger's performance;
- The individual's level in the organization and the internal relationship of annual cash bonus potentials within Kroger;
- Individual performance;
- The recommendation of the CEO for the other NEOs; and
- The compensation consultant's benchmarking report regarding annual cash bonus potential and total compensation awarded by our peer group.

## 2017 Annual Cash Bonus Plan Metrics

The 2017 annual cash bonus plan had the following measurable performance metrics, all of which are interconnected:

Metric	Weight	Rationale for Use
<i>ID Sales</i>	20%	<ul style="list-style-type: none"> <li>ID Sales represent sales, without fuel, at our supermarkets that have been open without expansion or relocation for five full quarters.</li> <li>We believe this is the best measure of the real growth of our sales across the enterprise. A key driver of our model is strong ID Sales; it is the engine that fuels our growth.</li> </ul>
<i>Net Operating Profit, without Supermarket Fuel Operating Profit (“Net Operating Profit”)<sup>(1)</sup></i>	20%	<ul style="list-style-type: none"> <li>Net Operating Profit allows us to evaluate our earnings from operating the business; we cannot achieve solid Net Operating Profit without a strong operating model.</li> <li>This is a good measure of the profitability of the business which takes into account the capital invested to generate the earnings.</li> </ul>
<i>Customer 1<sup>st</sup> Strategy</i>	60%	<ul style="list-style-type: none"> <li>Kroger’s Customer 1<sup>st</sup> Strategy is the focus, in our decision-making, on the customer. The “Four Keys” of our Customer 1<sup>st</sup> Strategy are People, Products, Shopping Experience and Price.</li> <li>This proprietary metric includes a mixture of strategic and operational metrics that measure the improvement in how Kroger is perceived by customers in each of the Four Keys.</li> <li>Annual cash bonus payout is based on certain elements of the Customer 1<sup>st</sup> Strategy, to highlight annual objectives that are intended to receive the most focused attention in that year.</li> </ul>
<b>Total of 3 Metrics</b>	<b>100%</b>	
<i>ClickList Bonus</i>	5% “Kicker”	<ul style="list-style-type: none"> <li>An additional 5% is earned if Kroger achieves certain goals with respect to our ClickList expansion and operations.</li> <li>The ClickList bonus is included in the annual cash bonus plan as an incentive to encourage the addition of ClickList locations at a faster rate, while maintaining certain operating and financial standards.</li> <li>The ClickList bonus of 5% is only available if the pre-determined measures are met. If any of the goals are not met, no portion of the ClickList bonus is earned.</li> </ul>

(1) Net Operating Profit is calculated as gross profit, minus operating, general and administrative expenses, minus depreciation and amortization, excluding supermarket fuel and the non-Kroger portion of earnings of consolidated variable interest entities.

## Results of 2017 Annual Cash Bonus Plan

The 2017 goals established by the Compensation Committee, the actual 2017 results and the bonus percentage earned for each of the performance metrics of the 2017 annual cash bonus plan were as follows:

Performance Metrics	Goals		Actual Performance	Actual Performance Compared to Minimum Goal (A)	Weight (B)	Amount Earned (A) x (B)
	Minimum	Target (100%)				
ID Sales	0.90%	2.90%	0.71%	0%	20%	0%
Net Operating Profit	\$2.93 Billion	\$3.45 Billion	\$2.85 Billion	0%	20%	0%
Customer 1 <sup>st</sup> Strategy <sup>(1)</sup>	*	*	*	*	60%	3.8%
ClickList Bonus <sup>(2)</sup>	*	*	*	*	0% or 5%	0%
<b>Total Earned</b>						<b>3.8%</b>

(1) The Customer 1<sup>st</sup> Strategy goal also was established by the Compensation Committee at the beginning of the year, but is not disclosed as it is competitively sensitive.

(2) An additional 5% would have been earned if Kroger had achieved certain goals with respect to its ClickList expansion and operation. These goals were established by the Compensation Committee at the beginning of the year, but are not disclosed as they are competitively sensitive.

Following the close of the year, the Compensation Committee reviewed Kroger's performance against each of the metrics outlined above and determined the extent to which Kroger achieved those objectives. Due to our performance when compared to the goals established by the Compensation Committee, the NEOs earned 3.8% of their bonus potentials.

In 2017, as in all years, the Compensation Committee retained discretion to reduce the annual cash bonus payout for all executive officers, including the NEOs, if the Compensation Committee determined for any reason that the bonus payouts were not appropriate given their assessment of Company performance – however, no adjustments were made in 2017 that affected NEO bonuses. The independent directors retained that discretion for the CEO's bonus. The Compensation Committee and the independent directors also retained discretion to adjust the goals for each metric under the plan should unanticipated developments arise during the year.

The actual annual cash bonus percentage payout for 2017 represented performance that did not meet many of our business plan objectives. The strong link between pay and performance is illustrated by a comparison of earned amounts under our annual cash bonus plan in previous years, such as 2011, 2014 and 2015, when payouts significantly exceeded 100%. In those years, we achieved and/or exceeded many of our business plan objectives. A comparison of actual annual cash bonus percentage payouts this year and in prior years demonstrates the variability of annual cash bonus incentive compensation and its strong link to our performance:

Fiscal Year	Annual Cash Bonus Payout Percentage
2017	3.8%
2016	19.9%
2015	126.7%
2014	121.5%
2013	104.9%
2012	85.9%
2011	138.7%
2010	53.9%
2009	38.5%
2008	104.9%

As described above, the annual cash bonus payout percentage is applied to each NEO's bonus potential, which is determined by the Compensation Committee, and the independent directors in the case of the CEO. The actual amounts of performance-based annual cash bonuses paid to the NEOs for 2017 are reported in the Summary Compensation Table in the "Non-Equity Incentive Plan Compensation" column and footnote 4 to that table.

## ***Long-Term Compensation***

The Compensation Committee believes in the importance of providing an incentive to the NEOs to achieve the long-term goals established by the Board. As such, a majority of compensation is conditioned on the achievement of the Company's long-term goals and is delivered via four long-term compensation vehicles: long-term cash bonus, performance units, stock options and restricted stock. Long-term compensation promotes long-term value creation and discourages the over-emphasis of attaining short-term goals at the expense of long-term growth.

The Compensation Committee considers several factors in determining the target value of long-term compensation awarded to the NEOs or, in the case of the CEO, recommending to the independent directors the amount awarded. These factors include:

- Individual performance;
- The NEO's level in the organization and the internal relationship of long-term compensation awards within Kroger;
- The compensation consultant's benchmarking report regarding long-term compensation awarded by our peer group; and
- The recommendation of the CEO, for the other NEOs.

Long-term incentives are structured to be a combination of performance- and time-based compensation that reflects elements of financial and common shares performance to provide both retention value and alignment with company performance. Long-term cash bonus and performance unit payouts are contingent on the achievement of certain strategic performance and financial measures and incentivize recipients to promote long-term value creation and enhance shareholder wealth by supporting the Company's long-term strategic goals. Stock options and restricted stock are linked to common shares performance creating alignment between the NEOs and our shareholders' interests. Options have no initial value and recipients only realize benefits if the value of our common shares increases following the date of grant.

A majority of long-term compensation is equity-based (performance units, stock options, and restricted stock) and is tied to the future value of our common shares, further aligning the interests of our NEOs with our shareholders. All four components of long-term compensation are intended to focus executive behaviors on our long-term strategy. Each component is described in more detail below.

Amounts of long-term compensation awards issued and outstanding for the NEOs are set forth in the Executive Compensation Tables section.

## ***Long-Term Incentive Plan Design***

In recent years, we have adopted a similar Long-Term Incentive Plan each year, which provides for overlapping three-year performance periods. The Long-Term Incentive Plans adopted in 2015, 2016 and 2017, which consist of a performance-based long-term cash bonus and performance units, have the following characteristics:

- The long-term cash bonus potential is equal to the participant's salary at the end of the fiscal year preceding the plan effective date (or for those participants entering the plan after the commencement date, the date of eligibility for the plan).
- In addition, a fixed number of performance units is awarded to each participant at the beginning of the performance period (or for those participants entering the plan after the commencement date, the date of eligibility for the plan). The earned awards are paid out in Kroger common shares based on actual performance, along with a cash amount equal to the dividends paid during the performance period on the number of issued common shares ultimately earned.
- The actual long-term cash bonus and number of performance units earned are each determined based on our performance against the metrics established by the Compensation Committee (the independent directors, for the CEO) at the beginning of the performance period.
- Performance at the end of the three-year period is measured against the baseline of each performance metric established at the beginning of the performance period.
- The payout percentage, based on the extent to which the performance metrics are achieved, is applied to both the long-term cash bonus potential and the number of performance units awarded.



- Actual payouts cannot exceed 100% of the long-term cash bonus potential or 100% of the number of performance units awarded.

The Compensation Committee anticipates adopting a new Long-Term Incentive Plan each year, measuring improvement over successive three-year periods. Each year when establishing the performance metric baselines and percentage payouts per unit of improvement, the Compensation Committee considers the difficulty of achieving compounded improvement over time.

### **Long-Term Incentive Plan Metrics**

The following table summarizes the Long-Term Incentive Plans adopted in 2015, 2016 and 2017:

<b>Metric</b>	<b>Rationale for Use</b>
<i>Customer 1<sup>st</sup> Strategy</i>	<ul style="list-style-type: none"> <li>• Kroger's Customer 1<sup>st</sup> Strategy is the focus, in our decision-making, on the customer. The Four Keys of our Customer 1<sup>st</sup> Strategy are People, Products, Shopping Experience and Price.</li> <li>• This proprietary metric measures the improvement in how Kroger is perceived by customers in each of the Four Keys.</li> <li>• Long-Term Incentive Plan payout is based on all of the elements of the Customer 1<sup>st</sup> Strategy, to maintain our top executives' consistent focus on the entirety of the Customer 1<sup>st</sup> Strategy. This is in contrast to the 2017 annual cash bonus payout, which is based on certain elements of the Customer 1<sup>st</sup> Strategy, to highlight annual objectives that are intended to receive the most focused attention in that year.</li> </ul>
<i>Improvement in Associate Engagement</i>	<ul style="list-style-type: none"> <li>• Kroger measures associate engagement in an annual survey of associates.</li> <li>• This metric is included in these Long-Term Incentive Plans as an acknowledgement that our Company's success is directly tied to our associates connecting with and serving our customers every day, whether in our stores, manufacturing plants, distribution centers or offices.</li> </ul>
<i>Reduction in Operating Costs<sup>(1)</sup> as a Percentage of Sales, without Fuel</i>	<ul style="list-style-type: none"> <li>• An essential part of Kroger's model is to increase productivity and efficiency, and to take costs out of the business in a sustainable way.</li> <li>• We strive to be disciplined, so that as the Company grows, expenses are properly managed. Including this metric in these Long-term Incentive Plans, provides an incentive to implement policies for sustainable improvement over a long period of time.</li> </ul>
<i>ROIC<sup>(2)</sup></i>	<ul style="list-style-type: none"> <li>• Part of our long-term growth strategy is to make substantial capital investments over time. We have a pipeline of high quality projects.</li> <li>• With significant capital spend, it is essential that we achieve the proper returns on our investments.</li> <li>• This measure is intended to hold executives accountable for the returns on the capital investments.</li> </ul>

- (1) Operating Costs is a non-GAAP measure and is calculated as the sum of (i) operating, general and administrative expenses, depreciation and amortization, and rent expense, without fuel, and (ii) warehouse and transportation costs, shrink, and advertising expenses, for our supermarket operations, without fuel. Operating costs will exclude one-time expenses incurred in lieu of future anticipated obligations. Future expenses that are avoided by virtue of the incurrence of the one-time expense will be deemed to be total operating costs in the year in which they otherwise would have been incurred.
- (2) Return on invested capital is a non-GAAP measure and is calculated 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 our last-in, first out ("LIFO") charge, depreciation and amortization, and rent. Average invested capital will be 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, excluding accrued income taxes.

The following table summarizes the Long-Term Incentive Plans for the years shown, as adopted:

	<u>2015 Plan</u>	<u>2016 Plan</u>	<u>2017 Plan</u>
<b>Performance Period</b>	2015 to 2017	2016 to 2018	2017 to 2019
<b>Payout Date</b>	March 2018	March 2019	March 2020
<b>Long-term Cash Bonus Potential</b>	Salary at end of fiscal year 2014*	Salary at end of fiscal year 2015*	Salary at end of fiscal year 2016*
<b>Performance Metrics</b>			
<b>Customer 1<sup>st</sup> Strategy</b>	4% payout per unit improvement	4% payout per unit improvement	4% payout per unit improvement
<b>Improvement in Associate Engagement</b>	4% payout per unit improvement	4% payout per unit improvement	4% payout per unit improvement
<b>Reduction in Operating Cost as a Percentage of Sales, without Fuel</b>	0.50% payout per 0.01% reduction in operating costs Baseline: 26.41%	0.50% payout per 0.01% reduction in operating costs Baseline: 26.16%	0.50% payout per 0.01% reduction in operating costs Baseline: 26.23%
<b>ROIC</b>	1% payout per 0.01% improvement in ROIC Baseline: 13.50%	1% payout per 0.01% improvement in ROIC Baseline: 13.73%	4% payout per 0.01% improvement in ROIC Baseline: 13.23%

\* Or date of plan entry, if later.

As described above, under “Looking Ahead – Realignment of Performance-Based Pay to Restock Kroger for 2018 and Beyond” the metrics listed above for the 2016 and 2017 plans will be used to measure performance through 2017 and will be applied to the previously granted cash and performance unit bonus targets on a prorated basis. Performance for 2018 and 2019 will be measured on the *Restock Kroger* metrics of free cash flow and cost savings included in FIFO operating profit growth and will also be applied to bonus targets on a prorated basis.

### **Results of 2015 Long-Term Incentive Plan**

The 2015 Long-Term Incentive Plan, which measured improvements over the three year period from 2015 to 2017, paid out in March 2018 and was calculated as follows:

<b>Metric</b>	<b>Baseline</b>	<b>Result</b>	<b>Improvement (A)</b>	<b>Payout per Improvement (B)</b>	<b>Percentage Earned (A) x (B)</b>
Customer 1 <sup>st</sup> Strategy <sup>(1)</sup>	*	*	6 units of improvement	4.0%	24.0%
Improvement in Associate Engagement <sup>(1)</sup>	*	*	no improvement	4.0%	0.0%
Reduction in Operating Cost as a Percentage of Sales, without Fuel	26.41%	26.77%	no improvement	0.5%	0.0%
Return on Invested Capital	13.50%	12.31%	no improvement	1.0%	0.0%
<b>Total</b>					<b>24.0%</b>

(1) The Customer 1<sup>st</sup> Strategy and Improvement in Associate Engagement components were established by the Compensation Committee at the beginning of the performance period, but are not disclosed as they are competitively sensitive.

Accordingly, each NEO received a long-term cash bonus in an amount equal to 24.0% of that executive’s long-term cash bonus potential, and was issued the number of Kroger common shares equal to 24.0% of the number of performance units awarded to that executive, along with a cash amount equal to the dividends paid on that number of common shares during the three year performance period. The cash payout and dividends paid on common shares earned under the 2015 Long-Term Incentive Plan are reported in the “Non-Equity Incentive Plan

Compensation” and “All Other Compensation” columns of the Summary Compensation Table and footnotes 4 and 6 to that table, respectively, and the common shares issued under the plan are reported in the 2017 Option Exercises and Stock Vested Table and footnote 2 to that table.

### ***Stock Options and Restricted Stock***

Stock options and restricted stock continue to play an important role in rewarding NEOs for the achievement of long-term business objectives and providing incentives for the creation of shareholder value. Awards based on Kroger’s common shares are granted annually to the NEOs and a large number of other employees. Kroger historically has distributed time-based equity awards widely, aligning the interests of employees with your interest as shareholders.

The options permit the holder to purchase Kroger common shares at an option price equal to the closing price of Kroger common shares on the date of the grant. Options are granted only on one of the four dates of Board meetings conducted after Kroger’s public release of its quarterly earnings results.

The Compensation Committee determines the vesting schedule for stock options and restricted stock. During 2017, the Compensation Committee granted to the NEOs stock options and restricted stock, each with a five-year vesting schedule, with the exception of a special one-time restricted stock grant awarded to each of Messrs. Donnelly and Aitken, each of which vests 25% on each of the first two anniversaries of the grant date and 50% on the third anniversary of the grant date.

As discussed below under Stock Ownership Guidelines, covered individuals, including the NEOs, must hold 100% of common shares issued pursuant to performance units earned, the shares received upon the exercise of stock options or upon the vesting of restricted stock, except those necessary to pay the exercise price of the options and/or applicable taxes, until applicable stock ownership guidelines are met, unless the disposition is approved in advance by the CEO, or by the Board or Compensation Committee for the CEO.

### ***Retirement and Other Benefits***

Kroger maintains several defined benefit and defined contribution retirement plans for its employees. The NEOs participate in one or more of these plans, as well as one or more excess plans designed to make up the shortfall in retirement benefits created by limitations under the Internal Revenue Code (the “Code”) on benefits to highly compensated individuals under qualified plans. Additional details regarding certain retirement benefits available to the NEOs can be found below in footnote 6 to the Summary Compensation Table and the 2017 Pension Benefits Table and the accompanying narrative.

Kroger also maintains an executive deferred compensation plan in which some of the NEOs participate. This plan is a nonqualified plan under which participants can elect to defer up to 100% of their cash compensation each year. Additional details regarding our nonqualified deferred compensation plans available to the NEOs can be found below in the 2017 Nonqualified Deferred Compensation Table and the accompanying narrative.

Kroger also maintains The Kroger Co. Employee Protection Plan (“KEPP”), which covers all of our management employees who are classified as exempt under the federal Fair Labor Standards Act and certain administrative or technical support personnel who are not covered by a collective bargaining agreement, with at least one year of service. KEPP provides for severance benefits and extended Kroger-paid health care, as well as the continuation of other benefits as described in the plan, when an employee is actually or constructively terminated without cause within two years following a change in control of Kroger (as defined in KEPP). Participants are entitled to severance pay of up to 24 months’ salary and target annual bonus. The actual amount is dependent upon pay level and years of service. KEPP can be amended or terminated by the Board at any time prior to a change in control.

Performance-based long-term cash bonus, performance unit, stock option, and restricted stock agreements with award recipients provide that those awards “vest,” with 50% of the long-term cash bonus potential being paid, common shares equal to 50% of the performance units being awarded, options becoming immediately exercisable, and restrictions on restricted stock lapsing upon a change in control as described in the grant agreements.

None of the NEOs is party to an employment agreement.

### ***Perquisites***

Our NEOs receive limited perquisites because the Compensation Committee does not believe that it is necessary for the attraction or retention of management talent to provide executives a substantial amount of

compensation in the form of perquisites. In 2017, all of the NEOs received the following benefits: premiums paid on life insurance policies, premiums paid on accidental death and dismemberment insurance and premiums paid on long-term disability insurance policies. In 2017, Mr. Aitken received reimbursement of tax preparation fees and cell phone fees. Further details on these benefits can be found in footnote 6 to the Summary Compensation Table.

### Process for Establishing Executive Compensation

The Compensation Committee of the Board has the primary responsibility for establishing the compensation of our executive officers, including the NEOs, with the exception of the CEO. The Compensation Committee's role regarding the CEO's compensation is to make recommendations to the independent members of the Board; those members of the Board establish the CEO's compensation.

The Compensation Committee directly engaged a compensation consultant from Mercer to advise the Compensation Committee in the design of compensation for executive officers, through the 2017 compensation planning cycle.

The Mercer consultant conducted an annual competitive assessment of executive positions at Kroger for the Compensation Committee. The assessment is one of several bases, as described above, on which the Compensation Committee determines compensation. The consultant assessed:

- base salary;
- target performance-based annual cash bonus;
- target annual cash compensation (the sum of salary and annual cash bonus potential);
- annualized long-term compensation, such as performance-based long-term cash bonus potential and performance units, stock options and restricted stock; and
- total direct compensation (the sum of target annual cash compensation and annualized long-term compensation).

In addition to the factors identified above, the consultant also reviewed actual payout amounts against the targeted amounts.

The consultant compared these elements against those of other companies in a group of publicly traded companies selected by the Compensation Committee. For 2017, our peer group consisted of:

Best Buy	Home Depot	Target
Cardinal Health	Johnson & Johnson	TJX Companies
Costco Wholesale	Lowe's	Wal-Mart
CVS Health	Procter & Gamble	Walgreens Boots Alliance
Express Scripts	Sysco	

The make-up of the compensation peer group is reviewed annually and modified as circumstances warrant. The Compensation Committee modified the peer group in 2016 because of industry consolidation and other competitive forces. Previously, the Compensation Committee used a primary peer group consisting only of food and drug retailers. In addition, the Compensation Committee considered data from "general industry" companies provided by its independent compensation consultant, a representation of major publicly-traded companies of similar size and scope from outside the retail industry. This data provided reference points, particularly for senior executive positions where competition for talent extends beyond the retail sector. The new peer group includes a combination of food and drug retailers, other large retailers based on revenue size, and large consumer-facing companies. Median 2017 revenue for the peer group was \$87.8 billion, compared to our 2017 revenue of \$122.7 billion.

Considering the size of Kroger in relation to other peer group companies, the Compensation Committee believes that salaries paid to our NEOs should be competitively positioned relative to amounts paid by peer group companies for comparable positions. The Compensation Committee also aims to provide an annual cash bonus potential to our NEOs that, if achieved at superior levels, would cause total cash compensation to be meaningfully above the median. Actual payouts may be as low as zero if performance does not meet the baselines established by the Compensation Committee.

The independent members of the Board have the exclusive authority to determine the amount of the CEO's compensation. In setting total compensation, the independent directors consider the median compensation of the peer group's CEOs. With respect to the annual bonus, the independent directors make two determinations: (1) they

determine the annual cash bonus potential that will be multiplied by the annual cash bonus payout percentage earned that is applicable to the NEOs and (2) the independent directors determine the annual cash bonus amount paid to the CEO by retaining discretion to reduce the annual cash bonus percentage payout the CEO would otherwise receive under the formulaic plan.

The Compensation Committee performs the same function and exercises the same authority as to the other NEOs. In its annual review of compensation for the NEOs the Compensation Committee:

- Conducts an annual review of all components of compensation, quantifying total compensation for the NEOs on tally sheets. The review includes a summary for each NEO of salary; performance-based annual cash bonus; long-term performance-based cash and performance unit compensation; stock options; restricted stock; accumulated realized and unrealized stock option gains and restricted stock and performance unit values; the value of any perquisites; retirement benefits; company paid health and welfare benefits; banked vacation; severance benefits available under KEPP; and earnings and payouts available under Kroger's nonqualified deferred compensation program.
- Considers internal pay equity at Kroger to ensure that the CEO is not compensated disproportionately. The Compensation Committee has determined that the compensation of the CEO and that of the other NEOs bears a reasonable relationship to the compensation levels of other executive positions at Kroger taking into consideration performance and differences in responsibilities.
- Reviews a report from the Compensation Committee's compensation consultant comparing NEO and other senior executive compensation with that of other companies, including both our peer group of competitors and a larger general industry group, to ensure that the Compensation Committee's objectives of competitiveness are met.
- Takes into account a recommendation from the CEO (except in the case of his own compensation) for salary, annual cash bonus potential and long-term compensation awards for each of the senior officers including the other NEOs. The CEO's recommendation takes into consideration the objectives established by and the reports received by the Compensation Committee as well as his assessment of individual job performance and contribution to our management team.

The Compensation Committee does not make use of a formula, but both qualitatively and quantitatively considers each of the factors identified above in setting compensation.

### Advisory Vote to Approve Executive Compensation

At the 2017 annual meeting, we held our seventh annual advisory vote on executive compensation. Over 93% of the votes cast were in favor of the advisory vote in 2017. The Compensation Committee believes it conveys our shareholders' support of the Compensation Committee's decisions and the existing executive compensation programs. The Compensation Committee made no material changes in the structure of our compensation programs for 2017 or our pay for performance philosophy. At the 2017 annual meeting, we held an advisory vote on the frequency of the advisory vote on executive compensation. Approximately 88% of the votes cast were in favor of an annual vote and accordingly, we will continue to have an annual advisory vote.

### Stock Ownership Guidelines

To more closely align the interests of our officers and directors with your interests as shareholders, the Board has adopted stock ownership guidelines. These guidelines require non-employee directors, executive officers, and other key executives to acquire and hold a minimum dollar value of Kroger common shares as set forth below:

Position	Multiple
Chief Executive Officer	5 times base salary
President and Chief Operating Officer	4 times base salary
Executive Vice Presidents and Senior Vice Presidents	3 times base salary
Group Vice Presidents, Division Presidents, and Other Designated Key Executives	2 times base salary
Non-employee Directors	5 times annual base cash retainer

All covered individuals are expected to achieve the target level within five years of appointment to their positions. Until the requirements are met, covered individuals, including the NEOs, must hold 100% of common



shares issued pursuant to performance units earned, shares received upon the exercise of stock options and upon the vesting of restricted stock, except those necessary to pay the exercise price of the options and/or applicable taxes, and must retain all Kroger common shares unless the disposition is approved in advance by the CEO, or by the Board or Compensation Committee for the CEO.

### **Executive Compensation Recoupment Policy (Clawback)**

If a material error of facts results in the payment to an executive officer at the level of Group Vice President or higher of an annual cash bonus or a long-term cash bonus in an amount higher than otherwise would have been paid, as determined by the Compensation Committee, then the officer, upon demand from the Compensation Committee, will reimburse Kroger for the amounts that would not have been paid if the error had not occurred. This recoupment policy applies to those amounts paid by Kroger within 36 months prior to the detection and public disclosure of the error. In enforcing the policy, the Compensation Committee will take into consideration all factors that it deems appropriate, including:

- the materiality of the amount of payment involved;
- the extent to which other benefits were reduced in other years as a result of the achievement of performance levels based on the error;
- individual officer culpability, if any; and
- other factors that should offset the amount of overpayment.

### **Compensation Policies as They Relate to Risk Management**

As part of the Compensation Committee's review of our compensation practices, the Compensation Committee considers and analyzes the extent to which risks arise from such practices and their impact on Kroger's business. As discussed in this Compensation Discussion and Analysis, our policies and practices for compensating employees are designed to, among other things, attract and retain high quality and engaged employees. In this process, the Compensation Committee also focuses on minimizing risk through the implementation of certain practices and policies, such as the executive compensation recoupment policy, which is described above under "Executive Compensation Recoupment Policy (Clawback)". Accordingly, we do not believe that our compensation practices and policies create risks that are reasonably likely to have a material adverse effect on Kroger.

### **Prohibition on Hedging and Pledging**

After considering best practices related to ownership of company shares, the Board has adopted a policy prohibiting Kroger directors and executive officers from engaging, directly or indirectly, in the pledging of, hedging transactions in, or short sales of, Kroger securities.

### **Section 162(m) of the Internal Revenue Code**

Prior to the effective date of the Tax Cuts and Jobs Act of 2017, Section 162(m) of the Code generally disallowed a federal tax deduction to public companies for compensation greater than \$1 million paid in any tax year to specified executive officers unless the compensation was "qualified performance-based compensation" under that section. Pursuant to the Tax Cuts and Jobs Act of 2017, the exception for "qualified performance-based compensation" under Section 162(m) of the Code was eliminated with respect to all remuneration in excess of \$1 million other than qualified performance based compensation pursuant to a written binding contract in effect on November 2, 2017 or earlier which was not modified in any material respect on or after such date (the legislation providing for such transition rule, the "Transition Rule").

As a result, performance based compensation that the Compensation Committee structured in previous years with the intent of qualifying as performance-based compensation under Section 162(m) that will be paid after January 1, 2018 may not be fully deductible, depending on the application of the Transition Rule. The committee will—consistent with its past practice—continue to retain flexibility to design compensation programs that are in the best long-term interests of the company and our shareholders, with deductibility of compensation being one of a variety of considerations taken into account.



## **Compensation Committee Report**

The Compensation Committee has reviewed and discussed with Kroger's management the Compensation Discussion and Analysis contained in this proxy statement. Based on its review and discussions with management, the Compensation Committee has recommended to the Board that the Compensation Discussion and Analysis be included in Kroger's proxy statement and incorporated by reference into its Annual Report on Form 10-K.

Compensation Committee:

Clyde R. Moore, Chair  
Susan J. Kropf  
Jorge P. Montoya  
James A. Runde

## Executive Compensation Tables

### Summary Compensation Table

The following table and footnotes provide information regarding the compensation of the NEOs for the fiscal years presented.

Name and Principal Position <sup>(1)</sup>	Fiscal Year	Salary (\$)	Stock Awards (\$) <sup>(2)</sup>	Option Awards (\$) <sup>(3)</sup>	Non-Equity Incentive Plan Compensation (\$) <sup>(4)</sup>	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) <sup>(5)</sup>	All Other Compensation (\$) <sup>(6)</sup>	Total (\$)
W. Rodney McMullen	2017	1,318,752	5,166,317	2,700,116	359,806	1,691,406	298,463	11,534,860
Chairman and Chief Executive Officer	2016	1,251,781	5,125,034	2,699,044	719,945	3,139,537	282,051	13,217,392
	2015	1,216,665	4,332,252	2,300,092	2,999,693	618,033	279,656	11,746,391
J. Michael Schlotman	2017	898,316	1,973,228	1,040,846	207,136	873,808	242,637	5,235,971
Executive Vice President and Chief Financial Officer	2016	850,360	1,973,247	1,040,436	372,855	1,436,752	141,427	5,815,077
	2015	793,825	2,489,148	1,040,847	1,394,752	44,163	148,104	5,910,839
Michael J. Donnelly	2017	817,967	2,230,028	780,637	183,832	1,032,483	247,149	5,292,096
Executive Vice President and Chief Operating Officer	2016	757,036	1,480,011	780,323	341,308	2,207,236	188,569	5,754,483
	2015	700,684	1,919,013	585,529	1,274,152	321,545	175,112	4,976,035
Christopher T. Hjelm	2017	744,245	1,480,025	780,637	173,536	520	190,917	3,369,880
Executive Vice President and Chief Information Officer	2016	706,567	1,480,011	780,323	326,280	832	151,201	3,445,214
	2015	653,368	1,992,003	780,633	1,302,852	168	138,145	4,867,169
Stuart W. Aitken	2017	721,328	1,275,567	262,612	160,015	-	110,363	2,529,884
Group Vice President								

(1) Mr. Aitken became an NEO in 2017.

(2) Amounts reflect the grant date fair value of restricted stock and performance units granted each fiscal year, as computed in accordance with FASB ASC Topic 718. The following table reflects the value of each type of award granted to the NEOs in 2017:

Name	Restricted Stock	Performance Units
Mr. McMullen	\$ 3,750,010	\$ 1,416,307
Mr. Schlotman	\$ 1,479,921	\$ 493,307
Mr. Donnelly	\$ 1,860,019	\$ 370,009
Mr. Hjelm	\$ 1,110,016	\$ 370,009
Mr. Aitken	\$ 1,151,111	\$ 124,456

The grant date fair value of the performance units reflected in the stock awards column and in the table above is computed based on the probable outcome of the performance conditions as of the grant date. This amount is consistent with the estimate of aggregate compensation cost to be recognized by the Company over the three-year performance period of the award determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. The assumptions used in calculating the valuations are set forth in Note 12 to the consolidated financial statements in Kroger's 10-K for fiscal year 2017.

Assuming that the highest level of performance conditions is achieved, the aggregate fair value of the 2017 performance unit awards at the grant date is as follows:

Name	Value of Performance Units Assuming Maximum Performance
Mr. McMullen	\$2,832,614
Mr. Schlotman	\$ 986,614
Mr. Donnelly	\$ 740,018
Mr. Hjelm	\$ 740,018
Mr. Aitken	\$ 248,911

- (3) These amounts represent the aggregate grant date fair value of option awards computed in accordance with FASB ASC Topic 718. The assumptions used in calculating the valuations are set forth in Note 12 to the consolidated financial statements in Kroger's 10-K for fiscal year 2017.
- (4) Non-equity incentive plan compensation earned for 2017 consists of amounts earned under the 2017 performance-based annual cash bonus plan and the 2015 Long-Term Incentive Plan.

Name	Annual Cash Bonus	Long-Term Cash Bonus
Mr. McMullen	\$ 71,806	\$ 288,000
Mr. Schlotman	\$ 24,736	\$ 182,400
Mr. Donnelly	\$ 24,736	\$ 159,096
Mr. Hjelm	\$ 24,736	\$ 148,800
Mr. Aitken	\$ 16,160	\$ 143,855

In accordance with the terms of the 2017 performance-based annual cash bonus plan, Kroger paid 3.8% to the NEOs. These amounts were earned with respect to performance in 2017 and paid in March 2018. See "Results of 2017 Annual Cash Bonus Plan" in the Compensation Discussion and Analysis ("CD&A") for more information on this plan.

The long-term cash bonus awarded under the 2015 Long-Term Incentive Plan is a performance-based bonus plan designed to reward participants for improving the long-term performance of the Company. The plan covered performance during fiscal years 2015, 2016 and 2017 and amounts earned under the plan were paid in March 2018. In accordance with the terms of the plan, participants earned and Kroger paid 24% of long-term cash bonus potentials. The long-term cash bonus potential equaled the participant's salary in effect on the last day of fiscal 2014, and for Mr. Aitken, the day he became eligible for the plan. See "Results of 2015 Long-Term Incentive Plan" in the CD&A for more information on this plan.

- (5) For 2017, the amounts reported consist of the aggregate change in the actuarial present value of each NEO's accumulated benefit under a defined benefit pension plan (including supplemental plans), which applies to Messrs. McMullen, Schlotman, Donnelly and Hjelm, and preferential earnings on nonqualified deferred compensation, which applies to Messrs. McMullen, Donnelly and Hjelm. Mr. Aitken does not participate in a pension plan and neither Mr. Schlotman nor Mr. Aitken participate in a nonqualified deferred compensation plan.

Name	Change in Pension Value	Preferential Earnings on Nonqualified Deferred Compensation
Mr. McMullen	\$1,591,548	\$99,858
Mr. Schlotman	\$ 873,808	—
Mr. Donnelly	\$1,026,782	\$ 5,701
Mr. Hjelm	\$ 313	\$ 207
Mr. Aitken	—	—

*Change in Pension Value.* These amounts represent the aggregate change in the actuarial present value of accumulated pension benefits. Pension values may fluctuate significantly from year to year depending on a number of factors, including age, years of service, average annual earnings and the assumptions used to determine the present value, such as the discount rate. The increase in the actuarial present value of accumulated pension benefits for 2017 compared to 2016 is due to a lower discount rate and additional benefits accrued, as applicable. Please see the 2017 Pension Benefits section for further information regarding the assumptions used in calculating pension benefits.

*Preferential Earnings on Nonqualified Deferred Compensation.* Messrs. McMullen, Donnelly and Hjelm participate in The Kroger Co. Executive Deferred Compensation Plan (the "Deferred Compensation Plan"). Under the plan, deferred compensation earns interest at a rate representing Kroger's cost of ten-year debt, as determined by the CEO and approved by the Compensation Committee prior to the beginning of each deferral year. For each participant, a separate deferral account is created each year and the interest rate established for that year is applied to that deferral account until the deferred compensation is paid out. If the interest rate established by Kroger for a particular year exceeds 120% of the applicable federal long-term interest rate that corresponds most closely to the plan rate, the amount by which the plan rate exceeds 120% of the corresponding federal rate is deemed to be above-market or preferential. In fifteen of the twenty-four years in which at least one NEO deferred compensation, the rate set under the plan for that year exceeds 120% of the corresponding federal rate. For each of the deferral accounts in which the plan rate is deemed to be above-

market, Kroger calculates the amount by which the actual annual earnings on the account exceed what the annual earnings would have been if the account earned interest at 120% of the corresponding federal rate, and discloses those amounts as preferential earnings. Amounts deferred in 2017 earn interest at a rate higher than 120% of the corresponding federal rate; accordingly, there are preferential earnings on these amounts.

- (6) Amounts reported in the “All Other Compensation” column for 2017 include the dollar value of premiums paid by the Company for life insurance, Company contributions to defined contribution retirement plans, dividend equivalents paid on earned performance units, and dividends paid on unvested restricted stock. The following table identifies the value of each benefit.

Name	Life Insurance Premiums	Retirement Plan Contributions <sup>(a)</sup>	Payment of Dividend Equivalents on Earned Performance Units	Dividends Paid on Unvested Restricted Stock	Other <sup>(b)</sup>
Mr. McMullen	\$ 94,386	—	\$16,718	\$187,359	—
Mr. Schlotman	\$165,719	—	\$ 8,247	\$ 68,671	—
Mr. Donnelly	\$147,823	\$45,733	\$ 4,639	\$ 48,954	—
Mr. Hjelm	\$100,665	\$36,043	\$ 6,186	\$ 48,023	—
Mr. Aitken	\$ 23,508	\$48,824	\$ 2,066	\$ 24,898	\$11,067

(a) *Retirement plan contributions.* The Company makes automatic and matching contributions to NEOs’ accounts under the applicable defined contribution plan on the same terms and using the same formulas as other participating employees. The Company also makes contributions to NEOs’ accounts under the applicable defined contribution plan restoration plan, which is intended to make up the shortfall in retirement benefits caused by the limitations on benefits to highly compensated individuals under the defined contribution plans in accordance with the Code. The aggregate amounts in the table above represent the following contributions for 2017:

- Mr. Donnelly – a \$13,500 matching contribution to the Dillon Companies, Inc. Employees’ Profit Sharing Plan and a \$32,233 matching contribution to the Dillon Companies, Inc. Excess Benefit Profit Sharing Plan;
- Mr. Hjelm – a \$10,872 matching contribution and a \$2,000 automatic company contribution to The Kroger Co. 401(k) Retirement Savings Account Plan (the “401(k) Plan”) and a \$23,171 contribution to The Kroger Co. 401(k) Retirement Savings Account Restoration Plan (the “Restoration Plan”); and
- Mr. Aitken – a \$10,864 matching contribution and a \$2,000 automatic company contribution to the 401(k) Plan and a \$35,960 contribution to the Restoration Plan.

(b) *Other.* For each of Messrs. McMullen, Schlotman, Donnelly and Hjelm the total amount of other benefits was less than \$10,000. For Mr. Aitken, this amount includes the dollar value of insurance premiums paid by the Company on accidental death and dismemberment insurance and long-term disability insurance and reimbursement of tax preparation fees and cell phone fees.

## 2017 Grants of Plan-Based Awards

The following table provides information about equity and non-equity incentive awards granted to the NEOs in 2017.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards		Estimated Future Payouts Under Equity Incentive Plan Awards		All Other Stock Awards: Number of Shares of Stock or Units (#) <sup>(4)</sup>	All Other Option Awards: Number of Securities Underlying Options (#) <sup>(5)</sup>	Exercise or Base Price of Option Awards (\$/Sh)	Grant Date Fair Value of Stock and Option Awards
		Target (\$)	Maximum (\$)	Target (#) <sup>(3)</sup>	Maximum (#) <sup>(3)</sup>				
W. Rodney McMullen		\$ 1,889,623 <sup>(1)</sup>	\$ 3,779,245 <sup>(1)</sup>						
	7/13/2017	\$ 57,488 <sup>(2)</sup>	\$ 1,277,500 <sup>(2)</sup>	5,561	123,587				\$ 1,416,307
	7/13/2017					163,613			\$ 3,750,010
	7/13/2017						573,127	\$ 22.92	\$ 2,700,116
J. Michael Schlotman		\$ 650,943 <sup>(1)</sup>	\$ 1,301,887 <sup>(1)</sup>						
	7/13/2017	\$ 39,161 <sup>(2)</sup>	\$ 870,240 <sup>(2)</sup>	1,937	43,046				\$ 493,307
	7/13/2017					64,569			\$ 1,479,921
	7/13/2017						220,930	\$ 22.92	\$ 1,040,846
Michael J. Donnelly		\$ 650,943 <sup>(1)</sup>	\$ 1,301,887 <sup>(1)</sup>						
	7/13/2017	\$ 34,763 <sup>(2)</sup>	\$ 772,500 <sup>(2)</sup>	1,453	32,287				\$ 370,009
	7/13/2017					48,430			\$ 1,110,016
	12/7/2017					28,270			\$ 750,003
7/13/2017						165,698	\$ 22.92	\$ 780,637	
Christopher T. Hjelm		\$ 650,943 <sup>(1)</sup>	\$ 1,301,887 <sup>(1)</sup>						
	7/13/2017	\$ 32,445 <sup>(2)</sup>	\$ 721,000 <sup>(2)</sup>	1,453	32,287				\$ 370,009
	7/13/2017					48,430			\$ 1,110,016
	7/13/2017						165,698	\$ 22.92	\$ 780,637
Stuart W. Aitken		\$ 425,250 <sup>(1)</sup>	\$ 850,500 <sup>(1)</sup>						
	7/13/2017	\$ 31,286 <sup>(2)</sup>	\$ 695,250 <sup>(2)</sup>	489	10,860				\$ 124,456
	7/13/2017					17,500			\$ 401,100
	7/13/2017					32,723			\$ 750,011
7/13/2017						55,742	\$ 22.92	\$ 262,612	

(1) These amounts relate to the 2017 performance-based annual cash bonus plan. The amount listed under “Target” represents the annual cash bonus potential of the NEO. By the terms of the plan, payouts are limited to no more than 200% of a participant’s annual cash bonus potential; accordingly, the amount listed under “Maximum” is two times that officer’s annual cash bonus potential amount. Each NEO’s target and maximum amounts are prorated to reflect his increased annual cash bonus potential following the annual compensation review. The amounts actually earned under this plan were paid in March 2018 and are included in the Summary Compensation Table for 2017 in the “Non-Equity Incentive Plan Compensation” column and are described in footnote 4 to that table.

(2) These amounts relate to the long-term cash bonus potential under the 2017 Long-Term Incentive Plan, which covers performance during fiscal years 2017, 2018 and 2019. The long-term cash bonus potential amount equals the annual base salary of the NEOs as of the last day of fiscal 2016. By the terms of the plan, payouts are limited to no more than 100% of a participant’s long-term cash bonus potential; accordingly, the amount listed under “Maximum” is the participant’s long-term cash bonus potential. Because the actual payout is based on the level of performance achieved, the target amount is not determinable and therefore, in accordance with SEC rules, the amount listed under “Target” is a representative amount based on 2017 performance.

(3) These amounts represent performance units awarded under the 2017 Long-Term Incentive Plan, which covers performance during fiscal years 2017, 2018 and 2019. The amount listed under “Maximum” represents the maximum number of common shares that can be earned by the NEO under the award. Because the actual payout is based on the level of performance achieved, the target amount is not determinable and therefore, in accordance with SEC rules, the amount listed under “Target” is a representative amount based on 2017 performance. The grant date fair value reported in the last column is based on the probable outcome of the performance conditions as of the grant date. This amount is consistent with the estimate of aggregate

compensation cost to be recognized by the Company over the three-year performance period of the award determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. The aggregate grant date fair value of these awards is included in the Summary Compensation Table for 2017 in the "Stock Awards" column and described in footnote 2 to that table.

- (4) These amounts represent the number of shares of restricted stock granted in 2017. The aggregate grant date fair value reported in the last column is calculated in accordance with FASB ASC Topic 718. The aggregate grant date fair value of these awards is included in the Summary Compensation Table for 2017 in the "Stock Awards" column and described in footnote 2 to that table.
- (5) These amounts represent the number of stock options granted in 2017. Options are granted with an exercise price equal to the closing price of Kroger common shares on the grant date. The aggregate grant date fair value reported in the last column is calculated in accordance with FASB ASC Topic 718. The aggregate grant date fair value of these awards is included in the Summary Compensation Table for 2017 in the "Option Awards" column.

The Compensation Committee, and the independent members of the Board in the case of the CEO, established the bonus potential amounts for the performance-based annual cash bonus awards (shown in this table as "Target"), the number of performance units awarded (shown in this table as "Maximum"), and the bonus potential amounts for the long-term cash bonus awards (shown in this table as "Maximum"). Amounts are payable to the extent that Kroger's actual performance meets specific performance metrics established by the Compensation Committee at the beginning of the performance period. There are no guaranteed or minimum payouts; if none of the performance metrics are achieved, then none of the award is earned and no payout is made. As described in the CD&A, actual earnings under the performance-based annual cash bonus plan may exceed the target amount if the Company's performance exceeds the performance goals, but are limited to 200% of the target amount. The performance units and the long-term cash bonus potentials awarded under the 2017 Long-Term Incentive Plan are more particularly described in the CD&A.

The annual restricted stock and nonqualified stock options awards granted to the NEOs vest in equal amounts on each of the first five anniversaries of the grant date, so long as the officer remains a Kroger employee. Mr. Donnelly's 12/7/17 restricted stock award of 28,270 shares and Mr. Aitken's 7/13/17 restricted stock award of 32,373 shares were special awards that vest 25% on each of the first two anniversaries of the grant date and 50% on the third anniversary of the grant date. Any dividends declared on Kroger common shares are payable on unvested restricted stock.



## 2017 Outstanding Equity Awards at Fiscal Year-End

The following table provides information about outstanding equity-based incentive compensation awards for the NEOs as of the end of 2017. The vesting schedule for each award is described in the footnotes to this table. The market value of unvested restricted stock and unearned performance units is based on the closing price of Kroger's common shares of \$29.34 on February 2, 2018, the last trading day of 2017.

Name	Option Awards				Stock Awards			
	Number of Securities Underlying Unexercised Options Exercisable (#)	Number of Securities Underlying Unexercised Options Unexercisable (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
W. Rodney McMullen	130,000	—	\$14.31	6/26/2018	14,616 <sup>(6)</sup>	\$428,833	0 <sup>(15)</sup>	\$0 <sup>(15)</sup>
	130,000	—	\$11.17	6/25/2019	32,000 <sup>(7)</sup>	\$938,880	5,561 <sup>(16)</sup>	\$171,458 <sup>(16)</sup>
	140,000	—	\$10.08	6/24/2020	45,000 <sup>(8)</sup>	\$1,320,300		
	182,880	—	\$12.37	6/23/2021	51,657 <sup>(9)</sup>	\$1,515,616		
	194,880	—	\$10.98	7/12/2022	80,044 <sup>(10)</sup>	\$2,348,491		
	155,904	38,976 <sup>(1)</sup>	\$18.88	7/15/2023	163,613 <sup>(11)</sup>	\$4,800,405		
	180,000	120,000 <sup>(2)</sup>	\$24.67	7/15/2024				
	94,166	141,249 <sup>(3)</sup>	\$38.33	7/15/2025				
	71,618	286,473 <sup>(4)</sup>	\$37.48	7/13/2026				
	—	573,127 <sup>(5)</sup>	\$22.92	7/13/2027				
J. Michael Schlotman	50,000	—	\$10.08	6/24/2020	8,196 <sup>(6)</sup>	\$240,471	0 <sup>(15)</sup>	\$0 <sup>(15)</sup>
	91,280	—	\$12.37	6/23/2021	12,000 <sup>(8)</sup>	\$352,080	1,937 <sup>(16)</sup>	\$59,720 <sup>(16)</sup>
	109,280	—	\$10.98	7/12/2022	23,166 <sup>(9)</sup>	\$679,690		
	87,424	21,856 <sup>(1)</sup>	\$18.88	7/15/2023	4,445 <sup>(12)</sup>	\$130,416		
	48,000	32,000 <sup>(2)</sup>	\$24.67	7/15/2024	31,589 <sup>(10)</sup>	\$926,821		
	42,612	63,919 <sup>(3)</sup>	\$38.33	7/15/2025	64,569 <sup>(11)</sup>	\$1,894,454		
	27,607	110,431 <sup>(4)</sup>	\$37.48	7/13/2026				
	—	220,930 <sup>(5)</sup>	\$22.92	7/13/2027				
Michael J. Donnelly	40,000	—	\$10.08	6/24/2020	4,804 <sup>(6)</sup>	\$140,949	0 <sup>(15)</sup>	\$0 <sup>(15)</sup>
	70,720	—	\$12.37	6/23/2021	9,000 <sup>(8)</sup>	\$264,060	1,453 <sup>(16)</sup>	\$44,793 <sup>(16)</sup>
	50,720	—	\$10.98	7/12/2022	17,729 <sup>(9)</sup>	\$520,169		
	40,576	—	\$18.88	7/15/2023	4,445 <sup>(12)</sup>	\$130,416		
	36,000	24,000 <sup>(2)</sup>	\$24.67	7/15/2024	23,693 <sup>(10)</sup>	\$695,153		
	23,971	35,958 <sup>(3)</sup>	\$38.33	7/15/2025	48,430 <sup>(11)</sup>	\$1,420,936		
	20,705	82,823 <sup>(4)</sup>	\$37.48	7/13/2026	28,270 <sup>(13)</sup>	\$829,442		
	—	165,698 <sup>(5)</sup>	\$22.92	7/13/2027				
Christopher T. Hjelm	16,000	—	\$11.17	6/25/2019	3,804 <sup>(6)</sup>	\$111,609	0 <sup>(15)</sup>	\$0 <sup>(15)</sup>
	24,000	—	\$10.08	6/24/2020	9,000 <sup>(8)</sup>	\$264,060	1,453 <sup>(16)</sup>	\$44,793 <sup>(16)</sup>
	40,576	—	\$12.37	6/23/2021	17,376 <sup>(9)</sup>	\$509,812		
	50,720	—	\$10.98	7/12/2022	4,445 <sup>(12)</sup>	\$130,416		
	40,576	10,144 <sup>(1)</sup>	\$18.88	7/15/2023	23,693 <sup>(10)</sup>	\$695,153		
	36,000	24,000 <sup>(2)</sup>	\$24.67	7/15/2024	48,430 <sup>(11)</sup>	\$1,420,936		
	31,959	47,939 <sup>(3)</sup>	\$38.33	7/15/2025				
	20,705	82,823 <sup>(4)</sup>	\$37.48	7/13/2026				
	—	165,698 <sup>(5)</sup>	\$22.92	7/13/2027				
Stuart W. Aitken	8,930	13,396 <sup>(3)</sup>	\$38.33	7/15/2025	4,853 <sup>(9)</sup>	\$142,387	0 <sup>(15)</sup>	\$0 <sup>(15)</sup>
	6,965	27,863 <sup>(4)</sup>	\$37.48	7/13/2026	6,667 <sup>(6)</sup>	\$195,610	489 <sup>(16)</sup>	\$15,067 <sup>(16)</sup>
	—	55,742 <sup>(5)</sup>	\$22.92	7/13/2027	8,562 <sup>(10)</sup>	\$251,209		
					17,500 <sup>(11)</sup>	\$513,450		
					32,723 <sup>(14)</sup>	\$960,093		

(1) Stock options vest on 7/15/2018.

(2) Stock options vest in equal amounts on 7/15/2018 and 7/15/2019.

(3) Stock options vest in equal amounts on 7/15/2018, 7/15/2019, and 7/15/2020.

(4) Stock options vest in equal amounts on 7/13/2018, 7/13/2019, 7/13/2020, and 7/13/2021.

(5) Stock options vest in equal amounts on 7/13/2018, 7/13/2019, 7/13/2020, 7/13/2021 and 7/13/2022.

(6) Restricted stock vests on 7/15/2018.

- (7) Restricted stock vests on 12/12/2018.
- (8) Restricted stock vests in equal amounts on 7/15/2018 and 7/15/2019.
- (9) Restricted stock vests in equal amounts on 7/15/2018, 7/15/2019, and 7/15/2020.
- (10) Restricted stock vests in equal amounts on 7/13/2018, 7/13/2019, 7/13/2020, and 7/13/2021.
- (11) Restricted stock vests in equal amounts on 7/13/2018, 7/13/2019, 7/13/2020, 7/13/2021 and 7/13/2022.
- (12) Restricted stock vests on 9/17/2018.
- (13) Restricted stock vests 25% on each of 12/7/2018 and 12/7/2019 and 50% on 12/7/2020.
- (14) Restricted stock vests 25% on each of 7/13/2018 and 7/13/2019 and 50% on 7/13/2020.
- (15) Performance units granted under the 2016 Long-Term Incentive Plan are earned as of the last day of fiscal 2018, to the extent performance conditions are achieved. Because the awards earned are not currently determinable, in accordance with SEC rules, the number of units and the corresponding market value reflect performance through 2017, including cash payments equal to projected dividend equivalent payments.
- (16) Performance units granted under the 2017 Long-Term Incentive Plan are earned as of the last day of fiscal 2019, to the extent performance conditions are achieved. Because the awards earned are not currently determinable, in accordance with SEC rules, the number of units and the corresponding market value reflect performance through 2017, including cash payments equal to projected dividend equivalent payments.

## 2017 Option Exercises and Stock Vested

The following table provides information regarding 2017 stock options exercised, restricted stock vested, and common shares issued pursuant to performance units earned under the 2015 Long-Term Incentive Plan.

Name	Option Awards <sup>(1)</sup>		Stock Awards <sup>(2)</sup>	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
W. Rodney McMullen	120,000	\$2,176,200	133,484	\$3,180,600
J. Michael Schlotman	—	—	60,634	\$1,390,177
Michael J. Donnelly	80,000	\$1,406,776	32,860	\$ 750,535
Christopher T. Hjelm	8,000	\$ 130,680	32,902	\$ 752,208
Stuart W. Aitken	—	—	12,087	\$ 278,971

- (1) Stock options have a ten-year life and expire if not exercised within that ten-year period. The value realized on exercise is the difference between the exercise price of the option and the closing price of Kroger's common shares on the exercise date.
- (2) The Stock Awards columns include vested restricted stock and earned performance units, as follows:

Name	Vested Restricted Stock		Earned Performance Units	
	Number of Shares	Value Realized	Number of Shares	Value Realized
Mr. McMullen	120,961	\$2,884,682	12,523	\$295,918
Mr. Schlotman	54,456	\$1,244,200	6,178	\$145,977
Mr. Donnelly	29,385	\$ 668,416	3,475	\$ 82,119
Mr. Hjelm	28,268	\$ 642,714	4,634	\$109,494
Mr. Aitken	10,425	\$ 239,687	1,662	\$ 39,284

*Restricted stock.* The table includes the number of shares acquired upon vesting of restricted stock and the value realized on the vesting of restricted stock, based on the closing price of Kroger common shares on the vesting date.

*Performance Units.* In 2015, participants in the 2015 Long-Term Incentive Plan were awarded performance units that were earned based on performance criteria established by the Compensation Committee at the beginning of the three-year performance period. Actual payouts were based on the level of performance achieved, and were paid in common shares. The number of common shares issued and the value realized based on the closing price of Kroger common shares of \$23.63 on March 15, 2018, the date of deemed delivery of the shares, are reflected in the table above.

## 2017 Pension Benefits

The following table provides information regarding pension benefits for the NEOs as of the last day of 2017. Mr. Aitken does not participate in a pension plan.

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit (\$) <sup>(1)</sup>	Payments during Last fiscal year (\$)
W. Rodney McMullen	Pension Plan	32	\$ 1,412,451	—
	Excess Plan	32	\$14,576,108	—
J. Michael Schlotman	Pension Plan	32	\$ 1,520,588	—
	Excess Plan	32	\$ 7,416,810	—
Michael J. Donnelly	Pension Plan	38	\$ 754,056	—
	Excess Plan	38	\$ 5,960,476	—
Christopher T. Hjelm	Pension Plan	—	— <sup>(2)</sup>	— <sup>(2)</sup>

- (1) The discount rate used to determine the present values was 3.99% for each of The Kroger Consolidated Retirement Benefit Plan Spin Off (the “Pension Plan”) and The Kroger Co. Consolidated Retirement Excess Benefit Plan (the “Excess Plan”), which are the same rates used at the measurement date for financial reporting purposes. Additional assumptions used in calculating the present values are set forth in Note 15 to the consolidated financial statements in Kroger’s 10-K for fiscal year 2017.
- (2) In 2017, the cash balance portion of the Pension Plan was terminated and Mr. Hjelm’s balance was distributed via a transfer to an annuity contract on December 5, 2017. Accordingly, Mr. Hjelm is no longer a participant in the Pension Plan and had no present value of accumulated benefits on the last day of 2017. See the narrative discussion following this table under the heading “Cash Balance Participants” for additional information on the termination of the Pension Plan for cash balance participants.

### **Pension Plan and Excess Plan**

In 2017, Messrs. McMullen, Schlotman, Donnelly and Hjelm were participants in the Pension Plan, which is a qualified defined benefit pension plan. Messrs. McMullen, Schlotman and Donnelly also participate in the Excess Plan, which is a nonqualified deferred compensation plan as defined in Section 409A of the Code. The purpose of the Excess Plan is to make up the shortfall in retirement benefits caused by the limitations on benefits to highly compensated individuals under the qualified defined benefit pension plans in accordance with the Code.

Although participants generally receive credited service beginning at age 21, certain participants in the Pension Plan and the Excess Plan who commenced employment prior to 1986, including Messrs. McMullen and Schlotman, began to accrue credited service after attaining age 25 and one year of service. The Pension Plan and the Excess Plan generally determine accrued benefits using a cash balance formula, but retain benefit formulas applicable under prior plans for certain “grandfathered participants” who were employed by Kroger on December 31, 2000. Each of Messrs. McMullen, Schlotman and Donnelly is eligible for these grandfathered benefits. Mr. Hjelm is not a grandfathered participant, and therefore, his benefits are determined using the cash balance formula.

### *Grandfathered Participants*

Benefits for grandfathered participants are determined using formulas applicable under prior plans, including the Kroger formula covering service to The Kroger Co. and the Dillon formula covering service to Dillon Companies, Inc. As “grandfathered participants”, Messrs. McMullen, Schlotman and Donnelly will receive benefits under the Pension Plan and the Excess Plan, determined as follows:

- $1\frac{1}{2}\%$  times years of credited service multiplied by the average of the highest five years of total earnings (base salary and annual cash bonus) during the last ten calendar years of employment, reduced by  $1\frac{1}{4}\%$  times years of credited service multiplied by the primary social security benefit;
- normal retirement age is 65;
- unreduced benefits are payable beginning at age 62; and
- benefits payable between ages 55 and 62 will be reduced by  $\frac{1}{3}$  of one percent for each of the first 24 months and by  $\frac{1}{2}$  of one percent for each of the next 60 months by which the commencement of benefits precedes age 62.

In the event of a termination of employment other than death or disability, Messrs. McMullen, Schlotman and Donnelly currently are eligible for a reduced early retirement benefit, as each has attained age 55. If a “grandfathered participant” becomes disabled while employed by Kroger and after attaining age 55, the participant will receive the full retirement benefit. If a married “grandfathered participant” dies while employed by Kroger, the surviving spouse will receive benefits as though a retirement occurred on such date, based on the greater of: actual benefits payable to the participant if he or she was over age 55, or the benefits that would have been payable to the participant assuming he or she was age 55 on the date of death.

### *Cash Balance Participants*

Mr. Hjelm began participating in the Pension Plan in August 2005 as a cash balance participant. Until the plan was frozen on December 31, 2006, cash balance participants received an annual pay credit equal to 5% of that year’s eligible earnings plus an annual interest credit equal to the account balance at the beginning of the plan year multiplied by the annual rate of interest on 30-year Treasury Securities in effect prior to the plan year. Beginning on January 1, 2007, cash balance participants receive an annual interest credit but no longer receive an annual pay credit.

In 2017, the Company terminated the Pension Plan with respect to active non-union cash balance participants and distributed the current balance of each eligible participant, at his/her election, via a transfer to a 401(k) plan, IRA or a lump sum cash payment. Participants that did not make an election had their balance transferred to an insurer through an annuity contract. On December 5, 2017, Mr. Hjelm’s balance of \$11,407.48 was distributed via transfer to an annuity contract. Mr. Hjelm is no longer a participant in the Pension Plan.

### *Offsetting Benefits*

Mr. Donnelly also participates in the Dillon Companies, Inc. Employees’ Profit Sharing Plan (the “Dillon Profit Sharing Plan”), which is a qualified defined contribution plan under which Dillon Companies, Inc. and its participating subsidiaries may choose to make discretionary contributions each year that are allocated to each participant’s account. Participation in the Dillon Profit Sharing Plan was frozen in 2001 and participants are no longer able to make employee contributions, but certain participants, including Mr. Donnelly, are still eligible for employer contributions. Participants elect from among a number of investment options and the amounts in their accounts are invested and credited with investment earnings in accordance with their elections. Due to offset formulas contained in the Pension Plan, Mr. Donnelly’s accrued benefits under the Dillon Profit Sharing Plan offset a portion of the benefit that would otherwise accrue for him under the Pension Plan for his service with Dillon Companies, Inc. Mr. Donnelly also participates in the Dillon Companies, Inc. Excess Benefit Profit Sharing Plan (“Dillon Excess Profit Sharing Plan”) which provides Company contributions in excess of the qualified plan limits. The Dillon Excess Profit Sharing Plan is offset by Mr. Donnelly’s benefit from the Excess Plan. The offsets are reflected in the Pension Benefits table above.

## 2017 Nonqualified Deferred Compensation

The following table provides information on nonqualified deferred compensation for the NEOs for 2017. Messrs. Schlotman and Aitken do not participate in a nonqualified deferred compensation plan.

Name	Executive Contributions in Last FY	Aggregate Earnings in Last FY <sup>(1)</sup>	Aggregate Balance at Last FYE <sup>(2)</sup>
W. Rodney McMullen	\$113,409 <sup>(3)</sup>	\$618,075	\$9,765,811
J. Michael Schlotman	—	—	—
Michael J. Donnelly	\$111,014 <sup>(4)</sup>	\$ 30,817	\$ 540,667
Christopher T. Hjelm	—	\$ 11,697	\$ 259,712
Stuart W. Aitken	—	—	—

- (1) These amounts include the aggregate earnings on all accounts for each NEO, including any above-market or preferential earnings. The following amounts earned in 2017 are deemed to be preferential earnings and are included in the “Change in Pension Value and Nonqualified Deferred Compensation Earnings” column of the Summary Compensation Table for 2017: Mr. McMullen, \$99,858; Mr. Donnelly, \$5,701; and Mr. Hjelm, \$207.
- (2) The following amounts in the Aggregate Balance column were reported in the Summary Compensation Tables covering fiscal years 2006 – 2016: Mr. McMullen, \$2,925,884; Mr. Donnelly, \$134,959; and Mr. Hjelm, \$149,163.
- (3) This amount includes the deferral of \$5,417 of his salary in fiscal 2017; this amount is included in the “Salary” column of the Summary Compensation Table for 2017. This amount also includes the deferral of \$56,925 of his 2014 Long-Term Incentive Plan cash bonus earned for performance over the three year period 2014 to 2016 and paid in March 2017 and the deferral of \$51,067 of his 2016 performance-based annual cash bonus plan earned in 2016 and paid in March 2017; these amounts are included in the “Non-Equity Incentive Plan Compensation” column of the Summary Compensation Table for 2016.
- (4) This amount represents the deferral of a portion of his 2014 Long-Term Incentive Plan cash bonus earned for performance over the three year period 2014 to 2016 and paid in March 2017; this amount is included in the “Non-Equity Incentive Plan Compensation” column of the Summary Compensation Table for 2016.

### Executive Deferred Compensation Plan

Messrs. McMullen, Donnelly and Hjelm participate in the Deferred Compensation Plan, which is a nonqualified deferred compensation plan. Participants may elect to defer up to 100% of the amount of their salary that exceeds the sum of the FICA wage base and pre-tax insurance and other Code Section 125 plan deductions, as well as up to 100% of their annual and long-term cash bonus compensation. Kroger does not match any deferral or provide other contributions. Deferral account amounts are credited with interest at the rate representing Kroger’s cost of ten-year debt as determined by Kroger’s CEO and approved by the Compensation Committee prior to the beginning of each deferral year. The interest rate established for deferral amounts for each deferral year will be applied to those deferral amounts for all subsequent years until the deferred compensation is paid out. Amounts deferred in 2017 earn interest at a rate of 2.8%. Participants can elect to receive lump sum distributions or quarterly installments for periods up to ten years. Participants also can elect between lump sum distributions and quarterly installments to be received by designated beneficiaries if the participant dies before distribution of deferred compensation is completed.

Participants may not withdraw amounts from their accounts until they leave Kroger, except that Kroger has discretion to approve an early distribution to a participant upon the occurrence of an unforeseen emergency. Participants who are “specified employees” under Section 409A of the Code, which includes the NEOs, may not receive a post-termination distribution for at least six months following separation. If the employee dies prior to or during the distribution period, the remainder of the account will be distributed to his or her designated beneficiary in lump sum or quarterly installments, according to the participant’s prior election.

### Potential Payments upon Termination or Change in Control

Kroger does not have employment agreements or other contracts, agreements, plans or arrangements that provide for payments to the NEOs in connection with a termination of employment or a change in control of Kroger. However, KEPP, award agreements for stock options, restricted stock and performance units, and the long-term cash bonus plans provide for certain payments and benefits to participants, including the NEOs, in the event of a



termination of employment or a change in control of Kroger, as defined in the applicable plan or agreement. Our pension plan and nonqualified deferred compensation plan also provide for certain payments and benefits to participants in the event of a termination of employment, as described above in the 2017 Pension Benefits section and the 2017 Nonqualified Deferred Compensation section, respectively.

## **KEPP**

KEPP applies to all management employees who are classified as exempt under the federal Fair Labor Standards Act and to certain administrative or technical support personnel who are not covered by a collective bargaining agreement, with at least one year of service, including the NEOs. KEPP provides severance benefits when a participant's employment is terminated actually or constructively within two years following a change in control of Kroger, as defined in KEPP. The actual amount of the severance benefit is dependent on pay level and years of service. Exempt employees, including the NEOs, are eligible for the following benefits:

- a lump sum severance payment equal to up to 24 months of the participant's annual base salary and target annual bonus potential;
- a lump sum payment equal to the participant's accrued and unpaid vacation, including banked vacation;
- continued medical and dental benefits for up to 24 months and continued group term life insurance coverage for up to 6 months; and
- up to \$10,000 as reimbursement for eligible outplacement expenses.

In the event that any payments or benefits received or to be received by an eligible employee in connection with a change in control or termination of employment (whether pursuant to KEPP or any other plan, arrangement or agreement with Kroger or any person whose actions result in a change in control) would constitute parachute payments within the meaning of Section 280G of the Code and would be subject to the excise tax under Section 4999 of the Code, then such payments and benefits will either be (i) paid in full or (ii) reduced to the minimum extent necessary to ensure that no portion of such payments or benefits will be subject to the excise tax, whichever results in the eligible employee receiving the greatest aggregate amount on an after-tax basis.

## **Long-Term Incentive Awards**

The following table describes the treatment of long-term incentive awards following a termination of employment or change in control of Kroger, as defined in the applicable agreement. In each case, the continued vesting, exercisability or eligibility for the incentive awards will end if the participant provides services to a competitor of Kroger.

<b>Triggering Event</b>	<b>Stock Options</b>	<b>Restricted Stock</b>	<b>Performance Units</b>	<b>Performance-Based Long-Term Cash Bonus</b>
<b>Involuntary Termination</b>	Forfeit all unvested options. Previously vested options remain exercisable for the shorter of one year after termination or the remainder of the original 10-year term.	Forfeit all unvested shares	Forfeit all rights to units for which the three year performance period has not ended	Forfeit all rights to long-term cash bonuses for which the three year performance period has not ended
<b>Voluntary Termination/ Retirement</b>  - Prior to minimum age and five years of service <sup>(2)</sup>	Forfeit all unvested options. Previously vested options remain exercisable for the shorter of one year after termination or the remainder of the original 10-year term.	Forfeit all unvested shares	Forfeit all rights to units for which the three year performance period has not ended	Forfeit all rights to long-term cash bonuses for which the three year performance period has not ended
<b>Voluntary Termination/ Retirement</b>  - After minimum age and five years of service <sup>(2)</sup>	Unvested options continue vesting on the original schedule. All options are exercisable for remainder of the original 10-year term.	Unvested shares continue vesting on the original schedule	Pro rata portion <sup>(1)</sup> of units earned based on performance results over the full three-year period	Pro rata portion <sup>(1)</sup> of long-term cash bonuses earned based on performance results over the full three-year period



<b>Triggering Event</b>	<b>Stock Options</b>	<b>Restricted Stock</b>	<b>Performance Units</b>	<b>Performance-Based Long-Term Cash Bonus</b>
<b>Death</b>	Unvested options are immediately vested. All options are exercisable for the remainder of the original 10-year term.	Unvested shares immediately vest	Pro rata portion <sup>(1)</sup> of units earned based on performance results through the end of the fiscal year in which death occurs. Award will be paid following the end of such fiscal year.	Pro rata portion <sup>(1)</sup> of long-term cash bonuses earned based on performance results through the end of the fiscal year in which death occurs. Award will be paid following the end of such fiscal year.
<b>Disability</b>	Unvested options are immediately vested. All options are exercisable for remainder of the original 10-year term.	Unvested shares immediately vest	Pro rata portion <sup>(1)</sup> of units earned based on performance results over the full three-year period	Pro rata portion <sup>(1)</sup> of long-term cash bonuses earned based on performance results over the full three-year period
<b>Change in Control<sup>(3)</sup></b>	Unvested options are immediately vested and exercisable	Unvested shares immediately vest	50% of the units granted at the beginning of the performance period earned immediately	50% of the bonus granted at the beginning of the performance period earned immediately

- (1) The prorated amount is equal to the number of weeks of active employment during the performance period divided by the total number of weeks in the performance period.
- (2) The minimum age requirement is age 62 for stock options and restricted stock and age 55 for performance units and the long-term cash bonus.
- (3) These benefits are payable upon a change in control of Kroger, as defined in the applicable agreement, with or without a termination of employment.

## Quantification of Payments upon Termination or Change in Control

The following table provides information regarding certain potential payments that would have been made to the NEOs if the triggering event occurred on the last day of the fiscal year, February 3, 2018, given compensation, age and service levels as of that date and, where applicable, based on the closing market price per Kroger common share on the last trading day of the fiscal year (\$29.34 on February 2, 2018). Amounts actually received upon the occurrence of a triggering event will vary based on factors such as the timing during the year of such event, the market price of Kroger common shares, and the officer's age, length of service and compensation level.

Name	Involuntary Termination	Voluntary Termination/Retirement	Death	Disability	Change in Control without Termination	Change in Control with Termination
<b>W. Rodney McMullen</b>						
Accrued and Banked Vacation	\$705,370	\$705,370	\$ 705,370	\$ 705,370	\$ 705,370	\$ 705,370
Severance	—	—	—	—	—	6,631,800
Continued Health and Welfare Benefits <sup>(1)</sup>	—	—	—	—	—	69,946
Stock Options <sup>(2)</sup>	—	—	4,648,164	4,648,164	4,648,164	4,648,164
Restricted Stock <sup>(3)</sup>	—	—	11,352,526	11,352,526	11,352,526	11,352,526
Performance Units <sup>(4)</sup>	—	54,402	54,402	54,402	2,889,403	2,889,403
Long-Term Cash Bonus <sup>(5)</sup>	—	19,166	19,166	19,166	1,258,750	1,258,750
Executive Group Life Insurance	—	—	5,213,600	—	—	—
<b>J. Michael Schlotman</b>						
Accrued and Banked Vacation	\$479,564	\$479,564	\$ 479,564	\$ 479,564	\$ 479,564	\$ 479,564
Severance	—	—	—	—	—	3,192,720
Continued Health and Welfare Benefits <sup>(1)</sup>	—	—	—	—	—	104,012
Stock Options <sup>(2)</sup>	—	—	1,796,584	1,796,584	1,796,584	1,796,584
Restricted Stock <sup>(3)</sup>	—	—	4,223,933	4,223,933	4,223,933	4,223,933
Performance Units <sup>(4)</sup>	—	18,948	18,948	18,948	1,017,658	1,017,658
Long-Term Cash Bonus <sup>(5)</sup>	—	13,056	13,056	13,056	855,120	855,120
Executive Group Life Insurance	—	—	50,000	—	—	—
<b>Michael J. Donnelly</b>						
Accrued and Banked Vacation	\$211,530	\$211,530	\$ 211,530	\$ 211,530	\$ 211,530	\$ 211,530
Severance	—	—	—	—	—	3,150,000
Continued Health and Welfare Benefits <sup>(1)</sup>	—	—	—	—	—	85,275
Stock Options <sup>(2)</sup>	—	—	1,282,087	1,282,087	1,282,087	1,282,087
Restricted Stock <sup>(3)</sup>	—	—	4,001,125	4,001,125	4,001,125	4,001,125
Performance Units <sup>(4)</sup>	—	14,212	14,212	14,212	763,295	763,295
Long-Term Cash Bonus <sup>(5)</sup>	—	11,590	11,590	11,590	761,250	761,250
Executive Group Life Insurance	—	—	3,132,800	—	—	—
<b>Christopher T. Hjelm</b>						
Accrued and Banked Vacation	\$ 28,562	\$ 28,562	\$ 28,562	\$ 28,562	\$ 28,562	\$ 28,562
Severance	—	—	—	—	—	2,885,208
Continued Health and Welfare Benefits <sup>(1)</sup>	—	—	—	—	—	64,442
Stock Options <sup>(2)</sup>	—	—	1,282,087	1,282,087	1,282,087	1,282,087
Restricted Stock <sup>(3)</sup>	—	—	3,131,986	3,131,986	3,131,986	3,131,986
Performance Units <sup>(4)</sup>	—	14,212	14,212	14,212	763,295	763,295
Long-Term Cash Bonus <sup>(5)</sup>	—	10,817	10,817	10,817	710,500	710,500
Executive Group Life Insurance	—	—	2,920,400	—	—	—
<b>Stuart W. Aitken</b>						
Accrued and Banked Vacation	\$ 8,264	\$ 8,264	\$ 8,264	\$ 8,264	\$ 8,264	\$ 8,264
Severance	—	—	—	—	—	2,027,000
Continued Health and Welfare Benefits <sup>(1)</sup>	—	—	—	—	—	34,943
Stock Options <sup>(2)</sup>	—	—	357,864	357,864	357,864	357,864
Restricted Stock <sup>(3)</sup>	—	—	2,062,749	2,062,749	2,062,749	2,062,749
Performance Units <sup>(4)</sup>	—	—	4,780	4,780	256,740	256,740
Long-Term Cash Bonus <sup>(5)</sup>	—	—	10,431	10,431	685,125	685,125
Executive Group Life Insurance	—	—	3,889,100	—	—	—

- (1) Represents the aggregate present value of continued participation in the Company's medical, dental and executive term life insurance plans, based on the premiums payable by the Company during the eligible period. The eligible period for continued medical and dental benefits is based on the level and length of service, which is 20 months for Mr. Aitken, and 24 months for the other NEOs. The eligible period for continued executive term life insurance coverage is six months for the NEOs. The amounts reported may ultimately be lower if the NEO is no longer eligible to receive benefits, which could occur upon obtaining other employment and becoming eligible for substantially equivalent benefits through the new employer.
- (2) Amounts reported in the death, disability and change in control columns represent the intrinsic value of the accelerated vesting of unvested stock options, calculated as the difference between the exercise price of the stock option and the closing price per Kroger common share on February 2, 2018. A value of \$0 is attributed to stock options with an exercise price greater than the market price on the last day of the fiscal year. In accordance with SEC rules, no amount is reported in the voluntary termination/retirement column because vesting is not accelerated, but the options may continue to vest on the original schedule if the conditions described above are met.
- (3) Amounts reported in the death, disability and change in control columns represent the aggregate value of the accelerated vesting of unvested restricted stock. In accordance with SEC rules, no amount is reported in the voluntary termination/retirement column because vesting is not accelerated, but the restricted stock may continue to vest on the original schedule if the conditions described above are met.
- (4) Amounts reported in the voluntary termination/retirement, death and disability columns represent the aggregate value of the performance units granted in 2016 and 2017, based on performance through the last day of fiscal 2017 and prorated for the portion of the performance period completed. Amounts reported in the change in control column represent the aggregate value of 50% of the maximum number of performance units granted in 2016 and 2017. Awards under the 2015 Long-Term Incentive Plan were earned as of the last day of 2017 so each NEO age 55 or over was entitled to receive (regardless of the triggering event) the amount actually earned, which is reported in the Stock Awards column of the 2017 Stock Vested Table.
- (5) Amounts reported in the voluntary termination/retirement, death and disability columns represent the aggregate value of the long-term cash bonuses granted in 2016 and 2017, based on performance through the last day of fiscal 2017 and prorated for the portion of the performance period completed. Amounts reported in the change in control column represent the aggregate value of 50% of the long-term cash bonus potentials under the 2016 and 2017 Long-Term Incentive Plans. Awards under the 2015 Long-Term Incentive Plan were earned as of the last day of 2017, so each NEO age 55 or over was entitled to receive (regardless of the triggering event) the amount actually earned, which is reported in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table for 2017.

## CEO Pay Ratio

As required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and Item 402(u) of Regulation S-K, we are providing the following information regarding the ratio of the annual total compensation of our Chairman and CEO, Mr. McMullen, to the annual total compensation of our median employee.

As reported in the Summary Compensation Table, our CEO had annual total compensation for 2017 of \$11,534,860. Using this Summary Compensation Table methodology, the annual total compensation of our median employee for 2017 was \$21,075. As a result, we estimate that the ratio of our CEO's annual total compensation to that of our median employee for fiscal 2017 was 547 to 1.

This pay ratio is a reasonable estimate calculated in a manner consistent with SEC rules based on our payroll records and the methodology described below. The SEC rules for identifying the median compensated employee and calculating the pay ratio based on that employee's annual total compensation allow companies to adopt a variety of methodologies, to apply certain exclusions, and to make reasonable estimates and assumptions that reflect their compensation practices. As such, other companies may have different employment and compensation practices and may utilize different methodologies, exclusions, estimates and assumptions in calculating their own pay ratios. Therefore, the estimated pay ratio reported above may not be comparable to the pay ratios reported by other companies and should not be used as a basis for comparison between companies.

We identify the "median employee" from our employee population on the last day of our 11<sup>th</sup> fiscal period (December 2, 2017), which included full-time, part-time, temporary, and seasonal employees who were employed on that date. The consistently applied compensation measure we used was "base salary/wages paid", which we measured from the beginning of our fiscal year, January 29, 2017, through December 2, 2017; and we multiplied

the average weekly earnings during this period of each full-time and part-time permanent employee by 53, which was the number of weeks in fiscal 2017. We annualized the earnings of all permanent employees who were on a leave of absence or were new-hires in 2017. We did not make any other adjustments permissible by the SEC nor did we make any other material assumptions or estimates to identify our median employee.

Once the median employee was identified, we then determined the median employee's annual total compensation using the Summary Compensation Table methodology as detailed in Item 402(c)(2)(x) of Regulation S-K, and compared it to the annual total compensation of Mr. McMullen as detailed in the "Total" column of the Summary Compensation Table for 2017, to arrive at the pay ratio disclosed above.

## **Item No. 2 Advisory Vote to Approve Executive Compensation**

**You are being asked to vote, on an advisory basis, to approve the compensation of our NEOs. The Board of Directors recommends that you vote FOR the approval of compensation of our NEOs.**

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010, requires that we give our shareholders the right to approve, on a nonbinding, advisory basis, the compensation of our NEOs as disclosed earlier in this proxy statement in accordance with the SEC's rules.

As discussed earlier in the CD&A, our compensation philosophy is to attract and retain the best management talent and to motivate these employees to achieve our business and financial goals. Our incentive plans are designed to reward the actions that lead to long-term value creation. To achieve our objectives, we seek to ensure that compensation is competitive and that there is a direct link between pay and performance. To do so, we are guided by the following principles:

- A significant portion of pay should be performance-based, with the percentage of total pay tied to performance increasing proportionally with an executive's level of responsibility;
- Compensation should include incentive-based pay to drive performance, providing superior pay for superior performance, including both a short- and long-term focus;
- Compensation policies should include an opportunity for, and a requirement of, equity ownership to align the interests of executives and shareholders; and
- Components of compensation should be tied to an evaluation of business and individual performance measured against metrics that directly drive our business strategy.

The vote on this resolution is not intended to address any specific element of compensation. Rather, the vote relates to the compensation of our NEOs as described in this proxy statement. The vote is advisory. This means that the vote is not binding on Kroger. The Compensation Committee of the Board is responsible for establishing executive compensation. In so doing, the Compensation Committee will consider, along with all other relevant factors, the results of this vote.

We ask our shareholders to vote on the following resolution:

"RESOLVED, that the compensation paid to the Company's NEOs, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables, and the related narrative discussion, is hereby APPROVED."

The next advisory vote will occur at our 2019 annual meeting.

**The Board of Directors Recommends a Vote For This Proposal.**

## **Item No. 3 Vote to Approve Amendment to Regulations to Permit Proxy Access**

You are being asked to vote to approve an amendment to our Regulations to incorporate a provision that will permit proxy access nominations of directors to our Board of Directors. Our Board of Directors recommends that you vote FOR this proposal.

Under this Item No. 3, the Board is recommending that our shareholders adopt an amendment to our Regulations to implement proxy access. The proposed amendment is contained in a new Article I, Section 2(B)(3) to our Regulations, a copy of which is included in Appendix A attached to this Proxy Statement (the "Amendment"). Proxy access allows eligible shareholders to include their own nominees for director in the Company's proxy materials along with the Board of Director's nominees.

In connection with our review of our corporate governance practices and recent trends, in combination with views expressed by certain of our shareholders, the Board approved the Amendment. Pursuant to our Regulations, the Amendment will not become effective unless it is adopted by the affirmative vote of a majority of our shareholders. The Board of Directors' decision to approve and seek shareholder adoption of this proposal to implement proxy access reflects its continuing commitment to respond to the views of the Company's shareholders and provide them with a voice in corporate governance matters. Furthermore, the Board of Directors believes that the implementation of proxy access in the manner set forth in this proposal will provide meaningful rights to our shareholders while ensuring the rights are used by shareholders in a responsible manner.

### **Description of Amendment**

The following description of the Amendment is qualified in its entirety by reference to the complete text of the Amendment, which is included in the Regulations and set forth in Appendix A. You are urged to read the Amendment in its entirety.

### **Eligibility of Shareholders to Nominate Directors**

The Amendment would permit any shareholder, or group of no more than 20 shareholders, owning 3 percent or more of our outstanding common shares continuously for at least the previous three years who complies with the requirements set forth in the provision, to include one director nominee in the Company's proxy statement for its annual meeting of shareholders.

### **Calculation of Qualifying Ownership**

To ensure that the interests of shareholders seeking to include director nominees in the Company's proxy materials are aligned with those of other shareholders, a nominating shareholder would be deemed to own only those outstanding common shares of the Company as to which the shareholder possesses both the full voting and investment rights pertaining to the shares and the full economic interest in (including the opportunity for profit from and risk of loss on) such shares.

### **Number of Shareholder-Nominated Candidates**

The maximum number of shareholder-nominated candidates that the Company would be required to include in its proxy materials would equal the greater of 2 or 20% of the directors in office at the time of nomination. If the 20% calculation does not result in a whole number, the maximum number of shareholder-nominated candidates would be the closest whole number below 20%. Based on our current Board of Directors size of 11 directors, the maximum number of shareholder-nominated candidates we would be required to include in our annual meeting proxy materials is two. If one or more vacancies occur on the Board, or the Board decides to reduce the size of the Board in connection therewith, after the nomination deadline, the nominee limit would be calculated based on the reduced number of directors. The maximum number of shareholder-nominated candidates would be reduced by candidates nominated under proxy access procedures who (i) are included in the Company's proxy statement as a nominee of the Board of Directors, or (ii) were previously elected to the Board of Directors at one of the last two annual meetings and renominated as a director by the Board of Directors. In addition, such number will be further reduced (but not below one) by the number of director nominees submitted by shareholders pursuant to the Company's advance notice nomination procedures.

Each nominating shareholder or group of shareholders may nominate one, but not more than one, director. If the number of shareholder-nominated candidates exceed the maximum permitted number of nominees, then such candidates would be included in the proxy material in order of the number of Company common shares (largest to smallest) held by each nominating shareholder or group of shareholders until the maximum is reached.

### **Nominating Procedure**

In order to provide adequate time to assess shareholder nominated candidates, requests to include shareholder nominated candidates in the Company's proxy materials must be received not later than the close of business on the 120th calendar day nor earlier than the close of business on the 150th calendar day prior to the date on which the Company's proxy statement for the prior year's annual meeting of shareholders was first mailed to shareholders.

## Information Required; Representations and Undertakings

Each shareholder seeking to include a shareholder-nominated candidate in the Company's proxy materials would be required to provide certain information and make certain representations and undertakings at the time of nomination, including:

- Proof that the nominating shareholder or group of shareholders has held the required number of shares for the requisite period;
- The shareholder's notice on Schedule 14N required to be filed with the SEC;
- The written consent of the shareholder-nominated candidate to being named in the proxy statement as a nominee and to serving as a director if elected; and
- Representations and undertakings, including with respect to the shareholder's intent and compliance with applicable laws, including the lack of an intent to change or influence control of the Company and an undertaking to assume liability stemming from any violation arising out of any communications by the nominating shareholder with the Company's shareholders and from the information that the shareholder provides to the Company.

In addition, each shareholder-nominated candidate would be required to submit certain information, including as necessary to permit the Board of Directors to determine if the shareholder-nominated candidate is independent under the NYSE listing standards, any applicable rules of the SEC, or any publicly disclosed standards used by the Board of Directors in determining and disclosing the independence of the Company's directors. Each shareholder-nominated candidate would also be required to provide certain representations and agreement, including in relation to adherence to applicable Company policies, disclosure of voting commitment or compensation arrangement in connection with his or her nomination or service as a director and the completion of any applicable questionnaires as requested by the Company.

## Qualifications and Eligibility of Shareholder-Nominated Candidates

The Company would not be required to include the shareholder-nominated candidate in its proxy materials under certain circumstances, including if:

- the Board of Directors determines he or she is not independent under the NYSE listing standards, any applicable rules of the SEC, or any disclosed standards used by the Board of Directors in determining and disclosing the independence of the Company's directors;
- the shareholder-nominated candidate has participated in another person's solicitation;
- the Company would be in violation of its organizational documents, applicable law or NYSE listing standards;
- the shareholder-nominated candidate or shareholder has provided materially false or misleading information to the Company;
- the shareholder-nominated candidate is party to an undisclosed voting commitment or compensation arrangement; or
- the shareholder nominated candidate's business or personal interests place such candidate in a conflict of interest with the Company.

## Renomination of Shareholder-Nominated Candidates

Any shareholder-nominated candidate who is included in the Company's proxy materials, but subsequently withdraws from or becomes ineligible for election at the meeting, or does not receive at least 25% of the vote cast in favor of his or her election would be ineligible for nomination for the following two annual meetings.

## Supporting Statement

Nominating shareholders may submit to the Company for inclusion in the proxy materials a 500-word statement in support of their nominee(s). The Company may omit any information or statement that it believes would violate any applicable law or regulation.

## The Board of Directors Recommends a Vote For This Proposal.



#### **Item No. 4 Vote to Approve Amendment to Regulations to Permit Board Amendments in Accordance with Ohio Law**

Under this Item No. 4, we are asking our shareholders to approve an amendment to our Regulations allowing the Board of Directors to adopt amendments to the Regulations to the extent permitted by Ohio law. Our Regulations currently require our shareholders to adopt all amendments.

The text of the revised Article VII of our Regulations, with the additional text proposed by the amendment indicated by underlining is set forth below. The following discussion is qualified in its entirety by reference to the proposed text of the amendment below.

Like many Ohio companies whose shareholders have voted to amend their regulations to permit amendments by their boards of directors, we are asking our shareholders to approve Proposal No. 4 in light of the following:

- Many jurisdictions, such as Delaware, have historically allowed the directors of a corporation to amend the corporation's bylaws (the Delaware equivalent of Ohio's regulations) without shareholder approval.
- Since 2006, Ohio law provides Ohio corporations with flexibility similar to Delaware corporations, to make certain amendments to their regulations without shareholder approval, if the authority is provided in the corporation's articles of incorporation or regulations, subject to statutory limitations that prohibit directors from amending the regulations in a way that affects important rights that Ohio law reserves for shareholders.
- Giving this flexibility to our Board of Directors would enable them to efficiently and cost-effectively streamline and improve the Regulations as needed in the future and also to quickly adapt them to changes in state law or governance trends, such as adopting modern provisions regarding electronic notice and actions.

Even if Proposal 4 is approved, the Board's ability to amend the Regulations will be limited. Under Ohio law, only our shareholders would be able to make the following amendments to our Regulations:

- changing the percentage of common shares needed to call a special shareholders' meeting;
- changing the length of the time period required for notice of shareholders' meetings;
- changing the requirement for a quorum at shareholders' meetings;
- prohibiting shareholder or director actions from being authorized or taken without a meeting;
- defining terms of office for directors or providing for classification of directors;
- requiring greater than a majority vote of shareholders to remove directors without cause;
- changing the requirements for a quorum at directors' meetings or the required vote for an action of the directors; or
- including a requirement that a control share acquisition of the corporation be approved by the corporation's shareholders.

Accordingly, if shareholders approve Proposal 4:

- Article VII of our Regulations would be revised to allow the Board of Directors to amend our Regulations in the future to the extent permitted by Ohio law, which authority could not be delegated to a committee of the Board of Directors; and
- the Board would be able to amend, repeal and adopt new regulations to implement ministerial and other changes to our Regulations, other than with respect to the matters reserved for shareholders under Ohio law, including as set forth above, without the time-consuming and expensive process of seeking shareholder approval.

The amendment also clarifies that the power to amend the Regulations, whether exercised by the Board or shareholders, includes the power to adopt new regulations.

If Proposal 4 is approved, we would promptly notify shareholders of any amendments to our Regulations made by the Board of Directors either by filing a report with the SEC or by sending a notice to shareholders of record as of the date of the adoption of the amendment. Our shareholders would continue to be able to adopt, amend and repeal the Regulations without action by the Board and, therefore, to change any amendment made by the Board of Directors should they determine that to be appropriate.

The actual text of the revised Article VII of our Regulations, with changes indicated by underlining, is set forth below. The amendment would become effective at the time of the shareholder vote.

## ARTICLE VII

### Amendment of Regulations

These regulations may be amended or repealed **or new regulations may be adopted** (A) at any meeting of the shareholders called for that purpose or without such meeting by the affirmative vote or consent of the holders of record of shares entitling them to exercise a majority of the voting power on such proposal except that the affirmative vote or consent of the holders of record of shares entitling them to exercise 75% of the voting power on such proposal shall be required to amend, alter, change or repeal Sections 1 or 5 of Article II or this Article VII, or to amend, alter, change or repeal these regulations in any way inconsistent with the intent of the foregoing provisions, **or (B) by the Board of directors to the extent permitted by the Ohio Revised Code.**

**The Board of Directors Recommends a Vote For This Proposal.**

### **Item No. 5 Ratification of the Appointment of Kroger's Independent Auditor**

**You are being asked to ratify the appointment of Kroger's independent auditor, PricewaterhouseCoopers LLC. The Board of Directors recommends that you vote FOR the ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm.**

The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities regarding the Company's financial reporting and accounting practices including the integrity of the Company's financial statements; the Company's compliance with legal and regulatory requirements; the independent public accountants' qualifications and independence; the performance of the Company's internal audit function and independent public accountants; and the preparation of the Audit Committee Report. The Audit Committee performs this work pursuant to a written charter approved by the Board of Directors. The Audit Committee charter most recently was revised during fiscal 2012 and is available on the Company's website at [ir.kroger.com](http://ir.kroger.com) under Investors – Governance – Committee Composition. The Audit Committee has implemented procedures to assist it during the course of each fiscal year in devoting the attention that is necessary and appropriate to each of the matters assigned to it under the Audit Committee's charter. The Audit Committee held 5 meetings during fiscal year 2017.

### **Selection of Independent Auditor**

The Audit Committee of the Board of Directors is directly responsible for the appointment, compensation, retention, and oversight of Kroger's independent auditor, as required by law and by applicable NYSE rules. On March 14, 2018, the Audit Committee appointed PricewaterhouseCoopers LLP as Kroger's independent auditor for the fiscal year ending February 2, 2019.

In determining whether to reappoint the independent auditor, our Audit Committee:

- Reviews PricewaterhouseCoopers LLP's independence and performance;
- Reviews, in advance, all non-audit services provided by PricewaterhouseCoopers LLP, specifically with regard to the effect on the firm's independence;
- Conducts an annual assessment of PricewaterhouseCoopers LLP's performance, including an internal survey of their service quality by members of management and the Audit Committee;
- Conducts regular executive sessions with PricewaterhouseCoopers LLP;
- Conducts regular executive sessions with the Vice President of Internal Audit;
- Considers PricewaterhouseCoopers LLP's familiarity with our operations, businesses, accounting policies and practices and internal control over financial reporting;
- Reviews candidates for the lead engagement partner in conjunction with the mandated rotation of the public accountants' lead engagement partner;
- Reviews recent Public Company Accounting Oversight Board reports on PricewaterhouseCoopers LLP and its peer firms; and
- Obtains and reviews a report from PricewaterhouseCoopers LLP describing all relationships between the independent auditor and Kroger at least annually to assess the independence of the internal auditor.

As a result, the members of the Audit Committee believe that the continued retention of PricewaterhouseCoopers LLP to serve as our independent registered public accounting firm is in the best interests of our company and its shareholders.

While shareholder ratification of the selection of PricewaterhouseCoopers LLP as our independent auditor is not required by Kroger's Regulations or otherwise, the Board of Directors is submitting the selection of PricewaterhouseCoopers LLP to shareholders for ratification, as it has in past years, as a good corporate governance practice. If the shareholders fail to ratify the selection, the Audit Committee may, but is not required to, reconsider whether to retain that firm. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different auditor at any time during the year if it determines that such a change would be in the best interests of our company and our shareholders.

A representative of PricewaterhouseCoopers LLP is expected to be present at the meeting to respond to appropriate questions and to make a statement if he or she desires to do so.

### **Audit and Non-Audit Fees**

The following table presents the aggregate fees billed for professional services performed by PricewaterhouseCoopers LLP for the annual audit and quarterly reviews of our consolidated financial statements for fiscal 2017 and 2016, and for audit-related, tax and all other services performed in 2017 and 2016.

	<b>Fiscal Year Ended</b>	
	<b>February 3, 2018</b>	<b>January 28, 2017</b>
Audit Fees <sup>(1)</sup>	\$5,178,208	\$5,894,384
Audit-Related Fees	775,000	—
Tax Fees <sup>(2)</sup>		30,736
All Other Fees	900	—
<b>Total</b>	<b>\$5,954,108</b>	<b>\$5,925,120</b>

(1) Includes annual audit and quarterly reviews of Kroger's consolidated financial statements, the issuance of comfort letters to underwriters, consents, and assistance with review of documents filed with the SEC.

(2) Fees for state sales tax consulting.

The Audit Committee requires that it approve in advance all audit and non-audit work performed by PricewaterhouseCoopers LLP. In 2007, the Audit Committee adopted an audit and non-audit service pre-approval policy. Pursuant to the terms of that policy, the Committee will annually pre-approve certain defined services that are expected to be provided by the independent auditors. If it becomes appropriate during the year to engage the independent accountant for additional services, the Audit Committee must first approve the specific services before the independent accountant may perform the additional work.

PricewaterhouseCoopers LLP has advised the Audit Committee that neither the firm, nor any member of the firm, has any financial interest, direct or indirect, in any capacity in Kroger or its subsidiaries.

### **The Board of Directors Recommends a Vote For This Proposal.**

## Audit Committee Report

Management of the Company is responsible for the preparation and presentation of the Company's financial statements, the Company's accounting and financial reporting principles and internal controls, and procedures that are designed to provide reasonable assurance regarding compliance with accounting standards and applicable laws and regulations. The independent public accountants are responsible for auditing the Company's financial statements and expressing opinions as to the financial statements' conformity with generally accepted accounting principles and the effectiveness of the Company's internal control over financial reporting.

In performing its functions, the Audit Committee:

- Met separately with the Company's internal auditor and PricewaterhouseCoopers LLP with and without management present to discuss the results of the audits, their evaluation and management's assessment of the effectiveness of Kroger's internal controls over financial reporting and the overall quality of the Company's financial reporting;
- Met separately with the Company's Chief Financial Officer or the Company's General Counsel when needed;
- Met regularly in executive sessions;
- Reviewed and discussed with management the audited financial statements included in our Annual Report;
- Discussed with PricewaterhouseCoopers LLP the matters required to be discussed under the applicable requirements of the Public Company Accounting Oversight Board; and
- Received the written disclosures and the letter from PricewaterhouseCoopers LLP required by the applicable requirements of the Public Accounting Oversight Board regarding the independent public accountant's communication with the Audit Committee concerning independence and discussed with the matters related to their independence.

Based upon the review and discussions described in this report, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the year ended February 3, 2018, as filed with the SEC.

This report is submitted by the Audit Committee.

Ronald L. Sargent, Chair  
Anne Gates  
Bobby S. Shackouls  
Mark S. Sutton

## **Item No. 6 Shareholder Proposal – Recyclability of Packaging**

We have been notified by one shareholder, the name and shareholdings of which will be furnished promptly to any shareholder upon written or oral request to Kroger's Secretary at our executive offices, that it intends to propose the following resolution at the annual meeting:

“WHEREAS: A portion of Kroger house brand product packaging is unrecyclable, including plastics, which are a growing component of plastic pollution and marine litter. Authorities say that marine litter kills and injures marine life, spreads toxics, and poses a potential threat to human health. The environmental cost of consumer plastic products and packaging exceeds \$139 billion annually, according to the American Chemistry Council.

Plastic is the fastest growing form of packaging; U.S. flexible plastic sales are estimated at \$26 billion. Dried fruit, frozen meat, cheese, and dog food are some of the Kroger house brand items packaged in unrecyclable plastic pouches. Private label items account for a quarter of all sales –nearly \$20 billion annually. Using unrecyclable packaging when recyclable alternatives are available wastes valuable resources. William McDonough, a leading green design advisor, calls pouch packaging a “monstrous hybrid” designed to end up either in a landfill or incinerator.

Recyclability of household packaging is a growing area of focus as consumers become more environmentally conscious, yet recycling rates stagnate. Only 14% of plastic packaging is recycled, according to the U.S. Environmental Protection Agency (EPA). Billions of pouches and similar multi-layer plastic laminates, lie buried in landfills. Unrecyclable packaging is more likely to be littered and swept into waterways. An assessment of marine debris by the Global Environment Facility concluded that one cause of debris entering oceans is “design and marketing of products internationally without appropriate regard to their environmental fate or ability to be recycled...”

In the marine environment, plastics break down into indigestible particles that marine life mistake for food. Studies by the EPA suggest a synergistic effect between plastic debris and persistent, bio-accumulative, toxic chemicals. Plastics absorb toxics such as polychlorinated biphenyls and dioxins from water or sediment and transfer them to the marine food web and potentially to human diets. If no actions are taken, oceans are expected to contain more plastic than fish by 2050!

Making all packaging recyclable, if possible, is the first step needed to reduce the threat posed by plastic pollution. Better management of plastic could save consumer goods companies \$4 billion a year. Companies who aspire to corporate sustainability yet use these risky materials need to explain why they use unrecyclable packaging. Other companies who manufacture and sell food and household goods are moving towards recyclability. Walmart uses sustainable packaging guidelines to incentivize its suppliers to increase the amount of packaging they use that can be recycled. Colgate-Palmolive, PepsiCo, Procter & Gamble, Unilever, and Walmart have all developed packaging recyclability goals.

RESOLVED: Shareowners of Kroger request that the board of directors issue a report, at reasonable cost, omitting confidential information, assessing the environmental impacts of continuing to use unrecyclable brand packaging.

Supporting Statement: Proponents believe that the report should include an assessment of the reputational, financial and operational risks associated with continuing to use unrecyclable brand packaging and, if possible, goals and a timeline to phase out unrecyclable packaging.”

### **The Board of Directors Recommends a Vote Against This Proposal for the Following Reasons:**

Kroger recognizes the important role our company plays as a good steward of the environment, including efforts to reduce packaging and increase recyclability. We focus on reducing waste through our commitment to be a Zero Waste Company (diverting at least 90% of waste from landfills) by 2020 (as of 2017, Kroger had diverted more than 75% of its waste), and as part of our Zero Hunger I Zero Waste social impact plan to end hunger in our communities and eliminate waste across the company by 2025.

In 2016, Kroger announced its 2020 Sustainability Goals. One of these goals specifically focuses on improvements in Our Brands packaging:

#### **Goal: 100% Our Brands Packaging Optimization**

By 2020, Kroger will optimize packaging in Our Brands by following a balanced, multi-pronged approach that considers design attributes including but not limited to food safety, shelf life, availability, quality, material type and source, function, recyclability and cost. Through the design optimization process, Kroger will strive to increase the recyclability of Our Brands manufactured plastic packaging.

This goal has many parts. The detailed packaging optimization goals for 2020 and an update on our progress can be found at <http://sustainability.kroger.com/2020-goals.html>.

### *Source Reduction*

The focus on Our Brands packaging is intended to reduce the amount of plastics in our packaging, increase recycled content and certified virgin fiber, plus increase recyclability.

The Our Brands packaging team is designing product packages that use less plastic, helping Kroger make significant progress on our goal to reduce plastic in Our Brands packaging by 10 million pounds by 2020. By the end of 2017, we reached the 9.8-million-pound mark. Hence, Kroger is on track to achieve our goal well ahead of schedule.

The biggest example of source reduction is the redesign of Our Brands gallon milk jug. Our new milk jug still is made of the same 100% recyclable high density polyethylene as the old jugs, but our unique design allows us to use approximately 10% less plastic while retaining the same performance. This lighter-weight milk jug is currently in production at six Kroger dairies:

- Centennial Farms Dairy in Atlanta, Georgia;
- Heritage Farms Dairy in Murfreesboro, Tennessee;
- Jackson Hutchinson Dairy in Hutchinson, Kansas;
- Michigan Dairy in Livonia, Michigan;
- Vandervoort Dairy in Ft. Worth, Texas; and
- Westover Dairy in Lynchburg, Virginia.

We will continue to roll out the new jug throughout 2018 at additional facilities. We will also continue to identify other projects to reduce packaging at the source and promote sustainable packaging across our operations.

### *Recycling Solutions*

We also offer a popular in-store plastics recycling program for our customers – typically located in our store lobbies. We accept several types of Our Brands packaging, such as clean and dry plastic shopping bags, bread and produce bags, bottled water case wraps, and bathroom tissue and diaper plastic overwraps. We also accept national brand product packaging types that are compatible with in-store drop-off programs. In addition, Kroger associates use this program to recycle pallet shrink wrap. In 2017, we collected more than 37.9 million pounds of plastic through this program.

### *Customer Communication*

We continue to improve our product labels as part of our packaging updates to help increase awareness among our customers about how to recycle our packaging. We label recyclable Our Brands products according to the Federal Trade Commission's Green Guides, prompting our customers to "Please Recycle." As we update our packaging labels, we clearly denote when packaging, such as plastic, paper and aluminum containers, is recyclable. Where a shrink sleeve may interfere with the recyclability of a plastic bottle, we are adding a tear perforation and the message "Remove Label to Recycle Bottle" to the labels. Similarly, where products use plastic overwrap that can be recycled through our in-store plastics recycling programs, we are adding language to the overwrap that directs our customers to "Please Recycle at your local, Kroger Family of Stores drop-off location."

### *Reusable Bags and Plastic Containers*

While helping recycle plastic bags, we strongly advocate for transitioning to reusable bags and encourage customers to change their habits by offering a wide variety of reusable bags; in fact, each year, we sell millions of these reusable bags to our customers. Additionally, many parking lots at our Kroger Family of Stores have signs on the cart corrals that remind our customers to bring their reusable bags into our stores. Simple reminders like these can further reduce plastic bag waste and encourage customers to change their shopping habits.

We also ship fresh produce to our stores using reusable plastic containers (RPCs), which improve product quality and significantly reduce waste by eliminating the use of cardboard boxes. We continue to increase our volume of fresh produce shipped in RPCs, and used 140 million containers in 2017.

### *Advocacy*

We are actively engaging in industry collaboration groups and directly with our stakeholders on these topics. To accelerate efforts to achieve our packaging goals, Kroger joined the Sustainable Packaging Coalition in 2017.



We believe our participation will accelerate our progress and help advance industry-wide and supply chain-wide initiatives to move the needle on recyclability and identify suppliers who can support our sustainable packaging goals.

Guided by our 2020 Sustainability Goals and our Zero Hunger | Zero Waste social impact plan, Kroger will continue to support plastic waste reduction, find optimized solutions for packaging and create opportunities for our associates and customers to recycle plastics in our stores. We will continue to optimize Our Brands packaging in ways that support our financial, environmental and social responsibilities to our customers, shareholders and other stakeholders.

The proposal asks that Kroger issue a report on unrecyclable packaging material. Kroger publishes details on our sustainability goals, initiatives, and progress against our targets in our Sustainability Report and on our website (<http://sustainability.kroger.com>). Given our extensive reporting and our strong focus on ensuring we are responsible stewards of the environment, the Board believes that issuing a report on unrecyclable packaging would be unnecessary and would consume time and resources that are best spent on executing on our sustainability programs and targets.

We urge you to support these efforts and vote **AGAINST** this proposal.

### **Item No. 7 Shareholder Proposal – Renewable Energy**

We have been notified by one shareholder, the name and shareholdings of which will be furnished promptly to any shareholder upon written or oral request to Kroger's Secretary at our executive offices, that it intends to propose the following resolution at the annual meeting:

“WHEREAS: The long term interests of shareholders are best served by companies that operate their businesses in a sustainable manner, focused on long term value creation. This is particularly important in the context of climate change. To mitigate the worst impacts of climate change, global warming must be limited to under 2 degrees Celsius (IPCC 2013), a goal consistent with the internationally recognized Paris Agreement.

Kroger is one of the world's largest food retailers, exceeding \$115 billion in revenue. It is listed 18th on Fortune's Fortune 500 list and 40th on Fortune's Global 500 list. Despite its size and significant carbon impact, Kroger lags behind its peers in establishing greenhouse gas emission reduction targets. Where most companies are reducing carbon, Kroger's combined Scope 1 & 2 emissions have annually increased since 2013. (Kroger CDP Reports 2012-2017). Investors are concerned that Kroger's globally significant carbon emissions are not being adequately addressed.

One meaningful way Kroger could reduce its carbon footprint is to expand its use of renewable energy. While making some inroads on energy and supply chain efficiency, Kroger has not instituted comprehensive programs to reduce the carbon impact of its power sourcing. Kroger's failure to meaningfully invest in renewable energy is in strong contrast to its peers, which are rapidly and profitably scaling renewable energy. Competitor Walmart installed 145 MW of solar at 364 different sites; Target developed 147 MW of solar at 300 sites, and Costco 51 MW. (<https://www.seia.org/solar-means-business-report>). Walmart has further committed to 100% renewable electricity, joining other major companies such as Whole Foods Market, IKEA, and Starbucks. (<http://there100.org/companies>). Target recently announced new science based targets including a 100% renewable energy commitment (<https://cleantechnica.com/2017/10/19/target-announces-100-renewable-energy-target-amidst-new-climate-policy>), aligning with existing goals to install distributed solar power on 500 more stores and distribution centers by 2020. (Target 2015 Corporate Social Responsibility Report).

According to Eric Schmidt, Executive Chairman of Alphabet Inc., “Much of corporate America is buying renewable energy [...] not just to be sustainable, because it makes business sense, helping companies diversify their power supply, hedge against fuel risks, and support innovation in an increasingly cost competitive way.” (Google Green Blog 2014).

While Kroger claims it is committed to reducing its carbon footprint, it has yet to make meaningful commitments to shift its massive energy consumption away from fossil fuel sources. Accelerating renewable energy adoption will help Kroger stay competitive and protect Kroger's shareholder value into the future as intensifying climate change imposes growing costs on Kroger's supply chain, physical assets, and shareholders.

RESOLVED: Shareholders request Kroger produce a report, with board oversight, assessing the climate change risk reduction benefits of adopting quantitative, time-bound, enterprise-wide targets for increasing its renewable energy sourcing. The report should be produced at reasonable cost and exclude proprietary information.

SUPPORTING STATEMENT: Shareholders request the report also include discussion of the business risk Kroger faces from climate change; the potential for renewable energy procurement to reduce such risk; and options for increasing renewable energy adoption.”

### **The Board of Directors Recommends a Vote Against This Proposal for the Following Reasons:**

Kroger is committed to environmental sustainability, and we strive to reduce our impact on the environment by proactively reducing carbon emissions in our business over time. We believe the concerns of the proponent are addressed by a number of initiatives, including our 2020 Sustainability Goals and the commitments outlined in Kroger’s Zero Hunger | Zero Waste social impact plan, our vision to end hunger in the communities we call home and eliminate waste across our company by 2025.

Kroger has a history of reducing carbon emissions across our footprint through investments in energy efficiency, renewable energy and refrigerant emissions reductions. We continue to expand the implementation of existing solutions that have proven successful, as well as identify and evaluate new technologies that have the potential to further improve sustainability. As a result, we have demonstrated a long-term reduction trend in carbon emissions intensity (metric tons CO<sub>2</sub>e per square foot) across our company.

### **Our Commitments**

In 2016, Kroger announced a set of 2020 Sustainability Goals (<http://sustainability.kroger.com/2020-goals.html>). We continue to make progress toward achieving these goals, which include several goals to address carbon emissions reductions. We will publish our annual Sustainability Report again this year to highlight key achievements and initiatives. More information on Kroger’s 2020 Sustainability Goals and Zero Hunger | Zero Waste can be found at [www.thekrogerco.com](http://www.thekrogerco.com).

The following is an overview of our key commitments and progress to date in emissions reductions:

*Goal: Kroger will reduce cumulative electricity consumption in our stores by 40% by 2020, using 2000 as a baseline year.*

Kroger has shown long-term success in reducing energy consumption through the maintenance of existing processes and technologies as well as testing and learning from new technologies. In 2017, we installed new LED lighting in more than 1,500 stores, and we will continue to retrofit remaining stores in 2018. We also participate in the U.S. EPA’s ENERGY STAR program and have more than 790 ENERGY STAR certified Kroger-operated stores to date. We continue to pursue additional ENERGY STAR certifications on an ongoing basis. In fact, we recently earned the 2018 ENERGY STAR Partner of the Year award. As a result of these efforts, we made significant progress on our goal in 2017.

*Goal: Kroger will improve transportation efficiency by 20% by 2020, using 2010 as a baseline year.*

Our Logistics team continues to track our Ton Miles Per Gallon (TMPG), which effectively looks at how many miles we haul one ton of groceries on one gallon of fuel. By the end of 2017, we had achieved an improvement of 8.1% due to ongoing evaluation of new technologies and increasing efficiencies in how we make deliveries and operate our equipment. In addition, Kroger has committed to adding Tesla Semi electric trucks to its distribution fleet, which require lower energy cost per mile in comparison to conventional diesel tractors.

*Goal: Kroger will reduce refrigerant leaks in our supermarket refrigeration systems by 10% annually.*

Kroger continues to reduce refrigerant leaks in our stores and sets annual reduction targets through the EPA’s GreenChill Program. In 2017, we achieved our goal to further reduce refrigerant emissions by 10% in our stores as a result of installing refrigerant leak protection systems and an active leak detection program. We are committed to an additional 9% reduction in 2018.

*Goal: Kroger will be a Zero Waste Company by 2020 (90% or more of waste diverted away from landfills) and eliminate food waste across our company by 2025.*

Kroger previously committed to achieve Zero Waste across our company as part of our 2020 Sustainability Goals. Our current landfill diversion rate is greater than 75%, thanks to our Manufacturing and Logistics teams – both above 90% diversion – and the success of our Zero Hunger | Zero Waste Food Rescue Program. As part of Kroger’s commitment to Zero Hunger | Zero Waste, we set a new industry-leading goal to eliminate food waste across our company by 2025. As a food manufacturer and retailer, the reduction of food waste is an important component of our scope 3 emissions – key to reducing the production of methane, one of the most potent greenhouse gases. We are working with the World Wildlife Fund to assess our food waste impacts, set goals to reduce waste and establish a framework for food waste reporting going forward.

## Innovative Approaches

Kroger continues to evaluate and launch solar power installations at our facilities. In 2017, we activated new solar power parking lot installations at three Fry's supermarket locations. These combined solar power and shade technology projects generate renewable power for our stores as well as cover for our customers' cars while they shop with us. Collectively, our solar and wind power installations generated more than 14.5 million kWh of power this past year.

In late 2017, Kroger completed installation and activated a new anaerobic wastewater treatment facility at our KB Specialty Foods food production plant in Greensburg, Indiana. This anaerobic digestion process converts the wastewater into renewable biogas, which is used to produce electricity. When running at maximum capacity, the digester can produce up to 30% of the electricity needed to operate the KB Specialty Foods plant. This is Kroger's second anaerobic digester. The first is the Kroger Recovery System, an anaerobic digester at the Ralphs/Food 4 Less Distribution Center in Compton, California. This facility began operations in late 2012 and is designed to process inedible food and other organic waste into renewable biogas, and ultimately electricity. As with the Greensburg facility, the Compton digester can supply a portion of the distribution center's power needs.

## Looking Ahead

Finally, as part of our ongoing commitment to environmental sustainability, we continue to evaluate the next steps in our carbon reduction strategy. We continue to engage internal and external stakeholders in this discussion, as well as benchmark other companies with leading carbon reduction targets and initiatives. While we remain focused on achieving our 2020 and 2025 goals, we are also reviewing the means and opportunities for further carbon emission reductions in the future.

The proposal asks that Kroger issue a report on renewable energy. Kroger publishes details on our sustainability goals, initiatives, and progress against our targets in our Sustainability Report and on our website ([sustainability.kroger.com](http://sustainability.kroger.com)). Given our extensive reporting and our strong focus on ensuring we are responsible stewards of the environment, the Board believes that issuing a report on renewable energy would be unnecessary and would consume time and resources that are best spent on executing on our sustainability programs and targets.

We urge you to support the furthering of our current programs and vote **AGAINST** this proposal.

## Item No. 8 Shareholder Proposal – Independent Chairman

We have been notified by one shareholder, the name and shareholdings of which will be furnished promptly to any shareholder upon written or oral request to Kroger's Secretary at our executive offices, that it intends to propose the following resolution at the annual meeting:

"RESOLVED: Shareowners of The Kroger Co. ("Kroger") ask the Board of Directors to adopt a policy, and amend the bylaws as necessary, to require the Chair of the Board to be an independent member of the Board. This policy shall apply prospectively so as not to violate any contractual obligation. The policy should provide that (i) if the Board determines that a Chair who was independent when selected is no longer independent, the Board shall select a new Chair who satisfies the policy within 60 days of that determination; and (ii) compliance with this policy is waived if no independent director is available and willing to serve as Chair.

### SUPPORTING STATEMENT:

Except for brief "apprenticeship" periods at the outset of their CEO service, Kroger CEOs have also held the role of Board Chair for many decades. We believe the combination of these two roles in a single person weakens a corporation's governance, which can harm shareholder value. As Intel's former Chair Andrew Grove stated, "The separation of the two jobs goes to the heart of the conception of a corporation. Is a company a sandbox for the CEO, or is the CEO an employee? If he's an employee, he needs a boss, and that boss is the board. The chairman runs the board. How can the CEO be his own boss?"

In our view, shareholder value is enhanced by an independent Board Chair who can provide a balance of power between the CEO and the Board and support strong Board oversight.

Proxy advisor Glass Lewis opined in a 2016 report that "shareholders are better served when the board is led by an independent Chairman who we believe is better able to oversee the executives of the Company and set a pro-shareholder agenda without the management conflicts that exist when a CEO or other executive also serves as Chairman." ([www.glasslewis.com/wp-content/uploads/2016/03/2016-In-Depth-Report-INDEPENDENT-BOARD-CHAIRMAN.pdf](http://www.glasslewis.com/wp-content/uploads/2016/03/2016-In-Depth-Report-INDEPENDENT-BOARD-CHAIRMAN.pdf))

An independent Board Chair has been found in academic studies to improve the performance of public companies, although evidence overall is inconclusive. While separating the roles of Chair and CEO is the norm in Europe, 48% of S&P 500 company boards have also implemented this best practice. ([www.spencerstuart.com/media/pdr/020files/research%20and%20insight%20pdfs/spencer-stuart-us-board-index-2016.pdf](http://www.spencerstuart.com/media/pdr/020files/research%20and%20insight%20pdfs/spencer-stuart-us-board-index-2016.pdf))

We believe that independent Board leadership would be particularly useful at Kroger in providing more robust oversight regarding sustainability issues. We agree with the recent observations by State Street Global Advisors' CEO that "a long-term horizon requires a focus on sustainability" and that boards "are often better-equipped than the day-to-day management to see these issues over longer time horizons." ([www.ssga.com/investment-topics/environmental-social-governance/2017/long-term-value-begins-at-the-board-eu.pdf](http://www.ssga.com/investment-topics/environmental-social-governance/2017/long-term-value-begins-at-the-board-eu.pdf))

Kroger continues to risk its reputation by selling produce treated with neonicotinoids, a group of insecticides highly toxic to bees. Kroger has refused to join the Fair Food Program to ensure equitable treatment of farm workers. Kroger also faces reputational risk associated with its responses to the impacts of food production on deforestation. Independent Board leadership would, we think, more likely result in improved policies and practices to mitigate these business risks.

We urge shareholders to vote for this proposal."

### **The Board of Directors Recommends a Vote Against This Proposal for the Following Reasons:**

The Board should have the flexibility to determine the Board's structure tailored to Kroger's needs at any time, including separating or combining the roles of Chairman and CEO.

Kroger's Board is structured to provide the most effective leadership for our shareholders. Our shareholders' interests are best served when the company retains the flexibility to select the appropriate person to serve in the Chairman's role given the changing circumstances of the retail food marketplace. The Board believes that the proponent's rigid "one size fits all" proposal is not in the best interest of shareholders and should be rejected. Kroger has a balanced governance structure in which independent directors, including an independent Lead Director, exercise meaningful and vigorous oversight. Kroger's Board is led by a strong independent Lead Director who serves the same functions as a Chairman and provides the safeguards that the proposal seeks.

Kroger's independent Lead Director has robust responsibilities that ensure a strong, independent and active board that complements the Chairman's role.

The Lead Director's robust duties and responsibilities are addressed in detail in the Guidelines which are available at [ir.kroger.com](http://ir.kroger.com). The Lead Director serves a variety of roles, including:

- Reviewing and approving all Board meeting agendas, meeting materials, and schedule;
- Serving as a liaison between the Chairman and the independent directors;
- Presiding at the regularly conducted executive sessions of independent directors and meetings of the Board when the Chairman is not present;
- Calling an executive session of the independent directors at any time; and
- Serving as the Board's representative for any consultation and direct communication if requested by major shareholders.

While our current Chairman is also the CEO, this structure is a reflection of the Board's current view that both Kroger and our shareholders would not be best served by separation the roles at this time given the important skills and industry expertise that our CEO brings to the Board, particularly given Kroger's current transformation under the *Restock Kroger* plan. However, the Board routinely reviews Kroger's leadership structure which includes a discussion of Kroger's performance, the impact that the leadership has on that performance, and the structure that best serves the interests of shareholders.

Our strong governance practices ensure our Board's independent leadership and oversight. The Board has instituted structures and practices, in addition to the independent Lead Director, that create a balanced governance system of independent and effective oversight, including:

- all of Kroger's Board members are independent, except for the CEO;
- all members, including chairpersons, of each of the Board committees are independent;
- the full Board of independent directors annually evaluate the CEO's performance, led by the independent Lead Director;

- the full Board and each committee performs annual self-assessments;
- the Board is committed to board refreshment and diversity; and
- the Board and each of its committees have unfettered access to management and the authority to retain independent advisors, as they deem appropriate.

Contrary to the assertions in the proponent's supporting statement, there is no established consensus that separating the roles of the Chairman and the CEO is a best practice or that such a separation enhances returns for shareholders. The authors of a 2004 Wharton School of Business article entitled "Splitting Up the Roles of CEO and Chairman: Reform or Red Herring?" (<http://knowledge.wharton.upenn.edu/article.cfm?articleid=987>) concluded that there is no evidence that separating the positions of Chairman and CEO improves corporate performance. In "Corporate Governance Update: Analyzing Aspects of Board Composition," David A Katz and Laura A. McIntosh, New York Law Journal, January 26, 2012, the authors concluded that from a board effectiveness perspective, there is no need to separate the roles of Chairman and CEO so long as there is an effective lead director in place. In addition, the majority of U.S. companies have not implemented the structure recommended by the proposal.

The Board will continue to review Kroger's leadership structure to ensure that the structure best addresses Kroger's evolving and dynamic business in consultation with the current Board and our shareholders. The Board believes that eliminating the flexibility to determine which type of leadership structure is not in our shareholders' best interests.

For the foregoing reasons, we urge you to vote **AGAINST** this proposal.



## **Shareholder Proposals and Director Nominations – 2019 Annual Meeting**

Pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended, shareholder proposals intended for inclusion in the proxy material relating to Kroger's annual meeting of shareholders in June 2019 should be addressed to Kroger's Secretary and must be received at our executive offices not later than January 15, 2019. These proposals must comply with Rule 14a-8 and the SEC's proxy rules. If a shareholder submits a proposal outside of Rule 14a-8 for the 2019 annual meeting and such proposal is not delivered within the time frame specified in the Regulations, Kroger's proxy may confer discretionary authority on persons being appointed as proxies on behalf of Kroger to vote on such proposal.

In addition, Kroger's Regulations contain an advance notice of shareholder business and director nominations requirement, which generally prescribes the procedures that a shareholder of Kroger must follow if the shareholder intends, at an annual meeting, to nominate a person for election to Kroger's Board of Directors or to propose other business to be considered by shareholders. These procedures include, among other things, that the shareholder give timely notice to Kroger's Secretary of the nomination or other proposed business, that the notice contain specified information, and that the shareholder comply with certain other requirements. In order to be timely, this notice must be delivered in writing to Kroger's Secretary, at our principal executive offices, not later 45 calendar days prior to the date on which our proxy statement for the prior year's annual meeting of shareholders was mailed to shareholders. If a shareholder's nomination or proposal is not in compliance with the procedures set forth in the Regulations, we may disregard such nomination or proposal. Accordingly, if a shareholder intends, at the 2019 annual meeting, to nominate a person for election to the Board of Directors or to propose other business, the shareholder must deliver a notice of such nomination or proposal to Kroger's Secretary not later than March 31, 2019 and comply with the requirements of the Regulations. If Item No. 3 on proxy access is approved by the requisite vote at the 2018 Annual Meeting, eligible shareholders will have the ability to submit director nominees for inclusion in our proxy statement for the 2019 annual meeting of shareholders. As described in more detail in Item No. 3, to be eligible, shareholders must have owned at least 3% of our common shares for at least three years. Up to 20 shareholders will be able to aggregate for this purpose. Nominations must be submitted to our Corporate Secretary at our principal executive offices no earlier than December 16, 2018 and no later than January 15, 2019.

Shareholder proposals, director nominations, including, if applicable pursuant to proxy access, and advance notices should be addressed in writing to: Corporate Secretary, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45202-1100.

## **2017 Annual Report**

Attached to this Proxy Statement is our 2017 Annual Report which includes a brief description of our business, including the general scope and nature thereof during fiscal year 2017, together with the audited financial information contained in our 2017 Annual Report on Form 10-K filed with the SEC. A copy of that report is available to shareholders on request without charge by writing to: Carin Fike, Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45202 or by calling 513-762-1220. Our SEC filings are available to the public on the SEC's website at [www.sec.gov](http://www.sec.gov).

## **Householding of Proxy Materials**

We have adopted a procedure approved by the SEC called "householding." Under this procedure, shareholders of record who have the same address and last name will receive only one copy of the Notice of Availability of Proxy Materials (or proxy materials in the case of shareholders who receive paper copies of such materials) unless one or more of these shareholders notifies us that they wish to continue receiving individual copies. This procedure will reduce our printing costs and postage fees. Householding will not in any way affect dividend check mailings.

If you are eligible for householding, but you and other shareholders of record with whom you share an address currently receive multiple copies of our Notice of Availability of Proxy Materials (or proxy materials in the case of shareholders who receive paper copies of such materials), or if you hold in more than one account, and in either case you wish to receive only a single copy for your household or if you prefer to receive separate copies of our documents in the future, please contact your bank or broker, or contact Kroger's Secretary at 1014 Vine Street, Cincinnati, Ohio 45202 or via telephone at 513-762-4000.

Beneficial shareholders can request information about householding from their banks, brokers or other holders of record.

The management knows of no other matters that are to be presented at the meeting, but, if any should be presented, the Proxy Committee expects to vote thereon according to its best judgment.

By order of the Board of Directors,  
Christine S. Wheatley, Secretary



**Appendix A**  
**Proposed Proxy Access Provision**

(3) (a) Subject to the requirements of this Section 2, the Company shall include in its proxy statement and on its proxy card for any annual meeting of shareholders the name of any director nominee proposed by a shareholder for election to the Board of directors who is properly submitted pursuant to this Section 2(B)(3) (each a “Proxy Access Nominee”) provided that (i) timely written notice of such Proxy Access Nominee satisfying this Section 2(B)(3) (“Proxy Access Nomination Notice”) is delivered to the Company by or on behalf of a shareholder or group of shareholders that, at the time the Proxy Access Nomination Notice is delivered, satisfy the ownership and other requirements of this Section 2(B)(3) (such shareholder or shareholders, and any person on whose behalf they are acting, the “Eligible Shareholder”), (ii) the Eligible Shareholder expressly elects in writing at the time of providing the Proxy Access Nomination Notice to have its nominee included in the Company’s proxy statement pursuant to this Section 2(B)(3), and (iii) the Eligible Shareholder and the Proxy Access Nominee otherwise satisfy the requirements of this Section 2(B)(3) and the criteria for Board membership set forth in the Board of directors’ Guidelines on Issues of Corporate Governance or other document(s) setting forth qualifications for directors (the “Board Qualifications”).

(b) To be timely, the Eligible Shareholder must deliver to the secretary of the Company at the principal office of the Company the Proxy Access Nomination Notice not later than the close of business on the 120th calendar day nor earlier than the close of business on the 150th calendar day prior to the date on which the Company’s proxy statement for the prior year’s annual meeting of shareholders was first mailed to shareholders provided, however, that in the event that the date of the annual meeting is more than 30 days before or more than 60 days after the anniversary date of the preceding year’s annual meeting, to be timely, notice by the shareholder must be delivered by the 10th day following the day on which a public announcement of the subject meeting is first made by the Company. In no event shall the public announcement of an adjournment or postponement of an annual meeting of shareholders commence a new time period (or extend any time period) for the submission of such Proxy Access Nomination.

(c) In addition to including the name of the Proxy Access Nominee in the Company’s proxy statement for the annual meeting of shareholders, the Company also shall include (i) the information concerning the Proxy Access Nominee and the Eligible Shareholder that is required to be disclosed in the Company’s proxy statement pursuant to the proxy rules of the Securities and Exchange Commission (the “SEC”) and (ii) a Statement (defined below) (collectively, the “Required Information”). To be timely, the Required Information must be received by the secretary of the Company at the principal office of the Company within the time period specified in Section 2(B)(3)(b). Nothing in this Section 2(B)(3) shall limit the Company’s ability to solicit against and include in its proxy statement its own statements relating to any Proxy Access Nominee.

(d) The number of Proxy Access Nominees (including Proxy Access Nominees who were (i) submitted by an Eligible Shareholder for inclusion in the Company’s proxy statement pursuant to this Section 2(B)(3) that the Board of directors decides to nominate or (ii) previously elected based upon a nomination pursuant to this Section 2(B)(3) at any of the preceding two annual meetings and are being recommended for reelection by the Board of directors at the upcoming annual meeting) shall not exceed the greater of two or twenty percent of the number of directors in office as of the last day on which notice of a nomination may be delivered pursuant to this Section 2(B)(3) (the “Final Proxy Access Nomination Date”) or, if such amount is not a whole number, the closest whole number below twenty percent (the “Permitted Number”); provided, however, that the Permitted Number shall be reduced (but not below one) by the number of director nominees for which the Company received one or more valid notices that a shareholder intends to nominate a person or persons for election to the Board of directors at an annual meeting of shareholders pursuant to Section 2B(2). In the event that, for any reason, one or more vacancies on the Board of directors occurs at any time after the Final Proxy Access Nomination Date and before the date of the annual meeting of shareholders and the Board of directors resolves to reduce the size of the Board of directors in connection therewith, the Permitted Number shall be calculated based on the number of directors in office as so reduced. In the event that the number of Proxy Access Nominees submitted by Eligible Shareholders pursuant to this Section 2(B)(3) exceeds the Permitted Number, each Eligible Shareholder shall select one Proxy Access Nominee for inclusion in the Company’s proxy statement until the Permitted Number is reached, going in order of the amount (greatest to least) of voting power of the shares of the Company entitled to vote on the election of directors as disclosed in the Notice. If the Permitted Number is not reached after each Eligible Shareholder has selected one Proxy Access Nominee, this selection process shall continue as many times as necessary, following the same order each time, until the Permitted Number is reached.

(e) An Eligible Shareholder must have owned (as defined below) continuously for at least three years a number of shares that represents three percent or more of the total voting power of the Company's outstanding shares entitled to vote in the election of directors as of the most recent date prior to the submission of the Proxy Access Nomination Notice for which such amount is given in any filing by the Company with the SEC (the "Required Shares") as of both the date the Proxy Access Nomination Notice is received by the Company in accordance with this Section 2(B)(3) and the record date for determining shareholders entitled to vote at the annual meeting of shareholders and must continue to own the Required Shares through the meeting date. For purposes of satisfying the ownership requirement under this Section 2(B)(3), the voting power represented by the shares of the Company owned by one or more shareholders, or by the person or persons who own shares of the Company and on whose behalf any shareholder is acting, may be aggregated, provided that the number of shareholders and other persons whose ownership of shares is aggregated for such purpose shall not exceed twenty, and a group of two or more funds that are (i) under common management and investment control, (ii) under common management and funded primarily by the same employer (or by a group of related employers that are under common control), or (iii) a "group of investment companies," as such term is defined in Section 12(d)(1)(G)(ii) of the Investment Company Act of 1940, as amended, shall be treated as one shareholder or person for this purpose. With respect to any annual meeting of shareholders, no person may be a member of more than one group of persons constituting an Eligible Shareholder under this Section 2(B)(3).

(f) For purposes of this Section 2(B)(3), an Eligible Shareholder shall be deemed to "own" only those outstanding shares of the Company as to which the person possesses both (i) the full voting and investment rights pertaining to the shares and (ii) the full economic interest in (including the opportunity for profit and risk of loss on) such shares; provided that the number of shares calculated in accordance with clauses (i) and (ii) shall not include any shares (1) sold by such person or any of its affiliates in any transaction that has not been settled or closed, (2) borrowed by such person or any of its affiliates for any purposes or purchased by such person or any of its affiliates pursuant to an agreement to resell, or (3) subject to any option, warrant, forward contract, swap, contract of sale, other derivative or similar agreement entered into by such person or any of its affiliates, whether any such instrument or agreement is to be settled with shares or with cash based on the notional amount or value of the Company's outstanding shares, in any such case which instrument or agreement has, or is intended to have, the purpose or effect of reducing in any manner, to any extent or at any time in the future, such person's or affiliates' full right to vote or direct the voting of any such shares and/or hedging, offsetting or altering to any degree gain or loss arising from the full economic ownership of such shares by such person or affiliate. A person shall "own" shares held in the name of a nominee or other intermediary so long as the person retains the right to instruct how the shares are voted with respect to the election of directors and possesses the full economic interest in the shares. A person's ownership of shares shall be deemed to continue during any period in which the person has loaned such shares, provided that the person has the power to recall such loaned shares on five business days' notice and provides a representation that it will promptly recall such loaned shares upon being notified that any of its Proxy Access Nominees will be included in the Company's proxy statement, or the person has delegated any voting power by means of a proxy, power of attorney or other instrument or arrangement that is revocable at any time by the person. The terms "owned," "owning," and other variations of the word "own" shall have correlative meanings. For purposes of this Section 2(B)(3), the term "affiliate" shall have the meaning ascribed thereto pursuant to the proxy rules of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

(g) Within the time period specified in Section 2(B)(3)(b) for the Proxy Access Nomination Notice, an Eligible Shareholder must provide in writing to the secretary of the Company, with respect to the Shareholder Nominee, in addition to the information and representations required to be provided in the shareholder's notice pursuant to Section 2(B)(2), representations and agreements that such person: (i) has read and agrees to adhere to the Company's code of conduct, corporate governance guidelines, conflict of interest, confidentiality and share ownership and securities trading policies, and any other policies and guidelines applicable to directors, as well as any applicable law, rule or regulation or listing requirement; (ii) is not and will not become a party to any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such person, if elected as a director of the Company, will act or vote on any issue or question (a "Voting Commitment") that has not been disclosed to the Company, and (iii) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the Company with respect to any direct or indirect compensation, reimbursement or indemnification (a "Compensation Arrangement") in connection with such person's nomination for director and/or service as a director, that has not been disclosed to the Company. At the request of the Company, the Proxy Access Nominee must complete, sign and submit all questionnaires required of the Board of directors within five business days of receipt of each such questionnaire from the Company and provide within five business days of the Company's request such additional information as

the Company determines may be necessary to permit the Board of directors to determine whether such Proxy Access Nominee meets the requirements of this Section 2(B)(3) and/or satisfies the Board Qualifications, including whether: (1) such Proxy Access Nominee is independent under the listing standards of each principal U.S. exchange upon which the Company's shares are listed, any applicable rules of the SEC, and any publicly disclosed standards used by the Board of directors in determining and disclosing the independence of members of the Board of directors (the "Independence Standards"), (2) such Proxy Access Nominee has any direct or indirect relationship with the Company, and (3) such Proxy Access Nominee is not and has not been subject to any event specified in Item 401(f) of Regulation S-K under the Securities Act of 1933, as amended (the "Securities Act"), or any order of the type specified in Rule 506(d) of Regulation D under the Securities Act.

(h) Within the time period specified in Section 2(B)(3)(b) for the Proxy Access Nomination Notice, an Eligible Shareholder must provide the following information, representations and agreements: (i) the information and representations that would be required to be set forth in shareholder's notice of a nomination pursuant to Section 2(B)(1); (ii) one or more written statements from the record holder of the shares (and from each intermediary through which the shares are or have been held during the requisite three-year holding period) verifying that, as of a date within seven calendar days prior to the date the Proxy Access Nomination Notice is received by the secretary of the Company, the Eligible Shareholder owns, and has owned continuously for the preceding three years, the Required Shares, and the Eligible Shareholder's agreement to provide (1) written statements from the record holder and intermediaries verifying the Eligible Shareholder's continuous ownership of the Required Shares through the record date by not later than the close of business on the fifth business day after (A) the record date (if, prior to the record date, the Company (x) disclosed such date by press release or any filing with the SEC or (y) delivered a written notice of the record date (including by electronic mail) to the Eligible Shareholder) or (B) the date on which the Company delivered to the Eligible Shareholder written notice (including by electronic mail) of the record date (if such notice is provided after the record date); and (2) immediate notice if the Eligible Shareholder ceases to own any of the Required Shares prior to the date of the annual meeting of shareholders; (iii) documentation satisfactory to the Company demonstrating that a group of funds are entitled to be treated as one shareholder or person for purposes of this Section 2(B)(3); (iv) a representation that the Eligible Shareholder (including each member of any group of shareholders that together is an Eligible Shareholder hereunder): (1) acquired the Required Shares in the ordinary course of business and not with the intent to change or influence control of the Company, and does not presently have such intent, (2) has not nominated and will not nominate for election to the Board of directors at the meeting any person other than the Proxy Access Nominee(s) being nominated pursuant to this Section 2(B)(3), (3) has not engaged and will not engage in, and has not and will not be, a "participant" in another person's "solicitation" within the meaning of Rule 14a-1(l) under the Exchange Act in support of the election of any individual as a director at the annual meeting of shareholders other than its Proxy Access Nominee(s) or a nominee of the Board of directors, (4) will not distribute to any shareholder any form of proxy for the annual meeting of shareholders other than the form distributed by the Company, and (5) has provided and will provide facts, statements and other information in all communications with the Company and its shareholders that are or will be true and correct in all material respects and do not and will not omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; (v) a description of all agreements, arrangements or understandings between the Eligible Shareholder and each Shareholder Nominee and any other person or persons, including the Shareholder Nominee, such beneficial owners and control persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the Eligible Shareholder or that would be required to be disclosed pursuant to Rule 404 promulgated under Regulation S-K of the Exchange Act if the Eligible Shareholder making the nomination and any beneficial owner or control person on whose behalf the nomination is made, if any, or any affiliate or associate thereof or person acting in concert therewith, were the "registrant" for purposes of such rule and the Shareholder Nominee were a director or executive officer of such registrant (the "Related Person Agreements"); (vi) a description of any agreement, arrangement or understanding (including any derivative or short positions, profit interests, options, warrants, convertible securities, stock appreciation or similar rights, hedging transactions, and borrowed or loaned shares) that has been entered into as of the date of the shareholder's notice by, or on behalf of, such shareholder and such beneficial owners, whether or not such instrument or right shall be subject to settlement in underlying shares of capital stock of the Company, the effect or intent of which is to mitigate loss to, manage risk or benefit of share price changes for, or increase or decrease the voting power of, such stockholder or such beneficial owner, with respect to securities of the Company; (vii) a representation as to whether the shareholder intends to be or is part of a group that intends to deliver a proxy statement and/or form of proxy to holders of at least 10% of the shares entitled to vote or otherwise solicit proxies from shareholders in support of such proposal or nomination; and (viii) the written consent of each Proxy Access Nominee to be named in the Company's proxy statement as a nominee and to serve as a director if elected; (ix) a copy of the Schedule 14N that

has been filed with the SEC as required by Rule 14a-18 under the Exchange Act; (x) in the case of a nomination by a group of shareholders that together is an Eligible Shareholder, the designation by all group members of one group member that is authorized to act on behalf of all members of the nominating shareholder group with respect to the nominations and matters related thereto, including withdrawal of the nomination; and (xi) an undertaking that the Eligible Shareholder agrees to: (1) assume all liability stemming from any legal or regulatory violation arising out of the Eligible Shareholder's communications with the Company's shareholders or out of the information that the Eligible Shareholder provides to the Company, (2) indemnify and hold harmless the Company and each of its directors, officers and employees individually against any liability, loss or damages in connection with any threatened or pending action, suit or proceeding, whether legal, administrative or investigative, against the Company or any of its directors, officers or employees arising out of any solicitation or other activity by the Eligible Shareholder in connection with its efforts to elect the Proxy Access Nominee pursuant to this Section 2(B)(3), (3) file with the SEC any solicitation with the Company's shareholders relating to the meeting at which the Proxy Access Nominee will be nominated, regardless of whether any such filing is required pursuant to the proxy rules of the Securities and Exchange Commission or whether any exemption from filing is available for such solicitation pursuant to the proxy rules of the SEC, and (4) comply with all other applicable laws, rules, regulations and listing standards with respect to any solicitation in connection with the meeting.

(i) The Eligible Shareholder may with its Proxy Access Nomination Notice, provide to the secretary of the Company, a written statement for inclusion in the Company's proxy statement for the annual meeting of shareholders, not to exceed 500 words per Proxy Access Nominee, in support of each Proxy Access Nominee it names in its Notice (the "Statement"). Notwithstanding anything to the contrary contained in this Section 2(B)(3), the Company may omit from its proxy statement any information or Statement that it believes would violate any applicable law, rule, regulation, or listing standard.

(j) In the event that any information or communications provided by the Eligible Shareholder or Proxy Access Nominee to the Company or its shareholders ceases to be true and correct in any respect or omits a fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, each Eligible Shareholder or Proxy Access Nominee, as the case may be, shall promptly notify the secretary of the Company of any such inaccuracy or omission in such previously provided information and of the information that is required to make such information or communication true and correct.

(k) The Company shall not be required to include pursuant to this Section 2(B)(3), any Proxy Access Nominee in its proxy materials (or, if the proxy materials have already been filed, to allow the nomination of a Proxy Access Nominee, notwithstanding that proxies in respect of such vote may have been received by the Company) if (i) the Eligible Shareholder has or is engaged in, or has been or is a "participant" in another person's, "solicitation" within the meaning of Rule 14a-1(l) under the Exchange Act in support of the election of any individual as a director at the annual meeting of shareholders other than its Proxy Access Nominee(s) or any other nominee of the Board of directors, (ii) the Proxy Access Nominee is determined by the Board of directors not to be independent under the Independence Standards, (iii) the Proxy Access Nominee's election as a director would cause the Company to be in violation of these Regulations, the Company's certificate of incorporation, the Board Qualifications, the listing standards of the principal exchange upon which the Company's shares are traded, or any applicable state or federal law, rule or regulation, (iv) the Proxy Access Nominee is or becomes a party to any undisclosed Voting Commitment or Compensation Arrangement, (v) the Proxy Access Nominee is or has been, within the past three years, an officer or director of a competitor, as defined in Section 8 of the Clayton Antitrust Act of 1914, (vi) the Proxy Access Nominee is a named subject of a pending criminal proceeding (excluding traffic violations and other minor offenses) or has been convicted in such a criminal proceeding within the past ten years, (vii) the Proxy Access Nominee is subject to any order of the type specified in Rule 506(d) of Regulation D under the Securities Act, or (viii) the Proxy Access Nominee or the applicable Eligible Shareholder shall have provided information to the Company in respect of such nomination that was untrue in any material respect or omitted to state a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading or shall have breached its or their agreements, representations, undertakings, and/or obligations pursuant to this Section 2(B)(3).

(l) Notwithstanding anything to the contrary set forth herein, if (a) the Proxy Access Nominee and/or the applicable Eligible Shareholder shall have breached its or their agreements, representations, undertakings and/or obligations pursuant to this Section 2(B)(3), as determined by the Board of directors or the person presiding at the meeting, or (b) the Eligible Shareholder (or a qualified representative thereof) does not appear at the meeting to present any nomination pursuant to this Section 2(B)(3), the Board of directors or the person presiding at the



meeting shall be entitled to declare a nomination by an Eligible Shareholder to be invalid, and such nomination shall be disregarded notwithstanding that proxies in respect of such vote may have been received by the Company and the Company shall not be required to include in its proxy statement any successor or replacement nominee proposed by the applicable Eligible Shareholder or any other Eligible Shareholder.

(m) Any Shareholder Nominee who is included in the Company's proxy materials for a particular annual meeting of shareholders but either (A) withdraws from or becomes ineligible or unavailable for election at the meeting, or (B) does not receive at least twenty percent of the votes cast in favor of the Proxy Access Nominee's election, shall be ineligible to be a Proxy Access Nominee pursuant to this Section 2(B)(3) for the next two annual meetings of shareholders following the meeting for which the Shareholder Nominee has been nominated for election.

(n) This Section 2(B)(3) provides the exclusive method for shareholders to include nominees for director in the Company's proxy materials with respect to an annual meeting of shareholders.

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**2017 ANNUAL REPORT**

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## FINANCIAL REPORT 2017

### MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The management of The Kroger Co. has the responsibility for preparing the accompanying financial statements and for their integrity and objectivity. The statements were prepared in accordance with generally accepted accounting principles applied on a consistent basis and are not misstated due to material error or fraud. The financial statements include amounts that are based on management's best estimates and judgments. Management also prepared the other information in the report and is responsible for its accuracy and consistency with the financial statements.

Kroger's financial statements have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, whose selection has been ratified by the shareholders. Management has made available to PricewaterhouseCoopers LLP all of Kroger's financial records and related data, as well as the minutes of the shareholders' and directors' meetings. Furthermore, management believes that all representations made to PricewaterhouseCoopers LLP during its audit were valid and appropriate.

Management also recognizes its responsibility for fostering a strong ethical climate so that Kroger's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in *The Kroger Co. Policy on Business Ethics*, which is publicized throughout Kroger and available on Kroger's website at [ir.kroger.com](http://ir.kroger.com). *The Kroger Co. Policy on Business Ethics* addresses, among other things, the necessity of ensuring open communication within Kroger; potential conflicts of interests; compliance with all domestic and foreign laws, including those related to financial disclosure; and the confidentiality of proprietary information. Kroger maintains a systematic program to assess compliance with these policies.

### MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. With the participation of the Chief Executive Officer and the Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in *Internal Control — Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, management has concluded that the Company's internal control over financial reporting was effective as of February 3, 2018.

**W. Rodney McMullen**  
*Chairman of the Board and  
Chief Executive Officer*

**J. Michael Schlotman**  
*Executive Vice President and  
Chief Financial Officer*

## SELECTED FINANCIAL DATA

	Fiscal Years Ended				
	February 3, 2018	January 28, 2017	January 30, 2016	February 1, 2015	February 2, 2014
	(53 weeks)	(52 weeks)	(52 weeks)	(52 weeks)	(53 weeks)
	(In millions, except per share amounts)				
Sales	\$ 122,662	\$ 115,337	\$ 109,830	\$ 108,465	\$ 98,375
Net earnings including noncontrolling interests	1,889	1,957	2,049	1,747	1,531
Net earnings attributable to The Kroger Co.	1,907	1,975	2,039	1,728	1,519
Net earnings attributable to The Kroger Co. per diluted common share	2.09	2.05	2.06	1.72	1.45
Total assets	37,197	36,505	33,897	30,497	29,281
Long-term liabilities, including obligations under capital leases and financing obligations	16,095	16,935	14,128	13,663	13,181
Total shareholders' equity — The Kroger Co.	6,931	6,698	6,820	5,412	5,384
Cash dividends per common share	0.490	0.450	0.395	0.340	0.308

## COMMON SHARE PRICE RANGE

Quarter	2017		2016	
	High	Low	High	Low
1st	\$ 34.75	\$ 28.29	\$ 40.91	\$ 33.62
2nd	\$ 30.93	\$ 20.46	\$ 37.97	\$ 32.02
3rd	\$ 23.71	\$ 19.69	\$ 33.24	\$ 28.71
4th	\$ 31.45	\$ 21.15	\$ 36.44	\$ 30.44

Main trading market: New York Stock Exchange (Symbol KR)

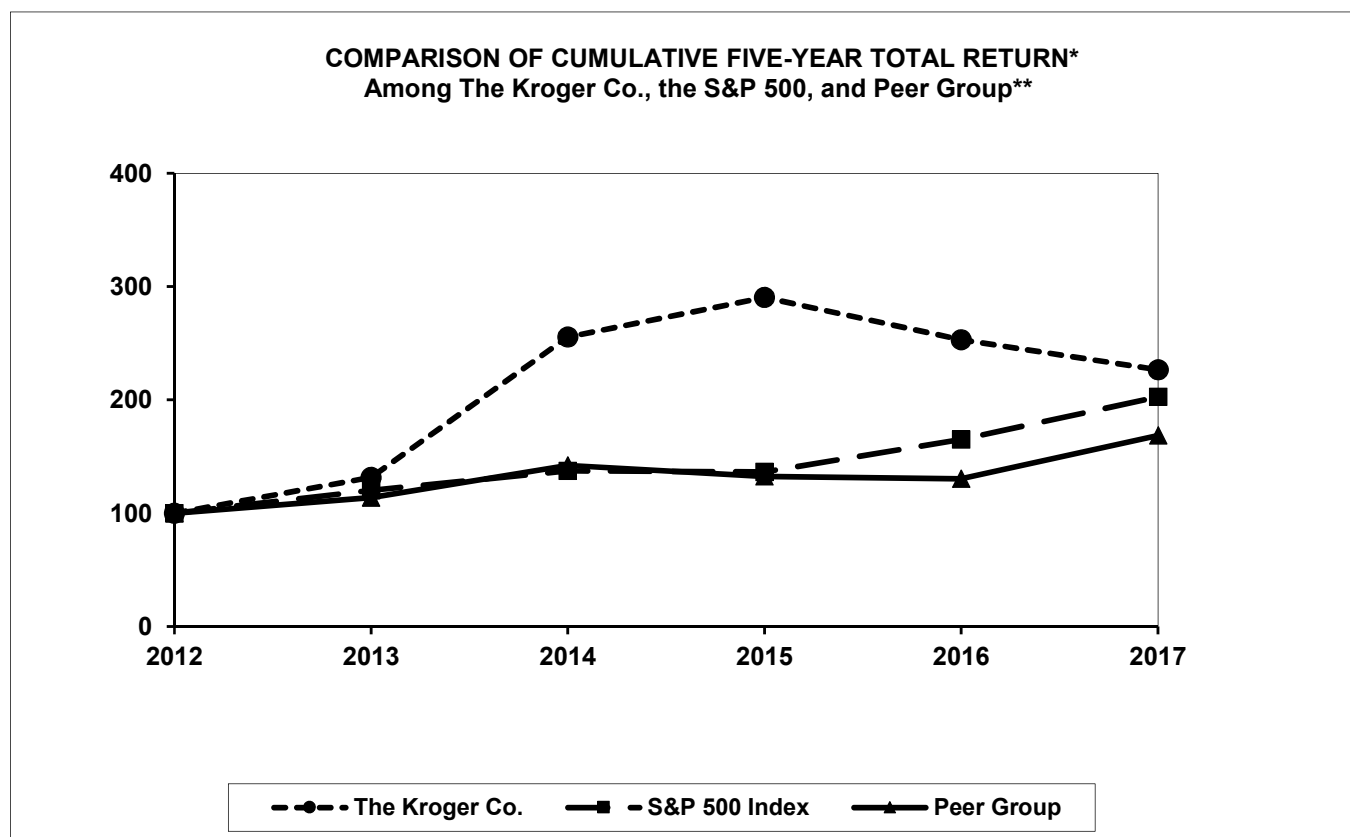
Number of shareholders of record at fiscal year-end 2017: 27,574

Number of shareholders of record at March 29, 2018: 27,448

During 2017, we paid two quarterly cash dividends of \$0.12 per share and two quarterly cash dividends of \$0.125 per share. During 2016, we paid two quarterly cash dividends of \$0.105 per share and two quarterly cash dividends of \$0.12 per share. On March 1, 2018, we paid a quarterly cash dividend of \$0.125 per share. On March 15, 2018, we announced that our Board of Directors declared a quarterly cash dividend of \$0.125 per share, payable on June 1, 2018, to shareholders of record at the close of business on May 15, 2018. We currently expect to continue to pay comparable cash dividends on a quarterly basis, that will increase over time, depending on our earnings and other factors, including approval by our Board.

## PERFORMANCE GRAPH

Set forth below is a line graph comparing the five-year cumulative total shareholder return on our common shares, based on the market price of the common shares and assuming reinvestment of dividends, with the cumulative total return of companies in the Standard & Poor's 500 Stock Index and a peer group composed of food and drug companies.



Company Name/Index	Base	INDEXED RETURNS				
	Period	Years Ending				
	2012	2013	2014	2015	2016	2017
The Kroger Co.	100	131.71	255.60	290.43	252.96	226.64
S&P 500 Index	100	120.30	137.42	136.50	164.99	202.66
Peer Group	100	113.70	142.19	132.67	130.48	168.56

Kroger's fiscal year ends on the Saturday closest to January 31.

Data supplied by Standard & Poor's.

The foregoing Performance Graph will not be deemed incorporated by reference into any other filing, absent an express reference thereto.

\* Total assumes \$100 invested on February 3, 2013, in The Kroger Co., S&P 500 Index, and the Peer Group, with reinvestment of dividends.

\*\* The Peer Group consists of Costco Wholesale Corp., CVS Caremark Corp, Etablissements Delhaize Freres Et Cie Le Lion ("Groupe Delhaize", which is included through July 22, 2016 when it merged with Koninklijke Ahold), Koninklijke Ahold Delhaize NV (changed name from Koninklijke Ahold after merger with Groupe Delhaize), Safeway, Inc. (included through January 29, 2015 when it was acquired by AB Acquisition LLC), Supervalu Inc., Target Corp., Tesco Plc (included through November 27, 2013 when it sold its U.S. business), Wal-Mart Stores Inc., Walgreens Boots Alliance Inc. (formerly, Walgreen Co.), Whole Foods Market Inc. (included through August 28, 2017 when it was acquired by Amazon.com, Inc.).

## ISSUER PURCHASES OF EQUITY SECURITIES

Period (1)	Total Number of Shares Purchased (2)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (4) (in millions)
First period - four weeks				
November 5, 2017 to December 2, 2017	3,845,500	\$ 22.39	3,845,500	\$ 507
Second period - four weeks				
December 3, 2017 to December 30, 2017	4,031,990	\$ 26.85	4,005,396	\$ 405
Third period — five weeks				
December 31, 2017 to February 3, 2018	5,150,914	\$ 28.86	5,118,081	\$ 272
<b>Total</b>	<b><u>13,028,404</u></b>	<b><u>\$ 26.33</u></b>	<b><u>12,968,977</u></b>	<b><u>\$ 272</u></b>

- (1) The fourth quarter of 2017 contained two 28-day periods and one 35-day period.
- (2) Includes (i) shares repurchased under the June 2017 Repurchase Program described below in (4), (ii) shares repurchased under 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, under which repurchases are limited to proceeds received from exercises of stock options and the tax benefits associated therewith (“1999 Repurchase Program”), and (iii) 59,427 shares that were surrendered to the Company by participants under our long-term incentive plans to pay for taxes on restricted stock awards.
- (3) Represents shares repurchased under the June 2017 Repurchase Program and the 1999 Repurchase Program.
- (4) On June 22, 2017, our Board of Directors approved a \$1.0 billion share repurchase program (the “June 2017 Repurchase Program”). The amounts shown in this column reflect the amount remaining under the June 2017 Repurchase Program as of the specified period end dates. Amounts available under the 1999 Repurchase Program are dependent upon option exercise activity. The June 2017 Repurchase Program and the 1999 Repurchase Program do not have an expiration date but may be suspended or terminated by our Board of Directors at any time. On March 15, 2018, our Board of Directors approved a \$1.0 billion share repurchase program, to supplement the June 2017 Repurchase Program, to reacquire shares via open market purchase or privately negotiated transactions, including accelerated stock repurchase transactions, block trades, or pursuant to trades intending to comply with rule 10b5-1 of the Securities Exchange Act of 1934. The June 2017 Repurchase Program was exhausted during the first quarter of 2018.

## **BUSINESS**

The Kroger Co. (the “Company” or “Kroger”) was founded in 1883 and incorporated in 1902. As of February 3, 2018, we are one of the largest retailers in the world based on annual sales. We also manufacture and process some of the food for sale in our supermarkets. We maintain a web site ([www.thekrogerco.com](http://www.thekrogerco.com)) that includes additional information about the Company. We make available through our web site, free of charge, our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and our interactive data files, including amendments. These forms are available as soon as reasonably practicable after we have filed them with, or furnished them electronically to, the SEC.

Our revenues are predominately earned and cash is generated as consumer products are sold to customers in our stores, fuel centers and via our online platforms. We earn income predominantly by selling products at price levels that produce revenues in excess of the costs to make these products available to our customers. Such costs include procurement and distribution costs, facility occupancy and operational costs and overhead expenses. Our fiscal year ends on the Saturday closest to January 31. All references to 2017, 2016 and 2015 are to the fiscal years ended February 3, 2018, January 28, 2017 and January 30, 2016, respectively, unless specifically indicated otherwise.

## **EMPLOYEES**

As of February 3, 2018, Kroger employed approximately 449,000 full- and part-time employees. A majority of our employees are covered by collective bargaining agreements negotiated with local unions affiliated with one of several different international unions. There are approximately 360 such agreements, usually with terms of three to five years.

## **STORES**

As of February 3, 2018, Kroger operated, either directly or through its subsidiaries, 2,782 supermarkets under a variety of local banner names, of which 2,268 had pharmacies and 1,489 had fuel centers. We offer ClickList™ and Harris Teeter ExpressLane— personalized, order online, pick up at the store services — at 1,056 of our supermarkets and continue to increase our home delivery service available to customers. Approximately 45% of our supermarkets were operated in Company-owned facilities, including some Company-owned buildings on leased land. Our current strategy emphasizes self-development and ownership of store real estate. Our stores operate under a variety of banners that have strong local ties and brand recognition. Supermarkets are generally operated under one of the following formats: combination food and drug stores (“combo stores”); multi-department stores; marketplace stores; or price impact warehouses.

The combo store is the primary food store format. They typically draw customers from a 2 — 2.5 mile radius. We believe this format is successful because the stores are large enough to offer the specialty departments that customers desire for one-stop shopping, including natural food and organic sections, pharmacies, general merchandise, pet centers and high-quality perishables such as fresh seafood and organic produce.

Multi-department stores are significantly larger in size than combo stores. In addition to the departments offered at a typical combo store, multi-department stores sell a wide selection of general merchandise items such as apparel, home fashion and furnishings, outdoor living, electronics, automotive products, toys and fine jewelry.

Marketplace stores are smaller in size than multi-department stores. They offer full-service grocery, pharmacy and health and beauty care departments as well as an expanded perishable offering and general merchandise area that includes apparel, home goods and toys.

Price impact warehouse stores offer a “no-frills, low cost” warehouse format and feature everyday low prices plus promotions for a wide selection of grocery and health and beauty care items. Quality meat, dairy, baked goods and fresh produce items provide a competitive advantage. The average size of a price impact warehouse store is similar to that of a combo store.

In addition to the supermarkets, as of February 3, 2018, we operated, through subsidiaries, 782 convenience stores, 274 fine jewelry stores and an online retailer. All 71 of our fine jewelry stores located in malls are operated in leased locations. In addition, 66 convenience stores were operated by franchisees through franchise agreements. Approximately 55% of the convenience stores operated by subsidiaries were operated in Company-owned facilities. The convenience stores offer a limited assortment of staple food items and general merchandise and, in most cases, sell fuel.

## SEGMENTS

We operate supermarkets, multi-department stores, jewelry stores, and convenience stores throughout the United States. Our retail operations, which represent over 97% of our consolidated sales, is our only reportable segment. We aggregate our operating divisions into one reportable segment due to the operating divisions having similar economic characteristics with similar long-term financial performance. In addition, our operating divisions offer customers similar products, have similar distribution methods, operate in similar regulatory environments, purchase the majority of the merchandise for retail sale from similar (and in many cases identical) vendors on a coordinated basis from a centralized location, serve similar types of customers, and are allocated capital from a centralized location. Our operating divisions are organized primarily on a geographical basis so that the operating division management team can be responsive to local needs of the operating division and can execute company strategic plans and initiatives throughout the locations in their operating division. This geographical separation is the primary differentiation between these retail operating divisions. The geographical basis of organization reflects how the business is managed and how our Chief Executive Officer, who acts as our chief operating decision maker, assesses performance internally. All of our operations are domestic. Revenues, profits and losses and total assets are shown in our Consolidated Financial Statements set forth in Item 8 below.

## MERCHANDISING AND MANUFACTURING

*Our Brands* products play an important role in our merchandising strategy. Our supermarkets, on average, stock over 15,000 private label items. *Our Brands* products are primarily produced and sold in three “tiers.” Private Selection® is the premium quality brand designed to be a unique item in a category or to meet or beat the “gourmet” or “upscale” brands. The “banner brand” (Kroger®, Ralphs®, Fred Meyer®, King Soopers®, etc.), which represents the majority of our private label items, is designed to satisfy customers with quality products. Before we will carry a “banner brand” product we must be satisfied that the product quality meets our customers’ expectations in taste and efficacy, and we guarantee it. P\$ST...®, Check This Out... and Heritage Farm™ are the three value brands, designed to deliver good quality at a very affordable price. In addition, we continue to grow *Our Brands* offerings, including Simple Truth® and Simple Truth Organic®. Both Simple Truth and Simple Truth Organic are Free From 101+ artificial preservatives and ingredients that customers have told us they do not want in their food, and the Simple Truth Organic products are USDA certified organic.

Approximately 33% of *Our Brands* units and 44% of the grocery category *Our Brands* units sold in our supermarkets are produced in our food production plants; the remaining *Our Brands* items are produced to our strict specifications by outside manufacturers. We perform a “make or buy” analysis on *Our Brands* products and decisions are based upon a comparison of market-based transfer prices versus open market purchases. As of February 3, 2018, we operated 37 food production plants. These plants consisted of 17 dairies, ten deli or bakery plants, five grocery product plants, two beverage plants, one meat plant and two cheese plants.

## SEASONALITY

The majority of our revenues are generally not seasonal in nature. However, revenues tend to be higher during the major holidays throughout the year. Additionally, significant inclement weather systems, particularly winter storms, tend to affect our sales trends.

## EXECUTIVE OFFICERS OF THE REGISTRANT

The disclosure regarding executive officers is set forth in Item 10 of Part III of this Form 10-K under the heading “Executive Officers of the Company,” and is incorporated herein by reference.



## COMPETITIVE ENVIRONMENT

For the disclosure related to our competitive environment, see Item 1A under the heading “Competitive Environment.”

## MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OUR BUSINESS

The Kroger Co. was founded in 1883 and incorporated in 1902. As of February 3, 2018, Kroger is one of the world’s largest retailers, as measured by revenue, operating 2,782 supermarkets under a variety of local banner names in 35 states and the District of Columbia. Of these stores, 2,268 have pharmacies and 1,489 have fuel centers. We offer ClickList™ and Harris Teeter ExpressLane — personalized, order online, pick up at the store services — at 1,056 of our supermarkets and continue to increase our home delivery service available to customers. In addition, we operate 782 convenience stores, either directly or through franchisees, 274 fine jewelry stores and an online retailer.

We operate 37 food production plants, primarily bakeries and dairies, which supply approximately 33% of *Our Brands* units and 44% of the grocery category *Our Brands* units sold in our supermarkets; the remaining *Our Brands* items are produced to our strict specifications by outside manufacturers.

Our revenues are earned and cash is generated as consumer products are sold to customers in our stores, fuel centers and via our online platforms. We earn income predominately by selling products at price levels that produce revenues in excess of the costs we incur to make these products available to our customers. Such costs include procurement and distribution costs, facility occupancy and operational costs, and overhead expenses. Our retail operations, which represent over 97% of our consolidated sales, is our only reportable segment.

On September 2, 2016, we closed our merger with Modern HC Holdings, Inc. (“ModernHEALTH”) by purchasing 100% of the outstanding shares of ModernHEALTH for \$407 million. ModernHEALTH is included in our ending Consolidated Balance Sheet for 2016 and 2017 and in our Consolidated Statements of Operations from September 2, 2016 through January 28, 2017 and all periods in 2017.

On December 18, 2015, we closed our merger with Roundy’s, Inc. (“Roundy’s”) by purchasing 100% of Roundy’s® outstanding common stock for \$3.60 per share and assuming Roundy’s outstanding debt, for a purchase price of \$866 million. Roundy’s is included in our ending Consolidated Balance Sheets for 2015, 2016 and 2017, and in our Consolidated Statements of Operations for the last six weeks of 2015 and all periods in 2016 and 2017.

See Note 2 to the Consolidated Financial Statements for more information related to our mergers with ModernHEALTH and Roundy’s.

### USE OF NON-GAAP FINANCIAL MEASURES

The accompanying Consolidated Financial Statements, including the related notes, are presented in accordance with generally accepted accounting principles (“GAAP”). We provide non-GAAP measures, including First-In, First-Out (“FIFO”) gross margin, FIFO operating profit, adjusted net earnings, adjusted net earnings per diluted share and free cash flow because management believes these metrics are useful to investors and analysts. These non-GAAP financial measures should not be considered as an alternative to gross margin, operating profit, net earnings, net earnings per diluted share and net cash provided or used by operating or investing activities or any other GAAP measure of performance. These measures should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. Our calculation and reasons these are useful metrics to investors and analysts are explained below.

We calculate FIFO gross margin as FIFO gross profit divided by sales. FIFO gross profit is calculated as sales less merchandise costs, including advertising, warehousing, and transportation expenses, but excluding the Last-In, First-Out (“LIFO”) credit or charge. Merchandise costs exclude depreciation and rent expenses. 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.

We calculate FIFO operating profit as operating profit excluding the LIFO credit or charge. FIFO operating profit is an important measure used by management to evaluate operational effectiveness. Management believes FIFO operating profit is a useful metric to investors and analysts because it measures our day-to-day operational effectiveness.

The adjusted net earnings per diluted share metric is an important measure used by management to compare the performance of core operating results between periods. We believe adjusted net earnings per diluted share is a useful metric to investors and analysts because it presents more accurate year-over-year comparisons for our net earnings per diluted share because adjusted items are not the result of our normal operations. Net earnings for 2017 include the following, which we define as the “2017 Adjusted Items”:

- Charges to operating, general and administrative expenses (“OG&A”) of \$550 million, \$360 million net of tax, for obligations related to withdrawing from and settlements of withdrawal liabilities for certain multi-employer pension funds; \$184 million, \$117 million net of tax, related to the voluntary retirement offering (“VRO”); \$110 million, \$74 million net of tax, related to the Kroger Specialty Pharmacy goodwill impairment; and \$502 million, \$335 million net of tax, related to a company-sponsored pension plan termination (the “2017 OG&A Adjusted Items”).
- A reduction to depreciation and amortization expenses of \$19 million, \$13 million net of tax, related to held for sale assets (the “2017 Depreciation Adjusted Item”).
- A reduction to income tax expense of \$922 million primarily due to the re-measurement of deferred tax liabilities and the reduction of the statutory rate for the last five weeks of the fiscal year from the Tax Cuts and Jobs Act (“Tax Act”) (the “2017 Tax Expense Adjusted Item”).

In addition, net earnings include \$119 million, \$79 million net of tax, due to a 53<sup>rd</sup> week in fiscal year 2017 (the “Extra Week”).

Net earnings for 2016 include \$111 million, \$71 million net of tax, of charges to OG&A related to the restructuring of certain pension obligations to help stabilize associates’ future benefits (the “2016 Adjusted Items”). There were no adjusted items in 2015.

We calculate free cash flow as net cash provided by operating activities minus net cash used by investing activities. Free cash flow is an important measure used by management to evaluate available funding for share repurchases, dividends, other strategic investments and managing debt levels. Management believes free cash flow is a useful metric to investors and analysts because it demonstrates our ability to make share repurchases and other strategic investments, pay dividends and manage debt levels.

## OVERVIEW

Notable items for 2017 are:

- Net earnings per diluted share of \$2.09.
- Adjusted net earnings per diluted share of \$2.04.
- The Extra Week in 2017 contributed \$0.09 to our net earnings per diluted share result for 2017.
- Identical supermarket sales, excluding fuel, increased 0.7% in 2017.
- Digital revenue up 90% in 2017, driven by ClickList. Digital revenue primarily includes revenue from all curbside pickup locations and online sales by Vitacost.com.
- On February 5, 2018, we announced a definitive agreement for the sale of our convenience store business unit to EG Group for \$2.15 billion.
- Gross margin for 2017 decreased, as a percentage of sales, as compared to 2016. See *Gross Margin, LIFO and FIFO Gross Margin* section for additional details.
- OG&A expenses for 2017 increased, as a percentage of sales, as compared to 2016. See *Operating, General and Administrative Expenses* section for additional details on these fluctuations.
- During 2017, we returned \$2.1 billion to shareholders from share repurchases and dividend payments.
- We contributed \$1.2 billion to company-sponsored and company-managed pension plans, which significantly addressed the underfunded position of these plans, and paid \$467 million to satisfy withdrawal obligations to the Central States Pension Fund. These contributions were deductible for tax purposes, resulting in a tax benefit of approximately \$613 million. Included in the contribution is an incremental \$111 million to the United Food and Commercial Workers International Union (“UFCW”) Consolidated Pension Plan (the “2017 UFCW Contribution”), which was contributed in the third quarter of 2017.
- Net cash provided by operating activities was \$3.4 billion in 2017 compared to \$4.3 billion in 2016. Net cash used by investing activities was \$2.7 billion in 2017 compared to \$3.9 billion in 2016.
- Free cash flow was \$706 million in 2017 compared to \$397 million during 2016.
- Announced *Restock Kroger* during 2017. *Restock Kroger* has four main drivers: Redefine the Food and Grocery Customer Experience, Expand Partnerships to Create Customer Value, Develop Talent, and Live Kroger’s Purpose. Over the next three years, *Restock Kroger* will be fueled by cost savings that we will invest in associates, customers and infrastructure. Our goal is to continue generating shareholder value even as we make strategic investments to grow our business.

The following table provides a reconciliation of net earnings attributable to The Kroger Co. to adjusted net earnings attributable to The Kroger Co. and a reconciliation of net earnings attributable to The Kroger Co. per diluted common share to adjusted net earnings attributable to The Kroger Co. per diluted common share, excluding the 2017 and 2016 Adjusted Items. In 2015, we did not have any adjustment items that affected net earnings or net earnings per diluted share.

**Net Earnings per Diluted Share excluding the Adjusted Items**  
(\$ in millions, except per share amounts)

	2017	2016	2015
Net earnings attributable to The Kroger Co.	\$ 1,907	\$ 1,975	\$ 2,039
Adjustments for pension plan agreements <sup>(1)(2)</sup>	360	71	—
Adjustment for voluntary retirement offering <sup>(1)(3)</sup>	117	—	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment <sup>(1)(4)</sup>	74	—	—
Adjustment for company-sponsored pension plan termination <sup>(1)(5)</sup>	335	—	—
Adjustment for depreciation related to held for sale assets <sup>(1)(6)</sup>	(13)	—	—
Adjustment for Tax Act <sup>(1)(7)</sup>	(922)	—	—
Total Adjusted Items	<u>(49)</u>	<u>71</u>	<u>—</u>
Net earnings attributable to The Kroger Co. excluding the Adjusted Items	<u>\$ 1,858</u>	<u>\$ 2,046</u>	<u>\$ 2,039</u>
Extra Week adjustment <sup>(1)(8)</sup>	<u>(79)</u>	<u>—</u>	<u>—</u>
Net earnings attributable to The Kroger Co. excluding the Adjusted Items and the Extra Week adjustment	<u>\$ 1,779</u>	<u>\$ 2,046</u>	<u>\$ 2,039</u>
Net earnings attributable to The Kroger Co. per diluted common share	\$ 2.09	\$ 2.05	\$ 2.06
Adjustments for pension plan agreements <sup>(9)</sup>	0.40	0.07	—
Adjustment for voluntary retirement offering <sup>(9)</sup>	0.13	—	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment <sup>(9)</sup>	0.08	—	—
Adjustment for company-sponsored pension plan termination <sup>(9)</sup>	0.37	—	—
Adjustment for depreciation related to held for sale assets <sup>(9)</sup>	(0.01)	—	—
Adjustment for Tax Act <sup>(9)</sup>	(1.02)	—	—
Total Adjusted Items	<u>(0.05)</u>	<u>0.07</u>	<u>—</u>
Net earnings attributable to The Kroger Co. per diluted common share excluding the Adjusted Items	<u>\$ 2.04</u>	<u>\$ 2.12</u>	<u>\$ 2.06</u>
Extra Week adjustment <sup>(9)</sup>	<u>(0.09)</u>	<u>—</u>	<u>—</u>
Net earnings attributable to The Kroger Co. per diluted common share excluding the Adjusted Items and the Extra Week adjustment	<u>\$ 1.95</u>	<u>\$ 2.12</u>	<u>\$ 2.06</u>
Average numbers of common shares used in diluted calculation	904	958	980

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

(2) The pre-tax adjustments for the pension plan agreements were \$550 and \$111 in 2017 and 2016, respectively.

(3) The pre-tax adjustment for the voluntary retirement offering was \$184.

(4) The pre-tax adjustment for Kroger Specialty Pharmacy goodwill impairment was \$110.

(5) The pre-tax adjustment for the company-sponsored pension plan termination was \$502.

(6) The pre-tax adjustment for depreciation related to held for sale assets was (\$19).

(7) Due to the re-measurement of deferred tax liabilities and the reduction of the statutory income tax rate for the last few weeks of the fiscal year.

(8) The pretax Extra Week adjustment was (\$119).

(9) The amount presented represents the net earnings per diluted common share effect of each adjustment.

## RESULTS OF OPERATIONS

### Sales

#### Total Sales (\$ in millions)

	2017	2017 Adjusted <sup>(2)</sup>	Percentage Change <sup>(3)</sup>	2016	Percentage Change <sup>(4)</sup>	2015
Total supermarket sales without fuel	\$ 100,800	\$ 99,025	2.2 %	\$ 96,900	6.1 %	\$ 91,310
Fuel sales	16,246	15,918	13.9 %	13,979	(5.6)%	14,804
Other Sales <sup>(1)</sup>	5,616	5,440	22.0 %	4,458	20.0 %	3,716
Total sales	<u>\$ 122,662</u>	<u>\$ 120,383</u>	4.4 %	<u>\$ 115,337</u>	5.0 %	<u>\$ 109,830</u>

(1) Other sales primarily relate to sales at convenience stores, excluding fuel; jewelry stores; food production plants to outside customers; data analytic services; variable interest entities; Kroger Specialty Pharmacy; in-store health clinics; digital coupon services; and online sales by Vitacost.com.

(2) The 2017 Adjusted column represents the items presented in the 2017 column adjusted to remove the Extra Week.

(3) This column represents the percentage change in 2017 adjusted sales, compared to 2016.

(4) This column represents the percentage change in 2016, compared to 2015.

The increase in total sales in 2017, compared to 2016, is due to the increase in adjusted sales and the Extra Week. Total adjusted sales increased in 2017, compared to 2016, by 4.4%. This increase was primarily due to our increases in total supermarket sales without fuel, fuel sales and our merger with Modern HC Holdings, Inc. ("ModernHEALTH"). The increase in total supermarket sales without fuel for 2017, adjusted for the Extra Week, compared to 2016, was primarily due to our identical supermarket sales increase, excluding fuel, of 0.7%, and an increase in supermarket square footage. Identical supermarket sales, excluding fuel, for 2017, compared to 2016, increased primarily due to an increase in the number of households shopping with us, changes in product mix and product cost inflation of 0.7%, partially offset by our continued investments in lower prices for our customers. Excluding mergers, acquisitions and operational closings, total supermarket square footage at the end of 2017 increased 1.9% over the end of 2016. Total adjusted fuel sales increased 13.9% in 2017, compared to 2016, primarily due to an increase in the average retail fuel price of 12.3% and an increase in fuel gallons sold of 1.4%. The increase in the average retail fuel price was caused by an increase in the product cost of fuel.

Total sales increased in 2016, compared to 2015, by 5.0%. This increase was primarily due to our increase in total supermarket sales, without fuel, and our merger with ModernHEALTH, partially offset by a decrease in fuel sales due to a 9.4% decrease in the average retail fuel price. The increase in total supermarket sales without fuel for 2016, compared to 2015, was primarily due to our merger with Roundy's, an increase in supermarket square footage and our identical supermarket sales increase, excluding fuel, of 1.0%. Identical supermarket sales, excluding fuel, for 2016, compared to 2015, increased primarily due to an increase in the number of households shopping with us, partially offset by product cost deflation of 0.8%. Excluding mergers, acquisitions and operational closings, total supermarket square footage at the end of 2016 increased 3.4% over 2015. Total fuel sales decreased 5.6% in 2016, compared to 2015, primarily due to a decrease in the average retail fuel price of 9.4%, partially offset by an increase in fuel gallons sold of 4.2%. The decrease in the average retail fuel price was caused by a decrease in the product cost of fuel.

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 multi-department stores. Our identical supermarket sales results are summarized in the following table. We used the identical supermarket dollar figures presented below to calculate percentage changes for 2017 and 2016.

**Identical Supermarket Sales**  
(\$ in millions)

	2017	2016 <sup>(1)</sup>
Including supermarket fuel centers	\$ 109,161	\$ 107,135
Excluding supermarket fuel centers	\$ 96,639	\$ 95,942
Including supermarket fuel centers	1.9 %	0.1 %
Excluding supermarket fuel centers	0.7 %	1.0 %

(1) Identical supermarket sales for 2016 were adjusted to a comparable 53 week basis by including week 1 of fiscal 2017 in our 2016 identical supermarket sales base. However, for purposes of determining the percentage change in identical supermarket sales from 2015 to 2016, 2016 identical supermarket sales were not adjusted to include the sales from week 1 of 2017.

*Gross Margin, LIFO and FIFO Gross Margin*

We define gross margin as sales minus merchandise costs, including advertising, warehousing, and transportation. Rent expense, depreciation and amortization expense, and interest expense are not included in gross margin.

Our gross margin rates, as a percentage of sales, were 22.01% in 2017, 22.40% in 2016 and 22.16% in 2015. The decrease in 2017, compared to 2016, resulted primarily from continued investments in lower prices for our customers and our merger with ModernHEALTH due to its lower gross margin rate, and increased warehousing, transportation and shrink costs, as a percentage of sales, partially offset by improved merchandise costs, a lower LIFO charge, a change in our product sales mix, including higher gross margin perishable departments growing their percentage share of sales to total sales, growth in *Our Brands* products which have a higher gross margin compared to national brand products, decreased advertising costs, as a percentage of sales, and a higher gross margin rate on fuel sales.

The increase in 2016, compared to 2015, resulted primarily from lower fuel sales, a lower LIFO charge and our merger with Roundy's due to its historically higher gross margin rate, partially offset by continued investments in lower prices for our customers, unfavorable pricing and cost effects due to transitioning to a deflationary operating environment, our merger with ModernHEALTH due to its historically lower gross margin rate and increased warehousing and shrink costs, as a percentage of sales.

Our LIFO credit for 2017 was \$8 million, compared to a LIFO charge of \$19 million in 2016 and \$28 million in 2015. Our LIFO credit in 2017 was primarily due to a reduction of pharmacy inventory in 2017 compared to 2016. In 2016, our LIFO charge primarily resulted from annualized product cost inflation related to pharmacy, and was partially offset by annualized product cost deflation in other departments. In 2015, our LIFO charge primarily resulted from annualized product cost inflation related to pharmacy, and was partially offset by annualized product cost deflation related to meat and dairy.

Our FIFO gross margin rates, which exclude the LIFO credit and charge, were 22.01% in 2017, 22.42% in 2016 and 22.18% in 2015. Excluding the effect of fuel, the Extra Week and ModernHEALTH, our FIFO gross margin rate decreased 19 basis points in 2017, compared to 2016. This decrease resulted primarily from continued investments in lower prices for our customers, increased warehousing, transportation and shrink costs, as a percentage of sales, partially offset by improved merchandise costs, a change in our product sales mix, including higher gross margin perishable departments growing their percentage share of sales to total sales, growth in *Our Brands* products which have a higher gross margin compared to national brand products and decreased advertising costs, as a percentage of sales. Excluding the effect of fuel and our mergers with Roundy's and ModernHEALTH, our FIFO gross margin rate decreased seven basis points in 2016, compared to 2015. This decrease resulted primarily from continued investments in lower prices for our customers, unfavorable pricing and cost effects due to transitioning to a deflationary operating environment and increased warehousing and shrink costs, as a percentage of sales.



## *Operating, General and Administrative Expenses*

OG&A expenses consist primarily of employee-related costs such as wages, healthcare benefit costs and retirement plan costs; and utility 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, were 17.58% in 2017, 16.63% in 2016 and 16.34% in 2015. The increase in 2017, compared to 2016, resulted primarily from the 2017 OG&A Adjusted Items, investing in our digital strategy, increases in store wages attributed to investing in incremental labor hours and higher wages to improve retention, employee engagement and customer experience, the 2017 UFCW Contribution, increases in incentive plan and healthcare costs, partially offset by savings from the VRO, effective cost controls, higher fuel sales, the 2016 Adjusted Items and our merger with ModernHEALTH due to its lower OG&A rate, as a percentage of sales. Our fuel sales lower our OG&A rate, as a percentage of sales, due to the very low OG&A rate, as a percentage of sales, of fuel sales compared to non-fuel sales. Excluding the effect of fuel, the Extra Week, the 2017 UFCW Contribution, the 2017 OG&A and 2016 Adjusted Items and ModernHEALTH, our OG&A rate increased 22 basis points in 2017, compared to 2016. This increase resulted primarily from investing in our digital strategy, increases in store wages attributed to investing in incremental labor hours and higher wages to improve retention, employee engagement and customer experience, increases in incentive plan and healthcare costs, partially offset by savings from the VRO and effective cost controls.

The increase in 2016, compared to 2015, resulted primarily from a decrease in fuel sales, the loss of sales leverage due to transitioning to a deflationary operating environment, the 2016 Adjusted Items, our mergers with Roundy's and ModernHEALTH due to their historically higher OG&A rate, compared to our other divisions, and increases in healthcare benefit and credit card costs, partially offset by increased supermarket sales, productivity improvements, effective cost controls, \$110 million UFCW contributions made during 2015 ("2015 UFCW Contributions") and decreases in incentive plans, company-sponsored pension plans and utility costs, as a percentage of sales. Excluding the effect of fuel, the 2016 Adjusted Items, recent mergers and the 2015 UFCW Contributions, our OG&A rate decreased five basis points in 2016, compared to 2015. This decrease resulted primarily from increased supermarket sales, productivity improvements, effective cost controls and decreases in incentive plans, company-sponsored pension plans and utility costs, partially offset by the loss of sales leverage due to transitioning to a deflationary operating environment and increases in healthcare benefit and credit card costs, as a percentage of sales.

### *Rent Expense*

Rent expense decreased as a percentage of sales in 2017, compared to 2016, due to our continued emphasis on owning rather than leasing, whenever possible, and higher fuel sales, which decreases our rent expense, as a percentage of sales, partially offset by increased closed store liabilities.

Rent expense increased as a percentage of sales in 2016, compared to 2015, due to our merger with Roundy's, due to its higher volume of leased versus owned supermarkets, and lower fuel sales, which increases our rent expense rate, as a percentage of sales.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense decreased as a percentage of sales in 2017, compared to 2016, due to higher fuel sales, which decreases our depreciation expense as a percentage of sales, the Extra Week and the 2017 Depreciation Adjusted Item, partially offset by additional depreciation on capital investments, excluding mergers and lease buyouts, of \$3.0 billion, during 2017.

Depreciation and amortization expense increased as a percentage of sales 2016, compared to 2015, due to additional depreciation on capital investments, excluding mergers and lease buyouts, of \$3.6 billion, during 2016, unfavorable sales leveraging from transitioning to a deflationary operating environment, and our merger with Roundy's.

### *Operating Profit and FIFO Operating Profit*

Operating profit was \$2.1 billion in 2017, \$3.4 billion in 2016 and \$3.6 billion in 2015. Operating profit, as a percentage of sales, was 1.70% in 2017, 2.98% in 2016 and 3.26% in 2015. Operating profit, as a percentage of sales, decreased 128 basis points in 2017, compared to 2016, due to a lower gross margin and increased OG&A, partially offset by lower depreciation and amortization expenses and a lower LIFO charge, as a percentage of sales.

Operating profit, as a percentage of sales, decreased 28 basis points in 2016, compared to 2015, due to increased OG&A, depreciation and amortization and rent expenses, partially offset by higher gross margin and a lower LIFO charge, as a percentage of sales.

FIFO operating profit was \$2.1 billion in 2017, \$3.5 billion in 2016 and \$3.6 billion in 2015. FIFO operating profit, as a percentage of sales, was 1.69% in 2017, 3.00% in 2016 and 3.28% in 2015. Fuel sales lower our operating profit rate due to the very low operating profit rate, as a percentage of sales, of fuel sales compared to non-fuel sales. FIFO operating profit, as a percentage of sales excluding fuel, the Extra Week, the 2017 UFCW Contribution, the 2017 and 2016 Adjusted Items and ModernHEALTH, decreased 46 basis points in 2017, compared to 2016, due to a lower gross margin and increased OG&A and depreciation and amortization expenses, as a percentage of sales.

FIFO operating profit, as a percentage of sales excluding fuel, the 2016 Adjusted Items, the effects of our recent mergers and the 2015 UFCW Contributions, decreased 14 basis points in 2016, compared to 2015. This decrease was due to lower gross margin, higher depreciation and amortization, partially offset by decreased OG&A and rent expenses, as a percentage of sales.

Specific factors of the above operating trends under operating profit and FIFO operating profit are discussed earlier in this section.

### *Interest Expense*

Interest expense totaled \$601 million in 2017, \$522 million in 2016 and \$482 million in 2015. The increase in interest expense in 2017, compared to 2016, resulted primarily from additional borrowings used for share repurchases, the Extra Week, the \$1.2 billion we contributed to company-sponsored and company-managed pension plans in 2017, a \$467 million pre-tax payment to satisfy withdrawal obligations to the Central States Pension Fund, partially offset by a lower weighted average interest rate. The increase in interest expense in 2016, compared to 2015, resulted primarily from additional borrowings used for share repurchases, mergers and a higher weighted average interest rate.

### *Income Taxes*

Our effective income tax rate was (27.3)% in 2017, 32.8% in 2016 and 33.8% in 2015. The 2017 tax rate differed from the federal statutory rate primarily as a result of remeasuring deferred taxes due to the Tax Act, the Domestic Manufacturing Deduction and other changes, partially offset by non-deductible goodwill impairment charges and the effect of state income taxes. The 2016 tax rate differed from the federal statutory rate primarily as a result of the recognition of excess tax benefits related to share-based payments after the adoption of ASU 2016-09, the utilization of tax credits, the Domestic Manufacturing Deduction and other changes, partially offset by the effect of state income taxes. The 2015 tax rate differed from the federal statutory rate primarily as a result of the utilization of tax credits, the Domestic Manufacturing Deduction and other changes, partially offset by the effect of state income taxes.

### *Net Earnings and Net Earnings Per Diluted Share*

Our net earnings are based on the factors discussed in the Results of Operations section.

Net earnings of \$2.09 per diluted share in 2017 represented an increase of 2.0% from net earnings of \$2.05 per diluted share in 2016. Excluding the 2017 and 2016 Adjusted Items and the Extra Week, adjusted net earnings of \$1.95 per diluted share in 2017 represented a decrease of 8.0% from adjusted net earnings of \$2.12 per diluted share in 2016. The 8.0% decrease in adjusted net earnings per diluted share resulted primarily from lower non-fuel FIFO operating profit and increased interest expense, partially offset by higher fuel earnings, a lower LIFO charge, decreased income tax expense and lower weighted average common shares outstanding due to common share repurchases.

Net earnings of \$2.05 per diluted share in 2016 represented a decrease of 0.5% from net earnings of \$2.06 per diluted share in 2015. Excluding the 2016 Adjusted Items, net earnings of \$2.12 per diluted share in 2016 represented an increase of 2.9% from net earnings of \$2.06 per diluted share in 2015. The net earnings of 2015 do not include any adjusted items. The 2.9% increase resulted primarily from a lower LIFO charge, lower income tax expense and lower weighted average common shares outstanding due to common share repurchases, partially offset by lower non-fuel FIFO operating profit and lower fuel earnings.

## **COMMON SHARE REPURCHASE PROGRAMS**

We maintain share repurchase programs that comply with Rule 10b5-1 of the Securities Exchange Act of 1934 and allow for the orderly repurchase of our common shares, from time to time. The share repurchase programs do not have an expiration date but may be suspended or terminated by our Board of Directors at any time. We made open market purchases of our common shares totaling \$1.6 billion in 2017, \$1.7 billion in 2016 and \$500 million in 2015 under these repurchase programs. In addition to these repurchase programs, we also repurchase common shares to reduce dilution resulting from our employee stock option plans. This program is solely funded by proceeds from stock option exercises, and the tax benefit from these exercises. We repurchased approximately \$66 million in 2017, \$105 million in 2016 and \$203 million in 2015 of our common shares under the stock option program.

The shares repurchased in 2017 were reacquired under the following repurchase programs authorized by the Board of Directors to reacquire shares via open market purchases:

- On September 15, 2016, our Board of Directors approved a \$500 million share repurchase program (the "September 2016 Repurchase Program"). This program was exhausted during the first quarter of 2017.
- On March 9, 2017, our Board of Directors approved an additional \$500 million share repurchase program to supplement the September 2016 Repurchase Program. This program was exhausted during the second quarter of 2017.
- On June 22, 2017, our Board of Directors approved a \$1.0 billion share repurchase program. As of February 3, 2018, there was \$272 million remaining under this share repurchase program.

On March 15, 2018, our Board of Directors approved a \$1.0 billion share repurchase program, to supplement the June 2017 Repurchase Program, to reacquire shares via open market purchase or privately negotiated transactions, including accelerated stock repurchase transactions, block trades, or pursuant to trades intending to comply with rule 10b5-1 of the Securities Exchange Act of 1934 (the "March 2018 Repurchase Program").

During the first quarter through March 29, 2018, we used an additional \$388 million of cash to repurchase 16 million common shares at an average price of \$25.05 per share. As of March 29, 2018, we have exhausted the June 2017 Repurchase Program and have \$885 million remaining under the March 2018 Repurchase Program.

## CAPITAL INVESTMENTS

Capital investments, including changes in construction-in-progress payables and excluding mergers and the purchase of leased facilities, totaled \$3.0 billion in 2017, \$3.7 billion in 2016 and \$3.3 billion in 2015. Capital investments for mergers totaled \$16 million in 2017, \$401 million in 2016 and \$168 million in 2015. We merged with ModernHEALTH in 2016 and Roundy's in 2015. Refer to Note 2 to the Consolidated Financial Statements for more information on these mergers. Capital investments for the purchase of leased facilities totaled \$13 million in 2017, \$5 million in 2016 and \$35 million in 2015. The table below shows our supermarket storing activity and our total supermarket square footage:

### Supermarket Storing Activity

	2017	2016	2015
Beginning of year	2,796	2,778	2,625
Opened	24	50	31
Opened (relocation)	15	21	12
Acquired	3	—	159
Closed (operational)	(41)	(32)	(37)
Closed (relocation)	(15)	(21)	(12)
End of year	<u>2,782</u>	<u>2,796</u>	<u>2,778</u>
Total supermarket square footage (in millions)	179	178	173

## 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 to our U.S. GAAP operating profit of the prior four quarters. 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, (iv) the average other current liabilities, excluding accrued income taxes and (v) the average liabilities held for sale. Averages are calculated for ROIC 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.

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.

The following table provides a calculation of ROIC for 2017 and 2016 on a 52 week basis (\$ in millions).

	<b>Rolling Four Quarters Ended</b>	
	<b>February 3, 2018</b>	<b>January 28, 2017</b>
<b>Return on Invested Capital</b>		
<b>Numerator</b>		
Operating profit on a 53 week basis in fiscal year 2017	\$ 2,085	\$ 3,436
Extra Week operating profit adjustment	(131)	—
LIFO (credit) charge	(8)	19
Depreciation and amortization	2,436	2,340
Rent on 53 week basis in fiscal year 2017	911	881
Extra Week rent adjustment	(17)	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment	110	—
Adjustments for pension plan agreements	550	111
Adjustment for company-sponsored pension plan termination	502	—
Adjustment for depreciation related to held for sale assets	(19)	—
Adjustments for voluntary retirement offering	184	—
Adjusted operating profit on a 52 week basis	<u>\$ 6,603</u>	<u>\$ 6,787</u>
<b>Denominator</b>		
Average total assets	\$ 36,851	\$ 35,201
Average taxes receivable <sup>(1)</sup>	(181)	(262)
Average LIFO reserve	1,270	1,283
Average accumulated depreciation and amortization	20,287	18,940
Average trade accounts payable	(5,838)	(5,773)
Average accrued salaries and wages	(1,167)	(1,330)
Average other current liabilities <sup>(2)</sup>	(3,363)	(3,265)
Average liabilities held for sale	(130)	—
Rent x 8	7,152	7,048
Average invested capital	<u>\$ 54,881</u>	<u>\$ 51,842</u>
<b>Return on Invested Capital</b>	<u>12.03 %</u>	<u>13.09 %</u>

(1) Taxes receivable were \$229 as of February 3, 2018, \$132 as of January 28, 2017 and \$392 as of January 30, 2016. The January 30, 2016 balance is higher than the other comparative balances due to changes to tangible property regulations in 2015. Refer to Note 5 of the Consolidated Financial Statements for further detail.

(2) Other current liabilities included accrued income taxes of \$1 as of January 28, 2017. We did not have any accrued income taxes as of February 3, 2018 or January 30, 2016. 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. Our significant accounting policies are summarized in Note 1 to the Consolidated Financial Statements.

The preparation of financial statements in conformity with GAAP 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 differ from those estimates.

We believe that the following accounting policies are the most critical in the preparation of our financial statements because they involve the most difficult, subjective or complex judgments about the effect of matters that are inherently uncertain.

### *Self-Insurance Costs*

We primarily are self-insured for costs related to workers' compensation and general liability claims. The liabilities represent our best estimate, using generally accepted actuarial reserving methods, of the ultimate obligations for reported claims plus those incurred but not reported for all claims incurred through February 3, 2018. We establish case reserves for reported claims using case-basis evaluation of the underlying claim data and we update as information becomes known.

For both workers' compensation and general liability claims, we have purchased stop-loss coverage to limit our exposure to any significant exposure on a per claim basis. We are insured for covered costs in excess of these per claim limits. We account for the liabilities for workers' compensation claims on a present value basis utilizing a risk-adjusted discount rate. A 25 basis point decrease in our discount rate would increase our liability by approximately \$3 million. General liability claims are not discounted.

The assumptions underlying the ultimate costs of existing claim losses are subject to a high degree of unpredictability, which can affect the liability recorded for such claims. For example, variability in inflation rates of health care costs inherent in these claims can affect the amounts realized. Similarly, changes in legal trends and interpretations, as well as a change in the nature and method of how claims are settled can affect ultimate costs. Our estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, and any changes could have a considerable effect on future claim costs and currently recorded liabilities.

### *Impairments of Long-Lived Assets*

We monitor the carrying value of long-lived assets for potential impairment each quarter based on whether certain triggering events have occurred. These events include current period losses combined with a history of losses or a projection of continuing losses or a significant decrease in the market value of an asset. When a triggering event occurs, we perform an impairment calculation, comparing projected undiscounted cash flows, utilizing current cash flow information and expected growth rates related to specific stores, to the carrying value for those stores. If we identify impairment for long-lived assets to be held and used, we compare the assets' current carrying value to the assets' fair value. Fair value is determined based on market values or discounted future cash flows. We record impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for disposal, we adjust the value of the property and equipment to reflect recoverable values based on our previous efforts to dispose of similar assets and current economic conditions. We recognize impairment for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. We recorded asset impairments in the normal course of business totaling \$71 million in 2017, \$26 million in 2016 and \$46 million in 2015. We record costs to reduce the carrying value of long-lived assets in the Consolidated Statements of Operations as "Operating, general and administrative" expense.

The factors that most significantly affect the impairment calculation are our estimates of future cash flows. Our cash flow projections look several years into the future and include assumptions on variables such as inflation, the economy and market competition. Application of alternative assumptions and definitions, such as reviewing long-lived assets for impairment at a different level, could produce significantly different results.

### *Goodwill*

Our goodwill totaled \$2.9 billion as of February 3, 2018. We review goodwill for impairment in the fourth quarter of each year, and also upon the occurrence of triggering events. We perform reviews of each of our operating divisions and variable interest entities (collectively, "reporting units") that have goodwill balances. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and we compare fair value to the carrying value of a reporting unit for purposes of identifying potential impairment. We base projected future cash flows on management's knowledge of the current operating environment and expectations for the future. We recognize goodwill impairment for any excess of a reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit.



Our annual evaluation of goodwill is performed for our reporting units during the fourth quarter. In 2017, we recorded goodwill impairment for our Kroger Specialty Pharmacy reporting unit totaling \$110 million, \$74 million net of tax. The annual evaluation of goodwill performed in 2016 and 2015 did not result in impairment. Based on current and future expected cash flows, we believe additional goodwill impairments are not reasonably likely. A 10% reduction in fair value of our reporting units would not indicate a potential for impairment of our goodwill balance.

For additional information relating to our results of the goodwill impairment reviews performed during 2017, 2016 and 2015 see Note 3 to the Consolidated Financial Statements.

The impairment review requires the extensive use of management judgment and financial estimates. Application of alternative estimates and assumptions, such as reviewing goodwill for impairment at a different level, could produce significantly different results. The cash flow projections embedded in our goodwill impairment reviews can be affected by several factors such as inflation, business valuations in the market, the economy, market competition and our ability to successfully integrate recently acquired businesses.

#### *Post-Retirement Benefit Plans*

We account for our defined benefit pension plans using the recognition and disclosure provisions of GAAP, which require the recognition of the funded status of retirement plans on the Consolidated Balance Sheet. We record, as a component of Accumulated Other Comprehensive Income ("AOCI"), actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized.

The determination of our obligation and expense for company-sponsored pension plans and other post-retirement benefits is dependent upon our selection of assumptions used by actuaries in calculating those amounts. Those assumptions are described in Note 15 to the Consolidated Financial Statements and include, among others, the discount rate, the expected long-term rate of return on plan assets, mortality and the rate of increases in compensation and health care costs. Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect our recognized expense and recorded obligation in future periods. While we believe that our assumptions are appropriate, significant differences in our actual experience or significant changes in our assumptions, including the discount rate used and the expected return on plan assets, may materially affect our pension and other post-retirement obligations and our future expense. Note 15 to the Consolidated Financial Statements also discusses the effect of a 1% change in the assumed health care cost trend rate on other post-retirement benefit costs and the related liability.

The objective of our discount rate assumptions was intended to reflect the rates at which the pension benefits could be effectively settled. In making this determination, we take into account the timing and amount of benefits that would be available under the plans. Our methodology for selecting the discount rates was to match the plan's cash flows to that of a hypothetical bond portfolio whose cash flow from coupons and maturities match the plan's projected benefit cash flows. The discount rates are the single rates that produce the same present value of cash flows. The selection of the 4.00% and 3.93% discount rates as of year-end 2017 for pension and other benefits, respectively, represents the hypothetical bond portfolio using bonds with an AA or better rating constructed with the assistance of an outside consultant. We utilized a discount rate of 4.25% and 4.18% as of year-end 2016 for pension and other benefits, respectively. A 100 basis point increase in the discount rate would decrease the projected pension benefit obligation as of February 3, 2018, by approximately \$426 million.

Our 2017 assumed pension plan investment return rate was 7.50% compared to 7.40% in 2016 and 7.44% in 2015. The value of all investments in our company-sponsored defined benefit pension plans during the calendar year ending December 31, 2017, net of investment management fees and expenses, increased 8.7%. Historically, the Kroger pension plans' average rate of return was 5.7% for the 10 calendar years ended December 31, 2017, net of all investment management fees and expenses. For the past 20 years, the Kroger pension plans' average annual rate of return has been 7.10%. At the beginning of 2017, to determine the expected rate of return on pension plan assets held by Kroger for 2017, we considered current and forecasted plan asset allocations as well as historical and forecasted rates of return on various asset categories. Based on this information and forward looking assumptions for investments made in a manner consistent with our target allocations, which contemplates our transition to a liability driven investment strategy, we believed a 7.50% rate of return assumption was reasonable for 2017. In 2016, Kroger began managing the assets for the Harris Teeter and Roundy's pension plans, and our expected rate of return for 2016 reflects implementing a similar investment management strategy for the Harris Teeter and Roundy's plans' assets. See Note 15 to the Consolidated Financial Statements for more information on the asset allocations of pension plan assets.

On January 31, 2015, we adopted new industry specific mortality tables based on mortality experience and assumptions for generational mortality improvement in determining our benefit obligations. On January 28, 2017, we adopted an updated assumption for generational mortality improvement, based on additional years of published mortality experience.

Sensitivity to changes in the major assumptions used in the calculation of Kroger's pension plan liabilities is illustrated below (in millions).

	Percentage Point Change	Projected Benefit	Expense
		Obligation Decrease/(Increase)	Decrease/(Increase)
Discount Rate	+/- 1.0%	\$ 426/(516)	\$ 39/(49)
Expected Return on Assets	+/- 1.0%	—	\$ 31/(31)

In 2017, we contributed \$1.0 billion to our company-sponsored defined benefit plans and we are not required to make any contributions to these plans in 2018. We contributed \$3 million to our company-sponsored defined benefit plans in 2016 and \$5 million in 2015. Among other things, investment performance of plan assets, the interest rates required to be used to calculate the pension obligations, and future changes in legislation, will determine the amounts of contributions.

In 2017, we settled certain company-sponsored pension plan obligations using existing assets of the plan and the \$1.0 billion contribution. We recognized a settlement charge of approximately \$502 million, \$335 million net of tax, associated with the settlement of our obligations for the eligible participants' pension balances that were distributed out of the plan via a transfer to other qualified retirement plan options, a lump sum payout, or the purchase of an annuity contract, based on each participant's election.

We contributed and expensed \$219 million in 2017, \$215 million in 2016 and \$196 million in 2015 to employee 401(k) retirement savings accounts. The increase in 2016, compared to 2015, is primarily due to our recent mergers. The 401(k) retirement savings account plans provide to eligible employees both matching contributions and automatic contributions from the Company based on participant contributions, plan compensation and length of service.

#### *Multi-Employer Pension Plans*

We contribute to various multi-employer pension plans based on obligations arising from collective bargaining agreements. These multi-employer pension plans provide retirement benefits to participants based on their service to contributing employers. The benefits are paid from assets held in trust for that purpose. Trustees are appointed in equal number by employers and unions. The trustees typically are responsible for determining the level of benefits to be provided to participants as well as for such matters as the investment of the assets and the administration of the plans.

We recognize expense in connection with these plans as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. We made cash contributions to these plans of \$954 million in 2017, \$289 million in 2016 and \$426 million in 2015. The increase in 2017, compared to 2016, is due to the \$467 million pre-tax payment to satisfy withdrawal obligations to the Central States Pension Fund and the 2017 UFCW Contribution.

We continue to evaluate and address our potential exposure to under-funded multi-employer pension plans as it relates to our associates who are beneficiaries of these plans. These under-fundings are not our liability. When an opportunity arises that is economically feasible and beneficial to us and our associates, we may negotiate the restructuring of under-funded multi-employer pension plan obligations to help stabilize associates' future benefits and become the fiduciary of the restructured multi-employer pension plan. The commitments from these restructurings do not change our debt profile as it relates to our credit rating since these off balance sheet commitments are typically considered in our investment grade debt rating. We are currently designated as the named fiduciary of the UFCW Consolidated Pension Plan and the International Brotherhood of Teamsters ("IBT") Consolidated Pension Fund and have sole investment authority over these assets. As such, we include contributions to these plans when we disclose contributions to company-sponsored and company-managed pension plans. We became the fiduciary of the IBT Consolidated Pension Fund in 2017 due to the ratification of a new labor contract with the IBT that provided our withdrawal from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2017, we incurred a \$550 million charge, \$360 million net of tax, for obligations related to withdrawing from and settlements for withdrawal liabilities for certain multi-employer pension plan obligations, of which \$467 million was contributed to the Central States Pension Fund in 2017.
- In 2017, we contributed an incremental \$111 million, \$71 million net of tax, to the UFCW Consolidated Pension Plan.
- In 2016, we incurred a charge of \$111 million, \$71 million net of tax, due to commitments and withdrawal liabilities arising from the restructuring of certain multi-employer pension plan obligations, of which \$28 million was contributed to the UFCW Consolidated Pension Plan in 2016.
- In 2015, we contributed \$190 million to the UFCW Consolidated Pension Plan. We had previously accrued \$60 million of the total contributions at January 31, 2015 and recorded expense for the remaining \$130 million at the time of payment in 2015.

As we continue to work to find solutions to under-funded multi-employer pension plans, it is possible we could incur withdrawal liabilities for certain funds.

Based on the most recent information available to us, we believe that the present value of actuarially accrued liabilities in most of the multi-employer plans to which we contribute substantially exceeds the value of the assets held in trust to pay benefits. We have attempted to estimate the amount by which these liabilities exceed the assets, (i.e., the amount of underfunding), as of December 31, 2017. Because we are only one of a number of employers contributing to these plans, we also have attempted to estimate the ratio of our contributions to the total of all contributions to these plans in a year as a way of assessing our "share" of the underfunding. Nonetheless, the underfunding is not a direct obligation or liability of ours or of any employer. As of December 31, 2017, we estimate our share of the underfunding of multi-employer pension plans to which we contribute, or as it relates to certain funds, an estimated withdrawal liability, was approximately \$2.3 billion, \$1.8 billion net of tax. This represents a decrease in the estimated amount of underfunding of approximately \$700 million, \$446 million net of tax, as of December 31, 2017, compared to December 31, 2016. The decrease in the amount of underfunding is primarily attributable to withdrawing from and settlements for withdrawal liabilities for certain multi-employer pension plan obligations, the 2017 UFCW Contribution and returns on assets in the funds. Our estimate is based on the most current information available to us including actuarial evaluations and other data (that include the estimates of others), and such information may be outdated or otherwise unreliable.

We have made and disclosed this estimate not because, except as noted above, this underfunding is a direct liability of ours. Rather, we believe the underfunding is likely to have important consequences. In the event we were to exit certain markets or otherwise cease making contributions to these plans, we could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated, in accordance with GAAP.

The amount of underfunding described above is an estimate and could change based on contract negotiations, returns on the assets held in the multi-employer pension plans, benefit payments or future restructuring agreements. The amount could decline, and our future expense would be favorably affected, if the values of the assets held in the trust significantly increase or if further changes occur through collective bargaining, trustee action or favorable legislation. On the other hand, our share of the underfunding could increase and our future expense could be adversely affected if the asset values decline, if employers currently contributing to these funds cease participation or if changes occur through collective bargaining, trustee action or adverse legislation. We continue to evaluate our potential exposure to under-funded multi-employer pension plans. Although these liabilities are not a direct obligation or liability of ours, any commitments to fund certain multi-employer pension plans will be expensed when our commitment is probable and an estimate can be made.

See Note 16 to the Consolidated Financial Statements for more information relating to our participation in these multi-employer pension plans.

### *Inventories*

Inventories are stated at the lower of cost (principally on a LIFO basis) or market. In total, approximately 93% and 89% of inventories were valued using the LIFO method in 2017 and 2016, respectively. The remaining inventories, including substantially all fuel inventories, are stated at the lower of cost (on a FIFO basis) or net realizable value. Replacement cost was higher than the carrying amount by \$1.2 billion at February 3, 2018 and \$1.3 billion at January 28, 2017. We follow the Link-Chain, Dollar-Value LIFO method for purposes of calculating our LIFO charge or credit.

We follow the item-cost method of accounting to determine inventory cost before the LIFO adjustment for substantially all store inventories at our supermarket divisions. This method involves counting each item in inventory, assigning costs to each of these items based on the actual purchase costs (net of vendor allowances and cash discounts) of each item and recording the cost of items sold. The item-cost method of accounting allows for more accurate reporting of periodic inventory balances and enables management to more precisely manage inventory. In addition, substantially all of our inventory consists of finished goods and is recorded at actual purchase costs (net of vendor allowances and cash discounts).

We evaluate inventory shortages throughout the year based on actual physical counts in our facilities. We record allowances for inventory shortages based on the results of recent physical counts to provide for estimated shortages from the last physical count to the financial statement date.

### *Vendor Allowances*

We recognize all vendor allowances as a reduction in merchandise costs when the related product is sold. In most cases, vendor allowances are applied to the related product cost by item, and therefore reduce the carrying value of inventory by item. When it is not practicable to allocate vendor allowances to the product by item, we recognize vendor allowances as a reduction in merchandise costs based on inventory turns and as the product is sold. We recognized approximately \$8.5 billion in 2017, \$7.8 billion in 2016 and \$7.3 billion in 2015 of vendor allowances as a reduction in merchandise costs. We recognized approximately 93% of all vendor allowances in the item cost with the remainder being based on inventory turns.

## **RECENTLY ADOPTED ACCOUNTING STANDARDS**

In September 2015, the FASB issued Accounting Standards Update (“ASU”) 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments.” This amendment eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This amendment became effective for us beginning January 31, 2016, and was adopted prospectively in accordance with the standard. The adoption of this amendment did not have a material effect on our Consolidated Balance Sheets or Consolidated Statements of Operations.

During the second quarter of 2016, we adopted ASU 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." This amendment addresses several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. As a result of the adoption, we recognized \$49 million of excess tax benefits related to share-based payments in our provision for income taxes in 2016. These items were historically recorded in additional paid-in capital. In addition, for 2016, cash flows related to excess tax benefits are classified as an operating activity. Cash paid on employees' behalf related to shares withheld for tax purposes is classified as a financing activity. Retrospective application of the cash flow presentation requirements resulted in increases to both "Net cash provided by operating activities" and "Net cash used by financing activities" of \$59 million for 2016 and \$84 million for 2015. Our stock compensation expense continues to reflect estimated forfeitures.

During 2016, we adopted ASU 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Topic 205)". This standard requires us to evaluate, for each annual and interim reporting period, whether there are conditions and events, considered in the aggregate, that raise substantial doubt about our ability to continue as a going concern within one year after the date the Consolidated Financial Statements are issued or are available to be issued. If substantial doubt is raised, additional disclosures around our plan to alleviate these doubts are required. The adoption of this standard did not affect our Consolidated Financial Statements.

During 2016, we adopted ASU 2015-07, "Fair Value Measurement - Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent) (Topic 820)". This standard requires us to disclose which assets we value using net asset value as a practical expedient, and ends the requirement to classify these assets within the GAAP fair value hierarchy. See Note 15 of our Consolidated Financial Statements for disclosures of assets we value using net asset value as a practical expedient.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes." This amendment requires deferred tax liabilities and assets to be classified as noncurrent in a classified statement of financial position. This amendment became effective for us beginning January 29, 2017, and was adopted prospectively in accordance with the standard. The implementation of this amendment resulted in the reclassification of current deferred tax liabilities as non-current and had no effect on our Consolidated Statements of Operations.

During the fourth quarter of 2017, we adopted ASU 2017-04 "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating the second step from the goodwill impairment test. ASU 2017-04 requires applying a one-step quantitative test and recording the amount of goodwill impairment as the excess of the reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 does not amend the optional qualitative assessment of goodwill impairment. We performed our annual evaluation of goodwill in accordance with this standard, which resulted in a goodwill impairment charge of \$110 million, \$74 million net of tax, related to our Kroger Specialty Pharmacy reporting unit.

## **RECENTLY ISSUED ACCOUNTING STANDARDS**

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", as amended by several subsequent ASUs, which provides guidance for revenue recognition. The standard's overarching principle is that revenue must be recognized when goods and services are transferred to the customer in an amount that is proportionate to what has been delivered at that point and that reflects the consideration to which the company expects to be entitled for those goods or services. Per ASU 2015-14, "Deferral of Effective Date," this guidance will be effective for us in the first quarter of fiscal year ending February 2, 2019. We formed a project team to assess and document our accounting policies related to the new revenue guidance. As of the end of 2017, we have completed this assessment and documentation. Based on this project, we do not expect that the implementation of the new standard will have a material effect on our Consolidated Statements of Operations, Consolidated Balance Sheets or Consolidated Statements of Cash Flows. We intend to adopt the new standard on a modified retrospective basis and will be addressing new disclosures regarding revenue recognition policies as required by the new standard at adoption. During our assessment, we identified and will be implementing changes, at the beginning of the first quarter of 2018, to our accounting policies and practices, business processes, systems and controls to support the new revenue recognition and disclosure requirements.

In February 2016, the FASB issued ASU 2016-02, "Leases," which provides guidance for the recognition of lease agreements. The standard's core principle is that a company will now recognize most leases on its balance sheet as lease liabilities with corresponding right-of-use assets. This guidance will be effective for us in the first quarter of fiscal year ending February 1, 2020. Early adoption is permitted. The adoption of this ASU will result in a significant increase to our Consolidated Balance Sheets for lease liabilities and right-of-use assets, and we are currently evaluating the other effects of adoption of this ASU on our Consolidated Financial Statements. This evaluation process includes reviewing all forms of leases, performing a completeness assessment over the lease population, analyzing the practical expedients and assessing opportunities to make certain changes to our lease accounting information technology system in order to determine the best implementation strategy. We believe our current off-balance sheet leasing commitments are reflected in our investment grade debt rating.

In March 2017, the FASB issued ASU 2017-07 "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." ASU 2017-07 requires an employer to report the service cost component of retiree benefits in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented separately from the service cost component and outside a subtotal of income from operations. ASU 2017-07 is effective for years, and interim periods within those years, beginning after December 15, 2017, and requires retrospective application to all periods presented. This ASU will impact our Operating Profit subtotal as reported in our Consolidated Statement of Operations by excluding interest expense, investment returns, settlements and other non-service cost components of retiree benefit expenses. Information about interest expense, investment returns and other components of retiree benefit expenses can be found in Note 15 of our Consolidated Financial Statements.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income." ASU 2018-02 amends ASC 220, "Income Statement - Reporting Comprehensive Income," to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. In addition, under the ASU 2018-02, we may be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the effect of the standard on our Consolidated Financial Statements.

## **LIQUIDITY AND CAPITAL RESOURCES**

### *Cash Flow Information*

#### Net cash provided by operating activities

We generated \$3.4 billion of cash from operations in 2017, compared to \$4.3 billion in 2016 and \$4.9 billion in 2015. The cash provided by operating activities came from net earnings including non-controlling interests adjusted primarily for non-cash expenses of depreciation and amortization, LIFO (credit) charge, stock compensation, expense for company-sponsored pension plans, goodwill impairment charge and deferred income taxes. Changes in working capital created a net cash outflow in 2017 and 2016, and a net cash inflow for 2015.

The decrease in net cash provided by operating activities in 2017, compared to 2016, resulted primarily from a decrease in net earnings including noncontrolling interests, the \$1.0 billion contribution to the company-sponsored defined benefit plans and deferred taxes, partially offset by an increase in non-cash expenses and changes in working capital. Deferred taxes changed in 2017, compared to 2016, as a result of remeasuring deferred taxes due to the Tax Act.

The decrease in net cash provided by operating activities in 2016, compared to 2015, resulted primarily due to a decrease in net earnings including noncontrolling interests and changes in working capital, partially offset by an increase in non-cash expenses, deferred taxes and lower payments on long-term liabilities.



Cash provided (used) by operating activities for changes in working capital was (\$164) in 2017 compared to (\$492) million in 2016 and \$180 million in 2015. The decrease in cash used by operating activities for changes in working capital in 2017, compared to 2016, was primarily due to the following:

- A lower amount of cash used for inventory purchases due to decreased capital investments related to store growth,
- Increased cash collections due to our emphasis on better receivables management, and
- A lower increase, over the prior year, of prepaid benefit costs in 2017, compared to 2016; partially offset by
- An overpayment of our fourth quarter 2017 estimated income taxes, and
- An increase in store deposits in-transit due to increased sales in the last few days of the year.

The decrease in cash provided by operating activities for changes in working capital in 2016, compared to 2015, was primarily due to the net effect of the following:

- Higher receivables due to increasing vendor allowance activity and pharmacy sales requiring third party payments,
- Increased inventory purchases due to store growth and new distribution centers,
- Higher prepayment of benefit costs,
- Lower accrued expenses due to reduced incentive plan payout accruals, and
- Lower tax payments due to a 2015 tax deduction associated with tangible property regulations.

#### Net cash used by investing activities

Cash used by investing activities was \$2.7 billion in 2017, compared to \$3.9 billion in 2016 and \$3.6 billion in 2015. The amount of cash used by investing activities decreased in 2017 compared to 2016 primarily due to reduced cash payments for capital investments and lower payments for mergers. The amount of cash used by investing activities increased in 2016, compared to 2015, primarily due to increased cash payments for capital investments and our merger with ModernHEALTH.

#### Net cash used by financing activities

Cash used by financing activities was \$681 million in 2017, \$352 million in 2016 and \$1.3 billion in 2015. The increase in the amount of cash used for financing activities in 2017 compared to 2016 was primarily due to lower net long-term borrowings, partially offset by lower treasury stock purchases and higher net commercial paper borrowings. The decrease in the amount of cash used for financing activities in 2016, compared to 2015, was primarily due to higher treasury stock purchases, partially offset by higher long-term and commercial paper borrowings.

#### *Debt Management*

Total debt, including both the current and long-term portions of capital lease and lease-financing obligations, increased \$1.5 billion to \$15.6 billion as of year-end 2017 compared to 2016. The increase in 2017, compared to 2016, resulted from the issuance of (i) \$400 million of senior notes bearing an interest rate of 2.80%, (ii) \$600 million of senior notes bearing an interest rate of 3.70%, (iii) \$500 million of senior notes bearing an interest rate of 4.65% and (iv) increases in commercial paper borrowings, partially offset by payments of \$700 million on maturing long-term debt obligations.

Total debt, including both the current and long-term portions of capital lease and lease-financing obligations, increased \$2.0 billion to \$14.1 billion as of year-end 2016, compared to 2015. The increase in 2016, compared to 2015, resulted from the issuance of (i) \$1.0 billion of senior notes bearing an interest rate of 4.45%, (ii) \$750 million of senior notes bearing an interest rate of 2.65%, (iii) \$500 million of senior notes bearing an interest rate of 3.875%, (iv) \$500 million of senior notes bearing an interest rate of 1.5%, (v) increases in commercial paper borrowings and (vi) increases in capital lease obligations due to additional leased locations, partially offset by payments of \$1.4 billion on maturing long-term debt obligations.

### *Liquidity Needs*

We estimate our liquidity needs over the next twelve-month period to approximate \$6.9 billion, which includes anticipated requirements for working capital, capital investments, interest payments and scheduled principal payments of debt and commercial paper, offset by cash and temporary cash investments on hand at the end of 2017. We generally operate with a working capital deficit due to our efficient use of cash in funding operations and because we have consistent access to the capital markets. 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 \$2.1 billion of commercial paper and \$1.3 billion of senior notes maturing in the next twelve months, which is included in the \$6.9 billion of estimated liquidity needs. We expect to refinance this debt, in 2018, by issuing additional senior notes, a term loan or commercial paper on favorable terms based on our past experience. We currently plan to continue repurchases of common shares under the Company's share repurchase programs and have a growing dividend, subject to Board approval. 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.

### *Factors Affecting Liquidity*

We can currently borrow on a daily basis approximately \$2.75 billion under our commercial paper program. At February 3, 2018, we had \$2.1 billion of commercial paper borrowings outstanding. Commercial paper borrowings are backed by our credit facility, and reduce the amount we can borrow under the credit facility. If our short-term credit ratings fall, the ability to borrow under our current commercial paper program could be adversely affected for a period of time and increase our interest cost on daily borrowings under our commercial paper program. This could require us to borrow additional funds under the credit facility, under which we believe we have sufficient capacity. However, in the event of a ratings decline, we do not anticipate that our borrowing capacity under our commercial paper program would be any lower than \$500 million on a daily basis. Although our ability to borrow under the credit facility is not affected by our credit rating, the interest cost and applicable margin on borrowings under the credit facility could be affected by a downgrade in our Public Debt Rating. As of March 29, 2018, we had \$1.1 billion of commercial paper borrowings outstanding.

Our credit facility requires the maintenance of a Leverage Ratio and a Fixed Charge Coverage Ratio (our "financial covenants"). A failure to maintain our financial covenants would impair our ability to borrow under the credit facility. These financial covenants are described below:

- Our Leverage Ratio (the ratio of Net Debt to Adjusted EBITDA, as defined in the credit facility) was 2.45 to 1 as of February 3, 2018. If this ratio were to exceed 3.50 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.
- Our Fixed Charge Coverage Ratio (the ratio of Adjusted EBITDA plus Consolidated Rental Expense to Consolidated Cash Interest Expense plus Consolidated Rental Expense, as defined in the credit facility) was 4.49 to 1 as of February 3, 2018. If this ratio fell below 1.70 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.

Our credit facility is more fully described in Note 6 to the Consolidated Financial Statements. We were in compliance with our financial covenants at year-end 2017.

The tables below illustrate our significant contractual obligations and other commercial commitments, based on year of maturity or settlement, as of February 3, 2018 (in millions of dollars):

	2018	2019	2020	2021	2022	Thereafter	Total
<b>Contractual Obligations</b> <sup>(1)(2)</sup>							
Long-term debt <sup>(3)</sup>	\$ 3,509	\$ 1,243	\$ 721	\$ 795	\$ 897	\$ 7,622	\$ 14,787
Interest on long-term debt <sup>(4)</sup>	427	496	440	396	364	4,411	6,534
Capital lease obligations	88	78	74	71	68	692	1,071
Operating lease obligations	992	936	838	736	606	3,664	7,772
Financed lease obligations	8	8	9	9	9	43	86
Self-insurance liability <sup>(5)</sup>	234	142	98	65	41	115	695
Construction commitments <sup>(6)</sup>	616	—	—	—	—	—	616
Purchase obligations <sup>(7)</sup>	455	129	88	44	37	48	801
<b>Total</b>	<b>\$ 6,329</b>	<b>\$ 3,032</b>	<b>\$ 2,268</b>	<b>\$ 2,116</b>	<b>\$ 2,022</b>	<b>\$ 16,595</b>	<b>\$ 32,362</b>
<b>Other Commercial Commitments</b>							
Standby letters of credit	\$ 222	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 222
Surety bonds	412	—	—	—	—	—	412
<b>Total</b>	<b>\$ 634</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 634</b>

- (1) The contractual obligations table excludes funding of pension and other postretirement benefit obligations, which totaled approximately \$1.0 billion in 2017. This table also excludes contributions under various multi-employer pension plans, which totaled \$954 million in 2017.
- (2) The liability related to unrecognized tax benefits has been excluded from the contractual obligations table because a reasonable estimate of the timing of future tax settlements cannot be determined.
- (3) As of February 3, 2018, we had \$2.1 billion of commercial paper and no borrowings under our credit facility.
- (4) Amounts include contractual interest payments using the interest rate as of February 3, 2018, and stated fixed and swapped interest rates, if applicable, for all other debt instruments.
- (5) The amounts included in the contractual obligations table for self-insurance liability related to workers' compensation claims have been stated on a present value basis.
- (6) Amounts include funds owed to third parties for projects currently under construction. These amounts are reflected in other current liabilities in our Consolidated Balance Sheets.
- (7) Amounts include commitments, many of which are short-term in nature, to be utilized in the normal course of business, such as several contracts to purchase raw materials utilized in our food production plants and several contracts to purchase energy to be used in our stores and food production plants. Our obligations also include management fees for facilities operated by third parties and outside service contracts. Any upfront vendor allowances or incentives associated with outstanding purchase commitments are recorded as either current or long-term liabilities in our Consolidated Balance Sheets.

As of February 3, 2018, we maintained a \$2.75 billion (with the ability to increase by \$1 billion), unsecured revolving credit facility that, unless extended, terminates on August 29, 2022. Outstanding borrowings under the credit facility, the commercial paper borrowings, and some outstanding letters of credit, reduce funds available under the credit facility. As of February 3, 2018, we had \$2.1 billion of outstanding commercial paper and no borrowings under our credit facility. The outstanding letters of credit that reduce funds available under our credit facility totaled \$6 million as of February 3, 2018.

In addition to the available credit mentioned above, as of February 3, 2018, we had authorized for issuance \$2.5 billion of securities remaining under a shelf registration statement filed with the SEC and effective on December 14, 2016.

We also maintain surety bonds related primarily to our self-insured workers' compensation claims. These bonds are required by most states in which we are self-insured for workers' compensation and are placed with predominately third-party insurance providers to insure payment of our obligations in the event we are unable to meet our claim payment obligations up to our self-insured retention levels. These bonds do not represent liabilities of ours, as we already have reserves on our books for the claims costs. Market changes may make the surety bonds more costly and, in some instances, availability of these bonds may become more limited, which could affect our costs of, or access to, such bonds. Although we do not believe increased costs or decreased availability would significantly affect our ability to access these surety bonds, if this does become an issue, we would issue letters of credit, in states where allowed, against our credit facility to meet the state bonding requirements. This could increase our cost and decrease the funds available under our credit facility.

We also are contingently liable for leases that have been assigned to various third parties in connection with facility closings and dispositions. We could be required to satisfy obligations under the leases if any of the assignees are unable to fulfill their lease obligations. Due to the wide distribution of our assignments among third parties, and various other remedies available to us, we believe the likelihood that we will be required to assume a material amount of these obligations is remote. We have agreed to indemnify certain third-party logistics operators for certain expenses, including multi-employer pension plan obligations and withdrawal liabilities.

In addition to the above, we enter into various indemnification agreements and take on indemnification obligations in the ordinary course of business. Such arrangements include indemnities against third party claims arising out of agreements to provide services to us; indemnities related to the sale of our securities; indemnities of directors, officers and employees in connection with the performance of their work; and indemnities of individuals serving as fiduciaries on benefit plans. While our aggregate indemnification obligation could result in a material liability, we are not aware of any current matter that could result in a material liability.

## **OUTLOOK**

This discussion and analysis contains certain forward-looking statements about our future performance. These statements are based on management's assumptions and beliefs in light of the information currently available to it. Such statements are indicated by words such as "will," "would," "could," "continue," "targeting," "range," "guidance," "assume," "possible," "estimate," "may," "expect," "goal," "should," "intend," "believe," "anticipate," "plan," and similar words or phrases. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially.

Statements elsewhere in this report and below regarding our expectations, projections, beliefs, intentions or strategies are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. 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 are targeting identical supermarket sales growth, excluding fuel, to range from 1.5% to 2.0% in 2018.
- We expect net earnings to range from \$1.95 to \$2.15 per diluted share for 2018.
- We expect capital investments, excluding mergers, acquisitions, and purchases of leased facilities, to be approximately \$3.0 billion in 2018.
- We expect our 2018 tax rate to be approximately 22%.

Various uncertainties and other factors could cause actual results to differ materially from those contained in the forward-looking statements. These include:

- The extent to which our sources of liquidity are sufficient to meet our requirements may be affected by the state of the financial markets and the effect that such condition has on our ability to issue commercial paper at acceptable rates. Our ability to borrow under our committed lines of credit, including our bank credit facilities, could be impaired if one or more of our lenders under those lines is unwilling or unable to honor its contractual obligation to lend to us, or in the event that natural disasters or weather conditions interfere with the ability of our lenders to lend to us. Our ability to refinance maturing debt may be affected by the state of the financial markets.
- Our ability to achieve sales, earnings and cash flow goals may be affected by: labor negotiations or disputes; changes in the types and numbers of businesses that compete with us; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition; our response to these actions; the state of the economy, including interest rates, the inflationary and deflationary trends in certain commodities, and the unemployment rate; the effect that fuel costs have on consumer spending; volatility of fuel margins; 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; our ability to retain pharmacy sales from third party payors; consolidation in the healthcare industry, including pharmacy benefit managers; our ability to negotiate modifications to multi-employer pension plans; natural disasters or adverse weather conditions; the potential costs and risks associated with potential cyber-attacks or data security breaches; the success of our future growth plans; the successful integration of our acquired companies; and the successful completion of the sale of our convenience stores business. Our ability to achieve sales and earnings goals may also be affected by our ability to manage the factors identified above. Our ability to execute our financial strategy may be affected by our ability to generate cash flow.
- 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.

We cannot fully foresee the effects of changes in economic conditions on our business. We have assumed economic and competitive situations will not change significantly in 2018.

Other factors and assumptions not identified above, including those discussed in Item 1A of this Report, 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.

## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of The Kroger Co.

### ***Opinions on the Financial Statements and Internal Control over Financial Reporting***

We have audited the accompanying consolidated balance sheets of The Kroger Co. and its subsidiaries as of February 3, 2018 and January 28, 2017, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended February 3, 2018, including the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of February 3, 2018, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of February 3, 2018 and January 28, 2017, and the results of their operations and their cash flows for each of the three years in the period ended February 3, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 3, 2018, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

#### ***Change in Accounting Principles***

As discussed in Note 19 to the consolidated financial statements, the Company changed the manner in which it accounts for deferred income taxes and the manner in which it accounts for goodwill impairments in 2017.

#### ***Basis for Opinions***

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing on page A-1. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### ***Definition and Limitations of Internal Control over Financial Reporting***

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*PricewaterhouseCoopers LLP*

Cincinnati, Ohio  
April 3, 2018

We have served as the Company's auditor since 1929.



**THE KROGER CO.  
CONSOLIDATED BALANCE SHEETS**

(In millions, except par amounts)	February 3, 2018	January 28, 2017
<b>ASSETS</b>		
Current assets		
Cash and temporary cash investments	\$ 347	\$ 322
Store deposits in-transit	1,161	910
Receivables	1,637	1,649
FIFO inventory	7,781	7,852
LIFO reserve	(1,248)	(1,291)
Assets held for sale	604	—
Prepaid and other current assets	835	898
Total current assets	11,117	10,340
Property, plant and equipment, net	21,071	21,016
Intangibles, net	1,100	1,153
Goodwill	2,925	3,031
Other assets	984	965
Total Assets	<u>\$ 37,197</u>	<u>\$ 36,505</u>
<b>LIABILITIES</b>		
Current liabilities		
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 3,560	\$ 2,252
Trade accounts payable	5,858	5,818
Accrued salaries and wages	1,099	1,234
Deferred income taxes	—	251
Liabilities held for sale	259	—
Other current liabilities	3,421	3,305
Total current liabilities	14,197	12,860
Long-term debt including obligations under capital leases and financing obligations	12,029	11,825
Deferred income taxes	1,568	1,927
Pension and postretirement benefit obligations	792	1,524
Other long-term liabilities	1,706	1,659
Total Liabilities	30,292	29,795
Commitments and contingencies (see Note 13)		
<b>SHAREHOLDERS' EQUITY</b>		
Preferred shares, \$100 per share, 5 shares authorized and unissued	—	—
Common shares, \$1 par per share, 2,000 shares authorized; 1,918 shares issued in 2017 and 2016	1,918	1,918
Additional paid-in capital	3,161	3,070
Accumulated other comprehensive loss	(471)	(715)
Accumulated earnings	17,007	15,543
Common shares in treasury, at cost, 1,048 shares in 2017 and 994 shares in 2016	(14,684)	(13,118)
Total Shareholders' Equity - The Kroger Co.	6,931	6,698
Noncontrolling interests	(26)	12
Total Equity	6,905	6,710
Total Liabilities and Equity	<u>\$ 37,197</u>	<u>\$ 36,505</u>

The accompanying notes are an integral part of the consolidated financial statements.

**THE KROGER CO.  
CONSOLIDATED STATEMENTS OF OPERATIONS**

Years Ended February 3, 2018, January 28, 2017 and January 30, 2016

(In millions, except per share amounts)	2017 (53 weeks)	2016 (52 weeks)	2015 (52 weeks)
Sales	\$ 122,662	\$ 115,337	\$ 109,830
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	95,662	89,502	85,496
Operating, general and administrative	21,568	19,178	17,946
Rent	911	881	723
Depreciation and amortization	2,436	2,340	2,089
Operating profit	2,085	3,436	3,576
Interest expense	601	522	482
Net earnings before income tax (benefit) expense	1,484	2,914	3,094
Income tax (benefit) expense	(405)	957	1,045
Net earnings including noncontrolling interests	1,889	1,957	2,049
Net earnings (loss) attributable to noncontrolling interests	(18)	(18)	10
Net earnings attributable to The Kroger Co.	<u>\$ 1,907</u>	<u>\$ 1,975</u>	<u>\$ 2,039</u>
Net earnings attributable to The Kroger Co. per basic common share	<u>\$ 2.11</u>	<u>\$ 2.08</u>	<u>\$ 2.09</u>
Average number of common shares used in basic calculation	895	942	966
Net earnings attributable to The Kroger Co. per diluted common share	<u>\$ 2.09</u>	<u>\$ 2.05</u>	<u>\$ 2.06</u>
Average number of common shares used in diluted calculation	904	958	980
Dividends declared per common share	\$ 0.495	\$ 0.465	\$ 0.408

The accompanying notes are an integral part of the consolidated financial statements.

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

Years Ended February 3, 2018, January 28, 2017 and January 30, 2016

(In millions)	2017 (53 weeks)	2016 (52 weeks)	2015 (52 weeks)
Net earnings including noncontrolling interests	\$ 1,889	\$ 1,957	\$ 2,049
<b>Other comprehensive income (loss)</b>			
Realized and unrealized gains and losses on available for sale securities, net of income tax <sup>(1)</sup>	4	(20)	3
Change in pension and other postretirement defined benefit plans, net of income tax <sup>(2)</sup>	214	(64)	131
Unrealized gains and losses on cash flow hedging activities, net of income tax <sup>(3)</sup>	23	47	(3)
Amortization of unrealized gains and losses on cash flow hedging activities, net of income tax <sup>(4)</sup>	3	2	1
<b>Total other comprehensive income (loss)</b>	<b>244</b>	<b>(35)</b>	<b>132</b>
<b>Comprehensive income</b>	<b>2,133</b>	<b>1,922</b>	<b>2,181</b>
Comprehensive gain (loss) attributable to noncontrolling interests	(18)	(18)	10
<b>Comprehensive income attributable to The Kroger Co.</b>	<b>\$ 2,151</b>	<b>\$ 1,940</b>	<b>\$ 2,171</b>

(1) Amount is net of tax expense (benefit) of \$1 in 2017, \$(16) in 2016 and \$2 in 2015.

(2) Amount is net of tax expense (benefit) of \$83 in 2017, \$(39) in 2016 and \$77 in 2015.

(3) Amount is net of tax expense (benefit) of \$0 in 2017, \$27 in 2016 and \$(2) in 2015.

(4) Amount is net of tax expense of \$3 in 2017.

The accompanying notes are an integral part of the consolidated financial statements.

**THE KROGER CO.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended February 3, 2018, January 28, 2017 and January 30, 2016

(In millions)	2017 (53 weeks)	2016 (52 weeks)	2015 (52 weeks)
<b>Cash Flows from Operating Activities:</b>			
Net earnings including noncontrolling interests	\$ 1,889	\$ 1,957	\$ 2,049
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	2,436	2,340	2,089
Asset impairment charge	71	26	46
LIFO (credit) charge	(8)	19	28
Stock-based employee compensation	151	141	165
Expense for company-sponsored pension plans	591	94	103
Goodwill impairment charge	110	—	—
Deferred income taxes	(694)	201	317
Other	8	(28)	54
Changes in operating assets and liabilities net of effects from mergers of businesses:			
Store deposits in-transit	(265)	13	95
Receivables	61	(110)	(59)
Inventories	(23)	(382)	(184)
Prepaid and other current assets	41	(172)	(28)
Trade accounts payable	158	16	440
Accrued expenses	(40)	(118)	275
Income taxes receivable and payable	(96)	261	(359)
Contribution to company-sponsored pension plans	(1,000)	—	(5)
Other	23	14	(109)
<b>Net cash provided by operating activities</b>	<b>3,413</b>	<b>4,272</b>	<b>4,917</b>
<b>Cash Flows from Investing Activities:</b>			
Payments for property and equipment, including payments for lease buyouts	(2,809)	(3,699)	(3,349)
Proceeds from sale of assets	138	132	45
Payments for mergers, net of cash acquired	(16)	(401)	(168)
Other	(20)	93	(98)
<b>Net cash used by investing activities</b>	<b>(2,707)</b>	<b>(3,875)</b>	<b>(3,570)</b>
<b>Cash Flows from Financing Activities:</b>			
Proceeds from issuance of long-term debt	1,523	2,781	1,181
Payments on long-term debt	(788)	(1,355)	(1,245)
Net borrowings (payments) on commercial paper	696	435	(285)
Dividends paid	(443)	(429)	(385)
Excess tax benefits on stock-based awards	—	—	97
Proceeds from issuance of capital stock	51	68	120
Treasury stock purchases	(1,633)	(1,766)	(703)
Investment in the remaining equity of a noncontrolling interest	—	—	(26)
Other	(87)	(86)	(92)
<b>Net cash used by financing activities</b>	<b>(681)</b>	<b>(352)</b>	<b>(1,338)</b>
<b>Net increase in cash and temporary cash investments</b>	<b>25</b>	<b>45</b>	<b>9</b>
<b>Cash and temporary cash investments:</b>			
Beginning of year	322	277	268
End of year	\$ 347	\$ 322	\$ 277
<b>Reconciliation of capital investments:</b>			
Payments for property and equipment, including payments for lease buyouts	\$ (2,809)	\$ (3,699)	\$ (3,349)
Payments for lease buyouts	13	5	35
Changes in construction-in-progress payables	(188)	72	(35)
<b>Total capital investments, excluding lease buyouts</b>	<b>\$ (2,984)</b>	<b>\$ (3,622)</b>	<b>\$ (3,349)</b>
<b>Disclosure of cash flow information:</b>			
Cash paid during the year for interest	\$ 656	\$ 505	\$ 474
Cash paid during the year for income taxes	\$ 348	\$ 557	\$ 1,001

The accompanying notes are an integral part of the consolidated financial statements

**THE KROGER CO.**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

Years Ended February 3, 2018, January 28, 2017 and January 30, 2016

(In millions, except per share amounts)	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Gain (Loss)	Accumulated Earnings	Noncontrolling Interest	Total
	Shares	Amount		Shares	Amount				
Balances at January 31, 2015	1,918	\$ 1,918	\$ 2,748	944	\$ (10,809)	\$ (812)	\$ 12,367	\$ 30	\$ 5,442
Issuance of common stock:									
Stock options exercised	—	—	—	(9)	120	—	—	—	120
Restricted stock issued	—	—	(122)	(5)	37	—	—	—	(85)
Treasury stock activity:									
Treasury stock purchases, at cost	—	—	—	14	(500)	—	—	—	(500)
Stock options exchanged	—	—	—	7	(203)	—	—	—	(203)
Share-based employee compensation	—	—	165	—	—	—	—	—	165
Other comprehensive gain net of income tax of \$77	—	—	—	—	—	132	—	—	132
Investment in the remaining equity of a non-controlling interest	—	—	26	—	—	—	—	(57)	(31)
Other	—	—	163	—	(54)	—	—	(5)	104
Cash dividends declared (\$0.408 per common share)	—	—	—	—	—	—	(395)	—	(395)
Net earnings including non-controlling interests	—	—	—	—	—	—	2,039	10	2,049
Balances at January 30, 2016	1,918	\$ 1,918	\$ 2,980	951	\$ (11,409)	\$ (680)	\$ 14,011	\$ (22)	\$ 6,798
Issuance of common stock:									
Stock options exercised	—	—	(1)	(5)	68	—	—	—	67
Restricted stock issued	—	—	(116)	(3)	57	—	—	—	(59)
Treasury stock activity:									
Treasury stock purchases, at cost	—	—	—	47	(1,661)	—	—	—	(1,661)
Stock options exchanged	—	—	—	4	(105)	—	—	—	(105)
Share-based employee compensation	—	—	141	—	—	—	—	—	141
Other comprehensive loss net of income tax of \$(28)	—	—	—	—	—	(35)	—	—	(35)
Other	—	—	66	—	(68)	—	—	52	50
Cash dividends declared (\$0.465 per common share)	—	—	—	—	—	—	(443)	—	(443)
Net earnings (loss) including non-controlling interests	—	—	—	—	—	—	1,975	(18)	1,957
Balances at January 28, 2017	1,918	\$ 1,918	\$ 3,070	994	\$ (13,118)	\$ (715)	\$ 15,543	\$ 12	\$ 6,710
Issuance of common stock:									
Stock options exercised	—	—	—	(4)	51	—	—	—	51
Restricted stock issued	—	—	(119)	(2)	85	—	—	—	(34)
Treasury stock activity:									
Treasury stock purchases, at cost	—	—	—	58	(1,567)	—	—	—	(1,567)
Stock options exchanged	—	—	—	2	(66)	—	—	—	(66)
Share-based employee compensation	—	—	151	—	—	—	—	—	151
Other comprehensive gain net of income tax of \$87	—	—	—	—	—	244	—	—	244
Other	—	—	59	—	(69)	—	—	(20)	(30)
Cash dividends declared (\$0.495 per common share)	—	—	—	—	—	—	(443)	—	(443)
Net earnings (loss) including non-controlling interests	—	—	—	—	—	—	1,907	(18)	1,889
Balances at February 3, 2018	1,918	\$ 1,918	\$ 3,161	1,048	\$ (14,684)	\$ (471)	\$ 17,007	\$ (26)	\$ 6,905

The accompanying notes are an integral part of the consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

### 1. ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in preparing these financial statements.

#### *Description of Business, Basis of Presentation and Principles of Consolidation*

The Kroger Co. (the “Company”) was founded in 1883 and incorporated in 1902. As of February 3, 2018, the Company was one of the largest retailers in the world based on annual sales. The Company also manufactures and processes food for sale by its supermarkets. The accompanying financial statements include the consolidated accounts of the Company, its wholly-owned subsidiaries and the variable interest entities in which the Company is the primary beneficiary. Intercompany transactions and balances have been eliminated.

On June 25, 2015, the Company’s Board of Directors approved a two-for-one stock split of the Company’s common shares in the form of a 100% stock dividend, which was effective July 13, 2015. All share and per share amounts in the Company’s Consolidated Financial Statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

Refer to Note 19 for a description of changes to the Consolidated Statement of Operations and Consolidated Statement of Cash Flows for a recently adopted accounting standard regarding the presentation of employee share-based compensation payments.

#### *Fiscal Year*

The Company’s fiscal year ends on the Saturday nearest January 31. The last three fiscal years consist of the 53-week period ended February 3, 2018 and 52-week periods ended January 30, 2016 and January 31, 2015.

#### *Pervasiveness of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of consolidated revenues and expenses during the reporting period is also required. Actual results could differ from those estimates.

#### *Cash, Temporary Cash Investments and Book Overdrafts*

Cash and temporary cash investments represent store cash and short-term investments with original maturities of less than three months. Book overdrafts are included in “Trade accounts payable” and “Accrued salaries and wages” in the Consolidated Balance Sheets.

#### *Deposits In-Transit*

Deposits in-transit generally represent funds deposited to the Company’s bank accounts at the end of the year related to sales, a majority of which were paid for with debit cards, credit cards and checks, to which the Company does not have immediate access but settle within a few days of the sales transaction.

## *Inventories*

Inventories are stated at the lower of cost (principally on a last-in, first-out “LIFO” basis) or market. In total, approximately 93% of inventories in 2017 and 89% of inventories in 2016 were valued using the LIFO method. The remaining inventories, including substantially all fuel inventories, are stated at the lower of cost (on a FIFO basis) or net realizable value. Replacement cost was higher than the carrying amount by \$1,248 at February 3, 2018 and \$1,291 at January 28, 2017. The Company follows the Link-Chain, Dollar-Value LIFO method for purposes of calculating its LIFO charge or credit.

The item-cost method of accounting to determine inventory cost before the LIFO adjustment is followed for substantially all store inventories at the Company’s supermarket divisions. This method involves counting each item in inventory, assigning costs to each of these items based on the actual purchase costs (net of vendor allowances and cash discounts) of each item and recording the cost of items sold. The item-cost method of accounting allows for more accurate reporting of periodic inventory balances and enables management to more precisely manage inventory. In addition, substantially all of the Company’s inventory consists of finished goods and is recorded at actual purchase costs (net of vendor allowances and cash discounts).

The Company evaluates inventory shortages throughout the year based on actual physical counts in its facilities. Allowances for inventory shortages are recorded based on the results of these counts to provide for estimated shortages as of the financial statement date.

## *Property, Plant and Equipment*

Property, plant and equipment are recorded at cost or, in the case of assets acquired in a business combination, at fair value. Depreciation and amortization expense, which includes the depreciation of assets recorded under capital leases, is computed principally using the straight-line method over the estimated useful lives of individual assets. Buildings and land improvements are depreciated based on lives varying from 10 to 40 years. All new purchases of store equipment are assigned lives varying from three to nine years. Leasehold improvements are amortized over the shorter of the lease term to which they relate, which generally varies from four to 25 years, or the useful life of the asset. Food production plant and distribution center equipment is depreciated over lives varying from three to 15 years. Information technology assets are generally depreciated over five years. Depreciation and amortization expense was \$2,436 in 2017, \$2,340 in 2016 and \$2,089 in 2015.

Interest costs on significant projects constructed for the Company’s own use are capitalized as part of the costs of the newly constructed facilities. Upon retirement or disposal of assets, the cost and related accumulated depreciation and amortization are removed from the balance sheet and any gain or loss is reflected in net earnings. Refer to Note 4 for further information regarding the Company’s property, plant and equipment.

## *Deferred Rent*

The Company recognizes rent holidays, including the time period during which the Company has access to the property for construction of buildings or improvements and escalating rent provisions on a straight-line basis over the term of the lease. The deferred amount is included in “Other current liabilities” and “Other long-term liabilities” on the Company’s Consolidated Balance Sheets.

## *Goodwill*

The Company reviews goodwill for impairment during the fourth quarter of each year, and also upon the occurrence of a triggering event. The Company performs reviews of each of its operating divisions and variable interest entities (collectively, “reporting units”) that have goodwill balances. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and is compared to the carrying value of a reporting unit for purposes of identifying potential impairment. Projected future cash flows are based on management’s knowledge of the current operating environment and expectations for the future. Goodwill impairment is recognized for any excess of the carrying value of the reporting unit’s goodwill over the fair value, not to exceed the total amount of goodwill allocated to the reporting unit. Results of the goodwill impairment reviews performed during 2017, 2016 and 2015 are summarized in Note 3.



### *Impairment of Long-Lived Assets*

The Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether certain triggering events have occurred. These events include current period losses combined with a history of losses or a projection of continuing losses or a significant decrease in the market value of an asset. When a triggering event occurs, an impairment calculation is performed, comparing projected undiscounted future cash flows, utilizing current cash flow information and expected growth rates related to specific stores, to the carrying value for those stores. If the Company identifies impairment for long-lived assets to be held and used, the Company compares the assets' current carrying value to the assets' fair value. Fair value is based on current market values or discounted future cash flows. The Company records impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for disposal, the value of the property and equipment is adjusted to reflect recoverable values based on previous efforts to dispose of similar assets and current economic conditions. Impairment is recognized for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. The Company recorded asset impairments in the normal course of business totaling \$71, \$26 and \$46 in 2017, 2016 and 2015, respectively. Costs to reduce the carrying value of long-lived assets for each of the years presented have been included in the Consolidated Statements of Operations as "Operating, general and administrative" expense.

### *Store Closing Costs*

The Company provides for closed store liabilities relating to the present value of the estimated remaining non-cancellable lease payments after the closing date, net of estimated subtenant income. The Company estimates the net lease liabilities using a discount rate to calculate the present value of the remaining net rent payments on closed stores. The closed store lease liabilities usually are paid over the lease terms associated with the closed stores, which generally have remaining terms ranging from one to 20 years. Adjustments to closed store liabilities primarily relate to changes in subtenant income and actual exit costs differing from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known. Store closing liabilities are reviewed quarterly to ensure that any accrued amount that is not a sufficient estimate of future costs is adjusted to income in the proper period.

Owned stores held for disposal are reduced to their estimated net realizable value. Costs to reduce the carrying values of property, equipment and leasehold improvements are accounted for in accordance with the Company's policy on impairment of long-lived assets. Inventory write-downs, if any, in connection with store closings, are classified in the Consolidated Statements of Operations as "Merchandise costs." Costs to transfer inventory and equipment from closed stores are expensed as incurred.

The current portion of the future lease obligations of stores is included in "Other current liabilities," and the long-term portion is included in "Other long-term liabilities" in the Consolidated Balance Sheets.

### *Interest Rate Risk Management*

The Company uses derivative instruments primarily to manage its exposure to changes in interest rates. The Company's current program relative to interest rate protection and the methods by which the Company accounts for its derivative instruments are described in Note 7.

### *Benefit Plans and Multi-Employer Pension Plans*

The Company recognizes the funded status of its retirement plans on the Consolidated Balance Sheets. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized as part of net periodic benefit cost are required to be recorded as a component of Accumulated Other Comprehensive Income ("AOCI"). All plans are measured as of the Company's fiscal year end.

The determination of the obligation and expense for company-sponsored pension plans and other post-retirement benefits is dependent on the selection of assumptions used by actuaries and the Company in calculating those amounts. Those assumptions are described in Note 15 and include, among others, the discount rate, the expected long-term rate of return on plan assets, mortality and the rates of increase in compensation and health care costs. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in future periods. While the Company believes that the assumptions are appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the pension and other post-retirement obligations and future expense.

The Company also participates in various multi-employer plans for substantially all union employees. Pension expense for these plans is recognized as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. Refer to Note 16 for additional information regarding the Company's participation in these various multi-employer pension plans.

The Company administers and makes contributions to the employee 401(k) retirement savings accounts. Contributions to the employee 401(k) retirement savings accounts are expensed when contributed. Refer to Note 15 for additional information regarding the Company's benefit plans.

#### *Share Based Compensation*

The Company accounts for stock options under fair value recognition provisions. Under this method, the Company recognizes compensation expense for all share-based payments granted. The Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award. In addition, the Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying stock on the grant date of the award, over the period the awards lapse. Excess tax benefits related to share-based payments are recognized in the provision for income taxes. Refer to Note 12 for additional information regarding the Company's stock based compensation.

#### *Deferred Income Taxes*

Deferred income taxes are recorded to reflect the tax consequences of differences between the tax basis of assets and liabilities and their financial reporting basis. Refer to Note 5 for the types of differences that give rise to significant portions of deferred income tax assets and liabilities. Beginning in 2017, the Company classified all deferred tax liabilities and assets as noncurrent (see Note 5).

#### *Uncertain Tax Positions*

The Company reviews the tax positions taken or expected to be taken on tax returns to determine whether and to what extent a benefit can be recognized in its consolidated financial statements. Refer to Note 5 for the amount of unrecognized tax benefits and other related disclosures related to uncertain tax positions.

Various taxing authorities periodically audit the Company's income tax returns. These audits include questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income to various tax jurisdictions. In evaluating the exposures connected with these various tax filing positions, including state and local taxes, the Company records allowances for probable exposures. A number of years may elapse before a particular matter, for which an allowance has been established, is audited and fully resolved. As of February 3, 2018, the Internal Revenue Service had concluded its examination of our 2012 and 2013 federal tax returns.

The assessment of the Company's tax position relies on the judgment of management to estimate the exposures associated with the Company's various filing positions.

### Self-Insurance Costs

The Company is primarily self-insured for costs related to workers' compensation and general liability claims. Liabilities are actuarially determined and are recognized based on claims filed and an estimate of claims incurred but not reported. The liabilities for workers' compensation claims are accounted for on a present value basis. The Company has purchased stop-loss coverage to limit its exposure to any significant exposure on a per claim basis. The Company is insured for covered costs in excess of these per claim limits.

The following table summarizes the changes in the Company's self-insurance liability through February 3, 2018.

	2017	2016	2015
Beginning balance	\$ 682	\$ 639	\$ 599
Expense	247	263	234
Claim payments	(234)	(220)	(225)
Assumed from mergers	—	—	31
Ending balance	695	682	639
Less: Current portion	(234)	(229)	(223)
Long-term portion	\$ 461	\$ 453	\$ 416

The current portion of the self-insured liability is included in "Other current liabilities," and the long-term portion is included in "Other long-term liabilities" in the Consolidated Balance Sheets.

The Company maintains surety bonds related to self-insured workers' compensation claims. These bonds are required by most states in which the Company is self-insured for workers' compensation and are placed with third-party insurance providers to insure payment of the Company's obligations in the event the Company is unable to meet its claim payment obligations up to its self-insured retention levels. These bonds do not represent liabilities of the Company, as the Company has recorded reserves for the claim costs.

The Company is similarly self-insured for property-related losses. The Company maintains stop loss coverage to limit its property loss exposures including coverage for earthquake, wind, flood and other catastrophic events.

### Revenue Recognition

Revenues from the sale of products are recognized at the point of sale. Discounts provided to customers by the Company at the time of sale, including those provided in connection with loyalty cards, are recognized as a reduction in sales as the products are sold. Discounts provided by vendors, usually in the form of paper coupons, are not recognized as a reduction in sales provided the coupons are redeemable at any retailer that accepts coupons. The Company records a receivable from the vendor for the difference in sales price and cash received. Pharmacy sales are recorded when product is provided to the customer. Sales taxes are recorded as other accrued liabilities and not as a component of sales. The Company does not recognize a sale when it sells its own gift cards and gift certificates. Rather, it records a deferred liability equal to the amount received. A sale is then recognized when the gift card or gift certificate is redeemed to purchase the Company's products. In 2016, the Company began recognizing gift card and gift certificate breakage under the proportional method, where recognition of breakage income is based upon the historical run-off rate of unredeemed gift cards and gift certificates. Prior to 2016, gift card and gift certificate breakage was recognized under the remote method, where breakage income is recognized when redemption is unlikely to occur and there is no legal obligation to remit the value of the unredeemed gift cards or gift certificates. The amount of breakage was not material for 2017, 2016 and 2015.

### *Merchandise Costs*

The “Merchandise costs” line item of the Consolidated Statements of Operations includes product costs, net of discounts and allowances; advertising costs (see separate discussion below); inbound freight charges; warehousing costs, including receiving and inspection costs; transportation costs; and food production and operational costs. Warehousing, transportation and manufacturing management salaries are also included in the “Merchandise costs” line item; however, purchasing management salaries and administration costs are included in the “Operating, general and administrative” line item along with most of the Company’s other managerial and administrative costs. Rent expense and depreciation and amortization expense are shown separately in the Consolidated Statements of Operations.

Warehousing and transportation costs include distribution center direct wages, transportation direct wages, repairs and maintenance, utilities, inbound freight and, where applicable, third party warehouse management fees. These costs are recognized in the periods the related expenses are incurred.

The Company believes the classification of costs included in merchandise costs could vary widely throughout the industry. The Company’s approach is to include in the “Merchandise costs” line item the direct, net costs of acquiring products and making them available to customers in its stores. The Company believes this approach most accurately presents the actual costs of products sold.

The Company recognizes all vendor allowances as a reduction in merchandise costs when the related product is sold. When possible, vendor allowances are applied to the related product cost by item and, therefore, reduce the carrying value of inventory by item. When the items are sold, the vendor allowance is recognized. When it is not possible, due to systems constraints, to allocate vendor allowances to the product by item, vendor allowances are recognized as a reduction in merchandise costs based on inventory turns and, therefore, recognized as the product is sold.

### *Advertising Costs*

The Company’s advertising costs are recognized in the periods the related expenses are incurred and are included in the “Merchandise costs” line item of the Consolidated Statements of Operations. The Company’s pre-tax advertising costs totaled \$707 in 2017, \$717 in 2016 and \$679 in 2015. The Company does not record vendor allowances for co-operative advertising as a reduction of advertising expense.

### *Operating, General and Administrative Expenses*

Operating, general and administrative (“OG&A”) expenses include all operating costs of the Company, except merchandise costs, as described above, and rent and depreciation and amortization. Certain other income items are classified as a reduction of OG&A costs. These include items such as gift card and lottery commissions, coupon processing and vending machine fees, check cashing, money order and wire transfer fees, and baled salvage credits.

### *Consolidated Statements of Cash Flows*

For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be temporary cash investments.

## Segments

The Company operates supermarkets, multi-department stores, jewelry stores, and convenience stores throughout the United States. The Company's retail operations, which represent over 97% of the Company's consolidated sales are its only reportable segment. The Company's operating divisions have been aggregated into one reportable segment due to the operating divisions having similar economic characteristics with similar long-term financial performance. In addition, the Company's operating divisions offer customers similar products, have similar distribution methods, operate in similar regulatory environments, purchase the majority of the merchandise for retail sale from similar (and in many cases identical) vendors on a coordinated basis from a centralized location, serve similar types of customers, and are allocated capital from a centralized location. Operating divisions are organized primarily on a geographical basis so that the operating division management team can be responsive to local needs of the operating division and can execute company strategic plans and initiatives throughout the locations in the operating division. The geographical separation is the primary differentiation between these operating divisions. The Company's geographic basis of organization reflects the manner in which the business is managed and how the Company's Chief Executive Officer, who acts as the Company's chief operating decision maker, assesses performance internally. All of the Company's operations are domestic.

The following table presents sales revenue by type of product for 2017, 2016 and 2015.

	2017		2016		2015	
	Amount	% of total	Amount	% of total	Amount	% of total
Non Perishable <sup>(1)</sup>	\$ 62,378	50.9 %	\$ 60,220	52.2 %	\$ 57,187	52.1 %
Perishable <sup>(2)</sup>	29,145	23.8 %	27,666	24.0 %	25,726	23.4 %
Fuel	16,246	13.2 %	13,979	12.1 %	14,802	13.5 %
Pharmacy	10,752	8.8 %	10,432	9.0 %	9,778	8.9 %
Other <sup>(3)</sup>	4,141	3.3 %	3,040	2.7 %	2,337	2.1 %
<b>Total Sales and other revenue</b>	<b>\$ 122,662</b>	<b>100 %</b>	<b>\$ 115,337</b>	<b>100 %</b>	<b>\$ 109,830</b>	<b>100 %</b>

(1) Consists primarily of grocery, general merchandise, health and beauty care and natural foods.

(2) Consists primarily of produce, floral, meat, seafood, deli, bakery and fresh prepared.

(3) Consists primarily of sales related to jewelry stores, food production plants to outside customers, data analytic services, variable interest entities, specialty pharmacy, in-store health clinics, digital coupon services and online sales by Vitacost.com.

## 2. MERGERS

On September 2, 2016, the Company closed its merger with Modern HC Holdings, Inc. ("ModernHEALTH") by purchasing 100% of the outstanding shares of ModernHEALTH for \$407. This merger allows the Company to expand its specialty pharmacy services by significantly increasing geographic reach and patient therapies. The merger was accounted for under the purchase method of accounting and was financed through the issuance of commercial paper. In a business combination, the purchase price is allocated to assets acquired and liabilities assumed based on their fair values, with any excess of purchase price over fair value recognized as goodwill. In addition to recognizing the assets and liabilities on the acquired company's balance sheet, the Company reviews supply contracts, leases, financial instruments, employment agreements and other significant agreements to identify potential assets or liabilities that require recognition in connection with the application of acquisition accounting under Accounting Standards Codification ("ASC") 805. Intangible assets are recognized apart from goodwill when the asset arises from contractual or other legal rights, or are separable from the acquired entity such that they may be sold, transferred, licensed, rented or exchanged either on a standalone basis or in combination with a related contract, asset or liability.

The Company's purchase price allocation was finalized in the third quarter of 2017. The changes in the fair values assumed from the preliminary amounts determined as of September 2, 2016 were a decrease in goodwill of \$2, a decrease in current liabilities of \$2. The table below summarizes the final fair value of the assets acquired and liabilities assumed:

	September 2, 2016
<b>ASSETS</b>	
Total current assets	\$ 82
Property, plant and equipment	8
Intangibles	<u>136</u>
Total Assets, excluding Goodwill	226
<b>LIABILITIES</b>	
Total current liabilities	(68)
Fair-value of long-term debt including obligations under capital leases and financing obligations	(1)
Deferred income taxes	<u>(33)</u>
Total Liabilities	<u>(102)</u>
Total Identifiable Net Assets	124
Goodwill	283
Total Purchase Price	<u>\$ 407</u>

Of the \$136 allocated to intangible assets, the Company recorded \$131 and \$5 related to pharmacy prescription files and distribution agreements, respectively. The Company will amortize the pharmacy prescription files and distribution agreements, using the straight line method, over 10 years. The goodwill recorded as part of the merger was attributable to the assembled workforce of ModernHEALTH and operational synergies expected from the merger, as well as any intangible assets that did not qualify for separate recognition. The merger was treated as a stock purchase for income tax purposes. The assets acquired and liabilities assumed as part of the merger did not result in a step up of tax basis and goodwill is not expected to be deductible for tax purposes.

On December 18, 2015, the Company closed its merger with Roundy's by purchasing 100% of Roundy's outstanding common stock for \$3.60 per share and assuming Roundy's outstanding debt, for a purchase price of \$866. The merger brings a complementary store base in communities throughout Wisconsin and a stronger presence in the greater Chicagoland area. The merger was accounted for under the purchase method of accounting and was financed through a combination of commercial paper and long-term debt.

The Company's purchase price allocation was finalized in the fourth quarter of 2016. The changes in the fair values assumed from the preliminary amounts determined as of December 18, 2015 were a decrease in goodwill of \$13, a decrease in current liabilities of \$8 and a decrease in deferred tax liabilities of \$5. The table below summarizes the final fair value of the assets acquired and liabilities assumed:

	December 18, 2015
<b>ASSETS</b>	
Cash and temporary cash investments	\$ 20
Store deposits in-transit	30
Receivables	43
FIFO inventory	323
Prepaid and other current assets	19
Total current assets	<u>435</u>
Property, plant and equipment	342
Intangibles	324
Other assets	<u>4</u>
Total Assets, excluding Goodwill	1,105
<b>LIABILITIES</b>	
Current portion of obligations under capital leases and financing obligations	(9)
Trade accounts payable	(236)
Accrued salaries and wages	(40)
Other current liabilities	(81)
Total current liabilities	<u>(366)</u>
Fair-value of long-term debt	(678)
Fair-value of long-term obligations under capital leases and financing obligations	(20)
Deferred income taxes	(107)
Pension and postretirement benefit obligations	(36)
Other long-term liabilities	<u>(111)</u>
Total Liabilities	<u>(1,318)</u>
Total Identifiable Net Liabilities	(213)
Goodwill	401
Total Purchase Price	<u>\$ 188</u>

Of the \$324 allocated to intangible assets, \$211 relates to the Mariano's®, Pick 'n Save®, Metro Market and Copps™ trade names, to which was assigned an indefinite life and, therefore, will not be amortized. The Company also recorded \$69, \$38, and \$6 related to favorable leasehold interests, pharmacy prescription files and customer lists, respectively. The Company will amortize the favorable leasehold interests over a weighted average of twelve years. The Company will amortize the pharmacy prescription files and customer lists over seven and two years, respectively, on a straight-line basis. The goodwill recorded as part of the merger was attributable to the assembled workforce of Roundy's and operational synergies expected from the merger, as well as any intangible assets that do not qualify for separate recognition. The transaction was treated as a stock purchase for income tax purposes. The assets acquired and liabilities assumed as part of the merger did not result in a step up of the tax basis and goodwill is not expected to be deductible for tax purposes.



Pro forma results of operations for 2016 and 2015, assuming the Roundy's transaction had taken place at the beginning of 2014 and the ModernHEALTH merger had taken place at the beginning of 2015, are included in the following table. 2017 is not included in the following table as the entities are included within the Company's consolidated results for the entire fiscal year. The pro forma information includes historical results of operations of Roundy's and ModernHEALTH, as well as adjustments for interest expense that would have been incurred due to financing the mergers, depreciation and amortization of the assets acquired and excludes the pre-merger transaction related expenses incurred by Roundy's and ModernHEALTH and the Company. The pro forma information does not include efficiencies, cost reductions, synergies or investments in lower prices for our customers expected to result from the mergers. The unaudited pro forma financial information is not necessarily indicative of the results that actually would have occurred had the Roundy's merger completed at the beginning of 2014 or the ModernHEALTH merger completed at beginning of 2015.

	Fiscal year ended January 28, 2017	Fiscal year ended January 30, 2016
Sales	\$ 115,994	\$ 114,341
Net earnings including noncontrolling interests	1,958	2,059
Net earnings (loss) attributable to noncontrolling interests	<u>(18)</u>	<u>10</u>
Net earnings attributable to The Kroger Co.	<u>\$ 1,976</u>	<u>\$ 2,049</u>

### 3. GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the changes in the Company's net goodwill balance through February 3, 2018.

	2017	2016
Balance beginning of year		
Goodwill	\$ 5,563	\$ 5,256
Accumulated impairment losses	<u>(2,532)</u>	<u>(2,532)</u>
	<u>3,031</u>	<u>2,724</u>
Activity during the year		
Mergers	18	307
Impairment losses	(110)	—
Held for sale adjustment	<u>(14)</u>	<u>—</u>
Balance end of year		
Goodwill	5,567	5,563
Accumulated impairment losses	<u>(2,642)</u>	<u>(2,532)</u>
	<u>\$ 2,925</u>	<u>\$ 3,031</u>

In 2017, certain assets and liabilities including goodwill totaling \$14, primarily those related to the Company's convenience store business, were classified as held for sale in the Consolidated Balance Sheet as a result of the exploration of strategic alternatives (see Note 17).

In 2016, the Company acquired all of the outstanding shares of ModernHEALTH (see Note 2) resulting in additional goodwill totaling \$285. In 2017, the Company finalized its ModernHEALTH purchase allocation resulting in a decrease in goodwill before impairment consideration of \$2 (see Note 2).

Testing for impairment must be performed annually, or on an interim basis upon the occurrence of a triggering event or a change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying amount, in accordance with the newly adopted Accounting Standards Update ("ASU") 2017-04 "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The annual evaluations of goodwill and indefinite-lived intangible assets performed during the fourth quarter of 2016 and 2015 did not result in impairment.

Based on the results of the Company's impairment assessment in the fourth quarter of 2017, the Kroger Specialty Pharmacy reporting unit was the only reporting unit for which there was a potential impairment. In the fourth quarter of 2017, the operating performance of the Kroger Specialty Pharmacy reporting unit began to be affected by reduced margins as a result of compression in reimbursement by third party payers and a reduction of certain types of revenue. As a result of this decline, particularly in future expected cash flows, along with comparable fair value information, management concluded that the carrying value of goodwill for Kroger Specialty Pharmacy reporting unit exceeded its fair value, resulting in a pre-tax impairment charge of \$110 (\$74 after-tax). The pre-impairment goodwill balance for Kroger Specialty Pharmacy was \$353, as of the fourth quarter 2017. Based on current and future expected cash flows, the Company believes additional goodwill impairments are not reasonably likely. A 10% reduction in fair value of the Company's reporting units would not indicate a potential for impairment of the Company's recorded goodwill balance.

In 2016, the Company acquired definite and indefinite lived intangible assets totaling approximately \$136 as a result of the merger with ModernHEALTH (see Note 2).

The following table summarizes the Company's intangible assets balance through February 3, 2018.

	2017		2016	
	Gross carrying amount	Accumulated amortization <sup>(1)</sup>	Gross carrying amount	Accumulated amortization <sup>(1)</sup>
Definite-lived favorable leasehold interests	\$ 174	\$ (53)	\$ 167	\$ (41)
Definite-lived pharmacy prescription files	238	(70)	254	(56)
Definite-lived customer relationships	93	(67)	93	(55)
Definite-lived other	99	(44)	97	(33)
Indefinite-lived trade name	641	—	641	—
Indefinite-lived liquor licenses	89	—	86	—
<b>Total</b>	<b>\$ 1,334</b>	<b>\$ (234)</b>	<b>\$ 1,338</b>	<b>\$ (185)</b>

(1) Favorable leasehold interests are amortized to rent expense, pharmacy prescription files are amortized to merchandise costs, customer relationships are amortized to depreciation and amortization expense and other intangibles are amortized to operating, general and administrative ("OG&A") expense and depreciation and amortization expense.

Amortization expense associated with intangible assets totaled approximately \$59, \$63 and \$51, during fiscal years 2017, 2016 and 2015, respectively. Future amortization expense associated with the net carrying amount of definite-lived intangible assets for the years subsequent to 2017 is estimated to be approximately:

2018	\$ 55
2019	50
2020	47
2021	36
2022	33
Thereafter	149
<b>Total future estimated amortization associated with definite-lived intangible assets</b>	<b>\$ 370</b>

#### 4. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consists of:

	2017	2016
Land	\$ 3,201	\$ 3,197
Buildings and land improvements	12,072	11,643
Equipment	13,635	13,495
Leasehold improvements	9,773	9,342
Construction-in-progress	2,050	1,979
Leased property under capital leases and financing obligations	1,000	932
Total property, plant and equipment	41,731	40,588
Accumulated depreciation and amortization	(20,660)	(19,572)
Property, plant and equipment, net	<u>\$ 21,071</u>	<u>\$ 21,016</u>

Accumulated depreciation and amortization for leased property under capital leases was \$354 at February 3, 2018 and \$330 at January 28, 2017.

Approximately \$177 and \$219, net book value, of property, plant and equipment collateralized certain mortgages at February 3, 2018 and January 28, 2017, respectively.

#### 5. TAXES BASED ON INCOME

The provision for taxes based on income consists of:

	2017	2016	2015
Federal			
Current	\$ 309	\$ 721	\$ 723
Deferred	(747)	158	266
Subtotal federal	(438)	879	989
State and local			
Current	15	51	37
Deferred	18	27	19
Subtotal state and local	33	78	56
Total	<u>\$ (405)</u>	<u>\$ 957</u>	<u>\$ 1,045</u>

A reconciliation of the statutory federal rate and the effective rate follows:

	2017	2016	2015
Statutory rate	33.7 %	35.0 %	35.0 %
State income taxes, net of federal tax benefit	1.7 %	1.6 %	1.2 %
Credits	(2.5)%	(1.1)%	(1.2)%
Favorable resolution of issues	— %	(0.5)%	(0.2)%
Domestic manufacturing deduction	(1.1)%	(0.7)%	(0.7)%
Excess tax benefits from share-based payments	(0.4)%	(1.6)%	— %
Effect of Tax Cuts and Jobs Act	(60.8)%	— %	— %
Impairment of Goodwill	2.3 %	—	—
Other changes, net	(0.2)%	0.1 %	(0.3)%
	<u>(27.3)%</u>	<u>32.8 %</u>	<u>33.8 %</u>

The 2017 tax rate differed from the federal statutory rate primarily as a result of re-measuring deferred taxes due to the Tax Cuts and Jobs Act, the Domestic Manufacturing Deduction and other changes, partially offset by non-deductible goodwill impairment charges and the effect of state income taxes. On December 22, 2017, the United States enacted the Tax Cuts and Jobs Act which made changes to the tax code including, but not limited to, reducing the federal statutory corporate tax rate from 35% to 21% and eliminating the domestic manufacturing deduction. GAAP requires the recognition of the impact of tax laws in the period in which they are enacted. The benefit recognized in 2017 from the Tax Cuts and Jobs Act is \$922, primarily from the re-measurement of deferred taxes.

On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to finalize the calculations for certain income tax effects of the Tax Cuts and Jobs Act. Under the guidance in SAB 118, the income tax effects, for which the accounting under GAAP is incomplete, are reported as a provisional amount based on a reasonable estimate. The reasonable estimate is subject to adjustment during a "measurement period", not to exceed one year, until the accounting is complete. In accordance with SAB 118, the Company has determined that the net tax benefit of \$922 recorded in connection with the Tax Cuts and Jobs Act includes provisional amounts related to depreciation and the application of provisions of the Tax Cuts and Jobs Act related to accelerated depreciation.

The 2015 rate for state income taxes is less than 2017 and 2016 due to filing amended returns to claim additional benefits in years still under review, the favorable resolution of state issues and an increase in state credits.

The tax effects of significant temporary differences that comprise tax balances were as follows:

	2017	2016
<b>Current deferred tax assets:</b>		
Net operating loss and credit carryforwards	\$ —	\$ 23
Compensation related costs	—	67
Other	—	50
Subtotal	—	140
Valuation allowance	—	(11)
<b>Total current deferred tax assets</b>	<b>—</b>	<b>129</b>
<b>Current deferred tax liabilities:</b>		
Insurance related costs	—	(52)
Inventory related costs	—	(328)
<b>Total current deferred tax liabilities</b>	<b>—</b>	<b>(380)</b>
<b>Current deferred taxes</b>	<b>\$ —</b>	<b>\$ (251)</b>
<b>Long-term deferred tax assets:</b>		
Compensation related costs	\$ 348	\$ 783
Lease accounting	78	121
Closed store reserves	45	46
Insurance related costs	—	7
Net operating loss and credit carryforwards	146	101
Other	54	1
Subtotal	671	1,059
Valuation allowance	(62)	(39)
<b>Total long-term deferred tax assets</b>	<b>609</b>	<b>1,020</b>
<b>Long-term deferred tax liabilities:</b>		
Depreciation and amortization	(1,892)	(2,947)
Insurance related costs	(32)	—
Inventory related costs	(253)	—
<b>Total long-term deferred tax liabilities</b>	<b>(2,177)</b>	<b>(2,947)</b>
<b>Long-term deferred taxes</b>	<b>\$ (1,568)</b>	<b>\$ (1,927)</b>

The Company adopted ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes," which requires deferred tax liabilities and assets to be classified as noncurrent in a classified statement of financial position. The Company adopted the standard in 2017 prospectively and as a result of the implementation the 2017, as compared to 2016, current deferred tax liabilities were reclassified as non-current.

At February 3, 2018, the Company had net operating loss carryforwards for state income tax purposes of \$1,578. These net operating loss carryforwards expire from 2018 through 2037. The utilization of certain of the Company's state net operating loss carryforwards may be limited in a given year. Further, based on the analysis described below, the Company has recorded a valuation allowance against some of the deferred tax assets resulting from its state net operating losses.

At February 3, 2018, the Company had state credit carryforwards of \$55, most of which expire from 2018 through 2027. The utilization of certain of the Company's credits may be limited in a given year. Further, based on the analysis described below, the Company has recorded a valuation allowance against some of the deferred tax assets resulting from its state credits.

At February 3, 2018, the Company had federal net operating loss carryforwards of \$20. These net operating loss carryforwards expire from 2034 through 2035. The utilization of certain of the Company's federal net operating loss carryforwards may be limited in a given year. Further, based on the analysis described below, the Company has not recorded a valuation allowance against the deferred tax assets resulting from its federal net operating losses.

The Company regularly reviews all deferred tax assets on a tax filer and jurisdictional basis to estimate whether these assets are more likely than not to be realized based on all available evidence. This evidence includes historical taxable income, projected future taxable income, the expected timing of the reversal of existing temporary differences and the implementation of tax planning strategies. Projected future taxable income is based on expected results and assumptions as to the jurisdiction in which the income will be earned. The expected timing of the reversals of existing temporary differences is based on current tax law and the Company's tax methods of accounting. Unless deferred tax assets are more likely than not to be realized, a valuation allowance is established to reduce the carrying value of the deferred tax asset until such time that realization becomes more likely than not. Increases and decreases in these valuation allowances are included in "Income tax expense" in the Consolidated Statements of Operations. As of February 3, 2018, January 28, 2017 and January 30, 2016, the total valuation allowance was \$62, \$50 and \$52, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, including positions impacting only the timing of tax benefits, is as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Beginning balance	\$ 177	\$ 204	\$ 246
Additions based on tax positions related to the current year	11	10	11
Reductions based on tax positions related to the current year	(1)	(1)	(11)
Additions for tax positions of prior years	6	3	4
Reductions for tax positions of prior years	(8)	(30)	(27)
Settlements	—	(2)	(17)
Lapse of statute	(5)	(7)	(2)
Ending balance	<u>\$ 180</u>	<u>\$ 177</u>	<u>\$ 204</u>

The Company does not anticipate that changes in the amount of unrecognized tax benefits over the next twelve months will have a significant impact on its results of operations or financial position.

As of February 3, 2018, January 28, 2017 and January 30, 2016, the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$88, \$73 and \$83 respectively.

To the extent interest and penalties would be assessed by taxing authorities on any underpayment of income tax, such amounts have been accrued and classified as a component of income tax expense. During the years ended February 3, 2018, January 28, 2017 and January 30, 2016, the Company recognized approximately \$8, \$(1) and \$(5), respectively, in interest and penalties (recoveries). The Company had accrued approximately \$28, \$20 and \$25 for the payment of interest and penalties as of February 3, 2018, January 28, 2017 and January 30, 2016.

As of February 3, 2018, the Internal Revenue Service had concluded its examination of our 2012 and 2013 federal tax returns.

## 6. DEBT OBLIGATIONS

Long-term debt consists of:

	February 3, 2018	January 28, 2017
1.50% to 8.00% Senior Notes due through 2048	\$ 12,201	\$ 11,311
5.63% to 12.75% Mortgages due in varying amounts through 2027	22	38
0.91% to 1.68% Commercial paper borrowings due through February 2018	2,121	1,425
Other	443	541
Total debt, excluding capital leases and financing obligations	14,787	13,315
Less current portion	(3,509)	(2,197)
Total long-term debt, excluding capital leases and financing obligations	<u>\$ 11,278</u>	<u>\$ 11,118</u>

In 2017, the Company issued \$400 of senior notes due in fiscal year 2022 bearing an interest rate of 2.80%, \$600 of senior notes due in fiscal year 2027 bearing an interest rate of 3.70% and \$500 of senior notes due in fiscal year 2048 bearing an interest rate of 4.65%. In connection with the senior note issuances, the Company also terminated forward-starting interest rate swap agreements with an aggregate notional amount of \$600. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the second quarter of 2017. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$20, \$12 net of tax, has been deferred in Accumulated Other Comprehensive Loss, the Company will continue to amortize to earnings as the interest payments are made. The Company also repaid, upon maturity, \$600 of senior notes bearing an interest rate of 6.40%, with proceeds from the senior notes issuances.

In 2016, the Company issued \$1,000 of senior notes due in fiscal year 2047 bearing an interest rate of 4.45%, \$500 of senior notes due in fiscal year 2046 bearing an interest rate of 3.88%, \$750 of senior notes due in fiscal year 2026 bearing an interest rate of 2.65% and \$500 of senior notes due in fiscal year 2019 bearing an interest rate of 1.50%. The Company also repaid \$450 of senior notes bearing an interest rate of 2.20%, \$500 of senior notes bearing an interest rate of 3-month London Inter-Bank Offering Rate plus 53 basis points and \$300 of senior notes bearing an interest rate of 1.20%.

On August 29, 2017, the Company entered into an amended, extended and restated its \$2,750 unsecured revolving credit facility (the "Credit Agreement"), with a termination date of August 29, 2022, unless extended as permitted under the Credit Agreement. This Credit Agreement amended the Company's \$2,750 credit facility that would otherwise have terminated on June 30, 2019. The Company has the ability to increase the size of the Credit Agreement by up to an additional \$1,000, subject to certain conditions.

Borrowings under the Credit Agreement bear interest, at the Company's option, at either (i) LIBOR plus a market spread, based on the Company's Public Debt Rating or (ii) the base rate, defined as the highest of (a) the Federal Funds Rate plus 0.5%, (b) the Bank of America prime rate, and (c) one-month LIBOR plus 1.0%, plus a market rate spread based on the Company's Public Debt Rating. The Company will also pay a Commitment Fee based on its Public Debt Rating and Letter of Credit fees equal to a market rate spread based on the Company's Public Debt Rating. "Public Debt Rating" means, as of any date, the rating that has been most recently announced by either S&P or Moody's, as the case may be, for any class of non-credit enhanced long-term senior unsecured debt issued by the Company.

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



As of February 3, 2018, the Company had \$2,121 of commercial paper borrowings, with a weighted average interest rate of 1.68% and no borrowings under the Credit Agreement. As of January 28, 2017, the Company had \$1,425 of borrowings of commercial paper, with a weighted average interest rate of 0.91%, and no borrowings under the Credit Agreement.

As of February 3, 2018, the Company had outstanding letters of credit in the amount of \$222, of which \$6 reduces funds available under the Credit Agreement. The letters of credit are maintained primarily to support performance, payment, deposit or surety obligations of the Company.

Most of the Company's outstanding public debt is subject to early redemption at varying times and premiums, at the option of the Company. In addition, subject to certain conditions, some of the Company's publicly issued debt will be subject to redemption, in whole or in part, at the option of the holder upon the occurrence of a redemption event, upon not less than five days' notice prior to the date of redemption, at a redemption price equal to the default amount, plus a specified premium. "Redemption Event" is defined in the indentures as the occurrence of (i) any person or group, together with any affiliate thereof, beneficially owning 50% or more of the voting power of the Company, (ii) any one person or group, or affiliate thereof, succeeding in having a majority of its nominees elected to the Company's Board of Directors, in each case, without the consent of a majority of the continuing directors of the Company or (iii) both a change of control and a below investment grade rating.

The aggregate annual maturities and scheduled payments of long-term debt, as of year-end 2017, and for the years subsequent to 2017 are:

2018	\$ 3,509
2019	1,243
2020	721
2021	795
2022	897
Thereafter	7,622
Total debt	<u>\$ 14,787</u>

## 7. DERIVATIVE FINANCIAL INSTRUMENTS

GAAP 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 values 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 a commercial paper program, 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.

The Company reviews compliance with these guidelines annually with the Financial Policy Committee of the Board of Directors. 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 February 3, 2018 and January 28, 2017.

	2017		2016	
	Pay Floating	Pay Fixed	Pay Floating	Pay Fixed
Notional amount	\$ 100	\$ —	\$ 100	\$ —
Number of contracts	2	—	2	—
Duration in years	0.88	—	1.92	—
Average variable rate	7.23 %	—	6.37 %	—
Average fixed rate	6.80 %	—	6.80 %	—
Maturity	December 2018		December 2018	

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 earnings as "Interest expense." These gains and losses for 2017 and 2016 were as follows:

Consolidated Statements of Operations Classification	Year-To-Date			
	February 3, 2018		January 28, 2017	
	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings
Interest Expense	\$ —	\$ —	\$ (2)	\$ 2

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		Balance Sheet Location
	February 3, 2018	January 28, 2017	
Interest Rate Hedges	\$ (1)	\$ (1)	Other long-term liabilities

### Cash Flow Forward-Starting Interest Rate Swaps

As of February 3, 2018, the Company had nine forward-starting interest rate swap agreements with a maturity date of January 2019 with an aggregate notional amount totaling \$750 and five forward-starting interest rate swap agreements with maturity dates of January 2020 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 issuance of debt in January 2019 and January 2020. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of February 3, 2018, the fair value of the interest rate swaps was recorded in other assets for \$103 and accumulated other comprehensive income for \$73 net of tax.

As of January 28, 2017, the Company had eleven forward-starting interest rate swap agreements with maturity dates of August 2017 with an aggregate notional amount totaling \$600, nine forward-starting interest rate swap agreements with maturity dates of January 2019 with an aggregate notional amount totaling \$750 and five forward-starting interest rate swap agreements with maturity dates of January 2020 with an aggregate notional amount totaling \$250. The Company entered into these forward-starting interest rate swaps in order to lock in fixed interest rates on its forecasted issuance of debt in August 2017, January 2019 and January 2020. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of January 28, 2017, the fair value of the interest rate swaps was recorded in other assets and other long-term liabilities for \$67 and \$7, respectively, and accumulated other comprehensive income for \$38 net of tax.

During 2017, the Company terminated eleven forward-starting interest rate swaps with maturity dates of August 2017, with an aggregate notional amount totaling \$600. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the third quarter of 2017. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$20, \$12 net of tax, has been deferred in AOCI and will be amortized to earnings as the interest payments are made.

During 2016, the Company terminated forward-starting interest rate swaps with maturity dates of October 2016, with an aggregate notional amount totaling \$300. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued in 2016. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$13, \$8 net of tax, has been deferred in AOCI and will be amortized to earnings as the interest payments are made.

The following table summarizes the effect of the Company's derivative instruments designated as cash flow hedges for 2017 and 2016:

Derivatives in Cash Flow Hedging Relationships	Year-To-Date				Location of Gain/(Loss) Reclassified into Income (Effective Portion)
	Amount of Gain/(Loss) in AOCI on Derivative (Effective Portion)		Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)		
	2017	2016	2017	2016	
Forward-Starting Interest Rate Swaps, net of tax*	\$ 24	\$ (2)	\$ (3)	\$ (2)	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 that were terminated prior to end of 2017 and 2016, respectively.

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 February 3, 2018 and January 28, 2017, no cash collateral was received or pledged under the master netting agreements.

The effect of the net settlement provisions of these master netting agreements on the Company's derivative balances upon an event of default or termination event is as follows as of February 3, 2018 and January 28, 2017:

February 3, 2018	Gross Amount Recognized	Gross Amounts Offset in the Balance Sheet	Net Amount Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral	
<b>Assets</b>						
Cash Flow Forward-Starting Interest Rate Swaps	\$ 103	\$ —	\$ 103	\$ —	\$ —	\$ 103
<b>Liabilities</b>						
Fair Value Interest Rate Swaps	\$ 1	\$ —	\$ 1	\$ —	\$ —	\$ 1

January 28, 2017	Gross Amount Recognized	Gross Amounts Offset in the Balance Sheet	Net Amount Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral	
<b>Assets</b>						
Cash Flow Forward-Starting Interest Rate Swaps	\$ 67	\$ —	\$ 67	\$ —	\$ —	\$ 67
<b>Liabilities</b>						
Fair Value Interest Rate Swaps	\$ 1	\$ —	\$ 1	\$ —	\$ —	\$ 1
Cash Flow Forward-Starting Interest Rate Swaps	7	—	7	—	—	7
<b>Total</b>	<b>\$ 8</b>	<b>\$ —</b>	<b>\$ 8</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 8</b>

## 8. FAIR VALUE MEASUREMENTS

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

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

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

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

For items carried at (or adjusted to) fair value in the consolidated financial statements, the following tables summarize the fair value of these instruments at February 3, 2018 and January 28, 2017:

### February 3, 2018 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	\$ 64	\$ —	\$ —	\$ 64
Available-For-Sale Securities	25	—	—	25
Long-Lived Assets	—	—	27	27
Interest Rate Hedges	—	102	—	102
<b>Total</b>	<b>\$ 89</b>	<b>\$ 102</b>	<b>\$ 27</b>	<b>\$ 218</b>

### January 28, 2017 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	\$ 50	\$ —	\$ —	\$ 50
Long-Lived Assets	—	—	3	3
Interest Rate Hedges	—	59	—	59
<b>Total</b>	<b>\$ 50</b>	<b>\$ 59</b>	<b>\$ 3</b>	<b>\$ 112</b>

In 2017, unrealized gains on Level 1, available-for-sale securities totaled \$5.

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, long-lived assets and in the valuation of store lease exit costs. The Company reviews goodwill and indefinite-lived intangible assets for impairment annually, during the fourth quarter of each fiscal year, and as circumstances indicate the possibility of impairment. See Note 3 for further discussion related to the Company's carrying value of goodwill. Long-lived assets and store lease exit costs were measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. See Note 1 for further discussion of the Company's policies and recorded amounts for impairments of long-lived assets and valuation of store lease exit costs. In 2017, long-lived assets with a carrying amount of \$98 were written down to their fair value of \$27, resulting in an impairment charge of \$71. In 2016, long-lived assets with a carrying amount of \$29 were written down to their fair value of \$3, resulting in an impairment charge of \$26.

Mergers are accounted for using the acquisition method of accounting, which requires that the purchase price paid for a merger be allocated to the assets and liabilities acquired based on their estimated fair values as of the effective date of the merger, with the excess of the purchase price over the net assets being recorded as goodwill. See Note 2 for further discussion related to accounting for mergers.

## 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 upon the net present value of the future cash flow using the forward interest rate yield curve in effect at respective year-ends. At February 3, 2018, the fair value of total debt was \$15,167 compared to a carrying value of \$14,787. At January 28, 2017, the fair value of total debt was \$13,905 compared to a carrying value of \$13,315.

### *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*

In 2016, the Company entered into agreements with a third party. As part of the consideration for entering these agreements, the Company received a financial instrument that derives its value from the third party's business operations. The Company used the Monte-Carlo simulation method to determine the fair value of this financial instrument. The Monte-Carlo simulation is a generally accepted statistical technique used to generate a defined number of valuation paths in order to develop a reasonable estimate of the fair value of this financial instrument. The assumptions used in the Monte-Carlo simulation are classified as Level 3 inputs. The financial instrument was valued at \$335 and recorded in "Other assets" within the Consolidated Balance Sheets. As the financial instrument was obtained in exchange for certain obligations, the Company also recognized offsetting deferred revenue liabilities in "Other current liabilities" and "Other long-term liabilities" within the Consolidated Balance Sheets. The deferred revenue will be amortized to "Sales" within the Consolidated Statements of Operations over the term of the agreements. Post inception, the Company received a distribution of \$59, which was recorded as a reduction of the cost method investment.

The fair values of certain investments recorded in "other assets" within the Consolidated Balance Sheets were estimated based on quoted market prices for those or similar investments, or estimated cash flows, if appropriate. At February 3, 2018 and January 28, 2017, the carrying and fair value of long-term investments for which fair value is determinable was \$176 and \$151, respectively. At February 3, 2018 and January 28, 2017, the carrying value of notes receivable for which fair value is determinable was \$170 and \$182, respectively.

## 9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table represents the changes in AOCI by component for the years ended February 3, 2018 and January 28, 2017:

	Cash Flow Hedging Activities <sup>(1)</sup>	Available for sale Securities <sup>(1)</sup>	Pension and Postretirement Defined Benefit Plans <sup>(1)</sup>	Total <sup>(1)</sup>
Balance at January 30, 2016	\$ (51)	\$ 20	\$ (649)	\$ (680)
OCI before reclassifications <sup>(2)</sup>	47	(6)	(97)	(56)
Amounts reclassified out of AOCI <sup>(3)</sup>	2	(14)	33	21
Net current-period OCI	49	(20)	(64)	(35)
Balance at January 28, 2017	\$ (2)	\$ —	\$ (713)	\$ (715)
Balance at January 28, 2017	\$ (2)	\$ —	\$ (713)	\$ (715)
OCI before reclassifications <sup>(2)</sup>	23	4	165	192
Amounts reclassified out of AOCI <sup>(3)</sup>	3	—	49	52
Net current-period OCI	26	4	214	244
Balance at February 3, 2018	\$ 24	\$ 4	\$ (499)	\$ (471)

(1) All amounts are net of tax.

(2) Net of tax of \$27, \$(3) and \$(59) for cash flow hedging activities, available for sale securities and pension and postretirement defined benefit plans, respectively, as of January 28, 2017. Net of tax of \$0, \$1 and \$63 for cash flow hedging activities, available for sale securities and pension and postretirement defined benefit plans, respectively, as of February 3, 2018.

(3) Net of tax of \$20 and \$(13) for pension and postretirement defined benefit plans and available for sale securities, respectively, as of January 28, 2017. Net of tax of \$20 and \$3 for pension and postretirement defined benefit plans and cash flow hedging activities, respectively, as of February 3, 2018.

The following table represents the items reclassified out of AOCI and the related tax effects for the years ended February 3, 2018, January 28, 2017 and January 30, 2016:

	For the year ended February 3, 2018	For the year ended January 28, 2017	For the year ended January 30, 2016
<b>Cash flow hedging activity items</b>			
Amortization of gains and losses on cash flow hedging activities <sup>(1)</sup>	\$ 6	\$ 2	\$ 1
Tax expense	(3)	—	—
Net of tax	3	2	1
<b>Available for sale security items</b>			
Realized gains on available for sale securities <sup>(2)</sup>	—	(27)	—
Tax expense	—	13	—
Net of tax	—	(14)	—
<b>Pension and postretirement defined benefit plan items</b>			
Amortization of amounts included in net periodic pension expense <sup>(3)</sup>	69	53	85
Tax expense	(20)	(20)	(32)
Net of tax	49	33	53
Total reclassifications, net of tax	\$ 52	\$ 21	\$ 54

(1) Reclassified from AOCI into interest expense.

(2) Reclassified from AOCI into operating, general and administrative expense.

(3) Reclassified from AOCI into merchandise costs and OG&A expense. These components are included in the computation of net periodic pension costs.

## 10. LEASES AND LEASE-FINANCED TRANSACTIONS

While the Company's current strategy emphasizes ownership of store real estate, the Company operates primarily in leased facilities. Lease terms generally range from 10 to 20 years with options to renew for varying terms. Terms of certain leases include escalation clauses, percentage rent based on sales or payment of executory costs such as property taxes, utilities or insurance and maintenance. Rent expense for leases with escalation clauses or other lease concessions are accounted for on a straight-line basis beginning with the earlier of the lease commencement date or the date the Company takes possession. Portions of certain properties are subleased to others for periods generally ranging from one to 20 years.

Rent expense (under operating leases) consists of:

	2017	2016	2015
Minimum rentals	\$ 1,005	\$ 973	\$ 807
Contingent payments	19	16	18
Tenant income	(113)	(108)	(102)
<b>Total rent expense</b>	<b>\$ 911</b>	<b>\$ 881</b>	<b>\$ 723</b>

Minimum annual rentals and payments under capital leases and lease-financed transactions for the five years subsequent to 2017 and in the aggregate are:

	Capital Leases	Operating Leases	Lease- Financed Transactions
2018	\$ 88	\$ 992	\$ 8
2019	78	936	8
2020	74	838	9
2021	71	736	9
2022	68	606	9
Thereafter	692	3,664	43
<b>Total</b>	<b>\$1,071</b>	<b>\$ 7,772</b>	<b>\$ 86</b>
Less estimated executory costs included in capital leases	—		
Net minimum lease payments under capital leases	1,071		
Less amount representing interest	355		
<b>Present value of net minimum lease payments under capital leases</b>	<b>\$ 716</b>		

Total future minimum rentals under noncancellable subleases at February 3, 2018 were \$213.



## 11. EARNINGS PER COMMON SHARE

Net earnings attributable to The Kroger Co. per basic common share equals 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 equals 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:

(in millions, except per share amounts)	For the year ended February 3, 2018			For the year ended January 28, 2017			For the year ended January 30, 2016		
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Net earnings attributable to The Kroger Co. per basic common share	\$ 1,890	895	\$ 2.11	\$ 1,959	942	\$ 2.08	\$ 2,021	966	\$ 2.09
Dilutive effect of stock options		9			16			14	
Net earnings attributable to The Kroger Co. per diluted common share	\$ 1,890	904	\$ 2.09	\$ 1,959	958	\$ 2.05	\$ 2,021	980	\$ 2.06

The Company had combined undistributed and distributed earnings to participating securities totaling \$17, \$16 and \$18 in 2017, 2016 and 2015, respectively.

The Company had options outstanding for approximately 15.6 million, 7.1 million and 1.9 million shares, respectively, for the years ended February 3, 2018, January 28, 2017 and January 30, 2016, which were excluded from the computations of net earnings per diluted common share because their inclusion would have had an anti-dilutive effect on net earnings per diluted share.

## 12. STOCK OPTION PLANS

The Company grants options for common shares ("stock options") to employees under various plans at an option price equal to the fair market value of the stock at the date of grant. The Company accounts for stock options under the fair value recognition provisions. Under this method, the Company recognizes compensation expense for all share-based payments granted. The Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award.

Stock options typically expire 10 years from the date of grant. Stock options vest between one and five years from the date of grant. At February 3, 2018, approximately 27 million common shares were available for future option grants under the 2008, 2011 and 2014 Long-Term Incentive Plans (the "Plans").

In addition to the stock options described above, the Company awards restricted stock to employees and non-employee directors under various plans. The restrictions on these awards generally lapse between one and five years from the date of the awards. The Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying shares on the grant date of the award, over the period the awards lapse. As of February 3, 2018, approximately 12 million common shares were available under the Plans for future restricted stock awards or shares issued to the extent performance criteria are achieved. The Company has the ability to convert shares available for stock options under the Plans to shares available for restricted stock awards. Under the Plans, four shares available for option awards can be converted into one share available for restricted stock awards.

Equity awards granted are based on the aggregate value of the award on grant date. This can affect the number of shares granted in a given year as equity awards. Excess tax benefits related to equity awards are recognized in the provision for income taxes. Equity awards may be approved at one of four meetings of its Board of Directors occurring shortly after the Company's release of quarterly earnings. The 2017 primary grant was made in conjunction with the June meeting of the Company's Board of Directors.

All awards become immediately exercisable upon certain changes of control of the Company.

### Stock Options

Changes in options outstanding under the stock option plans are summarized below:

	Shares subject to option (in millions)	Weighted- average exercise price
Outstanding, year-end 2014	40.8	\$ 15.56
Granted	3.4	\$ 38.40
Exercised	(8.9)	\$ 13.54
Canceled or Expired	(0.4)	\$ 19.98
Outstanding, year-end 2015	34.9	\$ 18.26
Granted	4.8	\$ 37.10
Exercised	(4.9)	\$ 14.20
Canceled or Expired	(0.5)	\$ 28.35
Outstanding, year-end 2016	34.3	\$ 21.32
Granted	7.0	\$ 23.00
Exercised	(3.8)	\$ 14.08
Canceled or Expired	(0.8)	\$ 28.29
Outstanding, year-end 2017	36.7	\$ 22.23

A summary of options outstanding, exercisable and expected to vest at February 3, 2018 follows:

	Number of shares (in millions)	Weighted-average remaining contractual life (in years)	Weighted-average exercise price	Aggregate intrinsic value (in millions)
Options Outstanding	36.7	6.09	\$ 22.23	324
Options Exercisable	22.5	4.66	\$ 18.50	265
Options Expected to Vest	13.8	8.37	\$ 28.18	57

## Restricted stock

Changes in restricted stock outstanding under the restricted stock plans are summarized below:

	Restricted shares outstanding (in millions)	Weighted-average grant-date fair value
Outstanding, year-end 2014	10.2	\$ 21.04
Granted	3.2	\$ 38.34
Lapsed	(5.4)	\$ 21.49
Canceled or Expired	(0.4)	\$ 22.80
Outstanding, year-end 2015	7.6	\$ 28.01
Granted	3.6	\$ 37.03
Lapsed	(3.5)	\$ 28.52
Canceled or Expired	(0.3)	\$ 30.70
Outstanding, year-end 2016	7.4	\$ 32.09
Granted	5.8	\$ 23.04
Lapsed	(3.6)	\$ 31.05
Canceled or Expired	(0.4)	\$ 29.26
Outstanding, year-end 2017	<u>9.2</u>	\$ 26.78

The weighted-average grant date fair value of stock options granted during 2017, 2016 and 2015 was \$4.71, \$7.48 and \$9.78, 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 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 share 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 decrease in the fair value of the stock options granted during 2017, compared to 2016, resulted primarily from a decrease in the Company's share price, which increased the expected dividend yield, partially offset by an increase in the weighted average expected volatility and the weighted average risk-free interest rate. The decrease in the fair value of the stock options granted during 2016, compared to 2015, resulted primarily from a decrease in the market price per share of the Company's common shares, which increased the expected dividend yield, and decreases in the weighted average expected volatility and the weighted average risk free discount rate.

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

	2017	2016	2015
Weighted average expected volatility	22.78 %	21.40 %	24.07 %
Weighted average risk-free interest rate	2.21 %	1.29 %	2.12 %
Expected dividend yield	2.20 %	1.40 %	1.20 %
Expected term (based on historical results)	7.2 years	7.2 years	7.2 years

The weighted-average risk-free interest rate was based on the yield of a treasury note as of the grant date, continuously compounded, which matures at a date that approximates the expected term of the options. The dividend yield was based on our history and expectation of dividend payouts. Expected volatility was determined based upon historical stock volatilities; however, implied volatility was also considered. Expected term was determined based upon historical exercise and cancellation experience.

Total stock compensation recognized in 2017, 2016 and 2015 was \$151, \$141 and \$165, respectively. Stock option compensation recognized in 2017, 2016, and 2015 was \$32, \$28 and \$31, respectively. Restricted shares compensation recognized in 2017, 2016 and 2015 was \$119, \$113 and \$134, respectively.

The total intrinsic value of stock options exercised was \$55, \$105 and \$217 in 2017, 2016 and 2015, respectively. The total amount of cash received in 2017 by the Company from the exercise of stock options granted under share-based payment arrangements was \$51. As of February 3, 2018, there was \$214 of total unrecognized compensation expense remaining related to non-vested share-based compensation arrangements granted under Plans. This cost is expected to be recognized over a weighted-average period of approximately two years. The total fair value of options that vested was \$29, \$28 and \$33 in 2017, 2016 and 2015, respectively.

Shares issued as a result of stock option exercises may be newly issued shares or reissued treasury shares. Proceeds received from the exercise of options, and the related tax benefit, may be utilized to repurchase the Company's common shares under a stock repurchase program adopted by the Company's Board of Directors. During 2017, the Company repurchased approximately two million common shares in such a manner.

### **13. COMMITMENTS AND CONTINGENCIES**

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

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

The principal contingencies are described below:

*Insurance* — The Company's workers' compensation risks are self-insured in most states. In addition, other workers' compensation risks and certain levels of insured general liability risks are based on retrospective premium plans, deductible plans, and self-insured retention plans. The liability for workers' compensation risks is accounted for on a present value basis. Actual claim settlements and expenses incident thereto may differ from the provisions for loss. Property risks have been underwritten by a subsidiary and are all reinsured with unrelated insurance companies. Operating divisions and subsidiaries have paid premiums, and the insurance subsidiary has provided loss allowances, based upon actuarially determined estimates.

*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, 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 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 when an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involves 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.

*Assignments* — The Company is contingently liable for leases that have been assigned to various third parties in connection with facility closings and dispositions. The Company could be required to satisfy the obligations under the leases if any of the assignees is unable to fulfill its lease obligations. Due to the wide distribution of the Company's assignments among third parties, and various other remedies available, the Company believes the likelihood that it will be required to assume a material amount of these obligations is remote.

## **14. STOCK**

### *Preferred Shares*

The Company has authorized five million shares of voting cumulative preferred shares; two million shares were available for issuance at February 3, 2018. The shares have a par value of \$100 per share and are issuable in series.

### *Common Shares*

The Company has authorized two billion common shares, \$1 par value per share.

On June 25, 2015, the Company's Board of Directors approved a two-for-one stock split of The Kroger Co.'s common shares in the form of a 100% stock dividend, which was effective July 13, 2015. All share and per share amounts in the Company's Consolidated Financial Statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

### *Common Stock Repurchase Program*

The Company maintains stock repurchase programs that comply with Rule 10b5-1 of the Securities Exchange Act of 1934 to allow for the orderly repurchase of The Kroger Co. common shares, from time to time. The Company made open market purchases totaling \$1,567, \$1,661 and \$500 under these repurchase programs in 2017, 2016 and 2015, respectively. In addition to these repurchase programs, in December 1999, the Company began a program to repurchase common shares to reduce dilution resulting from its employee stock option plans. This program is solely funded by proceeds from stock option exercises and the related tax benefit. The Company repurchased approximately \$66, \$105 and \$203 under the stock option program during 2017, 2016 and 2015, respectively.

## **15. COMPANY- SPONSORED BENEFIT PLANS**

The Company administers non-contributory defined benefit retirement plans for some non-union employees and union-represented employees as determined by the terms and conditions of collective bargaining agreements. These include several qualified pension plans (the "Qualified Plans") and non-qualified pension plans (the "Non-Qualified Plans"). The Non-Qualified Plans pay benefits to any employee that earns in excess of the maximum allowed for the Qualified Plans by Section 415 of the Internal Revenue Code. The Company only funds obligations under the Qualified Plans. Funding for the company-sponsored pension plans is based on a review of the specific requirements and on evaluation of the assets and liabilities of each plan.

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees. The majority of the Company's employees may become eligible for these benefits if they reach normal retirement age while employed by the Company. Funding of retiree health care benefits occurs as claims or premiums are paid.

The Company recognizes the funded status of its retirement plans on the Consolidated Balance Sheets. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized as part of net periodic benefit cost are required to be recorded as a component of AOCI. All plans are measured as of the Company's fiscal year end.

Amounts recognized in AOCI as of February 3, 2018 and January 28, 2017 consists of the following (pre-tax):

	Pension Benefits		Other Benefits		Total	
	2017	2016	2017	2016	2017	2016
Net actuarial loss (gain)	\$ 1,040	\$ 1,308	\$ (130)	\$ (120)	\$ 910	\$ 1,188
Prior service credit	—	—	(77)	(58)	(77)	(58)
<b>Total</b>	<b>\$ 1,040</b>	<b>\$ 1,308</b>	<b>\$ (207)</b>	<b>\$ (178)</b>	<b>\$ 833</b>	<b>\$ 1,130</b>

Amounts in AOCI expected to be recognized as components of net periodic pension or postretirement benefit costs in the next fiscal year are as follows (pre-tax):

	Pension Benefits		Other Benefits		Total	
	2018		2018		2018	
Net actuarial loss (gain)	\$ 82		\$ (10)		\$ 72	
Prior service credit	—		(11)		(11)	
<b>Total</b>	<b>\$ 82</b>		<b>\$ (21)</b>		<b>\$ 61</b>	

Other changes recognized in other comprehensive income in 2017, 2016 and 2015 were as follows (pre-tax):

	Pension Benefits			Other Benefits			Total		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
Incurring net actuarial loss (gain)	\$ 322	\$ 165	\$ (83)	\$ (20)	\$ (9)	\$ (39)	\$ 302	\$ 156	\$ (122)
Amortization of prior service credit	—	—	—	8	8	11	8	8	11
Amortization of net actuarial gain (loss)	(88)	(71)	(102)	11	10	7	(77)	(61)	(95)
Settlement recognition of net actuarial loss	(502)	—	—	—	—	—	(502)	—	—
Other	—	—	—	(28)	—	(2)	(28)	—	(2)
<b>Total recognized in other comprehensive income (loss)</b>	<b>(268)</b>	<b>94</b>	<b>(185)</b>	<b>(29)</b>	<b>9</b>	<b>(23)</b>	<b>(297)</b>	<b>103</b>	<b>(208)</b>
<b>Total recognized in net periodic benefit cost and other comprehensive income</b>	<b>\$ 323</b>	<b>\$ 188</b>	<b>\$ (82)</b>	<b>\$ (30)</b>	<b>\$ 10</b>	<b>\$ (22)</b>	<b>\$ 293</b>	<b>\$ 198</b>	<b>\$ (104)</b>

Information with respect to change in benefit obligation, change in plan assets, the funded status of the plans recorded in the Consolidated Balance Sheets, net amounts recognized at the end of fiscal years, weighted average assumptions and components of net periodic benefit cost follow:

	<b>Pension Benefits</b>					
	<b>Qualified Plans</b>		<b>Non-Qualified Plans</b>		<b>Other Benefits</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Change in benefit obligation:</b>						
Benefit obligation at beginning of fiscal year	\$ 4,140	\$ 3,922	\$ 316	\$ 290	\$ 243	\$ 244
Service cost	53	68	2	2	8	9
Interest cost	163	177	13	14	9	10
Plan participants' contributions	—	—	—	—	12	12
Actuarial (gain) loss	126	186	15	29	(20)	(9)
Plan settlements	(1,040)	—	—	—	—	—
Benefits paid	(202)	(211)	(21)	(19)	(23)	(23)
Other	(5)	(2)	3	—	(27)	—
<b>Benefit obligation at end of fiscal year</b>	<b>\$ 3,235</b>	<b>\$ 4,140</b>	<b>\$ 328</b>	<b>\$ 316</b>	<b>\$ 202</b>	<b>\$ 243</b>
<b>Change in plan assets:</b>						
Fair value of plan assets at beginning of fiscal year	\$ 3,138	\$ 3,045	\$ —	\$ —	\$ —	\$ —
Actual return on plan assets	210	302	—	—	—	—
Employer contributions	1,000	3	21	19	11	11
Plan participants' contributions	—	—	—	—	12	12
Plan settlements	(1,198)	—	—	—	—	—
Benefits paid	(202)	(211)	(21)	(19)	(23)	(23)
Other	(5)	(1)	—	—	—	—
<b>Fair value of plan assets at end of fiscal year</b>	<b>\$ 2,943</b>	<b>\$ 3,138</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Funded status and net liability recognized at end of fiscal year</b>	<b>\$ (292)</b>	<b>\$ (1,002)</b>	<b>\$ (328)</b>	<b>\$ (316)</b>	<b>\$ (202)</b>	<b>\$ (243)</b>

As of February 3, 2018 and January 28, 2017, other current liabilities include \$30 and \$37, respectively, of net liability recognized for the above benefit plans.

In 2017, the Company settled certain company-sponsored pension plan obligations using existing assets of the plan and a \$1,000 contribution made to the plan in the third quarter of 2017. The Company recognized a settlement charge of approximately \$502, \$335 net of tax, associated with the settlement of the Company's obligations for the eligible participants' pension balances that were distributed out of the plan via a transfer to other qualified retirement plan options, a lump sum payout, or the purchase of an annuity contract, based on each participant's election.

As of February 3, 2018 and January 28, 2017, pension plan assets do not include common shares of The Kroger Co.

<b>Weighted average assumptions</b>	<b>Pension Benefits</b>			<b>Other Benefits</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Discount rate — Benefit obligation	4.00 %	4.25 %	4.62 %	3.93 %	4.18 %	4.44 %
Discount rate — Net periodic benefit cost	4.25 %	4.62 %	3.87 %	4.18 %	4.44 %	3.74 %
Expected long-term rate of return on plan assets	7.50 %	7.40 %	7.44 %			
Rate of compensation increase — Net periodic benefit cost	3.07 %	2.71 %	2.85 %			
Rate of compensation increase — Benefit obligation	3.03 %	3.07 %	2.71 %			

The Company's discount rate assumptions were intended to reflect the rates at which the pension benefits could be effectively settled. They take into account the timing and amount of benefits that would be available under the plans. The Company's policy is to match the plan's cash flows to that of a hypothetical bond portfolio whose cash flow from coupons and maturities match the plan's projected benefit cash flows. The discount rates are the single rates that produce the same present value of cash flows. The selection of the 4.00% and 3.93% discount rates as of year-end 2017 for pension and other benefits, respectively, represents the hypothetical bond portfolio using bonds with an AA or better rating constructed with the assistance of an outside consultant. A 100 basis point increase in the discount rate would decrease the projected pension benefit obligation as of February 3, 2018, by approximately \$426.

The Company's 2017 assumed pension plan investment return rate was 7.50% compared to 7.40% in 2016 and 7.44% in 2015. The value of all investments in the company-sponsored defined benefit pension plans during the calendar year ending December 31, 2017, net of investment management fees and expenses, increased 8.7%. Historically, the Company's pension plans' average rate of return was 5.7% for the 10 calendar years ended December 31, 2017, net of all investment management fees and expenses. For the past 20 years, the Company's pension plans' average annual rate of return has been 7.10%. At the beginning of 2017, to determine the expected rate of return on pension plan assets held by the Company for 2017, the Company considered current and forecasted plan asset allocations as well as historical and forecasted rates of return on various asset categories. Based on this information and forward looking assumptions for investments made in a manner consistent with its target allocations, which contemplates the Company's transition to a liability driven investment ("LDI") strategy, the Company believed a 7.50% rate of return assumption was reasonable for 2017.

The Company calculates its expected return on plan assets by using the market-related value of plan assets. The market-related value of plan assets is determined by adjusting the actual fair value of plan assets for gains or losses on plan assets. Gains or losses represent the difference between actual and expected returns on plan investments for each plan year. Gains or losses on plan assets are recognized evenly over a five year period. Using a different method to calculate the market-related value of plan assets would provide a different expected return on plan assets.

On January 31, 2015, the Company adopted new industry specific mortality tables based on mortality experience and assumptions for generational mortality improvement in determining the Company's benefit obligations. On January 28, 2017, the Company adopted an updated assumption for generational mortality improvement, based on additional years of published mortality experience.

The funded status increased in 2017, compared to 2016, due primarily to the \$1,000 in contributions made in 2017 to the qualified plans, partially offset by the decrease in discount rates from 2016 to 2017.

The following table provides the components of the Company's net periodic benefit costs for 2017, 2016 and 2015:

	Pension Benefits								
	Qualified Plans			Non-Qualified Plans			Other Benefits		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
Components of net periodic benefit cost:									
Service cost	\$ 53	\$ 68	\$ 62	\$ 2	\$ 2	\$ 3	\$ 8	\$ 9	\$ 10
Interest cost	163	177	154	13	14	12	9	10	9
Expected return on plan assets	(233)	(238)	(230)	—	—	—	—	—	—
Amortization of:									
Prior service credit	—	—	—	—	—	—	(8)	(8)	(11)
Actuarial (gain) loss	79	60	93	9	8	9	(11)	(10)	(7)
Settlement loss recognized	502	—	—	—	—	—	—	—	—
Other	—	3	—	3	—	—	1	—	—
Net periodic benefit cost	<u>\$ 564</u>	<u>\$ 70</u>	<u>\$ 79</u>	<u>\$ 27</u>	<u>\$ 24</u>	<u>\$ 24</u>	<u>\$ (1)</u>	<u>\$ 1</u>	<u>\$ 1</u>



The following table provides the projected benefit obligation (“PBO”), accumulated benefit obligation (“ABO”) and the fair value of plan assets for the company-sponsored pension plans with accumulated benefit obligations in excess of plan assets.

	<u>Qualified Plans</u>		<u>Non-Qualified Plans</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
PBO at end of fiscal year	\$ 3,051	\$ 4,140	\$ 328	\$ 316
ABO at end of fiscal year	\$ 2,916	\$ 3,997	\$ 313	\$ 297
Fair value of plan assets at end of year	\$ 2,755	\$ 3,138	\$ —	\$ —

The following table provides information about the Company’s estimated future benefit payments.

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2018	\$ 187	\$ 12
2019	\$ 199	\$ 14
2020	\$ 210	\$ 15
2021	\$ 206	\$ 15
2022	\$ 218	\$ 16
2023 —2027	\$ 1,217	\$ 83

The following table provides information about the target and actual pension plan asset allocations as of February 3, 2018.

	<u>Target allocations</u>	<u>Actual Allocations</u>	
	<u>2017</u>	<u>2017</u>	<u>2016</u>
Pension plan asset allocation			
Global equity securities	8.0 %	2.2 %	14.3 %
Emerging market equity securities	3.0	1.7	6.5
Investment grade debt securities	55.0	53.3	12.0
High yield debt securities	—	3.7	14.2
Private equity	6.0	9.6	7.5
Hedge funds	17.0	17.4	35.2
Real estate	3.0	3.2	2.8
Other	8.0	8.9	7.5
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

Investment objectives, policies and strategies are set by the Pension Investment Committee (the “Committee”). The primary objectives include holding and investing the assets and distributing benefits to participants and beneficiaries of the pension plans. Investment objectives have been established based on a comprehensive review of the capital markets and each underlying plan’s current and projected financial requirements. The time horizon of the investment objectives is long-term in nature and plan assets are managed on a going-concern basis.

Investment objectives and guidelines specifically applicable to each manager of assets are established and reviewed annually. Derivative instruments may be used for specified purposes, including rebalancing exposures to certain asset classes. Any use of derivative instruments for a purpose or in a manner not specifically authorized is prohibited, unless approved in advance by the Committee.

The target allocations shown for 2017 were established in 2017 in conjunction with the start of the Company's transition to a LDI strategy. A LDI strategy focuses on maintaining a close to fully-funded status over the long-term with minimal funded status risk. This is achieved by investing more of the plan assets in fixed income instruments to more closely match the duration of the plan liability. This LDI strategy will be phased in over time as the Company is able to transition out of illiquid investments. During this transition, the Company's target allocation will change by increasing the Company's fixed income instruments. Cash flow from employer contributions and redemption of plan assets to fund participant benefit payments can be used to fund underweight asset classes and divest overweight asset classes, as appropriate. The Company expects that cash flow will be sufficient to meet most rebalancing needs.

In 2017, the Company contributed \$1,000 to the company-sponsored defined benefit plans and the Company is not required to make any contributions to these plans in 2018. If the Company does make any contributions in 2018, the Company expects these contributions will decrease its required contributions in future years. Among other things, investment performance of plan assets, the interest rates required to be used to calculate the pension obligations, and future changes in legislation, will determine the amounts of any contributions. The Company expects 2018 expense for company-sponsored pension plans to be approximately \$94.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The Company used a 5.90% initial health care cost trend rate, which is assumed to decrease on a linear basis to a 4.50% ultimate health care cost trend rate in 2037, to determine its expense. A one-percentage-point change in the assumed health care cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Effect on total of service and interest cost components	\$ 2	\$ (2)
Effect on postretirement benefit obligation	\$ 19	\$ (16)

The following tables, which both reflect the adoption of ASU 2015-07 (see Note 19), set forth by level, within the fair value hierarchy, the Qualified Plans' assets at fair value as of February 3, 2018 and January 28, 2017:

Assets at Fair Value as of February 3, 2018

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets Measured at NAV	Total
Cash and cash equivalents	\$ 414	\$ —	\$ —	\$ —	\$ 414
Corporate Stocks	61	—	—	—	61
Corporate Bonds	—	900	—	—	900
U.S. Government Securities	—	222	—	—	222
Mutual Funds/Collective Trusts	1	—	—	—	1
Partnerships/Joint Ventures	—	—	—	271	271
Hedge Funds	—	—	56	545	601
Private Equity	—	—	—	278	278
Real Estate	—	—	68	22	90
Other	—	—	—	105	105
<b>Total</b>	<b>\$ 476</b>	<b>\$ 1,122</b>	<b>\$ 124</b>	<b>\$ 1,221</b>	<b>\$ 2,943</b>

Assets at Fair Value as of January 28, 2017

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets Measured at NAV	Total
Cash and cash equivalents	\$ 183	\$ —	\$ —	\$ —	\$ 183
Corporate Stocks	240	—	—	—	240
Corporate Bonds	—	57	—	—	57
U.S. Government Securities	—	37	—	—	37
Mutual Funds/Collective Trusts	122	4	—	827	953
Partnerships/Joint Ventures	—	156	—	—	156
Hedge Funds	—	—	67	1,034	1,101
Private Equity	—	—	—	245	245
Real Estate	—	—	65	22	87
Other	—	35	—	44	79
<b>Total</b>	<b>\$ 545</b>	<b>\$ 289</b>	<b>\$ 132</b>	<b>\$ 2,172</b>	<b>\$ 3,138</b>

The fair value of asset groupings changed significantly in 2017, as compared to 2016, due to the LDI transition that began in 2017 as described above.

For measurements using significant unobservable inputs (Level 3) during 2017 and 2016, a reconciliation of the beginning and ending balances is as follows:

	Hedge Funds	Real Estate
Ending balance, January 30, 2016	\$ 61	79
Contributions into Fund	10	9
Realized gains	1	12
Unrealized losses	(1)	(2)
Distributions	(4)	(32)
Other	—	(1)
Ending balance, January 28, 2017	67	65
Contributions into Fund	13	11
Realized gains	1	3
Unrealized gains	5	8
Distributions	(30)	(19)
Ending balance, February 3, 2018	<u>\$ 56</u>	<u>\$ 68</u>

See Note 8 for a discussion of the levels of the fair value hierarchy. The assets' fair value measurement level above is based on the lowest level of any input that is significant to the fair value measurement.

The following is a description of the valuation methods used for the Qualified Plans' assets measured at fair value in the above tables:

- Cash and cash equivalents: The carrying value approximates fair value.
- Corporate Stocks: The fair values of these securities are based on observable market quotations for identical assets and are valued at the closing price reported on the active market on which the individual securities are traded.

- **Corporate Bonds:** The fair values of these securities are primarily based on observable market quotations for similar bonds, valued at the closing price reported on the active market on which the individual securities are traded. When such quoted prices are not available, the bonds are valued using a discounted cash flow approach using current yields on similar instruments of issuers with similar credit ratings, including adjustments for certain risks that may not be observable, such as credit and liquidity risks.
- **U.S. Government Securities:** Certain U.S. Government securities are valued at the closing price reported in the active market in which the security is traded. Other U.S. government securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for similar securities, the security is valued under a discounted cash flow approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.
- **Mutual Funds/Collective Trusts:** The mutual funds/collective trust funds are public investment vehicles valued using a Net Asset Value (NAV) provided by the manager of each fund. The NAV is based on the underlying net assets owned by the fund, divided by the number of shares outstanding. The NAV's unit price is quoted on a private market that is not active. However, the NAV is based on the fair value of the underlying securities within the fund, which are traded on an active market, and valued at the closing price reported on the active market on which those individual securities are traded.
- **Partnerships/Joint Ventures:** These funds consist primarily of U.S. government securities, Corporate Bonds, Corporate Stocks, and derivatives, which are valued in a manner consistent with these types of investments, noted above.
- **Hedge Funds:** Hedge funds are private investment vehicles valued using a Net Asset Value (NAV) provided by the manager of each fund. The NAV is based on the underlying net assets owned by the fund, divided by the number of shares outstanding. The NAV's unit price is quoted on a private market that is not active. The NAV is based on the fair value of the underlying securities within the funds, which may be traded on an active market, and valued at the closing price reported on the active market on which those individual securities are traded. For investments not traded on an active market, or for which a quoted price is not publicly available, a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches, are employed by the fund manager to value investments. Fair values of all investments are adjusted annually, if necessary, based on audits of the Hedge Fund financial statements; such adjustments are reflected in the fair value of the plan's assets.
- **Private Equity:** Private Equity investments are valued based on the fair value of the underlying securities within the fund, which include investments both traded on an active market and not traded on an active market. For those investments that are traded on an active market, the values are based on the closing price reported on the active market on which those individual securities are traded. For investments not traded on an active market, or for which a quoted price is not publicly available, a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches, are employed by the fund manager to value investments. Fair values of all investments are adjusted annually, if necessary, based on audits of the private equity fund financial statements; such adjustments are reflected in the fair value of the plan's assets.
- **Real Estate:** Real estate investments include investments in real estate funds managed by a fund manager. These investments are valued using a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement.

The Company contributed and expensed \$219, \$215 and \$196 to employee 401(k) retirement savings accounts in 2017, 2016 and 2015, respectively. The 401(k) retirement savings account plans provide to eligible employees both matching contributions and automatic contributions from the Company based on participant contributions, compensation as defined by the plan and length of service.

## 16. MULTI-EMPLOYER PENSION PLANS

The Company contributes to various multi-employer pension plans based on obligations arising from collective bargaining agreements. These multi-employer pension plans provide retirement benefits to participants based on their service to contributing employers. The benefits are paid from assets held in trust for that purpose. Trustees are appointed in equal number by employers and unions. The trustees typically are responsible for determining the level of benefits to be provided to participants as well as for such matters as the investment of the assets and the administration of the plans.

The Company recognizes expense in connection with these plans as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. The Company made cash contributions to these plans of \$954 in 2017, \$289 in 2016 and \$426 in 2015. The increase in 2017, compared to 2016, is primarily due to the \$467 pre-tax payment to satisfy withdrawal obligations to the Central States Pension Fund and the 2017 UFCW Contribution.

The Company continues to evaluate and address potential exposure to under-funded multi-employer pension plans as it relates to the Company's associates who are beneficiaries of these plans. These under-fundings are not a liability of the Company. When an opportunity arises that is economically feasible and beneficial to the Company and its associates, the Company may negotiate the restructuring of under-funded multi-employer pension plan obligations to help stabilize associates' future benefits and become the fiduciary of the restructured multi-employer pension plan. The commitments from these restructurings do not change the Company's debt profile as it relates to its credit rating since these off balance sheet commitments are typically considered in the Company's investment grade debt rating.

The Company is currently designated as the named fiduciary of the UFCW Consolidated Pension Plan and the International Brotherhood of Teamsters ("IBT") Consolidated Pension Fund and has sole investment authority over these assets. The Company became the fiduciary of the IBT Consolidated Pension Fund in 2017 due to the ratification of a new labor contract with IBT that provided the Company's withdrawal from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2017, the Company incurred a \$550 charge, \$360 net of tax, for obligations related to withdrawals from and settlements of withdrawal liabilities for certain multi-employer pension plan funds, of which \$467 was contributed to the Central States Pension Plan in 2017.
- In 2017, the Company contributed \$111, \$71 net of tax, to the UFCW Consolidated Pension Plan.
- In 2016, the Company incurred a charge of \$111, \$71 net of tax, due to commitments and withdrawal liabilities arising from the restructuring of certain multi-employer pension plan obligations, of which \$28 was contributed to the UFCW Consolidated Pension Plan in 2016.
- In 2015, the Company contributed \$190 to the UFCW Consolidated Pension Plan. The Company had previously accrued \$60 of the total contributions at January 31, 2015 and recorded expense for the remaining \$130 at the time of payment in 2015.

The risks of participating in multi-employer pension plans are different from the risks of participating in single-employer pension plans in the following respects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan allocable to such withdrawing employer may be borne by the remaining participating employers.

- c. If the Company stops participating in some of its multi-employer pension plans, the Company may be required to pay those plans an amount based on its allocable share of the unfunded vested benefits of the plan, referred to as a withdrawal liability.

The Company's participation in multi-employer plans is outlined in the following tables. The EIN / Pension Plan Number column provides the Employer Identification Number ("EIN") and the three-digit pension plan number. The most recent Pension Protection Act Zone Status available in 2017 and 2016 is for the plan's year-end at December 31, 2016 and December 31, 2015, respectively. Among other factors, generally, plans in the red zone are less than 65 percent funded, plans in the yellow zone are less than 80 percent funded and plans in the green zone are at least 80 percent funded. The FIP/RP Status Pending / Implemented Column indicates plans for which a funding improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented. Unless otherwise noted, the information for these tables was obtained from the Forms 5500 filed for each plan's year-end at December 31, 2016 and December 31, 2015. The multi-employer contributions listed in the table below are the Company's multi-employer contributions made in fiscal years 2017, 2016 and 2015.

The following table contains information about the Company's multi-employer pension plans:

Pension Fund	EIN / Pension Plan Number	Pension Protection Act Zone Status		FIP/RP Status Pending/ Implemented	Multi-Employer Contributions			Surcharge Imposed <sup>(6)</sup>
		2017	2016		2017	2016	2015	
SO CA UFCW Unions & Food Employers Joint Pension Trust Fund <sup>(1)(2)</sup>	95-1939092 - 001	Yellow	Red	Implemented	\$ 66	\$ 60	\$ 55	No
Desert States Employers & UFCW Unions Pension Plan <sup>(1)</sup>	84-6277982 - 001	Green	Green	No	18	18	18	No
Sound Retirement Trust (formerly Retail Clerks Pension Plan) <sup>(1)(3)</sup>	91-6069306 - 001	Green	Red	Implemented	20	18	17	No
Rocky Mountain UFCW Unions and Employers Pension Plan <sup>(1)(5)</sup>	84-6045986 - 001	Green	Green	No	19	16	17	No
Oregon Retail Employees Pension Plan <sup>(1)</sup>	93-6074377 - 001	Green	Green	No	9	8	9	No
Bakery and Confectionary Union & Industry International Pension Fund <sup>(1)</sup>	52-6118572 - 001	Red	Red	Implemented	11	10	11	No
Retail Food Employers & UFCW Local 711 Pension <sup>(1)</sup>	51-6031512 - 001	Yellow	Red	Implemented	10	9	9	No
Denver Area Meat Cutters and Employers Pension Plan <sup>(1)</sup>	84-6097461 - 001	Green	Green	No	—	3	7	No
United Food & Commercial Workers Intl Union — Industry Pension Fund <sup>(1)(4)</sup>	51-6055922 - 001	Green	Green	No	33	37	35	No
Western Conference of Teamsters Pension Plan	91-6145047 - 001	Green	Green	No	34	33	31	No
Central States, Southeast & Southwest Areas Pension Plan <sup>(8)</sup>	36-6044243 - 001	Red	Red	Implemented	492	23	16	No
UFCW Consolidated Pension Plan <sup>(1)</sup>	58-6101602 - 001	Green	Green	No	201	34	190	No
Other <sup>(7)</sup>					41	20	11	
<b>Total Contributions</b>					<u>\$ 954</u>	<u>\$ 289</u>	<u>\$ 426</u>	

- (1) The Company's multi-employer contributions to these respective funds represent more than 5% of the total contributions received by the pension funds.
- (2) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at March 31, 2017 and March 31, 2016.
- (3) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at September 30, 2016 and September 30, 2015.
- (4) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at June 30, 2016 and June 30, 2015.
- (5) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at April 30, 2017 and April 30, 2016.
- (6) Under the Pension Protection Act, a surcharge may be imposed when employers make contributions under a collective bargaining agreement that is not in compliance with a rehabilitation plan. As of February 3, 2018, the collective bargaining agreements under which the Company was making contributions were in compliance with rehabilitation plans adopted by the applicable pension fund.
- (7) The increase in the "Other" funds in 2017, compared to 2016 and 2015, is due primarily to withdrawal settlement payments for certain multi-employer funds.
- (8) In 2017, the Company ratified a new contract with the IBT that provided the company to withdrawal from this pension fund and form the IBT consolidated pension fund. The company did not have any contributions in 2017 to the IBT consolidated pension fund.

The following table describes (a) the expiration date of the Company's collective bargaining agreements and (b) the expiration date of the Company's most significant collective bargaining agreements for each of the material multi-employer funds in which the Company participates.

Pension Fund	Expiration Date of Collective Bargaining Agreements	Most Significant Collective Bargaining Agreements <sup>(1)</sup> (not in millions)	
		Count	Expiration
SO CA UFCW Unions & Food Employers Joint Pension Trust Fund	March 2019 to June 2020	2	March 2019 to June 2020 February 2019 to August 2021
UFCW Consolidated Pension Plan	June 2018 to August 2021	8	October 2020
Desert States Employers & UFCW Unions Pension Plan	June 2018 to October 2020	1	October 2020
Sound Retirement Trust (formerly Retail Clerks Pension Plan)	April 2019 to January 2020	2	May 2019 to August 2019
Rocky Mountain UFCW Unions and Employers Pension Plan	January 2019 to February 2019	1	January 2019
Oregon Retail Employees Pension Plan	August 2018 to April 2022	3	August 2018 to June 2019
Bakery and Confectionary Union & Industry International Pension Fund	June 2018 to July 2022	4	July 2018 to May 2020
Retail Food Employers & UFCW Local 711 Pension	April 2017 (2) to March 2019	1	March 2019
Denver Area Meat Cutters and Employers Pension Plan	January 2019 to February 2019	1	January 2019
United Food & Commercial Workers Intl Union — Industry Pension Fund	June 2018 to June 2021	2	April 2019 to March 2021
Western Conference of Teamsters Pension Plan	April 2018 to July 2021	5	April 2019 to July 2021
International Brotherhood of Teamsters Consolidated Pension Fund	September 2022	2	September 2022

- (1) This column represents the number of significant collective bargaining agreements and their expiration date for each of the Company's pension funds listed above. For purposes of this table, the "significant collective bargaining agreements" are the largest based on covered employees that, when aggregated, cover the majority of the employees for which we make multi-employer contributions for the referenced pension fund.
- (2) Certain collective bargaining agreements for each of these pension funds are operating under an extension.

Based on the most recent information available to it, the Company believes the present value of actuarial accrued liabilities in most of these multi-employer plans substantially exceeds the value of the assets held in trust to pay benefits. Moreover, if the Company were to exit certain markets or otherwise cease making contributions to these funds, the Company could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated.

The Company also contributes to various other multi-employer benefit plans that provide health and welfare benefits to active and retired participants. Total contributions made by the Company to these other multi-employer health and welfare plans were approximately \$1,247 in 2017, \$1,143 in 2016 and \$1,192 in 2015.

## 17. HELD FOR SALE

In the third quarter of 2017, the Company announced that as a result of a review of its assets, the Company had decided to explore strategic alternatives, including a potential sale, of its convenience store business. On February 5, 2018, the Company announced a definitive agreement for the sale of the Company's convenience store business for \$2,150.

As of February 3, 2018, certain assets and liabilities, primarily those related to the Company's convenience store business, were classified as held for sale in the Consolidated Balance Sheet. The Company expects to complete the sale of these disposal groups within the next year. The businesses classified as held for sale will not be reported as discontinued operations as the dispositions do not represent a strategic shift that will have a major effect on the Company's operations and financial results.



The following table presents information related to the major classes of assets and liabilities that were classified as assets and liabilities held for sale in the Consolidated Balance Sheet as of February 3, 2018:

(In millions)	February 3, 2018
<b>Assets held for sale:</b>	
Cash and temporary cash investments	\$ 1
Store deposits in-transit	15
Receivables	49
FIFO inventory	95
LIFO reserve	(36)
Prepaid and other current assets	13
Property, plant and equipment, net	441
Intangibles, net	11
Goodwill	14
Other assets	1
<b>Total assets held for sale</b>	<b>\$ 604</b>
<b>Liabilities held for sale:</b>	
Trade accounts payable	\$ 119
Accrued salaries and wages	14
Other current liabilities	85
Other long-term liabilities	41
<b>Total liabilities held for sale</b>	<b>\$ 259</b>

## 18. VOLUNTARY RETIREMENT OFFERING

In 2016, the Company announced a Voluntary Retirement Offering (“VRO”) for certain non-store associates. Approximately 1,300 associates irrevocably accepted the VRO in the first quarter of 2017. Due to the employee acceptances, the Company recognized a VRO charge of \$184, \$117 net of tax, in the first quarter of 2017, which was comprised of \$165 for severance and other benefits, as well as \$19 of other non-cash charges. This charge was recorded in the OG&A caption within the Consolidated Statements of Operations for 2017. The Company paid \$162 of the severance and other benefits in 2017.

## 19. RECENTLY ADOPTED ACCOUNTING STANDARDS

In September 2015, the FASB issued ASU 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments.” This amendment eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This amendment became effective for the Company beginning January 31, 2016, and was adopted prospectively in accordance with the standard. The adoption of this amendment did not have a material effect on the Consolidated Balance Sheets or Consolidated Statements of Operations.

During the second quarter of 2016, the Company adopted ASU 2016-09, “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” This amendment addresses several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. As a result of the adoption, the Company recognized \$49 of excess tax benefits related to share-based payments in the Company’s provision for income taxes in 2016. These items were historically recorded in additional paid-in capital. In addition, for 2016, cash flows related to excess tax benefits are classified as an operating activity. Cash paid on employees’ behalf related to shares withheld for tax purposes is classified as a financing activity. Retrospective application of the cash flow presentation requirements resulted in increases to both “Net cash provided by operating activities” and “Net cash used by financing activities” of \$59 for 2016 and \$84 for 2015. The Company’s stock compensation expense continues to reflect estimated forfeitures.

During 2016, the Company adopted ASU 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Topic 205)". This standard requires the Company to evaluate, for each annual and interim reporting period, whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date the Consolidated Financial Statements are issued or are available to be issued. If substantial doubt is raised, additional disclosures around the Company's plan to alleviate these doubts are required. The adoption of this standard did not affect the Consolidated Financial Statements.

During 2016, the Company adopted ASU 2015-07, "Fair Value Measurement - Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent) (Topic 820)". This standard requires the Company to disclose which assets the Company values using net asset value as a practical expedient, and ends the requirement to classify these assets within the GAAP fair value hierarchy. See Note 15 of the Consolidated Financial Statements for disclosures of assets the Company values using net asset value as a practical expedient.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes." This amendment requires deferred tax liabilities and assets to be classified as noncurrent in a classified statement of financial position. This amendment became effective for the Company beginning January 29, 2017, and was adopted prospectively in accordance with the standard. The implementation of this amendment resulted in the reclassification of current deferred tax liabilities as non-current and had no effect on the Consolidated Statements of Operations.

During the fourth quarter of 2017, the Company adopted ASU 2017-04 "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating the second step from the goodwill impairment test. ASU 2017-04 requires applying a one-step quantitative test and recording the amount of goodwill impairment as the excess of the reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 does not amend the optional qualitative assessment of goodwill impairment. The Company performed its annual evaluation of goodwill in accordance with this standard, which resulted in a goodwill impairment charge of \$110, \$74 net of tax, related to the Company's Kroger Specialty Pharmacy reporting unit.

## **20. RECENTLY ISSUED ACCOUNTING STANDARDS**

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", as amended by several subsequent ASUs, which provides guidance for revenue recognition. The standard's overarching principle is that revenue must be recognized when goods and services are transferred to the customer in an amount that is proportionate to what has been delivered at that point and that reflects the consideration to which the company expects to be entitled for those goods or services. Per ASU 2015-14, "Deferral of Effective Date," this guidance will be effective for the Company in the first quarter of fiscal year ending February 2, 2019. The Company formed a project team to assess and document the accounting policies related to the new revenue guidance. As of the end of 2017, the Company has completed this assessment and documentation. Based on this project, the Company does not expect that the implementation of the new standard will have a material effect on the Consolidated Statements of Operations, Consolidated Balance Sheets or Consolidated Statements of Cash Flows. The Company intends to adopt the new standard on a modified retrospective basis and will be addressing new disclosures regarding revenue recognition policies as required by the new standard at adoption. During the assessment, the Company identified and will be implementing changes, at the beginning of the first quarter of 2018, to the Company's accounting policies and practices, business processes, systems and controls to support the new revenue recognition and disclosure requirements.

In February 2016, the FASB issued ASU 2016-02, "Leases," which provides guidance for the recognition of lease agreements. The standard's core principle is that a company will now recognize most leases on its balance sheet as lease liabilities with corresponding right-of-use assets. This guidance will be effective for the Company in the first quarter of fiscal year ending February 1, 2020. Early adoption is permitted. The adoption of this ASU will result in a significant increase to the Company's Consolidated Balance Sheets for lease liabilities and right-of-use assets, and the Company is currently evaluating the other effects of adoption of this ASU on the Consolidated Financial Statements. This evaluation process includes reviewing all forms of leases, performing a completeness assessment over the lease population, analyzing the practical expedients and assessing opportunities to make certain changes to the Company's lease accounting information technology system in order to determine the best implementation strategy. The Company believes the current off-balance sheet leasing commitments are reflected in the investment grade debt rating.

In March 2017, the FASB issued ASU 2017-07, "Compensation – Retirement Benefits (Topic 715 ): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." ASU 2017-07 requires an employer to report the service cost component of retiree benefits in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit costs are required to be presented separately from the service cost component and outside a subtotal of income from operations. ASU 2017-07 is effective for years, and interim periods within those years, beginning after December 15, 2017, and requires retrospective application to all periods presented. This ASU will impact the Company's Operating Profit subtotal as reported in its Consolidated Statement of Operations by excluding interest expense, investment returns, settlements and other non-service cost components of retiree benefit expenses. Information about interest expense, investment returns and other components of retiree benefit expenses can be found in Note 15 of the Consolidated Financial Statements.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income." ASU 2018-02 amends ASC 220, "Income Statement - Reporting Comprehensive Income," to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. In addition, under the ASU 2018-02, the Company may be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the effect of the standard on its Consolidated Financial Statements.

## 21. QUARTERLY DATA (UNAUDITED)

The two tables that follow reflect the unaudited results of operations for 2017 and 2016.

	Quarter				Total Year (53 Weeks)
	First (16 Weeks)	Second (12 Weeks)	Third (12 Weeks)	Fourth (13 Weeks)	
<b>2017</b>					
Sales	\$ 36,285	\$ 27,597	\$ 27,749	\$ 31,031	\$ 122,662
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	28,281	21,609	21,532	24,240	95,662
Operating, general and administrative	6,376	4,523	4,708	5,962	21,568
Rent	270	225	196	220	911
Depreciation and amortization	736	562	573	565	2,436
Operating profit	622	678	740	44	2,085
Interest expense	177	138	136	148	601
Earnings (loss) before income tax expense	445	540	604	(104)	1,484
Income tax expense (benefit)	148	189	215	(957)	(405)
Net earnings including noncontrolling interests	297	351	389	853	1,889
Net loss attributable to noncontrolling interests	(6)	(2)	(8)	(1)	(18)
Net earnings attributable to The Kroger Co.	\$ 303	\$ 353	\$ 397	\$ 854	\$ 1,907
Net earnings attributable to The Kroger Co. per basic common share	\$ 0.33	\$ 0.39	\$ 0.44	\$ 0.97	\$ 2.11
Average number of shares used in basic calculation	914	897	887	875	895
Net earnings attributable to The Kroger Co. per diluted common share	\$ 0.32	\$ 0.39	\$ 0.44	\$ 0.96	\$ 2.09
Average number of shares used in diluted calculation	925	905	893	884	904
Dividends declared per common share	\$ 0.120	\$ 0.125	\$ 0.125	\$ 0.125	\$ 0.495

Annual amounts may not sum due to rounding.

Net earnings for the first quarter of 2017 include \$199, \$126 net of tax, related to the withdrawal liability for certain multi-employer pension funds and \$184, \$117 net of tax, related to the voluntary retirement offering.

Net earnings for the fourth quarter of 2017 include charges to operating, general and administrative expenses of \$351, \$234 net of tax, related to obligations from withdrawing from and settlements of withdrawal liabilities for certain multi-employer pension funds, \$110, \$74 net of tax, related to the Kroger Specialty Pharmacy goodwill impairment and \$502, \$335 net of tax, related to a company-sponsored pension plan termination.

Net earnings for the fourth quarter of 2017 include a reduction to depreciation and amortization expenses of \$19, \$13 net of tax, related to held for sale assets. Net earnings for the fourth quarter 2017 include a reduction to income tax expense of \$922 primarily due to the re-measurement of deferred tax liabilities and the reduction of the statutory rate for the last five weeks of the fiscal year from the Tax Cuts and Jobs Act. In addition, net earnings include \$119, \$79 net of tax, due to a 53<sup>rd</sup> week in fiscal year 2017.

2016	Quarter				Total Year (52 Weeks)
	First (16 Weeks)	Second (12 Weeks)	Third (12 Weeks)	Fourth (12 Weeks)	
Sales	\$ 34,604	\$ 26,565	\$ 26,557	\$ 27,611	\$ 115,337
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	26,669	20,697	20,653	21,483	89,502
Operating, general and administrative	5,779	4,473	4,443	4,483	19,178
Rent	262	205	199	215	881
Depreciation and amortization	694	525	549	572	2,340
Operating profit	1,200	665	713	858	3,436
Interest expense	155	116	124	126	522
Earnings before income tax expense	1,045	549	589	732	2,914
Income tax expense	350	171	206	230	957
Net earnings including noncontrolling interests	695	378	383	502	1,957
Net loss attributable to noncontrolling interests	(1)	(5)	(8)	(4)	(18)
Net earnings attributable to The Kroger Co.	\$ 696	\$ 383	\$ 391	\$ 506	\$ 1,975
Net earnings attributable to The Kroger Co. per basic common share	\$ 0.72	\$ 0.40	\$ 0.41	\$ 0.54	\$ 2.08
Average number of shares used in basic calculation	954	943	940	929	942
Net earnings attributable to The Kroger Co. per diluted common share	\$ 0.71	\$ 0.40	\$ 0.41	\$ 0.53	\$ 2.05
Average number of shares used in diluted calculation	966	959	953	943	958
Dividends declared per common share	\$ 0.105	\$ 0.120	\$ 0.120	\$ 0.120	\$ 0.465

Annual amounts may not sum due to rounding.

In the second quarter of 2016, the Company incurred a \$111 charge to OG&A expenses for commitments and withdrawal liabilities associated with the restructuring of certain multi-employer pension plan agreements.

## 22. SUBSEQUENT EVENTS

### *Sale of Convenience Store Business*

On February 5, 2018, the Company announced that it has entered into a definitive agreement to sell its convenience store business for \$2,150.

### *Debt*

On March 16, 2018, the Company obtained a \$1,000 term loan facility with a maturity date of March 16, 2019. The funds were drawn on March 26, 2018 and were used to reduce outstanding commercial paper borrowings. Under the terms of the agreement, interest rates are adjusted monthly based on the Company's Public Debt Rating and prevailing LIBOR rates. At the Company's current Public Debt Rating, as of March 26, 2018, the term loan bears a variable interest rate of 2.72%.

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Kroger has a variety of plans under which employees may acquire common shares of Kroger. Employees of Kroger and its subsidiaries own shares through a profit sharing plan, as well as 401(k) plans and a payroll deduction plan called the Kroger Stock Exchange. If employees have questions concerning their shares in the Kroger Stock Exchange, or if they wish to sell shares they have purchased through this plan, they should contact:

Computershare Plan Managers  
P.O. Box 43021  
Providence, RI 02940  
Phone 800-872-3307

Questions regarding Kroger's 401(k) plans should be directed to the employee's Human Resources Department or 1-800-2KROGER. Questions concerning any of the other plans should be directed to the employee's Human Resources Department.

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SHAREHOLDERS: EQ Shareowner Services is Registrar and Transfer Agent for Kroger's common shares. For questions concerning payment of dividends, changes of address, etc., individual shareholders should contact:

EQ Shareowner Services  
P. O. Box 64854  
Saint Paul, MN 55164-0854  
Toll Free 1-855-854-1369

Shareholder questions and requests for forms available on the Internet should be directed to:  
[www.shareowneronline.com](http://www.shareowneronline.com).

FINANCIAL INFORMATION: Call (513) 762-1220 to request printed financial information, including Kroger's most recent report on Form 10-Q or 10-K, or press release. Written inquiries should be addressed to Shareholder Relations, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45202-1100. Information also is available on Kroger's corporate website at [ir.kroger.com](http://ir.kroger.com).

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## EXECUTIVE OFFICERS

**Mary Ellen Adcock**  
Group Vice President

**Jessica C. Adelman**  
Group Vice President

**Stuart Aitken**  
Group Vice President

**Robert W. Clark**  
Senior Vice President

**Yael Cosset**  
Group Vice President

**Michael J. Donnelly**  
Executive Vice President  
and Chief Operating Officer

**Carin L. Fike**  
Vice President and Treasurer

**Todd A. Foley**  
Vice President and Controller

**Christopher T. Hjelm**  
Executive Vice President and  
Chief Information Officer

**Calvin J. Kaufman**  
Senior Vice President

**Timothy A. Massa**  
Group Vice President

**Stephen M. McKinney**  
Senior Vice President

**W. Rodney McMullen**  
Chairman of the Board and  
Chief Executive Officer

**J. Michael Schlotman**  
Executive Vice President and  
Chief Financial Officer

**Erin S. Sharp**  
Group Vice President

**Alessandro Tosolini**  
Senior Vice President

**Mark C. Tuffin**  
Senior Vice President

**Christine S. Wheatley**  
Group Vice President, Secretary  
and General Counsel

## OPERATING UNIT HEADS

**Rodney C. Antolock**  
Harris Teeter

**Timothy F. Brown**  
Cincinnati Division

**Jerry Clontz**  
Mid-Atlantic Division

**Zane Day**  
Nashville Division

**Daniel C. De La Rosa**  
Columbus Division

**Peter M. Engel**  
Fred Meyer Jewelers

**Liz Ferneding**  
Ruler Foods

**Monica Garnes**  
Fry's Food & Drug

**Dennis R. Gibson**  
King Soopers/City Market

**Joseph A. Grieshaber, Jr.**  
Fred Meyer Stores

**Scott Hays**  
Michigan Division

**Brian Helman**  
Vitacost

**Scot R. Hendricks**  
Delta Division

**Valerie L. Jabbar**  
Ralphs

**Colleen Juergensen**  
Dillons Food Stores

**Bryan H. Kaltenbach**  
Food 4 Less

**Kenneth C. Kimball**  
Smith's

**Colleen R. Lindholz**  
Pharmacy and The Little Clinic

**Bruce A. Lucia**  
Atlanta Division

**Pamela J. Matthews**  
Central Division

**Michael Marx**  
Roundy's Supermarkets,  
Wisconsin

**Domenic A. Meffe**  
Specialty Pharmacy

**Gary Millerchip**  
Kroger Personal Finance

**Suzy Monford**  
QFC

**Ann M. Reed**  
Louisville Division

**Donald S. Rosanova**  
Mariano's

**Marlene A. Stewart**  
Houston Division

**Nicholas Tranchina**  
Murray's Cheese

**Dana Zurcher**  
Dallas Division



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WASTE**

[www.thekrogerco.com](http://www.thekrogerco.com)

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