

Notice of 2019 Annual Meeting of Shareholders
2019 Proxy Statement
and
2018 Annual Report



# **Supermarkets**































Pick n Save

**Price-Impact Stores** 

Food Less Foods Co. Ruler

**Multi-Department Stores** 













**Jewelry Stores** 

Fred Meyer Jewelers LITTMAN JEWELERS









**Services** 









#### Fellow Shareholders:

2018 was year one of *Restock Kroger*, our three-year plan to create shareholder value by pursuing our vision to serve America through food inspiration and uplift.

I'm pleased to report that Kroger achieved what we set out to do last year. We delivered over \$1 billion in savings through cost controls and process improvements, invested for the future, and delivered against our operating profit and cash flow goals.

Landing the first year of a three-year plan is always the toughest and most critical, since everything that follows depends on the foundation we've built. That foundation positions us to deliver on our 2020 *Restock Kroger* objectives and transform the company for long-term growth.

Restock Kroger is our commitment our customers, associates and communities. By serving these stakeholders, our shareholders are rewarded. We are investing for the future while also growing today. We are introducing new ways to shop, fresh foods to savor, and new ways to save, all so that our customers will love shopping with us. We are investing in our associates more than ever before. We are establishing new ways to live our Purpose through Zero Hunger | Zero Waste. And, through it all, we are reinventing the retail growth model. Together, this will transform Kroger for the better.

Of course, transformational change is hard, and we recognize that we have a lot of work to do. Just look at the Fortune 500 list. You can count about a dozen companies that have truly transformed themselves in the last 10-15 years. And fewer than a quarter of the companies who were on the list 30 years ago are here at all today. But transformation is an imperative, and we are energized by that today just as we always have been throughout our 136-year history.

Stakeholder expectations continue to evolve. Customers want to shop on their terms for anything, anytime, anywhere. Associates want more opportunities to grow, both personally and professionally, and to be a part of teams that respect and care about them. Shareholders rightly want sustainable, long-term growth and profitability – plus a growing dividend. And all stakeholders want to know that we are inspired by purpose and motivated by a vision that Kroger uniquely can deliver.

It's an exciting time in the food retail industry. And even as the industry, our stakeholders and our company embrace change, several things remain constant: our relentless commitment to customers, our clarity of Purpose – To Feed the Human Spirit, and our customer Promise – everyone friendly and caring, everything fresh, uplift every way, and improve every day.

Restock Kroger has four main drivers: Redefine the Grocery Customer Experience, Partner for Customer Value, Develop Talent, and Live Our Purpose. Combined, these drivers come together to Create Shareholder Value through incremental operating profit and cash flow growth by 2020. Our long-term strategy and annual business plan are reviewed and approved by Kroger's engaged Board of Directors.

### **Redefine the Grocery Customer Experience**

We are transforming Kroger to be the leading omnichannel retailer in the food industry.

Our customers don't distinguish between an in store and online experience; rather, they have a need or a problem to solve and want the easiest, most seamless solution. That could mean a delicious restaurant-style meal on the run, a meal kit for dinner tonight, an online order for Pickup or Delivery to stock up on grocery essentials for the week, a Ship order of pantry and household staples ... and the list goes on. We are rapidly expanding our capabilities to be relevant, available and accessible to our customers in both digital and physical environments.

We've been building Kroger's digital platform for several years. We are very pleased with the growth of digital sales, which grew 58% in 2018. The annual run rate for digital sales was about \$5 billion at the end of 2018. Going forward, we are trending toward a run rate of \$9 billion.

We continue working to seamlessly integrate our growing digital platform with our brick-and-mortar grocery business to serve customers anything, anytime, anywhere. At the end of 2018, we offered Pickup or Delivery to 91% of Kroger households. By the end of 2019, with full integration of Kroger Ship into our ecosystem, we will reach 100% of America.

Our Brands continues to shine. Our portfolio of brands grew at a record-setting pace in 2018, even reaching 30.5% unit share in the fourth quarter for the first time. Innovation remains a key driver of growth. We introduced 1,022 new items last year alone, which helped drive strong year-over-year sales lift across Kroger, Private Selection, and Simple Truth.

Simple Truth continued to outperform with double-digit sales growth in 2018. Simple Truth is now a \$2.3 billion brand. Designed to be a solution for customers who don't want to have to examine the label to understand what is in every product, all Simple Truth items are free from more than 101 ingredients that customers told us they don't want in their food. And in 2018 we formed partnerships that offer new platforms to expand the brand's reach even further, including our pilots with Walgreens and Alibaba's TMall platform in China.

#### **Partner for Customer Value**

Transformation requires innovative partnerships. We are identifying partners who will help us deliver customer value today and in the future.

We announced several exciting new partnerships in 2018, including Home Chef, Microsoft, Nuro, and Ocado among others. All of these partnerships accelerate our ability to provide customers anything, anytime, anywhere. And each partner shares our passion for exploring the nexus between technology and innovative customer experiences.

I'd like to highlight two of these partnerships, Home Chef and Ocado. We merged with Home Chef, an online meal kit company, in 2018. What made Home Chef such a compelling merger partner is their combination of technology-enabled culinary expertise and customer data driven decision making. Home Chef is #1 in customer satisfaction among meal kit companies because they are relentlessly focused on the customer. They continue to grow and shape the meal solutions category. Shortly after our merger, Home Chef launched their first ever in-store meal kits. Today the products are available in nearly 700 locations and we have plans for further expansion.

Our exclusive licensing agreement with Ocado, one of the world's largest dedicated online grocery retailers, will enable Kroger to provide a faster, more curated ecommerce shopping experience for customers than ever before. The Ocado Smart Platform utilizes advanced robotics and efficient automated warehouse technology to create an end-to-end supply chain solution that will advance our already-strong supply chain infrastructure. What does that mean for customers? Fresher food, delivered faster, to enjoy longer. We've identified the locations for the first three Ocado customer fulfillment centers, or "sheds", in the U.S. – southwest Ohio, central Florida and the Mid-Atlantic region – and will name additional locations in 2019.

### **Develop Talent**

Transformation starts with our people, which is why *Develop Talent* is a driver of *Restock Kroger*. Our talent development strategy has three parts: investing in associates, improving the associate experience, and developing high performing teams and leaders.

We are investing an incremental \$500 million in our associates over the three years of *Restock Kroger*. In 2018, we accelerated these planned investments to increase wages for our store associates. The federal tax reform was a catalyst enabling us to accelerate these investments. We chose to take a balanced approach to ensure tax reform benefited our shareholders, customers and associates alike. Shareholders are benefiting from approximately a third of the tax savings flowing through to net earnings per diluted share. Another third of the savings is being reinvested to improve the customer experience. And we are investing the final third to improve the associate experience through an increased 401k match, expanded associate discounts, and a new industry-leading education assistance program called *Feed Your Future*. Our combined efforts significantly improved employee retention in one of the tightest labor markets in years.

Feed Your Future strengthens human capital by improving access to education. We launched the program a year ago, which is available to all associates, full or part time, after six months of service. Among all the participants, 83% are hourly store associates.

Many people's first job is in retail. Kroger has always been a place where people can 'come for a job and stay for a career.' And, certainly, our hope with programs like *Feed Your Future* is that associates will bring their educational growth back to Kroger through increased performance and responsibility. But whether or not an associate remains with Kroger for the long term, we know that the investment we are making in them is going to last. It is going to give that person a better life, which is going to make the world a better place.

#### **Live Our Purpose**

Increasingly, customers, associates and investors are choosing to shop with, work for and invest in companies that are purpose driven and making the world a better place. At Kroger, our Purpose is to Feed the Human Spirit. And while we live our purpose in large ways and small every day across our stores, manufacturing plants, distribution facilities and offices, one of the most innovative ways we Feed the Human Spirit is through our social impact plan, Zero Hunger | Zero Waste.

136 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. 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 believe we can address this absurdity – perhaps better than anyone.

Zero Hunger | Zero Waste aims to end hunger in the places we call home and eliminate waste across the company by 2025.

In 2018, we celebrated several milestones on our journey. Kroger donated more than 316 million meals in food and funds to feed hungry families. That's more than 100 million pounds of nutritious food directed to local Feeding America food banks, and enough to feed nearly 80,000 food insecure people for a whole year. Our teams increased recycling by nearly 20% across the company, bringing total waste diversion to 76% as we work toward zero waste-to-landfill.

Also, in 2018 Kroger became the first major U.S. retailer to commit to phasing out single-use plastic grocery bags and transition to more sustainable options to better protect the planet. And we were thrilled to be recognized on Fortune magazine's Change the World 2018 list for using Kroger's scale for good – engaging our business to solve society's most complex issues – through Zero Hunger | Zero Waste.

We welcome you to join us on our journey, too. You can follow along at <a href="www.thekrogerco.com">www.thekrogerco.com</a> or #zerohungerzerowaste.

\* \* \*

### **Create Shareholder Value**

We are transforming from a grocery company to a growth company.

We are creating a virtuous circle built on our grocery business and the data that business generates. We use data both to serve our more than 60 million customers better and to create new business opportunities that leverage our consumer insights.

We are improving our seamless ecosystem by offering customers incredible physical and digital experiences, great meals and amazing products, friendly and caring associates, and unprecedented convenience.

A constantly-improving customer ecosystem generates traffic, customer data and insights.

These then fuel the growth of adjacent alternative profit streams like our Kroger Personal Finance, 84.51°, and Media businesses. It is worth noting that each of these businesses beat their operating profit targets for 2018. This was very encouraging because they are the biggest line items in our portfolio of alternative profit businesses.

It is a virtuous circle that works for customers and shareholders. Delivering an amazing customer experience creates incremental new profit streams, and new profit streams provide capital that can be reinvested in our core grocery business, making the seamless experience possible. Both parts are necessary to deliver sustainable, long-term growth and profitability.

# Strategic Sale of Assets

Throughout 2018 we explored strategic alternatives for several business units that had greater potential for growth outside of the Kroger ecosystem. Those explorations resulted in the sale of our Convenience Store business, YouTech, and Turkey Hill business. These transactions generated value for shareholders and will allow for each of these businesses to reach their full potential. The sale of YouTech includes a long-term services agreement with Inmar to provide digital coupon services to the Kroger family of stores and we will continue to offer our customers Turkey Hill's popular ice cream, iced teas, lemonades and other products.

\* \* \*

As America's grocer, Kroger has the winning combination of local presence plus a digital ecosystem, enhanced by strategic partnerships, that together enable us to offer our customers anything, anytime, anywhere. We are deploying our assets to serve more customers and create asset-light, margin-rich alternative profit streams. We are living our Purpose and pursuing our *Restock Kroger* vision to serve America through food inspiration and uplift.

Very few Fortune 500 companies have transformed themselves since the list's inception more than six decades ago. But Kroger has done so time and again by always focusing on the ever-evolving needs of our customers. We will transform because we have transformed, repeatedly, through our 136-year history.

When I think about Barney Kroger's fledgling business on Pearl Street near the Ohio River delivering groceries to customer homes by horse-drawn carriage ... and compare that to our business in Houston delivering groceries to customer homes by Nuro's self-driving R1 robot ... there are some dramatic differences but, really, it's about the same thing: delivering for our customers. It's just a different kind of horsepower.

\* \* \*

For our associates: Thank you for what you do every day, for our customers, the communities we call home, 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

Rodny M. Milla

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 "achieve," "believe," "committed," "continue," "deliver," "effect," "future," "growth," "imperative," "may, "plan," "reinventing;" "result," "strategy," "strong," "sustainable," "transform," "trend," "vision," and "will," as well as similar words or phrases. 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.

# 2018 Zero Hunger I Zero Waste Champion Award

Congratulations to The Kroger Co. Zero Hunger I Zero Waste Champions for 2018:

Division	Recipient
Atlanta	Matt Hall
Central	Mike Brown
Cincinnati	Tina Huff
Columbus	Charlotte Sullivan
Dallas	Booker Johnson
Delta	Amber Winchester
Dillon Stores	Kristen Honeycutt
Food 4 Less	Renee Morris
Fred Meyer	Terri Gigliotti
Fry's	Luke Adams
Houston	Chris Foreman
King Soopers/City Market	Brad Crowe
Louisville	Doug Oberhausen
Mariano's	Suzanne McDonnell
Michigan	Liz Olson
Mid-Atlantic	Jade Hughes
Nashville	Clarissa Whitfield
QFC	Amber Brask
Ralphs	Fawad Khan
Roundy's	Charles Barthel, Mitchell Prince
Ruler	Gary Dwiggins
Smith's	Dayzjah Sagapolu, Gus Sagapolu
Mariaha Farada	Maril Oscilla
Kenlake Foods	Karl Smith
Westover Dairy	Wendy Cheatham
Pace Dairy - Crawfordsville	Charlene Hall
County Oven Bakery	Michael Brown
Layton Dough	Dave Ross
Supply Chain	Ryan McCloy
Kroger Technology	Denise Haskamp, Jeff Pitzer, Devin Thomas, Erin Neace, Randal McClimans
84.51	Reid McCreary, Melissa Bailey, Tiffany Barker,
GO	Stephen Eadicicco, Lindsey Hasis Dana Urner



# **Notice of 2019 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 27, 2019, 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 consider and act upon a proposal to approve The Kroger Co. 2019 Long-Term Incentive Plan.

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 2019.

6. To vote on two 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 1,

2019 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.

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 may attend

the meeting. If you own your shares through a brokerage firm you must bring your brokerage statement to show you owned the shares as of the record date and valid photo identification, such as a driver's license or passport. If you own your shares directly, you should bring the notice of meeting that was mailed to you, or the top portion of your proxy card, and valid photo identification. We reserve the right to

exclude any person who cannot provide the required items.

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 at 11:00 a.m. eastern time on June 27, 2019.

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

May 14, 2019 Cincinnati, Ohio By Order of the Board of Directors, Christine S. Wheatley, Secretary

### **Proxy Statement**

May 14, 2019

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 27, 2019, 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 14, 2019.

#### Who can vote?

You can vote if, as of the close of business on May 1, 2019, 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 for base solicitation fees.

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?

Anne Gates, W. Rodney McMullen, and Ronald L. Sargent, all Kroger Directors, are the members of the Proxy Committee for our 2019 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.
- 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?

Shareholders holding shares at the close of business on the record date may attend the meeting. If you own your shares through a brokerage firm you must bring your brokerage statement to show you owned the shares as of the record date and valid photo identification, such as a driver's license or passport. If you own your shares directly, you should bring the notice of meeting that was mailed to you, or the top portion of your proxy card, and valid photo identification. We reserve the right to exclude any person who cannot provide the required items.

### 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 1, 2019, the record date, our outstanding voting securities consisted of 806,682,213 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 – 4 and 6 and 7, 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 and voting recommendation for each of the proposals?

Proposals	Board Recommendation	Voting Approval Standard	Effect of Abstention	Effect of broker Non-vote
No. 1 Election of Directors	FOR each Director Nominee	More votes "FOR" than "AGAINST" since an uncontested election	No Effect	No Effect
No. 2 Advisory Vote to Approve Executive Compensation	FOR	Affirmative vote of the majority of shares participating in the voting	No Effect	No Effect
No. 3 Vote to Approve The Kroger Co. 2019 Long-Term Incentive Plan	FOR	Affirmative vote of the majority of shares participating in the voting	No Effect	No Effect
No. 4 Vote to Approve Amendment to Regulations to Permit Board Amendments in Accordance with Ohio Law	FOR	Affirmative vote of 75% of the outstanding shares	Vote Against	Vote Against
No. 5 Ratification of Independent Auditors	FOR	Affirmative vote of the majority of shares participating in the voting	No Effect	Not Applicable
Nos. 6 and 7 Shareholder Proposals	AGAINST each Proposal	Affirmative vote of the majority of shares participating in the voting	No Effect	No Effect

# Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to be Held on June 27, 2019

The Notice of 2019 Annual Meeting, Proxy Statement and 2018 Annual Report and the means to vote by internet are available at www.proxyvote.com.

### **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.
- ✓ Adopted proxy access for director nominees, enabling a shareholder, or group of up to 20 shareholders, holding 3% of the Company's common shares for at least three years to nominate candidates for the greater of two seats or 20% of board nominees.

### **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 12 members. All nominees, if elected at the 2019 Annual Meeting, will serve until the annual meeting in 2020, or until their successors have been elected by the shareholders or by the Board pursuant to Kroger's Regulations, and qualified. As previously disclosed, Mr. Robert D. Beyer has informed the Board that he is retiring from the Board effective as of June 27, 2019 and will not stand for re-election.

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 2020

#### Nora A. Aufreiter

Age 59

Director Since 2014

Committees: Financial Policy Public Responsibilities Ms. Aufreiter is Director Emeritus of McKinsey & 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. She is also on the board of two privately held companies, 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.

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.

#### **Anne Gates**

Age 59

Director Since 2015

Committees: Audit\*

Public Responsibilities

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 1992-2012. Her roles included Executive Vice President, Managing Director, and Chief Financial Officer for Disney Consumer Products, 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. and Raymond James Financial, Inc.

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 and she serves as Chair of the Audit Committee.

<sup>\*</sup> Denotes Committee Chair

### Susan J. Kropf

Age 70

Director Since 2007

Committees:
Compensation &
Talent Development
Corporate Governance

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 is currently a director of Avon Products, Inc., Tapestry, Inc., and Sherwin Williams Company. She also serves on the board of a privately held company, New Avon, LLC. In the past five years she also served as a director of MeadWestvaco Corporation.

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.

### W. Rodney McMullen Chairman and Chief Executive Officer

Age 58

Director Since 2003

Mr. McMullen was elected Chairman of the Board in January 2015 and Chief Executive Officer of Kroger in January 2014. He served as Kroger's President and Chief Operating Officer from August 2009 to December 2013. Prior to that, Mr. McMullen was elected to various roles at Kroger including Vice Chairman in 2003, Executive Vice President, Strategy, Planning, and Finance in 1999, Senior Vice President in 1997, Group Vice President and Chief Financial Officer in June 1995, and Vice President, Planning and Capital Management in 1989. He is a director of Cincinnati Financial Corporation and VF Corporation.

Mr. McMullen has broad experience in the supermarket business, having spent his career spanning over 40 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 Chairman. His service as chair of Cincinnati Financial Corporation's compensation committee and on its executive and investment committees, as well as his service on the audit and nominating and governance committees of VF Corporation, adds depth to his extensive retail experience.

### Jorge P. Montoya

Age 72

Director Since 2007

Committees:
Compensation &
Talent Development
Public Responsibilities\*

Mr. Montoya was President of The Procter & Gamble Company's Global Snacks & Beverage division, and President of Procter & Gamble Latin America, from 1999 until his retirement in 2004. Prior to that, he was an Executive Vice President of Procter & Gamble, a provider of branded consumer packaged goods, from 1995 to 1999. Mr. Montoya is a director of The Gap, Inc.

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 & Technology, in *Hispanic Engineer & Information Technology Magazine*.

<sup>\*</sup> Denotes Committee Chair

Clyde R. Moore	Mr. Moore was the Chairman of First Service Networks, a national provider of facility					
Age 65	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.					
Director Since 1997	Mr. Moore has over 30 years of general management experience in public and private					
Committees: Compensation & Talent Development* Corporate Governance	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.					
James A. Runde	Mr. Runde is a special advisor and former Vice Chairman of Morgan Stanley, a financial					
Age 72	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					
Director Since 2006	acquisition by ConocoPhillips in 2006. Mr. Runde serves as a Trustee Emeritus of Marquette University and the Pierpont Morgan Library.					
Committees: Compensation & Talent Development Financial Policy*	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.					
Ronald L. Sargent	Mr. Sargent was Chairman and Chief Executive Officer of Staples, Inc., a business					
Lead Director	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					
Age 63	positions. He is a director of Five Below, Inc. and Wells Fargo & Company. In the past five years, he served as a director of Staples, Inc.					
Director Since 2006	Mr. Sargent has over 35 years of retail experience, first with Kroger and then with					
Committees:	increasing levels of responsibility and leadership at Staples, Inc. His efforts helped					
Audit Corporate Governance*	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.					
Public Responsibilities	Mr. Sargent has been designated an Audit Committee financial expert and serves as Lead Director of the Board.					
Bobby S. Shackouls	Mr. Shackouls was Chairman of the Board of Burlington Resources Inc., a natural					
Age 68	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					
Director Since 1999	was also President and Chief Executive Officer of Burlington Resources Oil and Gas Company (formerly known as Meridian Oil Inc.), a wholly-owned subsidiary of Burlington					
Committees:	Resources, from 1994 to 1995. Mr. Shackouls is a director of Oasis Petroleum Inc.,					
Audit Corporate Governance	Quintana Energy Services, Plains GP Holdings, L.P., and Plains All American Pipeline, L.P. Plains GP Holdings, L.P. is the ultimate general partner of Plains All American Pipeline, L.P. and although the two are separate publicly traded companies, they are governed by a single board, and directors receive compensation for service on the single board.					
	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.					

<sup>\*</sup> Denotes Committee Chair

#### Mark S. Sutton

Age 57

Director Since 2017

Committees:
Audit
Public Responsibilities

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. Mr. Sutton is a member of The Business Council. He serves on the boards of the American Forest & Paper Association, The Business Roundtable, the International Advisory Board of the Moscow School of Management – Skolkovo. He was appointed Chairman of the U.S. – Russian Business Council and New Memphis Institute Board of Governors. He also serves on the Board for Memphis Tomorrow.

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.

#### Ashok Vemuri

Age 51

Director Since 2019

Committees: Financial Policy Public Responsibilities Mr. Vemuri has served as Chief Executive Officer and a Director of Conduent Incorporated, a global digital interactions company, since the company's inception as a result of the spin-off from Xerox Corporation in January 2017. He previously served as Chief Executive Officer of Xerox Business Services, LLC and as an Executive Vice President of Xerox Corporation from July 2017 to December 2017. Prior to that, he was President, Chief Executive Officer, and a member of the Board of Directors of IGATE Corporation, a New Jersey-based global technology and services company now part of Capgemini, from 2013 to 2015. Before joining IGATE, Mr. Vemuri spent 14 years at Infosys Limited, a multinational consulting and technology services company, in a variety of leadership and business development roles and served on the board of Infosys from 2011 to 2013. Prior to joining Infosys in 1999, Mr. Vemuri worked in the investment banking industry at Deutsche Bank and Bank of America.

Mr. Vemuri brings to the Board a proven track record of leading technology services companies through growth and corporate transformations. His experience as CEO of global technology companies is of particular value to the Board as he brings a unique operational, financial, and client experience perspective.

#### The Board of Directors Recommends a Vote For Each Director Nominee.

### **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 who help the Board reflect the diversity of our shareholders, associates, customers, and the communities in which we operate. Some consideration is also 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.

The Corporate Governance Committee believes that it has been successful in its efforts to promote gender and ethnic diversity on our Board. The Corporate Governance Committee and Board believe that our director nominees for election at our 2019 annual meeting bring to our Board a variety of different experiences, skills, and qualifications that contribute to a well-functioning diverse Board that effectively oversees the Company's strategy and management. The charts below show the diversity of our director nominees and the skills and experience that we consider important for our directors in light of our current business, strategy, and structure:

	Nora Aufreiter			Rodney McMullen	Jorge Montoya			Ronald Sargent	Bobby Shackouls	Mark Sutton		Total (of 11)
Business Management	•	•	•	•	•	•	•	•	•	•	•	11
Retail	•	•	•	•	•			•				6
Consumer	•	•	•	•	•			•				6
Financial Expertise	•	•	•	•		•	•	•	•	•	•	10
Risk Management				•			•	•	•	•	•	6
Operations & Technology	•	•	•	•	•	•		•	•	•	•	10
Sustainability	•	•	•		•			•		•		6
Manufacturing		•	•		•	•				•		5



### **Information Concerning the Board of Directors**

### **Board Leadership Structure and Lead Independent Director**

The Board is currently composed of eleven 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 planning process, including 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. Ronald L. Sargent, an independent director and the Chair of the Corporate Governance Committee, was recently appointed Lead Director in June 2018. Mr. Sargent 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 an international retailer;
- 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 evaluation to determine whether the Board is functioning effectively both at the Board and at the committee levels. As part of this annual 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 ensuring 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 a detailed written annual evaluation of the Board and the committees on which he or she serves and the Lead Director conducts interviews with each of the directors. These Board evaluations are designed to 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 process also evaluates the relationship between management and the Board, including the level of access to management, responsiveness of management, and the effectiveness of the Board's evaluation of management performance. The results of this Board 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 New York Stock Exchange ("NYSE") listing standards. The current charter of each Board committee is available on our website at ir.kroger.com under Investors – Governance – Guidelines on Issues of Corporate Governance.

Name of Committee, Number of Meetings, and Current Members	Committee Functions
Audit Committee  Meetings in 2018: 5	<ul> <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> </ul>
Members: Anne Gates, <i>Chair</i> Ronald L. Sargent Bobby S. Shackouls	<ul> <li>Selects, evaluates, and oversees the compensation and work of the independent registered public accounting firm and reviews its performance, qualifications, and independence</li> </ul>
Mark S. Sutton	<ul> <li>Oversees and evaluates the Company's internal audit function, including review of its audit plan, policies and procedures, and significant findings</li> </ul>
	<ul> <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> </ul>
	• Reviews and monitors the Company's compliance programs, including the whistleblower program
Compensation Committee  Meetings in 2018: 4	Recommends for approval by the independent directors the compensation of the CEO and approves the compensation of other senior management
<b>Members:</b> Clyde R. Moore, <i>Chair</i> Susan J. Kropf	<ul> <li>Administers the Company's executive compensation policies and programs, including determining grants of equity awards under the plans</li> </ul>
Jorge P. Montoya James A. Runde	Has sole authority to retain and direct the committee's compensation consultant
	Assists the full Board with senior management succession planning

Name of Committee, Number of Meetings, and Current Members	Committee Functions
Corporate Governance Committee	Oversees the Company's corporate governance policies and procedures
Meetings in 2018: 2  Members:	<ul> <li>Develops criteria for selecting and retaining directors, including identifying and recommending qualified candidates to be director</li> </ul>
Ronald L. Sargent, <i>Chair</i> Robert D. Beyer	nominees  • Designates membership and Chairs of Board committees
Susan J. Kropf	Reviews the Board's performance and director independence
Clyde R. Moore Bobby S. Shackouls	Establishes and reviews the practices and procedures by which the Board performs its functions
Financial Policy Committee	Reviews and recommends financial policies and practices
Meetings in 2018: 2	Oversees management of the Company's financial resources
Members: James A. Runde, <i>Chair</i> Nora A. Aufreiter Robert D. Beyer	<ul> <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> </ul>
Ashok Vemuri	<ul> <li>Monitors the investment management of assets held in pension and profit sharing plans administered by the Company</li> </ul>
Public Responsibilities Committee  Meetings in 2018: 2	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,
Members:	government relations, political action, consumer and media relations, food and pharmacy safety and the safety of customers and employees
Jorge P. Montoya, <i>Chair</i> Nora A. Aufreiter Anne Gates Ronald L. Sargent Mark S. Sutton Ashok Vemuri	Reviews and examines the Company's evaluation of and response to changing public expectations and public issues affecting the business

# **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, science,
  technology, e-commerce, law, and government;
- experience in high growth companies and nominees whose business experience can help the Company innovate and derive new value from existing assets;
- · 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.

The *Guidelines on Issues of Corporate Governance* includes a policy that a director's normal retirement occurs at the Annual Meeting of Shareholders following the year in which the director reaches the age of 72. However, the Board believes that it is important to monitor the Board's composition, skills, diversity, and needs in the context of the Company's overall strategy, and, therefore, may elect to waive the policy in circumstances it deems necessary. Two directors will have reached their normal retirement date at the Annual Meeting, Jorge P. Montoya and James A. Runde. Upon review of the matter, the Corporate Governance Committee recommended, and the Board approved, waiving the retirement date for Mr. Montoya and Mr. Runde and nominating these directors for reelection at the Annual Meeting for an additional one-year term. The Corporate Governance Committee and the Board believe that Mr. Montoya's and Mr. Runde's experience as directors and their knowledge of the Company's business and strategy, particularly in light of the transition of the grocery industry will continue to be of value to the Board. Also, in light of Mr. Beyer, a long-tenured director, retiring from the Board, and the addition of four new directors since 2014, the Corporate Governance and Board believe it provides necessary continuity for Mr. Montoya and Mr. Runde to remain on the Board for an additional year.

### 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 2018, we requested meetings with shareholders representing nearly 50% of our outstanding shares during proxy season and off season engagement and ultimately engaged with shareholders representing over a third of our outstanding shares.

During these engagements, some of which included the participation of our Lead Director, 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 2020 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 30, 2020. 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."

Eligible shareholders have the ability to submit director nominees for inclusion in our proxy statement for the 2020 annual meeting of shareholders. 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 15, 2019 and no later than January 14, 2020.

#### **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 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 NYSE 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 Securities and Exchange Commission ("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 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) 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, ordinary business operations, or companies 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 five meetings in fiscal year 2018. During fiscal 2018, 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 of the then current 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 Korn Ferry Hay Group, Inc. ("Korn Ferry") beginning in December 2017. Retained by and reporting directly to the Compensation Committee, Korn Ferry provided the Committee with assistance in evaluating Kroger's executive compensation programs and policies.

In fiscal 2018, Kroger paid Korn Ferry \$366,831 for work performed for the Compensation Committee. Kroger, on management's recommendation, retained Korn Ferry to provide other services for Kroger in fiscal 2018. These other services primarily related to consulting on administrative management and digital and technology compensation structure redesign. The Compensation Committee expressly approved Korn Ferry performing these

additional services. After taking into consideration the NYSE's independence standards and the SEC rules, the Compensation Committee determined that Korn Ferry was independent, and their 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 2018, 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 2018, 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 interrelationships 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**

#### 2018 Director Compensation

The following table describes the 2018 compensation for non-employee directors. Mr. McMullen does not receive compensation for his Board service.

	Fees Earned or			Change in Pension Value And Nongualified	
Name	Paid in Cash	Stock Awards <sup>(1)</sup>	Option Awards <sup>(2)</sup>	Deferred Compensation Earnings <sup>(3)</sup>	Total
Nora A. Aufreiter	\$ 87,692	\$175,621	_	\$ 0	\$263,313
Robert D. Beyer	\$104,005	\$175,621		\$11,117	\$290,743
Anne Gates	\$112,400	\$175,621		_	\$288,021
Susan J. Kropf	\$ 87,692	\$175,621		_	\$263,313
Jorge P. Montoya	\$102,647	\$175,621		_	\$278,268
Clyde R. Moore	\$107,636	\$175,621		\$10,311	\$293,568
James A. Runde	\$102,647	\$175,621		_	\$278,268
Ronald L. Sargent	\$136,752	\$175,621		\$ 3,688	\$316,061
Bobby S. Shackouls	\$ 97,663	\$175,621	_	_	\$273,284
Mark S. Sutton	\$ 97,663	\$175,621	<u> </u>	_	\$273,284
Ashok Vemuri <sup>(4)</sup>	\$ 8,036	\$ 87,508	_	_	\$ 95,544

- (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, 2018, each non-employee director then serving received 6,261 incentive shares with a grant date fair value of \$175,621. Mr. Vemuri received a prorated award of 3,048 shares with a grant date fair value of \$87,508 on January 24, 2019 when he joined the Board.
- (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 was as follows: Mr. Shackouls held 7,800 options and Messrs. Beyer, Montoya, Moore, Runde, and Sargent and Ms. Kropf each held 52,000 options.
- (3) The amounts reported for Mr. Beyer 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 2018 is primarily due to additional benefit accruals but offset by the increase in the discount rate and mortality project scale updates.
- (4) Because Mr. Vemuri was appointed to the Board on January 24, 2019, he received a prorated cash retainer.

#### **Annual Compensation**

Each non-employee director receives an annual cash retainer of \$90,000. The Lead Director receives an additional annual retainer of \$37,500 per year; the members of the Audit Committee each receive an additional annual retainer of \$10,000; the Chair of the Audit Committee receives an additional annual retainer of \$25,000; the Chair of Compensation Committee receives an additional annual retainer of \$20,000; and the Chair of each of the other committees receive an additional annual retainer of \$15,000, Each non-employee director also receives an annual grant of incentive shares (Kroger common shares) with a value of approximately \$175,000.

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 was adjusted in 2018 and 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 six 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, 2019 by Kroger's directors, the NEOs, and the directors and executive officers as a group. The percentage of ownership is based on 798,332,967 of Kroger common shares outstanding on April 1, 2019. 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, 2019. 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, 2019 – included in column (a) (b)
Nora A. Aufreiter <sup>(2)</sup>	25,879	_
Robert D. Beyer <sup>(2)</sup>	185,998	52,000
Robert W. Clark	413,471	217,807
Michael J. Donnelly	710,584	370,667
Anne Gates <sup>(2)</sup>	20,548	_
Christopher T. Hjelm	618,933	352,504
Susan J. Kropf	140,171	52,000
W. Rodney McMullen	4,269,645	1,481,750
Jorge P. Montoya <sup>(3)</sup>	109,079	52,000
Clyde R. Moore	158,571	52,000
James A. Runde	164,613	52,000
Ronald L. Sargent <sup>(2)</sup>	171,921	52,000
J. Michael Schlotman	872,796	587,159
Bobby S. Shackouls <sup>(2)</sup>	87,906	7,800
Mark S. Sutton <sup>(2)</sup>	16,041	_
Ashok Vemuri	3,048	_
Directors and executive officers as a group (29 persons, including those named above)	10,677,615	4,457,326

- (1) No director or officer owned as much as 1% of Kroger common shares. The directors and executive officers as a group beneficially owned 1.34% of Kroger common shares.
- (2) This amount includes incentive share awards that were deferred under the deferred compensation plan for independent directors in the following amounts: Ms. Aufreiter, 9,225; Mr. Beyer, 7,198; Ms. Gates, 7,488; Mr. Sargent, 30,261; Mr. Shackouls, 30,261; Mr. Sutton, 6,350.
- (3) 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, 2019 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	57,852,610 <sup>(1)</sup>	7.30%
Vanguard Group Inc.	100 Vanguard Blvd. Malvern, PA 19355	68,141,855 <sup>(2)</sup>	8.54%

- (1) Reflects beneficial ownership by BlackRock Inc., as of December 31, 2018, as reported on Amendment No. 9 to Schedule 13G filed with the SEC on February 6, 2019, reporting sole voting power with respect to 49,985,270 common shares, and sole dispositive power with regard to 57,852,610 common shares.
- (2) Reflects beneficial ownership by Vanguard Group Inc. as of December 31, 2018, as reported on Amendment No. 4 to Schedule 13G filed with the SEC on February 11, 2019, reporting sole voting power with respect to 929,753 common shares, shared voting power with respect to 203,972 common shares, sole dispositive power of 67,029,453 common shares, and shared dispositive power of 1,112,402 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 2018 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 2018 fiscal year ended February 2, 2019, the NEOs were:

Name	<u>Title</u>
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
Robert W. Clark	Senior Vice President

# Summary of Key Compensation Practices

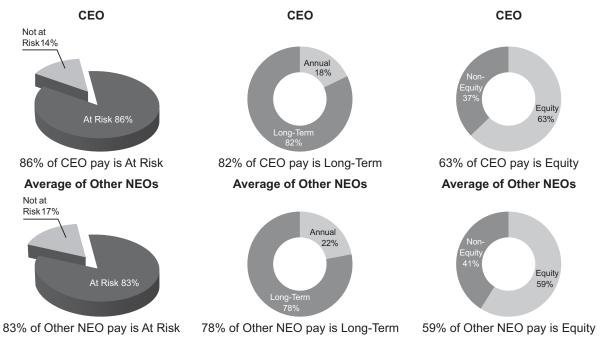
	What we do:		What we do not do:
<b>√</b>	Align pay and performance	X	No employment contracts with executives
✓	Significant share ownership guidelines of 5x salary for our CEO	×	No special severance or change in control programs applicable only to executive officers
✓	Multiple performance metrics under our short- and	x	No tax gross-up payments for executives
	long-term performance-based plans discourage excessive risk taking	×	No re-pricing or backdating of options
/	✓ Balance between short-term and long-term compensation to discourage short-term risk taking at the expense of long-term results		No guaranteed salary increases or bonuses
			No payment of dividends or dividend equivalents until performance units are earned
✓	Engagement of an independent compensation consultant	×	No single-trigger cash severance benefits upon a change in control
✓	Robust clawback policy		
✓	Ban on hedging, pledging and short sales of Kroger securities		
<b>✓</b>	Limited perquisites		

### 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	Attract, incentivize, retain talented executives     Benchmarked to peer group     Fixed cash component     Board reviews annually     No automatic or guaranteed increases     Based on individual performance & experience	FIXED			
	Other Limited additio		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 Executives receive limited perquisites because the Compensation Committee does not believe it is necessary for the attraction or retention of executive talent				
	Annual Incentive Plan	Cash Bonus	Metrics and targets align with annual business goals; payout depends on actual performance against each goal     Rewards and incentivizes Kroger employees, including NEOs, for annual performance on key financial and operational measures     Benchmarked to peer group median				
LONG-TERM INCENTIVE	Long-Term Incentive		Drive profitability and growth, create shareholder value, foster executive retention, and align executive and shareholder interests  All components paid in performance-based long-term cash bonuses and performance units to align	: / AT-RIS			
		executive and shareholder interests; vesting over a 3-year period     Rewards and incentivizes approximately 140 key employees, including NEOs, for long-term performance on key financial and operational measures	VARIABLE				
	Time- Based Restricted Stock		Stock options and restricted stock for NEOs vest over 4 years; exercise price of stock options is closing price on day of grant	>			
LOI	Awards	Stock Options	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				

The amounts used in the charts below are based on the amounts reported in the Summary Compensation Table for 2018, excluding the Change in Pension Value and Nonqualified Deferred Compensation Earnings column.



#### 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:

- 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 profit 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 Restock cash flow. As a result of our plan, over the three-year time period 2018 – 2020, we expect to generate:

- \$400 million in incremental FIFO operating profit, and
- \$6.5 billion of Restock cash flow before dividends.

We have prioritized our estimated \$9 billion in capital investments to support *Restock Kroger* over the three-year time period. 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.<sup>2</sup>

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 available to Kroger executives at the level of Vice President and above 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 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. Accordingly, in 2018, we made changes to our program to align with *Restock Kroger*.

Our 2018 three-year long-term plan (2018 – 2020) has performance metrics tied entirely to *Restock Kroger* goals: *Restock* cash flow and cost savings included in FIFO operating profit growth, with a return on invested capital modifier. We implemented 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. Because the 2016-2018 and 2017-2019 long term plans were mid-cycle, we felt strongly that we should focus on *Restock Kroger* metrics rather than having competing priorities. As a result, in setting 2018

<sup>&</sup>lt;sup>1</sup> Restock cash flow is an adjusted free cash flow measure calculated as net cash provided by operating activities minus net cash used by investing activities plus or minus adjustments for certain items.

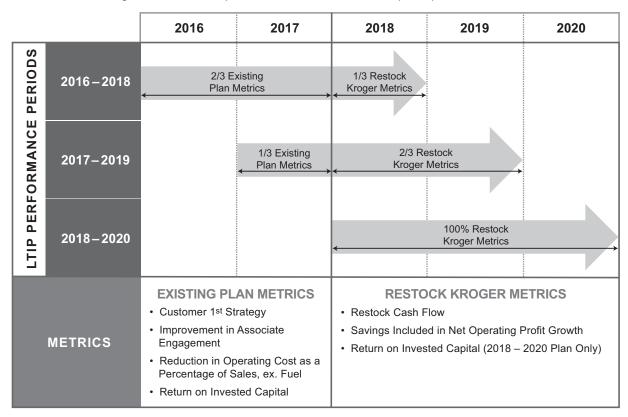
<sup>&</sup>lt;sup>2</sup> For important risk, uncertainties and other factors relating to these forward-looking statements, see the Risk Factors in our Annual Report on Form 10-K that accompanies this proxy statement.

compensation, the Compensation Committee determined that the metrics of the two mid-cycle plans should be modified to align with *Restock Kroger* and the payouts for the then current NEOs should be addressed as described below.

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

With respect to the mid-cycle plans for the then current NEOs, we did not adjust the cash bonus potentials or re-issue previously issued performance unit grants, we did not allow the re-earning of cash and performance units that were not earned in the completed year(s) of the outstanding plans, and we did not change the timing of the payout under the outstanding plans. Mr. Clark, who was not a named executive officer at the time the 2016 plan was modified, was eligible for a different plan as described below. These plan updates are illustrated below.



Our Annual Cash Bonus Program: Based on Meeting Financial Goals

We 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 had the following metrics:

- 1. ID supermarket sales
- 2. Earnings per share
- 3. Kroger Way Plans strategic business plans that support Restock Kroger

To further support the cost saving focus of *Restock Kroger*, for any payout under the Kroger Way 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 purpose: To Feed the Human Spirit.

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 were reviewed in June of 2018.

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 a 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.

### 2018 Annual Cash Bonus Plan Metrics

The annual cash bonus plan is a broad-based plan used across the Kroger enterprise. Approximately 41,000 associates receive bonus payouts based all or in part on the bonus plan described below. The 2018 annual cash bonus plan had the following measurable performance metrics, all of which are interconnected:

Metric	Weight	Rationale for Use
Earnings Per Share 6 bas		<ul> <li>ID Supermarket Sales represent sales, without fuel, at our supermarkets that have been open without expansion or relocation for five full quarters.</li> </ul>
	—— Combined -	<ul> <li>We believe this is the best measure of the real growth of our supermarket sales across the enterprise. A key driver of our model is strong ID Supermarket Sales; it is the engine that fuels our growth.</li> </ul>
	67%, based on a grid	<ul> <li>In previous years, we used Net Operating Profit as a performance metric as it allowed us to evaluate our earnings from operating the business; we cannot achieve solid Net Operating Profit without a strong operating model.</li> </ul>
		<ul> <li>During the first year of Restock Kroger, our business plan anticipated a reduction in Net Operating Profit, so we substituted Earnings per Share for the 2018 annual bonus plan to better motivate our associates across the enterprise to increase this measure of earnings growth as Earnings Per Share were expected to grow in 2018.</li> </ul>
Kroger Way Plans	33%	<ul> <li>Each major business line and department created a Kroger Way Plan – a strategic business plan to directly support one of the four pillars of Restock Kroger.</li> </ul>
		<ul> <li>Each proprietary Kroger Way Plan outlines both the resource allocation and the return commitment for that plan.</li> <li>Combined, these plans form the basis for achieving the three- year Restock Kroger commitments.</li> </ul>
		<ul> <li>Because cost savings is foundational to the success of Restock Kroger, no payout can be earned under the Kroger Way Plan metric without the Company achieving 2018 cost savings of \$950 million – regardless of the extent of the progress on the Kroger Way Plans.</li> </ul>
Total of 3 Metrics	100%	

#### Results of 2018 Annual Cash Bonus Plan

The 2018 goals established by the Compensation Committee, the actual 2018 results, and the bonus percentage earned for each of the performance metrics of the 2018 annual cash bonus plan were as follows:

Payout Matrix		ID Supermarket Sales			
ID Sales ar 2018 Fis		1%	1.65%	2%	3%
	\$1.73	0%	1.3 %	2%	4%
EPS	\$1.90	10%	50 %	75%	100%
	\$2.06	50%	100 %	125%	175%
	\$2.11	75%	125 %	150%	200%

		Payout Percentage	Weight	Amount Earned
Performance Metrics	Result	(A)	(B)	(A) x (B)
	ID Sales = 1.22%			
ID Sales/EPS	EPS = \$2.11	91.76% <sup>1</sup>	67%	61.48%
Kroger Way Plans	(2)	90%	33%	29.71%
Total Earned				91.18%

- (1) See grid above.
- (2) The Company achieved cost savings of \$1.10 billion, which is an amount in excess of the savings threshold of \$950 million. Because the threshold was achieved, it was possible to earn a payout on this metric. The Kroger Way Plan measures were approved by the Compensation Committee 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 payout on the 2018 annual bonus was 91.18% of the participant's bonus potential.

In 2018, 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 2018 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 2018 reflects strong performance on adjusted earnings per share and performance below business plan objectives on identical supermarket sales. 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 2009, 2016, and 2017, when payouts were particularly low. In those years, we failed to achieve 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
2018	91.2%
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 2018 are reported in the Summary Compensation Table in the "Non-Equity Incentive Plan Compensation" column and footnote 3 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 new Long-Term Incentive Plan each year, which provides for overlapping three-year performance periods. The Long-Term Incentive Plans adopted in 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 based on level and individual performance 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

### 2016 and 2017 Long-Term Incentive Plan Metrics

The following table summarizes the metrics applied to fiscal years 2016 and 2017 and the payout percentages:

Metric	Rationale for Use
Customer 1 <sup>st</sup> Strategy	<ul> <li>Kroger's Customer 1<sup>st</sup> Strategy is the focus, in our decision-making, on the customer. This proprietary metric measures the improvement in how Kroger is perceived by customers in each of People, Products, Shopping Experience and Price.</li> </ul>
	4% payout per unit of improvement.
Improvement in Associate Engagement	Kroger measures associate engagement in an annual survey of associates.
	<ul> <li>4% payout per unit of improvement.</li> </ul>
Reduction in Operating Costs <sup>(1)</sup> as a Percentage of Sales, without Fuel	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.
	<ul> <li>0.50% payout per 0.01% reduction in operating costs.</li> </ul>
ROIC <sup>(2)</sup>	Part of our long-term growth strategy is to make substantial capital investments over time. This measure is intended to hold executives accountable for the returns on the capital investments.
	1% payout per 0.01% improvement in ROIC.

- (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.

As described above, under "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 2016 Long-Term Incentive Plan

The 2016 Long-Term Incentive Plan, which measured performance over the three-year period from 2016 to 2018, paid out in March 2019. The 2016 plan was modified during 2018 as described above with respect to the then current named executive officers and was calculated in two parts as follows:

Part 1: Fiscal year 2016 and 2017 performance was measured on the existing plan metrics and was applied to two-thirds of the previously granted cash and performance unit bonus target amounts.

Metric	Baseline	Result	Improvement (A)	Payout per Improvement (B)	Percentage Earned (A) x (B)
Customer 1 <sup>st</sup> Strategy <sup>(1)</sup>	*	*	No improvement	4.0%	0.0%
Improvement in Associate Engagement <sup>(1)</sup>	*	*	No improvement	4.0%	0.0%
Reduction in Operating Cost as a Percentage of Sales, without Fuel	26.16%	26.95%	No improvement	0.5%	0.0%
Return on Invested Capital	13.73%	11.14%	No improvement	1.0%	0.0%
Total					0.0%

<sup>(1)</sup> 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.

Part 2: Fiscal year 2018 performance was measured on the *Restock Kroger* metrics of Restock cash flow and savings included in FIFO operating profit growth, with each metric accounting for 50% of the payout. The payout percentage was applied to one-third of the previously granted cash and performance unit bonus target amounts.

	Cut in = 50% Payout	Goal = 100% Payout	Result	Payout Percentage	Weight	Payout Amount
Savings included in FIFO operating profit growth	\$0.950B	\$1.016B	\$1.100B	100%	50%	50%
Cumulative Free Cash Flow	\$1.200B	\$1.860B	\$1.907B	100%	50%	50%
Total Payout						100%

Accordingly, no payout was earned on 2/3<sup>rds</sup> of the bonus target and 100% payout was earned on 1/3<sup>rd</sup> of the bonus target, resulting in a 33% overall payout. The then current NEOs received long-term cash bonus payments in an amount equal to 33% of that executive's long-term cash bonus potential and were issued the number of Kroger common shares equal to 33% 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. Mr. Clark, who was not a named executive officer at the time the 2016 plan was modified, received a 0% payment with respect to 2016 and 2017 performance and received a 100% payout with respect to 2018 performance on the full amount of his bonus target. The cash payout and dividends paid on common shares earned under the 2016 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 5 to that table, respectively, and the common shares issued under the plan are reported in the 2018 Option Exercises and Stock Vested Table and footnote 2 to that table.

# 2018-2020 Long-Term Incentive Plan Design

The Long-Term Incentive Plan adopted in 2018, which consists of a performance-based long-term cash bonus and performance units, has the following characteristics:

- The long-term cash bonus potential is set by the Compensation Committee, and the independent directors in the case of the CEO.
- In addition, a fixed number of performance units is awarded to each participant at the beginning of a three (3) year 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.
- 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 120% of the long-term cash bonus potential or number of performance units awarded.

Each of the following plan components account for 50% of the potential payout.

Plan Component	2018-2020
Cumulative Savings Included	in Net Operating Profit Growth
Cut in = 50% payout	\$3.0B
Goal = 100% payout	\$4.450B
Cumulative F	ree Cash Flow
Cut in = 50% payout	\$4.875B
Goal = 100% payout	\$6.5B

After the calculation of the two metrics above, a Return on Invested Capital multiplier is applied, as follows:

ROIC Modifier Component						
ROIC Results	Payout Modifier					
Less than 12.24%	80%					
12.24% - 12.44%	100%					
Greater than 12.44%	120%					

# 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 2018, the Compensation Committee granted to the NEOs stock options and restricted stock, each with a four-year vesting schedule, with the exception of a restricted stock grant awarded to Mr. Clark, 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 4 to the Summary Compensation Table and the 2018 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 2018 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 are 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 2018, some NEOs received premiums paid on life insurance policies. 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 Korn Ferry as a compensation consultant to advise the Compensation Committee in the design of compensation for executive officers, through the 2018 compensation planning cycle.

Korn Ferry 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 2018, our peer group consisted of:

Best Buy Home Depot Target

Cardinal Health Johnson & Johnson TJX Companies

Costco Wholesale Lowes 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 modified peer group includes a combination of food and drug retailers, other large retailers based on revenue size, and large consumer-facing companies. Median 2018 revenue for the peer group was \$91.47 billion, compared to our 2018 revenue of \$121.16 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 reflecting a
  comprehensive review of each element of pay mix, both annual and long-term and 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.

## Shareholder Engagement & the 2018 Advisory Vote to Approve Executive Compensation

At the 2018 annual meeting, we held our eighth annual advisory vote on executive compensation. Over 90.94% of the votes cast were in favor of the advisory vote in 2018. In 2018, we also requested meetings with shareholders representing nearly 50% of our outstanding shares during the proxy season and off season engagement and ultimately engaged with shareholders representing over a third of our outstanding shares. Conversations with our shareholders in these meetings included discussions of our compensation program, with our shareholders providing feedback that they appreciate the pay for performance nature of our program's structure. In light of this feedback and the strong support for our executive compensation program at the 2018 annual meeting, the Compensation Committee made no material changes in the structure of our compensation programs for 2018.

# **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 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	Fiscal	Salary	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
Position <sup>(1)</sup>	Year	(\$)	(\$)(1)	(\$)(2)	(\$)(3)	(\$)(4)	(\$) <sup>(5)</sup>	(\$)
W. Rodney McMullen	2018	\$1,311,984	\$4,999,996	\$2,367,858	\$2,692,833	\$ 335,955	\$329,246	\$12,037,872
Chairman and Chief	2017	1,318,752	5,166,317	2,700,116	359,806	1,690,923	298,463	11,534,377
Executive Officer	2016	1,251,781	5,125,034	2,699,044	719,945	3,139,537	282,051	13,217,392
J. Michael Schlotman	2018	907,292	2,350,843	752,700	1,374,160	295,994	91,133	5,772,122
Executive Vice President	2017	898,316	1,973,228	1,040,846	207,136	873,808	242,637	5,235,971
and Chief Financial Officer	2016	850,360	1,973,247	1,040,436	372,855	1,436,752	141,427	5,815,077
Michael J. Donnelly	2018	885,677	2,355,780	769,118	1,344,160	205,544	133,014	5,693,293
Executive Vice President	2017	817,967	2,230,028	780,637	183,832	1,032,483	247,149	5,292,096
and Chief Operating Officer	2016	757,036	1,480,011	780,323	341,308	2,207,236	188,569	5,754,483
Christopher T. Hjelm	2018	751,673	2,142,600	364,751	1,145,133	228	112,118	4,516,503
Executive Vice President	2017	744,245	1,480,025	780,637	173,536	520	190,917	3,369,880
and Chief Information Officer	2016	706,567	1,480,011	780,323	326,280	832	151,201	3,445,214
Robert Clark	2018	473,958	2,625,003	374,947	905,900	284,854	102,653	4,767,315
Senior Vice President								

(1) 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. Because Mr. Clark was not a NEO at the time the existing long-term plans were modified, he received additional grants which are reflected in the table. The following table reflects the value of each type of award granted to the NEOs in 2018:

Name	Restricted Stock	Performance Units
Mr. McMullen	\$2,368,205	\$2,631,791
Mr. Schlotman	\$1,454,505	\$ 896,338
Mr. Donnelly	\$1,480,788	\$ 874,992
Mr. Hjelm	\$1,400,004	\$ 742,596
Mr. Clark	\$1,500,002	\$1,125,001

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 Form 10-K for fiscal year 2018.

Assuming that the highest level of performance conditions is achieved, the aggregate fair value of the 2018 performance unit awards at the grant date is as follows:

Name	Value of Performance Units Assuming Maximum Performance
Mr. McMullen	\$3,158,150
Mr. Schlotman	\$1,075,605
Mr. Donnelly	\$1,049,990
Mr. Hjelm	\$ 891,115
Mr. Clark	\$1,200,001

- (2) 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 Form 10-K for fiscal year 2018.
- (3) Non-equity incentive plan compensation earned for 2018 consists of amounts earned under the 2018 performance-based annual cash bonus plan and the 2016 LTIP.

Name	Annual Cash Bonus	Long-Term Cash Bonus
Mr. McMullen	\$2,279,500	\$413,333
Mr. Schlotman	\$1,094,160	\$280,000
Mr. Donnelly	\$1,094,160	\$250,000
Mr. Hjelm	\$ 911,800	\$233,333
Mr. Clark	\$ 455,900	\$450,000

In accordance with the terms of the 2018 performance-based annual cash bonus plan, Kroger paid 91.18% to the NEOs. These amounts were earned with respect to performance in 2018 and paid in March 2019. See "Results of 2018 Annual Cash Bonus Plan" in the CD&A for more information on this plan.

The long-term cash bonus awarded under the 2016 LTIP is a performance-based bonus plan designed to reward participants for improving the long-term performance of the Company. See "Results of 2016 LTIP" in the CD&A for more information on this plan.

(4) For 2018, 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 Clark, and preferential earnings on nonqualified deferred compensation, which applies to Messrs. McMullen, Donnelly, and Hjelm. Neither Mr. Schlotman nor Mr. Clark participate in a nonqualified deferred compensation plan.

Name	Change in Pension Value	Preferential Earnings on Nonqualified Deferred Compensation
Mr. McMullen	\$224,954	\$111,001
Mr. Schlotman	\$295,994	_
Mr. Donnelly	\$199,248	\$ 6,296
Mr. Hjelm	_	\$ 228
Mr. Clark	\$284,854	_

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 2018 compared to 2017 is due to additional benefits accrued, as applicable. Please see the 2018 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 2018 earn interest at a rate higher than 120% of the corresponding federal rate; accordingly, there are preferential earnings on these amounts.
- (5) Amounts reported in the "All Other Compensation" column for 2018 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	\$94,560	_	\$35,953	\$198,734	_
Mr. Schlotman	_	_	\$12,899	\$ 78,234	_
Mr. Donnelly	_	\$45,534	\$ 9,675	\$ 77,805	_
Mr. Hjelm		\$40,831	\$ 9,675	\$ 61,612	_
Mr. Clark	\$18,454	\$34,509	\$ 7,086	\$ 42,604	_

- (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 2018:
  - Mr. Donnelly a \$13,750 matching contribution to the Dillon Companies, Inc. Employees' Profit
    Sharing Plan and a \$31,784 matching contribution to the Dillon Companies, Inc. Excess Benefit Profit
    Sharing Plan;
  - Mr. Hjelm a \$13,750 matching contribution and a \$2,000 automatic company contribution to The Kroger Co. 401(k) Retirement Savings Account Plan and a \$25,081 contribution to The Kroger Co. 401(k) Retirement Savings Account Restoration Plan; and
  - Mr. Clark a \$13,750 matching contribution to the Dillon Companies, Inc. Employees' Profit Sharing Plan and a \$20,759 matching contribution to the Dillon Companies, Inc. Excess Benefit Profit Sharing Plan
- (b) Other. For each of the NEOs the total amount of other benefits was less than \$10,000.

#### 2018 Grants of Plan-Based Awards

The following table provides information about equity and non-equity incentive awards granted to the NEOs in 2018.

		Estimated Fut Under No Incentive Pla	n-Equity	Payou Equity	ted Future its Under Incentive Awards	All Other Stock Awards: Number of Shares of Stock or	All Other Option Awards: Number of Securities Underlying	Exercise or Base Price of Option	Grant Date Fair Value of Stock and
Name	Grant Date	Target (\$)	Maximum (\$)	Target (#) <sup>(3)</sup>	Maximum (#) <sup>(3)</sup>	Units (#) <sup>(4)</sup>	Options (#) <sup>(5)</sup>	Awards (\$/Sh)	Option Awards
W. Rodney McMullen		\$2,500,000 <sup>(1)</sup>	\$5,000,000 <sup>(1)</sup>						
	7/13/2018	\$2,631,800 <sup>(2)</sup>	\$3,158,160 <sup>(2)</sup>			84,428			\$2,368,205
	7/13/2018					04,420	349,293	\$28.05	\$2,367,858
	7/13/2018			93,825	112,590		,	<b>+</b>	\$2,631,791
J. Michael Schlotman		\$1,200,000 <sup>(1)</sup>	\$2,400,000(1)						
	7/40/0040	\$ 896,350 <sup>(2)</sup>	\$1,075,620 <sup>(2)</sup>			54.054			<b>04 454 505</b>
	7/13/2018 7/13/2018					51,854	111,034	\$28.05	\$1,454,505 \$ 752,700
	7/13/2018			31,955	38,346		111,034	Ψ20.03	\$ 896,338
Michael J. Donnelly		\$1,200,000 <sup>(1)</sup>	\$2,400,000(1)	,,,,,,					, ,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,
		\$ 875,000 <sup>(2)</sup>	\$1,050,000 <sup>(2)</sup>						
	7/13/2018					52,791	440.450	<u></u>	\$1,480,788
	7/13/2018 7/13/2018			31,194	37,433		113,456	\$28.05	\$ 769,118 \$ 874,992
Christopher T. Hjelm	1710/2010	\$1,000,000 <sup>(1)</sup>	\$2,000,000(1)	01,101	01,100				Ψ 0. 1,002
		\$ 742,600 <sup>(2)</sup>	\$ 891,120(2)						
	7/13/2018					49,911			\$1,400,004
	7/13/2018 7/13/2018			26.474	31.769		53,806	\$28.05	\$ 364,751 \$ 742,596
Robert W. Clark	1/13/2016	\$ 500,000 <sup>(1)</sup>	\$1,000,000 <sup>(1)</sup>	20,474	31,709				\$ 742,590
		\$1,350,000 <sup>(2)</sup>	\$1,440,000 <sup>(2)</sup>						
	7/13/2018					53,476			\$1,500,002
	7/13/2018			40.40=			55,310	\$28.05	\$ 374,947
	7/13/2018			40,107	42,781				\$1,125,001

- (1) These amounts relate to the 2018 performance-based annual cash incentive bonus plan. The amount listed under "Target" represents the annual cash incentive 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 incentive bonus potential; accordingly, the amount listed under "Maximum" is two times that officer's annual cash incentive bonus potential amount. The amounts actually earned under this plan were paid in March 2019 and are included in the Summary Compensation Table for 2018 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 incentive potential under the 2018 Long-Term Incentive Plan, which covers performance during fiscal years 2018, 2019 and 2020. By the terms of the plan, payouts are limited to no more than 120% of a participant's long-term cash incentive potential; accordingly, the amount listed under "Target" is the participant's long-term cash incentive potential. The amount listed under "Maximum" is 120%.
- (3) These amounts represent performance units awarded under the 2018 Long-Term Incentive Plan, which covers performance during fiscal years 2018, 2019 and 2020. The amount listed under "Maximum" represents the maximum number of common shares that can be earned by the NEO under the award or 120% of the target amount. 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 grant date fair value reported in the last column is based on the probable outcome of the performance conditions as of the grant date. The aggregate grant date fair value of these awards is included in the Summary Compensation Table for 2018 in the "Stock Awards" column and described in footnote 1 to that table.

- (4) These amounts represent the number of shares of restricted stock granted in 2018. 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 2018 in the "Stock Awards" column and described in footnote 1 to that table.
- (5) These amounts represent the number of stock options granted in 2018. 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 2018 in the "Option Awards" column.

The Compensation Committee, and the independent members of the Board in the case of the CEO, established the incentive potential amounts for the performance-based annual cash incentive awards (shown in this table as "Target"), the number of performance units awarded (shown in this table as "Target"), and the bonus potential amounts for the long-term cash incentive awards (shown in this table as "Target"). 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 incentive 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 incentive potentials awarded under the 2018 LTIP 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 four anniversaries of the grant date, so long as the officer remains a Kroger employee. Mr. Clark's July 13, 2018 restricted stock award of 26,738 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.

# 2018 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 2018. 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 \$28.07 on February 1, 2019, the last trading day of fiscal 2018.

	Option Awards				Stock Awards			
Name	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	130,000 140,000 182,880 194,880	=	\$11.17 \$10.08 \$12.37 \$10.98	6/25/2019 6/24/2020 6/23/2021 7/12/2022	22,500 <sup>(6)</sup> 34,438 <sup>(7)</sup> 60,033 <sup>(8)</sup> 130,891 <sup>(9)</sup>	\$ 631,575 \$ 966,675 \$1,685,126 \$3,674,110		
	194,880 240,000 141,249 143,236 114,625		\$18.88 \$24.67 \$38.33 \$37.48 \$22.92 \$28.05	7/15/2023 7/15/2024 7/15/2025 7/13/2026 7/13/2027 7/13/2028	84,428 <sup>(10</sup>	\$2,369,894	84,492 <sup>(13)</sup> 90,916 <sup>(14)</sup>	\$2,505,197 \$2,702,036
J. Michael Schlotman	50,000 91,280 109,280 109,280 64,000 63,918	16,000 <sup>(1)</sup> 42,613 <sup>(2)</sup>	\$10.08 \$12.37 \$10.98 \$18.88 \$24.67 \$38.33	6/24/2020 6/23/2021 7/12/2022 7/15/2023 7/15/2024 7/15/2025	6,000 <sup>(6)</sup> 15,444 <sup>(7)</sup> 23,692 <sup>(8)</sup> 51,656 <sup>(9)</sup> 51,854 <sup>(10)</sup>	\$ 168,420 \$ 433,513 \$ 665,034 \$1,449,984 \$1,455,542		
	55,215 44,186 —	82,823 <sup>(3)</sup> 176,744 <sup>(4)</sup> 111,034 <sup>(5)</sup>	\$37.48 \$22.92 \$28.05	7/13/2026 7/13/2027 7/13/2028			29,429 <sup>(13)</sup> 30,964 <sup>(14)</sup>	\$ 872,573 \$ 935,075
Michael J. Donnelly	40,000 70,720 50,720 50,720 48,000 35,957 41,411 33,139	12,000 <sup>(1)</sup> 23,972 <sup>(2)</sup> 62,117 <sup>(3)</sup> 132,559 <sup>(4)</sup> 113,456 <sup>(5)</sup>	\$10.08 \$12.37 \$10.98 \$18.88 \$24.67 \$38.33 \$37.48 \$22.92 \$28.05	6/24/2020 6/23/2021 7/12/2022 7/15/2023 7/15/2024 7/15/2025 7/13/2026 7/13/2027 7/13/2028	4,500 <sup>(6)</sup> 11,819 <sup>(7)</sup> 17,770 <sup>(8)</sup> 38,744 <sup>(9)</sup> 21,203 <sup>(11)</sup> 52,791 <sup>(10)</sup>		22,074 <sup>(13)</sup> 30,227 <sup>(14)</sup>	\$ 654,481 \$ 898,346
Christopher T. Hjelm	16,000 24,000 40,576 50,720 50,720 48,000 47,938	115,450 — — — — — 12,000 <sup>(1)</sup> 31,960 <sup>(2)</sup>	\$11.17 \$10.08 \$12.37 \$10.98 \$18.88 \$24.67 \$38.33	6/25/2019 6/24/2020 6/23/2021 7/12/2022 7/15/2023 7/15/2024 7/15/2025	4,500 <sup>(6)</sup> 11,584 <sup>(7)</sup> 17,770 <sup>(8)</sup> 38,744 <sup>(9)</sup> 49,911 <sup>(10)</sup>	\$ 126,315 \$ 325,163 \$ 498,804 \$1,087,544 \$1,401,002	22,074 <sup>(13)</sup>	\$ 654,481
	41,411 33,139 —	62,117 <sup>(3)</sup> 132,559 <sup>(4)</sup> 53,806 <sup>(5)</sup>	\$37.48 \$22.92 \$28.05	7/13/2026 7/13/2027 7/13/2028			25,653 <sup>(14)</sup>	\$ 762,416
Robert W. Clark	21,500 7,000 22,500 10,000 16,000 25,000 30,000 24,000 17,982 22,811 21,014	6,000 <sup>(1)</sup> 11,988 <sup>(2)</sup> 34,219 <sup>(3)</sup> 84,060 <sup>(4)</sup> 55,310 <sup>(5)</sup>	\$10.08 \$10.94 \$12.37 \$11.76 \$10.98 \$15.75 \$18.88 \$24.67 \$38.33 \$37.48 \$22.92 \$28.05	6/24/2020 9/16/2020 6/23/2021 12/8/2021 7/12/2022 3/14/2023 7/15/2023 7/15/2024 7/15/2025 7/13/2026 7/13/2028	2,700 <sup>(6)</sup> 5,213 <sup>(7)</sup> 11,115 <sup>(8)</sup> 24,566 <sup>(9)</sup> 26,738 <sup>(10)</sup> 26,738 <sup>(12)</sup>	\$ 750,536	12,808 <sup>(15)</sup> 12,955 <sup>(14)</sup>	\$ 373,467 \$ 385,010

<sup>(1)</sup> Stock options vest on 7/15/2019.

- (2) Stock options vest in equal amounts on 7/15/2019 and 7/15/2020.
- (3) Stock options vest in equal amounts on 7/13/2019, 7/13/2020, and 7/13/2021.
- (4) Stock options vest in equal amounts on 7/13/2019, 7/13/2020, 7/13/2021, and 7/13/2022.
- (5) Stock options vest in equal amounts on 7/13/2019, 7/13/2020, 7/13/2021, and 7/13/2022.
- (6) Restricted stock vests on 7/15/2019.
- (7) Restricted stock vests in equal amounts on 7/15/2019 and 7/15/2020.
- (8) Restricted stock vests in equal amounts on 7/13/2019, 7/13/2020, and 7/13/2021.
- (9) Restricted stock vests in equal amounts on 7/13/2019, 7/13/2020, 7/13/2021, and 7/13/2022.
- (10) Restricted stock vests in equal amounts on 7/13/2019, 7/13/2020, 7/13/2021, and 7/13/2022.
- (11) Restricted stock vests 33% on 12/7/2019 and 67% on 12/7/2020.
- (12) Restricted stock vests 25% on each of 7/13/2019, 25% on 7/13/2020, and 50% on 7/13/2021.
- (13) 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 2018, including cash payments equal to projected dividend equivalent payments.
- (14) Performance units granted under the 2018 long-term incentive plan are earned as of the last day of fiscal 2020, 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 2018, including cash payments equal to projected dividend equivalent payments.
- (15) Performance units granted under the 2018 2019 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 2018, including cash payments equal to projected dividend equivalent payments.

# 2018 Option Exercises and Stock Vested

The following table provides information regarding 2018 stock options exercised, restricted stock vested, and common shares issued pursuant to performance units earned under long-term incentive plans.

	Option Awards <sup>(1)</sup>		Stock Awards <sup>(2)</sup>		
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)	
W. Rodney McMullen	130,000	\$1,528,800	163,526	\$4,560,593	
J. Michael Schlotman	_	_	55,948	\$1,543,895	
Michael J. Donnelly	_	_	48,916	\$1,361,803	
Christopher T. Hjelm	_	_	40,731	\$1,124,299	
Robert W. Clark	14,500	\$ 259,402	31,722	\$ 843,380	

<sup>(1)</sup> 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:

	Vested Rest	Vested Restricted Stock		<b>Earned Performance Units</b>		
Name	Number of Shares	Value Realized	Number of Shares	Value Realized		
Mr. McMullen	139,068	\$3,955,257	24,458	\$605,336		
Mr. Schlotman	47,173	\$1,326,714	8,775	\$217,181		
Mr. Donnelly	42,335	\$1,198,923	6,581	\$162,880		
Mr. Hjelm	34,150	\$ 961,419	6,581	\$162,880		
Mr. Clark	18,353	\$ 512,497	13,369	\$330,883		

*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. Participants in the 2016 LTIP, as modified, were awarded performance units that were earned based on performance criteria established by the Compensation Committee as described on page 19 of the CD&A. 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 \$24.75 on March 14, 2019, the date of deemed delivery of the shares, are reflected in the table above.

#### 2018 Pension Benefits

The following table provides information regarding pension benefits for the NEOs as of the last day of fiscal 2018.

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	33	\$ 1,478,015	_
	Excess Plan	33	\$14,735,498	_
J. Michael Schlotman	Pension Plan	33	\$ 1,601,117	_
	Excess Plan	33	\$ 7,632,275	_
Michael J. Donnelly	Pension Plan	39	\$ 841,548	_
	Excess Plan	39	\$ 6,072,232	_
Christopher T. Hjelm	Pension Plan	_	(2)	(2)
Robert W. Clark	Pension Plan	34	\$ 314,368	_
	Excess Plan	34	\$ 1,521,638	_

- (1) The discount rate used to determine the present values was 4.22% 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 2018.
- (2) Mr. Hjelm does not participate in the Pension Plan or the Excess Plan.

# Pension Plan and Excess Plan

In 2018, Messrs. McMullen, Schlotman, Donnelly, and Clark were participants in the Pension Plan, which is a qualified defined benefit pension plan. Messrs. McMullen, Schlotman, Donnelly, and Clark 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, Schlotman and Clark, 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, Donnelly and Clark are eligible for these grandfathered benefits.

# 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, Donnelly, and Clark will receive benefits under the Pension Plan and the Excess Plan, determined as follows:

- 1½% 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 1¼% 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 1/3 of one percent for each of the first 24 months and by 1/2 of one percent for each of the next 60 months by which the commencement of benefits precedes age 62.

In 2018, we announced changes to these company-sponsored pension plans. The Company will freeze the compensation and service periods used to calculate pension benefits for active employees who participate in the affected pension plans, including the NEO participants as of December 31, 2019. Beginning January 1, 2020, the affected active employees will no longer accrue additional benefits for future service and eligible compensation received under these plans.

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.

# Offsetting Benefits

Messrs. Donnelly and Clark also participate 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 Messrs. Donnelly and Clark, 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, Messrs. Donnelly and Clark'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. Messrs. Donnelly and Clark also participate 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 Messrs. Donnelly and Clark's benefit from the Excess Plan. The offsets are reflected in the Pension Benefits table above.

#### 2018 Nonqualified Deferred Compensation

The following table provides information on nonqualified deferred compensation for the NEOs for 2018. Messrs. Schlotman, Hjelm and Clark 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	\$131,544 <sup>(3)</sup>	\$666,069	\$10,563,424
J. Michael Schlotman	_	_	_
Michael J. Donnelly	\$ 91,916 <sup>(4)</sup>	\$ 36,245	\$ 668,829
Christopher T. Hjelm	_	\$ 12,294	\$ 272,006
Robert Clark	_	_	_

- (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 2018 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 2018: Mr. McMullen, \$111,001; Mr. Donnelly, \$6,296; and Mr. Hjelm, \$228.
- (2) The following amounts in the Aggregate Balance column were reported in the Summary Compensation Tables covering fiscal years 2006 2017: Mr. McMullen, \$3,102,637; Mr. Donnelly, \$232,576; and Mr. Hjelm, \$149,370.
- (3) This amount includes the deferral of \$59,583 of his salary in fiscal 2018; this amount is included in the "Salary" column of the Summary Compensation Table for 2018. This amount also includes the deferral of \$57,600 of his 2015 Long-Term Incentive Plan cash incentive earned for performance over the three year period 2015 to 2017 and paid in March 2018 and the deferral of \$14,361 of his 2017 performance-based annual cash incentive plan earned in 2017 and paid in March 2018; these amounts are included in the "Non-Equity Incentive Plan Compensation" column of the Summary Compensation Table for 2017.
- (4) This amount includes the deferral of \$79,548 of his 2015 Long-Term Incentive Plan cash incentive earned for performance over the three year period 2015 to 2017 and paid in March 2018; this amount is included in the "Non-Equity Incentive Plan Compensation" column of the Summary Compensation Table for 2018 and the deferral of \$12,368 of his 2017 performance-based annual cash incentive plan earned in 2017 and paid in March 2018.

#### **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 2018 earn interest at a rate of 3.6%. 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 2018 Pension Benefits section and the 2018 Nonqualified Deferred Compensation section, respectively.

## The Kroger Co. Employee Protection Plan

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.

Triggering Event	Stock Options	Restricted Stock	Performance Units	Performance-Based Long-Term Cash Bonus
Involuntary Termination	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
Voluntary Termination/ Retirement  - Prior to minimum age and five years of service <sup>(1)</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
Voluntary Termination/ Retirement  - After minimum age and five years of service <sup>(1)</sup>	Unvested options held greater than 1 year continue vesting on the original schedule. All options are exercisable for remainder of the original 10-year term.	Unvested shares held greater than 1 year continue vesting on the original schedule	Pro rata portion <sup>(2)</sup> of units earned based on performance results over the full three-year period	Pro rata portion <sup>(2)</sup> of long- term cash bonuses earned based on performance results over the full three- year period
Death	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>(2)</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>(2)</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.
Disability	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>(2)</sup> of units earned based on performance results over the full three-year period	Pro rata portion <sup>(2)</sup> of long- term cash bonuses earned based on performance results over the full three- year period
Change in Control <sup>(3)</sup>	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 minimum age requirement is age 62 for stock options and restricted stock and age 55 for performance units and the long-term cash bonus.
- (2) 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.
- (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 2, 2019, 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 (\$28.07 on February 1, 2019). 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
W. Rodney McMullen						
Accrued and Banked Vacation	\$653,934	\$ 653,934	\$ 653,934	\$ 653,934	\$ 653,934	\$ 653,934
Severance	_	_	_	_	_	7,631,808
Continued Health and Welfare Benefits <sup>(1)</sup>	_	_	_	_	_	25,337
Stock Options <sup>(2)</sup>	_	_	3,718,393	3,718,393	3,718,393	3,718,393
Restricted Stock <sup>(3)</sup>	_	_	9,327,380	9,327,380	9,327,380	9,327,380
Performance Units <sup>(4)</sup>	_	1,511,079	1,511,079	1,511,079	3,051,377	3,051,377
Long-Term Cash Bonus <sup>(5)</sup>	_	1,415,406	1,415,406	1,415,406	1,935,900	1,935,900
Executive Group Life Insurance	_	_	1,973,850	_	_	_
J. Michael Schlotman						
Accrued and Banked Vacation	\$445,773	\$ 445,773	\$ 445,773	\$ 445,773	\$ 445,773	\$ 445,773
Severance	_	_	_	_	_	4,246,512
Continued Health and Welfare Benefits <sup>(1)</sup>	_	_	_	_	_	25,313
Stock Options <sup>(2)</sup>	_	_	966,932	966,932	966,932	966,932
Restricted Stock <sup>(3)</sup>	_	_	4,172,493	4,172,493	4,172,493	4,172,493
Performance Units <sup>(4)</sup>	_	526,083	526,083	526,083	1,052,639	1,052,639
Long-Term Cash Bonus <sup>(5)</sup>	_	663,997	663,997	663,997	855,120	855,120
Executive Group Life Insurance			1,384,875			
Michael J. Donnelly	0.470.040	<b>4.70.040</b>	<b>A</b> 470.040	A 470.040	<b>6</b> 170 010	<b>A</b> 470.040
Accrued and Banked Vacation	\$173,813	\$ 173,813	\$ 173,813	\$ 173,813	\$ 173,813	\$ 173,813
Severance	_	_	_	_	_	4,202,520
Continued Health and Welfare Benefits <sup>(1)</sup>	_	_	705.000	705.000	725.000	12,229
Stock Options <sup>(2)</sup> Restricted Stock <sup>(3)</sup>	_	_	725,808	725,808	725,808	725,808
Performance Units <sup>(4)</sup>	_	396,927	4,121,434	4,121,434	4,121,434	4,121,434
Long-Term Cash Bonus <sup>(5)</sup>	_	590,92 <i>1</i> 591,401	396,927 591,401	396,927 591,401	890,956 761,250	890,956 761,250
Executive Group Life Insurance		391,401	1,351,875	331,401	701,230	701,230
Christopher T. Hjelm			1,001,070			
Accrued and Banked Vacation	\$ 5,884	\$ 5,884	\$ 5,884	\$ 5,884	\$ 5,884	\$ 5,884
Severance	_	_	_	_	_	3,529,800
Continued Health and Welfare Benefits <sup>(1)</sup>	_	_	_	_	_	55,345
Stock Options <sup>(2)</sup>	_	_	724,615	724,615	724,615	724,615
Restricted Stock <sup>(3)</sup>	_	_	3,438,828	3,438,828	3,438,828	3,438,828
Performance Units <sup>(4)</sup>	_	395,402	395,402	395,402	824,711	824,711
Long-Term Cash Bonus <sup>(5)</sup>	_	551,974	551,974	551,974	710,500	710,500
Executive Group Life Insurance	_	_	1,147,350	_	_	_
Robert W. Clark						
Accrued and Banked Vacation	\$ 5,769	\$ 5,769	\$ 5,769	\$ 5,769	\$ 5,769	\$ 5,769
Severance	_	_	_	_	_	2,000,016
Continued Health and Welfare Benefits <sup>(1)</sup>	_	_	_	_	_	32,916
Stock Options <sup>(2)</sup>	_	_	454,415	454,415	454,415	454,415
Restricted Stock <sup>(3)</sup>	_	_	2,724,755	2,724,755	2,724,755	2,724,755
Performance Units <sup>(4)</sup>	_	_	155,010	155,010	375,268	375,268
Long-Term Cash Bonus <sup>(5)</sup>	_	_	210,968	210,968	506,518	506,518
Executive Group Life Insurance	_	_	750,000	_	_	_

- (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 24 months for all 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 1, 2019. 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 2017 and 2018, based on performance through the last day of fiscal 2018 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 2017 and 2018. Awards under the 2016 Long-Term Incentive Plan were earned as of the last day of 2018 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 2018 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 2017 and 2018, based on performance through the last day of fiscal 2018 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 2017 and 2018 Long-Term Incentive Plans. Awards under the 2016 Long-Term Incentive Plan were earned as of the last day of 2018, 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 2018.

#### **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 2018 of \$12,037,872. Using this Summary Compensation Table methodology, the annual total compensation of our median employee for 2018 was \$24,912. As a result, we estimate that the ratio of our CEO's annual total compensation to that of our median employee for fiscal 2018 was 483 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 8, 2018), 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, February 4, 2018, through February 2, 2019; and we multiplied the

average weekly earnings during this period of each full-time and part-time permanent employee by 52, which was the number of weeks in fiscal 2018. We annualized the earnings of all permanent employees who were on a leave of absence or were new-hires in 2018. 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. The median employee did not change from the prior year. There were no changes in our employee population or compensation arrangements that would have significantly affected our pay ratio calculation.

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 2018, 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 2020 annual meeting.

The Board of Directors Recommends a Vote For This Proposal.

# Item No. 3 Vote to Approve The Kroger Co. 2019 Long-Term Incentive Plan

You are being asked to vote to approve the Kroger 2019 Long-Term Incentive Plan (the "2019 Plan"). Our Board of Directors has adopted and recommends that you vote FOR this proposal.

Under this Item No. 3, the Board is recommending that our shareholders approve the 2019 Plan, which was adopted, subject to shareholder approval, by the Board of Directors on April 29, 2019. The 2019 Plan is intended to replace our shareholder-approved 2014 Long-Term Incentive and Cash Bonus Plan, as amended (the "2014 Plan"), and our shareholder-approved 2011 Long-Term Incentive and Cash Bonus Plan, as amended (the "2011 Plan"), and to implement, among other things:

- Authorization of 38,000,000 new shares for issuance under the 2019 Plan;
- A mandated minimum vesting period of one (1) year; and
- A double-trigger approach for change-in-control vesting if awards are not assumed, substituted or otherwise replaced in connection with the change-in-control.

If the 2019 Plan is approved by our shareholders, it will become effective as of the date of the Annual Meeting and no additional awards will be granted under the 2014 Plan or the 2011 Plan. In the event that our shareholders do not approve this Proposal, the 2019 Plan will not become effective, and the 2014 Plan and 2011 Plan will continue to be effective in accordance with their terms. No awards have or will be made under the 2019 Plan prior to its approval by shareholders at the Annual Meeting.

As described above in the section entitled "Compensation Discussion and Analysis" beginning on page 19 above, the Compensation Committee of the Board of Directors has long maintained a strong pay for performance philosophy designed to attract and retain the best management talent, to motivate employees to achieve our business and financial goals, and 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. To achieve our objectives, the Compensation Committee seeks to ensure that compensation is competitive and that 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. If the 2019 Plan is approved, the Company will be able to continue to provide equity awards as part of its compensation program, which is necessary to successfully attract and retain the best possible candidates for positions of substantial responsibility within the Company and to ensure that compensation is competitive and has a direct link with performance. Moreover, awarding equity compensation aligns the interests of our NEOs with the interests of our shareholders and creates incentives to achieve the annual business plan targets and longer term company objectives. The details and design elements of the 2019 Plan are set forth in the section entitled "—Summary of the 2019 Plan" beginning on page 52 below.

Providing equity and equity-based awards aligns employee compensation interests with the investment interests of our shareholders, and reduces cash compensation expense, permitting cash to be reinvested in our business or returned to our shareholders. Approval of the 2019 Plan will allow Kroger to continue to provide equity and equity-based awards to recruit and compensate its officers and other key employees beyond the time at which the shares reserved under the 2014 Plan and the 2011 Plan would be depleted. If the 2019 Plan is not approved, the Company will continue to grant awards under the 2014 Plan and the 2011 Plan until there are no longer any shares available for grant.

We are requesting approval of 38,000,000 shares for awards under the 2019 Plan. Awards may also be made under the 2019 Plan with respect to an estimated 23,783,636 shares that, as of April 23, 2019, remain available for grant under the 2014 Plan and the 2011 Plan, each of which has previously been approved by our shareholders. In addition, if and only to the extent forfeited in accordance with the terms of such plans, a maximum of 26,311,950 shares previously granted under the 2014 Plan and the 2011 Plan may become available for awards under the 2019 Plan (for the avoidance of doubt, such shares are not initially available for grant under the 2019 Plan). We refer to the aggregate number of shares available for awards under the 2019 Plan as the "share reserve." The share reserve will be reduced by one share for each share subject to a stock option or share appreciation right, and by 2.83 shares for each share subject to a restricted stock award, award of restricted stock units (including performance units), or other share award. In determining the number of shares to request under the 2019 Plan, we evaluated our share availability under the 2014 Plan and the 2011 Plan, recent share usage, our historical annual equity award grant rate, our historical forfeiture rate and our estimates of the number of shares needed to attract new executive hires. We expect that the share reserve will allow us to continue to appropriately grant equity awards at reasonable and desirable levels for approximately the next three years; however, the

amount of future awards is not currently known and will depend on various factors that cannot be predicted, including, but not limited to, the price of our shares on future grant dates, the volatility of the stock and the types of awards that will be granted.

#### Key Plan Provisions

- The 2019 Plan has a ten-year term;
- The 2019 Plan provides for the following types of equity awards: stock options (both incentive stock options and nonqualified stock options), share appreciation rights, restricted stock awards, restricted stock units (including performance units), cash incentive awards and share awards;
- 38,000,000 shares will be newly authorized for issuance pursuant to awards under the 2019 Plan;
- An estimated 23,783,636 shares that remain available for grant under the 2014 Plan and the 2011 Plan as
  of April 23, 2019 may also be granted under the 2019 Plan;
- Any shares subject to outstanding awards under the 2014 Plan or 2011 Plan that are forfeited, cancelled
  or otherwise expire that would have been added back to the share reserves under the 2014 Plan or
  2011 Plan, will roll over into the share reserve of the 2019 Plan, subject to a maximum of
  26,311,950 shares that may be forfeited under such plans as described above;
- The share reserve will be reduced by one share for each share subject to a stock option or share appreciation right, and by 2.83 shares for each share subject to a restricted stock award, award of restricted stock units (including performance units), or other share award;
- All types of equity awards granted under the 2019 Plan may have all or a significant portion of compensation linked to the achievement of performance goals by the Company and/or the participant; and
- The 2019 Plan will be administered by the Compensation Committee, which is comprised entirely of
  independent non-employee directors, and which may delegate authority to a committee of executives in
  respect of awards to Kroger associates who are not our NEOs or subject to Section 16 under the
  Exchange Act.

In addition, the 2019 Plan increases flexibility for design of performance-based awards following the repeal of the exemption for performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986, as amended ("Section 162(m)"). The Compensation Committee aims to continue to retain flexibility to design compensation programs that are in the long-term best interests of Kroger and our shareholders, with deductibility of compensation being only one of a range of considerations taken into account.

#### **Key Shareholder Considerations**

Shareholders should consider the following in determining whether to approve the 2019 Plan:

Our burn rate is reasonable. As detailed in the table below, our three-year average adjusted burn rate, which we define as the number of shares subject to time-based equity awards granted and performance-based equity awards earned in a fiscal year divided by the weighted average common shares outstanding for that fiscal year, with a multiplier as assigned by ISS of 2.5 for full value shares, is 1.87%. It is our intention to remain within the burn rate guidelines established by ISS for our industry.

Fiscal Year	Options Granted	Full-Value Shares Granted	Total Granted (full-value shares adjusted)*	Weighted Average # of Common Shares Outstanding	Burn Rate
2018	2,780,977	4,611,375	14,309,415	810,166,210	1.77%
2017	7,000,000	5,800,000	21,500,000	895,000,000	2.40%
2016	4,800,000	3,600,000	13,800,000	942,000,000	1.46%

<sup>\*</sup> Total Granted = Options + (Adjusted Full-Value Shares)

• *Dilution*. Dilution is commonly measured by "overhang," which generally refers to the amount of total potential dilution to current shareholders that could result from future issuance of the shares reserved under an equity compensation plan. As of April 23, 2019, 34,671,157 shares were subject to outstanding

equity awards under our 2014 Plan and 2011 Plan, 13,481,250 shares were subject to outstanding equity awards under our 2008 Long-Term Incentive and Cash Bonus Plan, as amended (the "2008 Plan"), and our 2005 Long-Term Incentive Plan, as amended (the "2005 Plan"), an additional 23,783,636 shares were reserved for issuance under our 2014 Plan and 2011 Plan (and, for the avoidance of doubt, no shares remain available for issuance under the 2008 Plan and the 2005 Plan), and we are requesting an additional 38,000,000 shares for grant under the 2019 Plan, which based on 798,429,109 shares outstanding on April 23, 2019, results in a total potential dilution of 13.77%. This overhang is reasonable compared to that of our peers.

- Clawbacks. Awards granted under the 2019 Plan may be subject to recoupment in accordance with Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (regarding recoupment of erroneously awarded compensation). Awards may also be subject to recoupment under the terms of the 2019 Plan for a period of one (1) year following after the settlement of an award under the 2019 Plan or may be subject to Kroger's clawback policy as described on page 33 above in the section entitled "Executive Compensation Recoupment Policy (Clawback)" in the "Compensation Discussion & Analysis".
- The 2019 Plan follows best market practices. The 2019 Plan has been designed consistent with the qualitative standards of proxy advisory firms and equity plan best practices. As a result, the 2019 Plan:
  - provides that no award may vest prior to the one-year anniversary of such award's date of grant (other than vesting upon the death or disability of the participant, or upon a change in control), except that up to 5% of the share reserve of the 2019 Plan may be subject to awards that do not meet such minimum vesting requirement;
  - does not permit the repricing of awards granted under the 2019 Plan unless approved by shareholders;
  - does not provide for automatic acceleration of vesting of equity awards upon a change in control of the Company, also known as a "single-trigger acceleration;"
  - does not contain an annual "evergreen provision," and therefore shareholder approval is required to increase the maximum number of shares that may be issued under the 2019 Plan;
  - contains a "fungible share pool" provision, which limits shareholder dilution by charging the share reserve with 2.83 shares for each share subject to a full value award;
  - provides that all stock options and share appreciation rights have an exercise price equal to at least the fair market value of our common shares on the date the stock option or share appreciation right is granted, except in certain situations in which we are assuming options granted by another company that we are acquiring:
  - provides that (i) no dividends or dividend equivalent rights will be paid or provided with respect to awards other than restricted shares and share awards, and (ii) dividend equivalents accrued with respect to awards of restricted stock units (including performance units), if any, may not be paid before the date such awards have vested; and
  - does not provide for any tax gross-ups.

# Summary of the 2019 Plan

The principal features of the 2019 Plan are summarized below. The summary does not purport to be a complete statement of the terms of the 2019 Plan and is qualified in its entirety by reference to the full text of the 2019 Plan, a copy of which is attached as Appendix A to this Proxy Statement.

# **Purpose**

The purpose of the 2019 Plan is to align the interests of eligible participants with our shareholders by providing incentive compensation tied to Kroger's performance. The intent of the 2019 Plan is to advance Kroger's interests and increase shareholder value by attracting, retaining and motivating key personnel.

# Administration

Pursuant to its terms, the 2019 Plan may be administered by the Compensation Committee of the Board, such other committee of the Board appointed by the Board to administer the Plan or the Board, as determined by the Board (such administrator of the 2019 Plan, the "Committee"). The Committee has the power and discretion

necessary to administer the 2019 Plan, with such powers including, but not limited to, the authority to select persons to participate in the 2019 Plan, determine the form and substance of awards under the 2019 Plan, determine the conditions and restrictions, if any, subject to which such awards will be made, modify the terms of awards, accelerate the vesting of awards upon termination of service, and make determinations regarding a participant's termination of employment or service for purposes of an award. The Committee's determinations, interpretations and actions under the 2019 Plan are binding on the Company, the participants in the 2019 Plan and all other parties. Generally, the 2019 Plan will be administered by our Compensation Committee, which solely consists of independent directors, as appointed by the Board from time to time. The Compensation Committee may delegate authority to a committee of executives in respect of awards to Kroger associates who are not our NEOs or subject to Section 16 under the Exchange Act, as permitted under the 2019 Plan.

#### **Eligibility**

Any employee, officer, non-employee director, consultant or advisor to the Company or any of its subsidiaries or affiliates can participate in the 2019 Plan, at the Committee's discretion. In its determination of eligible participants, the Committee may consider any and all factors it considers relevant or appropriate, and designation of a participant in any year does not require the Committee to designate that person to receive an award in any other year. As of the record date, 439,000 employees, 19 officers, 11 non-employee directors, and no consultants or advisors are eligible to participate in the Plan.

#### **Awards**

The types of awards available under the 2019 Plan include stock options (both incentive and non-qualified), share appreciation rights, restricted stock awards, restricted stock units (including performance units), cash incentive awards and share awards. All awards granted to participants under the 2019 Plan will be represented by an award agreement. No award granted to participants under the 2019 Plan may vest prior to the one year anniversary of such award's date of grant (except for awards in respect of up to 5% of the share reserve of the 2019 Plan, and awards that vest upon the death or disability of the participant, or upon a change in control (to the extent that awards are not continued, assumed or substituted, or upon a qualifying termination of service following such change in control, as described below)).

#### **Stock Options**

A stock option grant entitles a participant to purchase a specified number of Company shares (the "Shares") during a specified term (with a maximum term of 10 years) at an exercise price that will not be less than the fair market value of a Share as of the date of grant.

Subject to the minimum vesting requirements described above, the Committee will determine the requirements for vesting and exercisability of the stock options, which may be based on the continued employment or service of the participant with the Company for a specified time period, upon the attainment of performance goals or both. The stock options may terminate prior to the end of the term or vesting date upon termination of employment or service (or for any other reason), as determined by the Committee. No dividends or dividend equivalent rights will be paid or granted with respect to stock options. Unless approved by the Company's shareholders, the Committee may not take any action with respect to a stock option that would be treated as a "repricing" under the then applicable rules, regulations or listing requirements of the stock exchange on which Shares are listed.

Stock options granted under the 2019 Plan are either non-qualified stock options or incentive stock options (with incentive stock options intended to meet the applicable requirements under the Code). Stock options are nontransferable except in limited circumstances.

# **Share Appreciation Rights**

A share appreciation right (SAR) granted under the 2019 Plan will give the participant a right to receive, upon exercise or other payment of the SAR, an amount in cash, Shares or a combination of both equal to the excess of (a) the fair market value of a Share on the date of exercise over (b) the base price of the SAR that the Committee specified on the date of the grant. The base price of a SAR will not be less than the fair market value of a Share as of the date of grant. The right of exercise in connection with a SAR may be made by the participant or automatically upon a specified date or event. SARs are non-transferable, except in limited circumstances.

Subject to the minimum vesting requirements described above, the Committee will determine the requirements for vesting and exercisability of the SARs, which may be based on the continued employment or service of the participant with the Company for a specified time period or upon the attainment of specific performance goals. The

SARs may be terminated prior to the end of the term (with a maximum term of 10 years) upon termination of employment or service, as determined by the Committee. No dividends or dividend equivalent rights will be paid or granted with respect to SARs. Unless approved by the Company's shareholders, the Committee may not take any action with respect to a SAR that would be treated as a "repricing" under the then applicable rules, regulations or listing requirements of the stock exchange on which Shares are listed.

#### **Restricted Stock Awards**

A restricted stock award is a grant of a specified number of Shares to a participant, which restrictions will lapse upon the terms that the Committee determines at the time of grant. Subject to the minimum vesting requirements described above, the Committee will determine the requirements for the lapse of the restrictions for the restricted stock awards, which may be based on the continued employment or service of the participant with the Company over a specified time period, upon the attainment of performance goals, or both.

The participant will have the rights of a shareholder with respect to the shares granted under a restricted stock award, including the right to vote the shares and receive all dividends and other distributions with respect thereto, unless the Committee determines otherwise to the extent permitted under applicable law. Any shares granted under a restricted stock award are nontransferable, except in limited circumstances. A participant may make an election under Section 83(b) of the Code for tax planning purposes.

#### **Restricted Stock Units (including Performance Units)**

A restricted stock unit or performance unit granted under the 2019 Plan will give the participant a right to receive, upon vesting and settlement of the restricted stock units (commonly known as RSUs) or performance units, one Share per vested unit or an amount per vested unit equal to the fair market value of one Share as of the date of determination, or a combination thereof, at the discretion of the Committee. The Committee may grant RSUs or performance units together with dividend equivalent rights (which will not be paid until the award vests), and the holder of any RSUs or performance units will not have any rights as a shareholder, such as dividend or voting rights, until the Shares underlying the RSUs or performance units are delivered.

Subject to the minimum vesting requirements described above, the Committee will determine the requirements for vesting and payment of the RSUs and performance units, which may be based on the continued employment or service of the participant with the Company for a specified time period and, for performance units, also upon the attainment of specific performance goals. RSU and performance unit awards will be forfeited if the vesting requirements are not satisfied. RSUs and performance units are nontransferable, except in limited circumstances.

## **Cash Incentive Awards**

Cash incentive awards if granted under the 2019 Plan may be payable based on the achievement of business and/or individual performance goals over a performance period, and may also be based on the continued employment or service of a participant with the Company during the performance period, or such other conditions as determined by the Committee. Cash incentive awards may be paid in any combination of cash or Shares, based on the fair market value of such Shares at the time of payment. The Compensation Committee will determine the requirements for vesting and payment of any cash incentive awards granted under the 2019 Plan.

#### **Share Awards**

Share awards may be granted to eligible participants under the 2019 Plan and consist of an award of Shares. A share award may be granted for past employment or service, in lieu of bonus or other cash compensation, as director's compensation or any other purpose as determined by the Committee. Subject to the minimum vesting requirements described above, the Committee will determine the requirements for the vesting and payment of the share award, with the possibility that awards may be made with no vesting requirements. Upon receipt of the share award, the participant will have all rights of a shareholder with respect to the Shares, including the right to vote and receive dividends.

#### **Performance-Based Compensation**

All types of awards granted under the 2019 Plan may be granted with vesting, payment, lapse of restrictions and/or exercisability requirements that are subject to the attainment of specific performance goals (with the exception of cash incentive awards, which must be granted subject to the attainment of performance goals). The Committee may adjust performance goals, or the manner of measurement thereof, as it deems appropriate.

#### **Plan Amendments or Termination**

The Board may amend, modify, suspend or terminate the 2019 Plan, provided that if such amendment, modification, suspension or termination materially and adversely affects any award the Company must obtain the affected participant's consent. Certain amendments or modifications of the 2019 Plan may also be subject to the approval of our shareholders as required by SEC and NYSE rules or applicable law.

#### **Termination of Service**

Awards under the 2019 plan may be subject to reduction, cancellation or forfeiture upon termination of service or failure to meet applicable performance conditions or other vesting terms.

Under the 2019 Plan, unless an award agreement provides otherwise, if a participant's employment or service is terminated for cause, or if after termination the Committee determines that the participant engaged in an act that falls within the definition of cause, or if after termination the participant engages in conduct that violates any continuing obligation of the participant with respect to the Company, the Company may cancel, forfeit and/or recoup any or all of that participant's outstanding awards. In addition, if the Committee makes the determination above, the Company may suspend the participant's right to exercise any stock option or share appreciation right, receive any payment or vest in any award pending a determination of whether the act falls within the definition of cause. The 2019 plan incorporates by reference the definition of cause from the KEPP. If a participant voluntarily terminates employment or service in anticipation of an involuntary termination for cause, that shall be deemed a termination for cause.

The Company has the right to recoup any gain realized by the participant from the exercise, vesting or payment of any award if, within one year after such exercise, vesting or payment, the participant is terminated for cause, the Committee determines the participant is subject to recoupment due to a clawback policy, or after the participant's termination the Committee determines that the participant engaged in an act that falls within the definition of cause or materially violated any continuing obligation of the participant with respect to the Company.

#### Change in Control

Under the 2019 Plan, in the event of a change in control of the Company, as defined in the 2019 Plan, all outstanding awards shall either (a) be continued or assumed by the surviving company or its parent, or (b) substituted by the surviving company or its parent for awards, with substantially similar terms (with appropriate adjustments to the type of consideration payable upon settlement, including conversion into the right to receive securities, cash or a combination of both, and with appropriate adjustment of performance conditions or deemed achieved of such conditions at the greater of the target level or actual performance, unless otherwise provided in an award agreement).

Only to the extent that outstanding awards are not continued, assumed or substituted upon or following a change in control, the Committee may, but is not obligated to, make adjustments to the terms and conditions of outstanding awards, including without limitation (i) acceleration of exercisability, vesting and/or payment immediately prior to or upon or following such event, (ii) upon written notice, providing that any outstanding stock option and share appreciation right must be exercised during a period of time immediately prior to such event or other period (contingent upon the consummation of such event), and at the end of such period, such stock options and share appreciation rights shall terminate to the extent not so exercised, and (iii) cancellation of all or any portion of outstanding awards for fair value (in the form of cash, Shares, other property or any combination of such consideration), less any applicable exercise or base price.

Notwithstanding the foregoing, if a participant's employment or service is terminated upon or within twenty four (24) months following a change in control by the Company without cause or by the participant for good reason (defined in the 2019 Plan by reference to the KEPP), the unvested portion (if any) of all outstanding awards held by the participant will immediately vest (and, to the extent applicable, become exercisable) and be paid in full upon such termination, with any performance conditions deemed achieved at the greater of the target level or actual performance, unless otherwise provided in an award agreement.

#### Assumption of Awards in Connection with an Acquisition

The Committee may assume or substitute any previously granted awards of an employee, director or consultant of another corporation who becomes eligible by reason of a corporate transaction. The terms of the assumed award may vary from the terms and conditions otherwise required by the 2019 Plan if the Committee deems it necessary. The assumed awards will not reduce the total number of shares available for awards under the 2019 Plan.

#### **Shares Available**

38,000,000 Shares are available for awards under the 2019 Plan.

Awards may also be made under the 2019 Plan with respect to an estimated 23,783,636 shares that, as of April 23, 2019, remain available for grant under the 2014 Plan and the 2011 Plan, each of which has previously been approved by our shareholders. In addition, if forfeited in accordance with their terms, a maximum of 26,311,950 shares previously granted under the 2014 Plan and the 2011 Plan may become available for awards under the 2019 Plan. We refer to the aggregate number of shares available for awards under the 2019 Plan as the "share reserve." Within the share reserve, a total of 10,000,000 Shares are available for awards of incentive stock options.

If any award granted under the 2019 Plan is canceled, expired, forfeited, surrendered, settled by delivery of fewer shares than the number underlying the award, or otherwise terminated without delivery of the Shares or payment of consideration to the participant, then such shares will be returned to the 2019 Plan and be available for future awards under the 2019 Plan. However, shares that are withheld from an award in payment of the exercise, base or purchase price or taxes or not issued or delivered as a result of the net settlement of an outstanding stock option, share appreciation right or other award will not be returned to the 2019 nor available for future awards under the 2019 Plan.

The share reserve will be reduced by one share for each Share subject to a stock option or share appreciation right, and by 2.83 shares for each Share subject to a restricted stock award, award of restricted stock units (including performance units), or other share award. If a Share that was subject to an award that counted as one share is returned to the share reserve, the share reserve will be credited with one share. If a Share that was subject to an award that counts as 2.83 shares is returned to the share reserve, the share reserve will be credited with 2.83 shares.

## **Adjustments**

In the event of any recapitalization, reclassification, share dividend, extraordinary dividend, share split, reverse share split, merger, reorganization, consolidation, combination, spin-off or other similar corporate event or transaction affecting the common shares of the Company, the Committee will make equitable adjustments to (i) the number and kind of Shares or other securities available for awards and covered by outstanding awards, (ii) the exercise, base or purchase price, or other value determinations of outstanding awards, and/or (iii) any other terms of an award affected by the corporate event.

#### Tax Consequences

#### **Incentive Stock Options**

An optionee recognizes no taxable income for regular income tax purposes as a result of the grant or exercise of an incentive stock option qualifying under Section 422 of the Code. Optionees who neither dispose of their shares within two years following the date the option was granted nor within one year following the exercise of the option normally will recognize a capital gain or loss equal to the difference, if any, between the sale price and the purchase price of the shares. If an optionee satisfies such holding periods upon a sale of the shares, the Company will not be entitled to any deduction for federal income tax purposes. If an optionee disposes of shares within two years after the date of grant or within one year after the date of exercise (a "disqualifying disposition"), the difference between the fair market value of the shares on the exercise date and the option exercise price (not to exceed the gain realized on the sale if the disposition is a transaction with respect to which a loss, if sustained, would be recognized) will be taxed as ordinary income at the time of disposition. Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. Any ordinary income recognized by the optionee upon the disqualifying disposition of the shares generally should be deductible by the Company for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code.

The difference between the option exercise price and the fair market value of the shares on the exercise date is treated as an adjustment in computing the optionee's alternative minimum taxable income and may be subject to an alternative minimum tax which is paid if such tax exceeds the regular tax for the year. Special rules may apply with respect to certain subsequent sales of the shares in a disqualifying disposition, certain basis adjustments for purposes of computing the alternative minimum taxable income on a subsequent sale of the shares and certain tax credits which may arise with respect to optionees subject to the alternative minimum tax.

#### **Nonqualified Stock Options**

Options not designated or qualifying as incentive stock options will be nonqualified stock options having no special tax status. An optionee generally recognizes no taxable income as the result of the grant of such an option. Upon exercise of a nonqualified stock option, the optionee normally recognizes ordinary income equal to the amount that the fair market value of the shares on such date exceeds the exercise price. If the optionee is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of shares acquired by the exercise of a nonqualified stock option, any gain or loss, based on the difference between the sale price and the fair market value on the exercise date, will be taxed as capital gain or loss.

## **Share Appreciation Rights**

In general, no taxable income is reportable when SARs are granted to a participant. Upon exercise, the participant will recognize ordinary income in an amount equal to the fair market value of any cash or shares received. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Any additional gain or loss recognized upon any later disposition of the shares would be capital gain or loss.

#### **Restricted Stock Awards**

A participant acquiring restricted stock generally will recognize ordinary income equal to the fair market value of the shares on the vesting date. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. The participant may elect, pursuant to Section 83(b) of the Code, to accelerate the ordinary income tax event to the date of acquisition by filing an election with the Internal Revenue Service no later than 30 days after the date the shares are acquired. Upon the sale of shares acquired pursuant to a restricted stock award, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

# Restricted Stock Unit Awards (including Performance Unit Awards)

There are no immediate tax consequences of receiving an award of RSUs or performance units. A participant who is awarded RSUs or performance units will be required to recognize ordinary income in an amount equal to the fair market value of shares issued to such participant at the end of the applicable vesting period or, if later, the settlement date elected by the Committee or a participant. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Any additional gain or loss recognized upon any later disposition of any shares received would be capital gain or loss.

## **Cash Incentive Awards**

A participant generally will recognize no income upon the grant of a performance cash incentive award. Upon the settlement of such award, participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any unrestricted shares received. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

#### **Share Awards**

A participant acquiring unrestricted shares generally will recognize ordinary income equal to the fair market value of the shares on the grant date. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of unrestricted shares acquired pursuant to a share award, any gain or loss, based on the difference between the sale price and the fair market value on the date the shares are granted, will be taxed as capital gain or loss.

#### Section 409A

Section 409A provides certain requirements for non-qualified deferred compensation arrangements with respect to an individual's deferral and distribution elections and permissible distribution events. Certain types of awards granted under the 2019 Plan may be subject to the requirements of Section 409A. It is intended that the 2019 Plan and all awards comply with, or be exempt from, the requirements of Section 409A. If an award is subject to and fails to satisfy the requirements of Section 409A, the recipient of that award may recognize ordinary income on the amounts deferred under the award, to the extent vested, which may be prior to when the compensation is actually or constructively received. Also, if an award that is subject to Section 409A fails to comply with Section 409A's provisions, Section 409A imposes an additional 20% federal income tax on compensation recognized as ordinary income, as well as interest on such deferred compensation.

# Tax Effect for the Company

The Company generally will be entitled to a tax deduction in connection with an award under the 2019 Plan in an amount equal to the ordinary income realized by a participant and at the time the participant recognizes such income (for example, the exercise of a nonqualified stock option). Special rules limit the deductibility of compensation paid to our chief executive officer, chief financial officer and the other "covered employees" as determined under Section 162(m) of the Code and applicable guidance. Under Section 162(m), the annual compensation paid to any of these covered employees, including awards that Kroger grants pursuant to the 2019 Plan, whether performance-based or otherwise, will be subject to the \$1 million annual deduction limitation. Because of the elimination of the performance-based compensation exemption, it is possible that all or a portion of the compensation paid to covered employees in the form of equity grants under the 2019 Plan may not be deductible by the Company, to the extent that the annual deduction limitation is exceeded.

THE FOREGOING IS ONLY A SUMMARY OF THE EFFECT OF U.S. FEDERAL INCOME TAXATION UPON PARTICIPANTS AND THE COMPANY WITH RESPECT TO AWARDS UNDER THE 2019 PLAN. IT DOES NOT PURPORT TO BE COMPLETE AND DOES NOT DISCUSS THE IMPACT OF EMPLOYMENT OR OTHER TAX REQUIREMENTS, THE TAX CONSEQUENCES OF A PARTICIPANT'S DEATH, OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY, STATE, OR FOREIGN COUNTRY IN WHICH THE PARTICIPANT MAY RESIDE.

#### New Plan Benefits

The issuance of any awards under the 2019 Plan will be at the discretion of the Committee. In addition, the benefit of any awards granted under the 2019 Plan will depend on a number of factors, including the fair market value of Company shares on future dates, and actual Company performance against performance goals established with respect to performance awards, among other things. Therefore, it is not possible to determine the amount or form of any award that will be granted to any individual in the future. For information regarding awards granted to our NEOs under the 2014 Plan during the 2018 fiscal year, please refer to the Grants of Plan-Based Awards table on page 38 made to our NEOs in fiscal 2018.

# **Equity Compensation Plan Information**

The following table provides information regarding shares outstanding and available for issuance under our existing equity compensation plans, effective as of February 2, 2019.

Number of convition

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights <sup>(1)</sup>	Weighted average exercise price of outstanding options, warrants and rights <sup>(1)</sup>	remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	36,526,924	\$23.42	28,386,544
Equity compensation plans not approved by security holders	<u> </u>	_	_
Total	36,526,924	\$23.42	28,386,544

(1) The total number of securities reported includes the maximum number of common shares, 2,378,494, that may be issued under performance units granted under our long-term incentive plans. The nature of the awards is more particularly described in the Compensation Discussion and Analysis section of this proxy statement. The weighted-average exercise price in column (b) does not take these performance unit awards into account. Based on historical data, or in the case of the awards made in 2016 through 2018 and earned in 2018 the actual payout percentage, our best estimate of the number of common shares that will be issued under the performance unit grants is approximately 2,379,302.

#### Equity Compensation Plan Information as of April 23, 2019

The information included in this Proxy Statement and our Annual Report on Form 10-K for the fiscal year ending February 2, 2019 is updated by the following information regarding all existing equity compensation plans as of April 23, 2019:

- Total number of stock options outstanding: 35,698,349
- Weighted-average exercise price of stock options outstanding: \$23.57
- Weighted-average remaining contractual term of stock options outstanding: 5.88 years
- Total number of full value awards outstanding (including performance units): 12,454,058
- Total number of shares of common stock outstanding: 798,429,109
- Total number of shares that were available for grant under the 2014 Plan: 13,012,884 (12,490,005 options, 522,879 restricted)
- Total number of shares that were available for grant under the 2011 Plan: 10,770,752 (7,305,393 options, 3,465,359 restricted)

#### Additional Information

For further discussion of our compensation program and the long-term incentive awards granted under our incentive plans, see "Compensation Discussion & Analysis" and the discussion of "Long-Term Compensation" therein.

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.

We also asked shareholders to approve this proposal at our 2018 Annual Meeting. We received the overwhelming support of 97% of our shareholders that voted on the proposal. However, the proposal requires the affirmative vote of 75% of outstanding shares, rather than of shares voted. We received the support of 73% of our outstanding shares falling just short of the 75% necessary that must support the proposal for the proposal to pass. Because of the overwhelming support, this year we are again requesting that our shareholders afford us the flexibility that many other Ohio public companies have to more efficiently oversee the company's governance by giving our Board the ability to amend our Regulations in certain circumstances.

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 that have also amended their regulations to permit amendments by their boards of directors, we are asking our shareholders to approve Item 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 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 or amending proxy access provisions or adopting modern
  provisions regarding electronic notice and actions.

Even if this Item No. 4 is approved, 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 Item No. 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; 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 Item No. 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 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 2018.

# 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 13, 2019, the Audit Committee appointed PricewaterhouseCoopers LLP as Kroger's independent auditor for the fiscal year ending February 1, 2020. PricewaterhouseCoopers LLP or its predecessor firm has been the Company's independent auditor since 1929.

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

- Reviews PricewaterhouseCoopers LLP's independence and performance;
- Considers the tenure of the independent registered public accounting firm and safeguards around auditor independence:
- 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 2018 and 2017, and for audit-related, tax and all other services performed in 2018 and 2017.

	Fiscal Ye	Fiscal Year Ended			
	February 2, 2019	February 3, 2018			
Audit Fees <sup>(1)</sup>	\$5,067,485	\$5,193,565			
Audit-Related Fees	\$1,110,870	\$ 775,000			
All Other Fees	\$ 900	900			
Total	\$6,179,255	\$5,969,465			

<sup>(1)</sup> 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.

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 2, 2019, as filed with the SEC.

This report is submitted by the Audit Committee.

Anne Gates, Chair Ronald L. Sargent 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. Kroger is lagging behind competitors. Our direct grocery competitors Walmart and Target have both agreed to make their packaging recyclable by 2025. Colgate-Palmolive, PepsiCo, Procter & Gamble, and Unilever have also 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 is committed to advancing sustainability in the area of packaging sustainability as part of our 2020 Sustainability Goals and our Zero Hunger | Zero Waste social impact plan. We agree that improving the recyclability of product packaging is needed to reduce the environmental impacts of plastic pollution.

# **Our Commitments**

A few years ago, Kroger introduced our 2020 Sustainability Goals, which include several targets to optimize *Our Brands* product packaging. These include improving the recyclability of plastic packaging and achieving 20% recycled content in packaging for Kroger manufactured products – which also helps drive demand for recycled materials. In addition, we pledged to increase communication with our customers about recyclability and help expand recycling infrastructure because we can not solve this problem alone. We committed to increase responsible fiber sourcing in paper packaging. And finally, we committed to reduce plastic in *Our Brands* packaging by 10 million pounds.

By the end of 2018, we had achieved more than 9 million pounds of reduced plastic in our manufactured plastic packaging since our 2015 baseline, in large part thanks to converting 8 more dairy plants to our lighter-weight milk jug, which is 10% lighter than our previous jug. We are in process of analyzing and calculating the recycled content and certified responsibly grown fiber proportion of our packaging footprint. We continue to add 'Please Recycle' to relevant packages, and we are working across relevant business units and with input from our suppliers to evaluate meaningful opportunities to add and increase recycled content in our packaging as well as move to more recyclable packaging materials and designs. And finally, we offer our customers an in-store recycling program through which they can drop plastic film packaging such as shopping bags, bread and produce bags and bottled water case wraps, in our store lobbies.

The detailed packaging optimization goals for 2020 and an update on our progress can be found at <a href="http://sustainability.kroger.com/2020-goals.html">http://sustainability.kroger.com/2020-goals.html</a>.

## **Looking Ahead**

As we approach 2020, we recognize the need to consider the next generation of packaging goals for Kroger, and we want to share our plans for 2019 that will inform this work. We will:

- 1) Track and share progress on Kroger's current packaging targets in our 2019 Sustainability Report, to be published mid-year.
- 2) Conduct an analysis of *Our Brands* products to fully understand the current state of packaging recyclability across the portfolio. These findings will help us identify key opportunity areas and set priorities for future packaging improvements. Kroger will share high-level findings from this analysis in our 2020 Sustainability Report.
- Evaluate multi-stakeholder initiatives focused on improving recycling accessibility and infrastructure and identify opportunities for Kroger to participate and support.
- 4) Join the How2Recycle product labeling program to support our recyclability assessment and improve communication with customers about how to recycle *Our Brands* packaging.
- 5) Set a time-bound target to increase recyclability of *Our Brands* packaging using findings from the analysis above and other benchmarking.

We believe our current packaging sustainability commitments, as well as the additional steps we have outlined for 2019, address the primary objectives outlined in the shareholder proposal.

As a result, we urge you to support these efforts and vote **AGAINST** this proposal.

## Item No. 7 Shareholder Proposal – Independent Chairman

We have been notified by several shareholders, 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.<sup>1</sup>"

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, 50% of S&P 500 company boards have also implemented this best practice.<sup>2</sup>

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.<sup>3</sup>"

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 believes it should have the ability to tailor its structure to Kroger's needs at any time and that Kroger's Board is currently 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, not by adopting a rigid "one size fits all" approach.

Kroger has a balanced governance structure in which independent directors, including an independent Lead Director, exercise meaningful and vigorous oversight. The Board recently appointed a new Lead Director, bringing a fresh perspective to the role. Mr. Sargent previously served as Chairman and CEO of Staples and brings over 35 years of retail experience and a deep understanding of retail operations, consumer insights, and e-commerce to the Board. Our strong independent Lead Director serves the same functions as a Chairman and provides the safeguards that the proposal seeks.

Kroger's independent Lead Director has a robust set of responsibilities that ensure a strong, independent and active board that complements the Chairman's role, which are addressed in detail in the Guidelines (available at 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 are best served by a combination of the roles at this time. Our CEO's strong background in finance, operations, and strategic partnerships are particularly important to the Board given Kroger's current transformation under the *Restock Kroger* plan. His consistent leadership, deep industry expertise, and extensive knowledge of the Company are also especially critical in the midst of the rapidly evolving retail landscape.

www.glasslewis.com/wp-content/uploads/2016/03/2016-In-Depth-Report-INDEPENDENT-BOARD-CHAIRMAN.pdf

<sup>&</sup>lt;sup>2</sup> https://www.spencerstuart.com/-/media/2018/october/ssbi 2018.pdf

<sup>3</sup> www.ssga.com/investment-topics/environmental-social-governance/2017 /long-term-value-begins-at-the-boardeu. Pdf"

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. The Board will continue to regularly review Kroger's leadership structure to ensure that the structure best addresses Kroger's evolving and dynamic business in consultation with our shareholders. The Board believes that retaining the flexibility to determine which type of leadership structure is most effective for Kroger's specific circumstances is critical for the long-term success of our company.

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.

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

## Shareholder Proposals and Director Nominations – 2020 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 2020 should be addressed to Kroger's Secretary and must be received at our executive offices not later than January 14, 2020. 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 2020 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 2020 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 30, 2020 and comply with the requirements of the Regulations. Eligible shareholders can submit director nominees for inclusion in our proxy statement for the 2020 annual meeting of shareholders. To be eligible, shareholders must have owned at least three percent 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 15, 2019 and no later than January 14, 2020.

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

## 2018 Annual Report

Attached to this Proxy Statement is our 2018 Annual Report which includes a brief description of our business, including the general scope and nature thereof during fiscal year 2018, together with the audited financial information contained in our 2018 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.

## **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

## THE KROGER CO.

#### 2019 LONG-TERM INCENTIVE PLAN

## 1. Purpose.

The purpose of The Kroger Co. 2019 Long-Term Incentive Plan is to further align the interests of eligible participants with those of the Company's shareholders by providing incentive compensation opportunities tied to the performance of the Company and its Common Shares. The Plan is intended to advance the interests of the Company and increase shareholder value by attracting, retaining and motivating key personnel upon whose judgment, initiative and effort the successful conduct of the Company's business is largely dependent.

2. <u>Definitions</u>. Capitalized terms used and not otherwise defined herein shall have the meanings set forth below:

"Affiliate" means any Person directly or indirectly controlling, controlled by, or under common control with such other Person.

"Award" means an award of a Stock Option, Share Appreciation Right, Restricted Share Award, Restricted Share Unit (including Performance Units), Cash Incentive Award or Share Award granted under the Plan.

"Award Agreement" means a notice or an agreement entered into between the Company and a Participant setting forth the terms and conditions of an Award granted to a Participant as provided in Section 16.2 hereof.

"Beneficial Owner" has the meaning ascribed to such term in Rule 13d-3 under the Exchange Act.

"Board" means the Board of Directors of the Company.

"Cash Incentive Award" means an Award that is denominated by a cash amount to an Eligible Person under Section 10 hereof and payable based on or conditioned upon the attainment of business and/or individual performance goals over a specified performance period.

"Cause" has the meaning set forth in the KEPP, unless otherwise defined in an Award Agreement.

"Change in Control" has the meaning set forth in Section 12.4 hereof.

"Code" means the Internal Revenue Code of 1986, as amended.

"Committee" means (i) the Compensation and Talent Development Committee of the Board, (ii) such other committee of the Board appointed by the Board to administer the Plan or (iii) the Board, as determined by the Board.

"Common Shares" means the Company's common shares, par value \$1.00 per share.

"Company" means The Kroger Co., or any successor thereto.

"Date of Grant" means the date on which an Award under the Plan is granted by the Committee or such later date as the Committee may specify to be the effective date of an Award.

"Disability" has the meaning set forth under the Company's long-term disability plan. Notwithstanding the foregoing, in any case in which a benefit that constitutes or includes "nonqualified deferred compensation" subject to Section 409A would be payable by reason of Disability, the term "Disability" will mean a disability described in Treasury Regulations Section 1.409A-3(i)(4)(i)(A).

"Effective Date" has the meaning set forth in Section 17.1 hereof.

"Eligible Person" means any person who is an officer, employee, Non-Employee Director, or any natural person who is a consultant or advisor of the Company or any of its Subsidiaries.

"Exchange Act" means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder, as the same may be amended from time to time.

"Fair Market Value" means, as applied to a specific date, the price of a Common Share that is based on the opening, closing, actual, high, low or average selling prices of a Common Share reported on any established stock exchange or national market system including without limitation the New York Stock Exchange on the applicable date, the preceding trading day, the next succeeding trading day, or an average of trading days, as determined by

the Committee in its discretion. Unless the Committee determines otherwise or unless otherwise specified in an Award Agreement, Fair Market Value shall be deemed to be equal to the closing price of a Common Share on the most recent date on which Common Shares were publicly traded. Notwithstanding the foregoing, if the Common Shares are not traded on any established stock exchange or national market system, Fair Market Value means the price of a Common Share as established by the Committee acting in good faith based on a valuation method that is consistent with the requirements of Section 409A of the Code and the regulations thereunder.

"Good Reason" has the meaning set forth in the KEPP, as amended from time to time, unless otherwise defined in an Award Agreement.

"Incentive Stock Option" means a Stock Option granted under Section 6 hereof that is intended to meet the requirements of Section 422 of the Code and the regulations thereunder.

"KEPP" means The Kroger Co. Employee Protection Plan, as amended from time to time.

"Non-Employee Director" means a member of the Board who is not an employee of the Company or any of its Subsidiaries.

"Nonqualified Stock Option" means a Stock Option granted under Section 6 hereof that is not an Incentive Stock Option.

"Participant" means any Eligible Person who holds an outstanding Award under the Plan.

"Performance Unit" means a Restricted Share Unit that is subject to vesting based on the achievement, or the level of achievement, during a specified performance period of one or more performance goals established by the Committee.

"Person" has the meaning set forth in Section 12.5 hereof.

"Plan" means the Kroger Co. 2019 Long-Term Incentive Plan as set forth herein, effective as of the Effective Date and as may be amended from time to time, as provided herein.

"Restricted Share Award" means a grant of Common Shares to an Eligible Person under Section 8 hereof that are issued subject to such vesting and transfer restrictions as the Committee shall determine, and such other conditions, as are set forth in the Plan and the applicable Award Agreement.

"Restricted Share Unit" means a contractual right granted to an Eligible Person under Section 9 hereof representing notional unit interests equal in value to a Common Share to be paid or distributed at such times, and subject to such conditions, as set forth in the Plan and the applicable Award Agreement.

"Securities Act" means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder, as the same may be amended from time to time.

"Service" means a Participant's employment with the Company or any Subsidiary or a Participant's service as a Non-Employee Director, consultant or other service provider with the Company or any Subsidiary, as applicable.

"Share Appreciation Right" means a contractual right granted to an Eligible Person under Section 7 hereof entitling such Eligible Person to receive a payment, representing the excess of the Fair Market Value of a Common Share over the base price per share of the right, at such time, and subject to such conditions, as are set forth in the Plan and the applicable Award Agreement.

"Share Awards" means a grant of Common Shares to an Eligible Person under Section 11 hereof.

"Stock Option" means a contractual right granted to an Eligible Person under Section 6 hereof to purchase Common Shares at such time and price, and subject to such conditions, as are set forth in the Plan and the applicable Award Agreement.

"Subsidiary" means an entity (whether or not a corporation) that is wholly or majority owned or controlled, directly or indirectly, by the Company or any other Affiliate of the Company that is so designated, from time to time, by the Committee, during the period of such Affiliated status; <a href="mailto:provided">provided</a>, <a href="mailto:however">however</a>, that with respect to Incentive Stock Options, the term "Subsidiary" shall include only an entity that qualifies under Section 424(f) of the Code as a "subsidiary corporation" with respect to the Company.

"Treasury Regulations" means regulations promulgated by the United States Treasury Department.

#### Administration.

- 3.1 Committee Members. The Plan shall be administered by a Committee comprised of no fewer than two members of the Board who are appointed by the Board to administer the Plan. To the extent deemed necessary by the Board, each Committee member shall satisfy the requirements for (i) an "independent director" under rules adopted by the New York Stock Exchange or other principal exchange on which the Common Shares are then listed and (ii) a "nonemployee director" within the meaning of Rule 16b-3 under the Exchange Act. Notwithstanding the foregoing, the mere fact that a Committee member shall fail to qualify under any of the foregoing requirements shall not invalidate any Award made by the Committee which Award is otherwise validly made under the Plan. The Board may exercise all powers of the Committee hereunder and may directly administer the Plan. Neither the Company nor any member of the Board or Committee shall be liable for any action or determination made in good faith by the Board or Committee with respect to the Plan or any Award thereunder.
- 3.2 Committee Authority. The Committee shall have all powers and discretion necessary or appropriate to administer the Plan and to control its operation, including, but not limited to, the power to (i) determine the Eligible Persons to whom Awards shall be granted under the Plan, (ii) prescribe the restrictions, terms and conditions of all Awards, (iii) interpret the Plan and terms of the Awards, (iv) adopt rules for the administration, interpretation and application of the Plan as are consistent therewith, and interpret, amend or revoke any such rules, (v) make all determinations with respect to a Participant's Service and the termination of such Service for purposes of any Award, (vi) correct any defect(s) or omission(s) or reconcile any ambiguity(ies) or inconsistency(ies) in the Plan or any Award thereunder, (vii) make all determinations it deems advisable for the administration of the Plan, (viii) decide all disputes arising in connection with the Plan and to otherwise supervise the administration of the Plan, (ix) subject to the terms of the Plan, amend the terms of an Award in any manner that is not inconsistent with the Plan, (x) accelerate the vesting or, to the extent applicable, exercisability of any Award upon termination of Service under certain circumstances, as set forth in the Award Agreement or otherwise, and (xi) adopt such procedures, modifications or subplans as are necessary or appropriate to permit participation in the Plan by Eligible Persons who are foreign nationals or employed outside of the United States. The Committee's determinations under the Plan need not be uniform and may be made by the Committee selectively among Participants and Eligible Persons, whether or not such persons are similarly situated. The Committee shall, in its discretion, consider such factors as it deems relevant in making its interpretations, determinations and actions under the Plan including, without limitation, the recommendations or advice of any officer or employee of the Company or such attorneys, consultants, accountants or other advisors as it may select. All interpretations, determinations, and actions by the Committee shall be final, conclusive, and binding upon all parties.
- 3.3 Delegation of Authority. The Committee shall have the right, from time to time, to delegate in writing to one or more officers of the Company the authority of the Committee to grant and determine the terms and conditions of Awards granted under the Plan, subject to such limitations as the Committee shall determine. In no event shall any such delegation of authority be permitted with respect to Awards granted to any member of the Board or to any Eligible Person who is subject to Rule 16b-3 under the Exchange Act. The Committee shall also be permitted to delegate, to any appropriate officer or employee of the Company, responsibility for performing certain ministerial functions under the Plan. In the event that the Committee's authority is delegated to officers or employees in accordance with the foregoing, all provisions of the Plan relating to the Committee shall be interpreted in a manner consistent with the foregoing by treating any such reference as a reference to such officer or employee for such purpose. Any action undertaken in accordance with the Committee's delegation of authority hereunder shall have the same force and effect as if such action was undertaken directly by the Committee and shall be deemed for all purposes of the Plan to have been taken by the Committee.

## 4. Shares Subject to the Plan.

4.1 Number of Shares Reserved. Subject to adjustment as provided in Section 4.4 hereof, the total number of Common Shares that are reserved for issuance under the Plan (the "Share Reserve") shall equal 38,000,000, plus (i) 23,783,636 Common Shares authorized for issuance but not yet issued under the Kroger Co. 2011 Long-Term Incentive and Cash Bonus Plan (the "2011 Plan") and the Kroger Co. 2014 Long-Term Incentive and Cash Bonus Plan (the "2014 Plan"), and (ii) up to a maximum of 26,311,950 Common Shares subject to outstanding awards under the 2011 Plan and the 2014 Plan that would have been available to be re-granted under the terms of the 2011 Plan and the 2014 Plan, as applicable (including shares subject to cancelled or forfeited awards). Within the Share Reserve, the total number of Common Shares available for issuance as Incentive Stock Options shall equal 10,000,000. Each Common Share subject to an Award shall reduce the Share Reserve by the applicable number of shares set forth in Section 4.3; provided, however, that Awards that are required to be paid in cash

pursuant to their terms shall not reduce the Share Reserve. Any Common Shares delivered under the Plan shall consist of authorized and unissued shares or treasury shares.

- 4.2 Share Replenishment. To the extent that an Award granted under this Plan is canceled, expired, forfeited, surrendered, settled by delivery of fewer Common Shares than the number underlying the Award, as applicable, or otherwise terminated without delivery of the Common Shares or payment of consideration to the Participant under the Plan, the Common Shares retained by or returned to the Company will (i) not be deemed to have been delivered under the Plan, as applicable, (ii) be available for future Awards under the Plan, and (iii) increase the Share Reserve by the applicable number of shares set forth in Section 4.3 for each share that is retained by or returned to the Company. Notwithstanding the foregoing, Common Shares that are (a) withheld from an Award in payment of the exercise, base or purchase price or taxes relating to such an Award or (b) not issued or delivered as a result of the net settlement of an outstanding Stock Option, Share Appreciation Right or other Award under the Plan, as applicable, will be deemed to have been delivered under the Plan and will not be available for future Awards under the Plan.
- 4.3 Fungible Share Pool. Subject to adjustment under Section 4.4, any Award that is not a Full-Value Award (as defined below) shall be counted against the Share Reserve as one share for each Common Share subject to such Award and any Award that is a Full-Value Award shall be counted against the Share Reserve as 2.83 shares for each Common Share subject to such Full-Value Award. "Full-Value Award" means any Restricted Share Award, Award of Restricted Share Units (including Performance Units) or Share Award. To the extent a Common Share that was subject to an Award that counted as one share is returned to the Share Reserve, the Share Reserve will be credited with one share. To the extent that a Common Share that was subject to an Award that counts as 2.83 shares is returned to the Share Reserve, the Share Reserve, the Share Reserve will be credited with 2.83 shares.
- 4.4 Adjustments. If there shall occur any change with respect to the outstanding Common Shares by reason of any recapitalization, reclassification, share dividend, extraordinary dividend, share split, reverse share split or other distribution with respect to the Common Shares or any merger, reorganization, consolidation, combination, spin-off or other corporate event or transaction or any other change affecting the Common Shares (other than regular cash dividends to shareholders of the Company), the Committee shall, in the manner and to the extent it considers appropriate and equitable to the Participants and consistent with the terms of the Plan, cause an adjustment to be made to (i) the maximum number and kind of Common Shares provided in Section 4.1 hereof, (ii) the number and kind of Common Shares, units or other securities or rights subject to then outstanding Awards, (iii) the exercise, base or purchase price for each share or unit or other security or right subject to then outstanding Awards, (iv) other value determinations applicable to the Plan and/or outstanding Awards, and/or (v) any other terms of an Award that are affected by the event. Notwithstanding the foregoing, (a) any such adjustments shall, to the extent necessary, be made in a manner consistent with the requirements of Section 409A of the Code and (b) in the case of Incentive Stock Options, any such adjustments shall, to the extent practicable, be made in a manner consistent with the requirements of Section 424(a) of the Code, unless otherwise determined by the Committee.

## 5. Eligibility and Awards.

- 5.1 Designation of Participants. Any Eligible Person may be selected by the Committee to receive an Award and become a Participant. The Committee has the authority, in its discretion, to determine and designate from time to time those Eligible Persons who are to be granted Awards, the types of Awards to be granted, the number of Common Shares or units subject to Awards to be granted and the terms and conditions of such Awards consistent with the terms of the Plan. In selecting Eligible Persons to be Participants, and in determining the type and amount of Awards to be granted under the Plan, the Committee shall consider any and all factors that it deems relevant or appropriate. Designation of a Participant in any year shall not require the Committee to designate such person to receive an Award in any other year or, once designated, to receive the same type or amount of Award as granted to such Participant in any other year.
- 5.2 Determination of Awards. The Committee shall determine the terms and conditions of all Awards granted to Participants in accordance with its authority under Section 3.2 hereof. An Award may consist of one type of right or benefit hereunder or of two or more such rights or benefits granted in tandem.
- 5.3 Award Agreements. Each Award granted to an Eligible Person shall be represented by an Award Agreement. The terms of the Award, as determined by the Committee, will be set forth in the applicable Award Agreement as described in Section 16.2 hereof.

5.4 Minimum Vesting Period. Notwithstanding anything in the Plan or any Award Agreement to the contrary, no equity-based Award may vest in less than one (1) year from its Date of Grant, and no equity-based Award that vests upon the attainment of performance goals shall have a performance period that is less than twelve (12) months, in each case, except for (i) Awards in respect of up to 5% of the Share Reserve; and (ii) Awards that vest upon the death or Disability of the Participant, or upon a Change in Control.

## 6. Stock Options.

- 6.1 *Grant of Stock Options*. A Stock Option may be granted to any Eligible Person selected by the Committee, except that an Incentive Stock Option may only be granted to an Eligible Person satisfying the conditions of Section 6.7(a) hereof. Each Stock Option shall be designated on the Date of Grant, in the discretion of the Committee, as an Incentive Stock Option or as a Nonqualified Stock Option. All Stock Options granted under the Plan are intended to comply with or be exempt from the requirements of Section 409A of the Code, to the extent applicable.
- 6.2 Exercise Price. The exercise price per share of a Stock Option shall not be less than one hundred percent (100%) of the Fair Market Value of a Common Share on the Date of Grant. The Committee may in its discretion specify an exercise price per share that is higher than the Fair Market Value of a Common Share on the Date of Grant.
- 6.3 Vesting of Stock Options. Subject to Section 5.4, the Committee shall, in its discretion, prescribe in an award agreement the time or times at which or the conditions upon which, a Stock Option or portion thereof shall become vested and/or exercisable. The requirements for vesting and exercisability of a Stock Option may be based on the continued Service of the Participant with the Company or a Subsidiary for a specified time period (or periods), on the attainment of a specified performance goal(s) and/or on such other terms and conditions as approved by the Committee in its discretion. If the vesting requirements of a Stock Option are not satisfied, the Award shall be forfeited.
- 6.4 Term of Stock Options. The Committee shall in its discretion prescribe in an Award Agreement the period during which a vested Stock Option may be exercised; provided, however, that the maximum term of a Stock Option shall be ten (10) years from the Date of Grant. The Committee may provide that a Stock Option will cease to be exercisable upon or at the end of a specified time period following a termination of Service for any reason as set forth in the Award Agreement or otherwise. A Stock Option may be earlier terminated as specified by the Committee and set forth in an Award Agreement upon or following the termination of a Participant's Service with the Company or any Subsidiary, including by reason of voluntary resignation, death, Disability, termination for Cause or any other reason. Subject to Section 409A of the Code and the provisions of this Section 6, the Committee may extend at any time the period in which a Stock Option may be exercised.
- 6.5 Stock Option Exercise; Tax Withholding. Stock Options may be granted on a basis that allows for the exercise of the right by the Participant, or that requires the Stock Options to be exercised or surrendered for payment of the right upon a specified date or event. Subject to such terms and conditions as specified in an Award Agreement (including applicable vesting requirements), a Stock Option may be exercised in whole or in part at any time during the term thereof by notice in the form required by the Company, together with payment of the aggregate exercise price and applicable withholding tax. Payment of the exercise price may be made: (i) in cash or by cash equivalent acceptable to the Committee, or, (ii) to the extent permitted by the Committee in its sole discretion in an Award Agreement or otherwise (A) in Common Shares valued at the Fair Market Value of such shares on the date of exercise, (B) through an open-market, broker-assisted sales transaction pursuant to which the Company is promptly delivered the amount of proceeds necessary to satisfy the exercise price, (C) by reducing the number of Common Shares otherwise deliverable upon the exercise of the Stock Option by the number of Common Shares having a Fair Market Value on the date of exercise equal to the exercise price, (D) by a combination of the methods described above or (E) by such other method as may be approved by the Committee. In accordance with Section 16.11 hereof, and in addition to and at the time of payment of the exercise price, the Participant shall pay to the Company the full amount of any and all applicable income tax, employment tax and other amounts required to be withheld in connection with such exercise, payable under such of the methods described above for the payment of the exercise price as may be approved by the Committee and set forth in the Award Agreement.
- 6.6 Limited Transferability of Nonqualified Stock Options. All Stock Options shall be nontransferable except (i) upon the Participant's death, in accordance with Section 16.3 hereof or (ii) in the case of Nonqualified Stock Options only, for the transfer of all or part of the Stock Option to a Participant's "family member" (as defined for purposes of the Form S-8 registration statement under the Securities Act), in each case as may be approved by the Committee in its discretion at the time of proposed transfer. The transfer of a Nonqualified Stock Option may be

subject to such terms and conditions as the Committee may in its discretion impose from time to time. Subsequent transfers of a Nonqualified Stock Option shall be prohibited other than in accordance with Section 16.3 hereof.

- 6.7 Additional Rules for Incentive Stock Options.
- (a) *Eligibility*. An Incentive Stock Option may only be granted to an Eligible Person who is considered an employee for purposes of Treasury Regulation Section 1.421-1(h) with respect to the Company or any Subsidiary that qualifies as a "subsidiary corporation" with respect to the Company for purposes of Section 424(f) of the Code.
- (b) Annual Limits. No Incentive Stock Option shall be granted to a Participant as a result of which the aggregate Fair Market Value (determined as of the Date of Grant) of the Common Shares with respect to which incentive Stock Options under Section 422 of the Code are exercisable for the first time in any calendar year under the Plan and any other Stock Option plans of the Company, would exceed \$100,000, determined in accordance with Section 422(d) of the Code. This limitation shall be applied by taking Stock Options into account in the order in which granted. Any Stock Option grant that exceeds such limit shall be treated as a Nonqualified Stock Option.
- (c) Additional Limitations. In the case of any Incentive Stock Option granted to an Eligible Person who owns, either directly or indirectly (taking into account the attribution rules contained in Section 424(d) of the Code), shares possessing more than ten percent (10%) of the total combined voting power of all classes of shares of the Company or any Subsidiary, the exercise price shall not be less than one hundred ten percent (110%) of the Fair Market Value of a Common Share on the Date of Grant and the maximum term shall be five (5) years.
- (d) Termination of Service. An Award of an Incentive Stock Option may provide that such Stock Option may be exercised not later than (i) three (3) months following termination of Service of the Participant with the Company and all Subsidiaries (other than as set forth in clause (ii) of this Section 6.7(d)) or (ii) one year following termination of Service of the Participant with the Company and all Subsidiaries due to death or permanent and total disability within the meaning of Section 22(e)(3) of the Code, in each case as and to the extent determined by the Committee to comply with the requirements of Section 422 of the Code.
- (e) Other Terms and Conditions; Nontransferability. Any Incentive Stock Option granted hereunder shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as are deemed necessary or desirable by the Committee, which terms, together with the terms of the Plan, shall be intended and interpreted to cause such Incentive Stock Option to qualify as an "incentive stock option" under Section 422 of the Code. A Stock Option that is granted as an Incentive Stock Option shall, to the extent it fails to qualify as an "incentive stock option" under the Code, be treated as a Nonqualified Stock Option. An Incentive Stock Option shall by its terms be nontransferable other than by will or by the laws of descent and distribution, and shall be exercisable during the lifetime of a Participant only by such Participant.
- (f) Disqualifying Dispositions. If Common Shares acquired by exercise of an Incentive Stock Option are disposed of within two years following the Date of Grant or one year following the transfer of such shares to the Participant upon exercise, the Participant shall, promptly following such disposition, notify the Company in writing of the date and terms of such disposition and provide such other information regarding the disposition as the Company may reasonably require.
- 6.8 Repricing Prohibited. Subject to the adjustment provisions contained in Section 4.4 hereof, without the prior approval of the Company's shareholders, neither the Committee nor the Board shall cancel a Stock Option when the exercise price per share exceeds the Fair Market Value of one Common Share in exchange for cash or another Award (other than in connection with a Change in Control) or cause the cancellation, substitution or amendment of a Stock Option that would have the effect of reducing the exercise price of such a Stock Option previously granted under the Plan or otherwise approve any modification to such a Stock Option, that would be treated as a "repricing" under the then applicable rules, regulations or listing requirements adopted by the New York Stock Exchange or other principal exchange on which the Common Shares are then listed.
- 6.9 *Dividend Equivalent Rights.* Dividends and dividend equivalent rights shall not be paid or granted with respect to Stock Options.
- 6.10 No Rights as Shareholder. The Participant shall not have any rights as a shareholder with respect to the shares underlying a Stock Option until such time as Common Shares are delivered to the Participant pursuant to the terms of the Award Agreement.

## 7. Share Appreciation Rights.

- 7.1 Grant of Share Appreciation Rights. Share Appreciation Rights may be granted to any Eligible Person selected by the Committee. Share Appreciation Rights may be granted on a basis that allows for the exercise of the right by the Participant, or that provides for the automatic exercise or payment of the right upon a specified date or event. Share Appreciation Rights shall be non-transferable, except as provided in Section 16.3 hereof. All Share Appreciation Rights granted under the Plan are intended to comply with or otherwise be exempt from the requirements of Section 409A of the Code, to the extent applicable.
- 7.2 Terms of Share Appreciation Rights. Subject to Section 5.4, the Committee shall in its discretion provide in an Award Agreement the time or times at which or the conditions upon which, a Share Appreciation Right or portion thereof shall become vested and/or exercisable. The requirements for vesting and exercisability of a Share Appreciation Right may be based on the continued Service of a Participant with the Company or a Subsidiary for a specified time period (or periods), on the attainment of a specified performance goal(s) and/or on such other terms and conditions as approved by the Committee in its discretion. If the vesting requirements of a Share Appreciation Right are not satisfied, the Award shall be forfeited. A Share Appreciation Right will be exercisable or payable at such time or times as determined by the Committee; provided, however, that the maximum term of a Share Appreciation Right shall be ten (10) years from the Date of Grant. The Committee may provide that a Share Appreciation Right will cease to be exercisable upon or at the end of a period following a termination of Service for any reason. The base price of a Share Appreciation Right shall be determined by the Committee in its discretion; provided, however, that the base price per share shall not be less than one hundred percent (100%) of the Fair Market Value of a Common Share on the Date of Grant.
- 7.3 Payment of Share Appreciation Rights. A Share Appreciation Right will entitle the holder, upon exercise or other payment of the Share Appreciation Right, as applicable, to receive an amount determined by multiplying: (i) the excess of the Fair Market Value of a Common Share on the date of exercise or payment of the Share Appreciation Right over the base price of such Share Appreciation Right, by (ii) the number of shares as to which such Share Appreciation Right is exercised or paid. Payment of the amount determined under the foregoing may be made, as approved by the Committee and set forth in the Award Agreement, in Common Shares valued at their Fair Market Value on the date of exercise or payment, in cash or in a combination of Common Shares and cash, subject to applicable tax withholding requirements.
- 7.4 Repricing Prohibited. Subject to the adjustment provisions contained in Section 4.4 hereof, without the prior approval of the Company's shareholders, neither the Committee nor the Board shall cancel a Share Appreciation Right when the base price per share exceeds the Fair Market Value of one Common Share in exchange for cash or another Award (other than in connection with a Change in Control) or cause the cancellation, substitution or amendment of a Share Appreciation Right that would have the effect of reducing the base price of such a Share Appreciation Right previously granted under the Plan or otherwise approve any modification to such Share Appreciation Right that would be treated as a "repricing" under the then applicable rules, regulations or listing requirements adopted by the New York Stock Exchange or other principal exchange on which the Common Shares are then listed.
- 7.5 *Dividend Equivalent Rights.* Dividends and dividend equivalent rights shall not be paid or provided with respect to Share Appreciation Rights.
- 7.6 Dividends shall not be paid with respect to Share Appreciation Rights. Dividend equivalent rights may be granted with respect to the Common Shares subject to Share Appreciation Rights to the extent permitted by the Committee and set forth in the Award Agreement. Any dividend equivalent rights accumulated with respect to a Share Appreciation Right shall not be paid until, and only to the extent that, the Award vests, unless otherwise provided in the Award Agreement. Dividend equivalent rights may be subject to forfeiture under the same conditions as apply to the underlying Share Appreciation Rights.

## 8. Restricted Share Awards.

- 8.1 *Grant of Restricted Share Awards*. A Restricted Share Award may be granted to any Eligible Person selected by the Committee.
- 8.2 Vesting Requirements. Subject to Section 5.4, the restrictions imposed on shares granted under a Restricted Share Award shall lapse in accordance with the vesting requirements specified by the Committee in the Award Agreement. The requirements for vesting of a Restricted Share Award may be based on the continued Service of the Participant with the Company or a Subsidiary for a specified time period (or periods), on the attainment of a specified performance goal(s) and/or on such other terms and conditions as approved by the

Committee in its discretion. If the vesting requirements of a Restricted Share Award are not satisfied, the Award shall be forfeited and the Common Shares subject to the Award shall be returned to the Company.

- 8.3 Transfer Restrictions. Shares granted under any Restricted Share Award may not be transferred, assigned or subject to any encumbrance, pledge or charge until all applicable restrictions are removed or have expired, except as provided in Section 16.3 hereof. Failure to satisfy any applicable restrictions shall result in the subject shares of the Restricted Share Award being forfeited and returned to the Company. The Committee may require in an Award Agreement that certificates (if any) representing the shares granted under a Restricted Share Award bear a legend making appropriate reference to the restrictions imposed, and that certificates (if any) representing the shares granted or sold under a Restricted Share Award will remain in the physical custody of an escrow holder until all restrictions are removed or have expired.
- 8.4 Rights as Shareholder. Subject to the foregoing provisions of this Section 8 and the applicable Award Agreement, the Participant shall have all rights of a shareholder with respect to the shares granted to the Participant under a Restricted Share Award, including the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto, unless the Committee determines otherwise at the time the Restricted Share Award is granted.
- 8.5 Section 83(b) Election. If a Participant makes an election pursuant to Section 83(b) of the Code with respect to a Restricted Share Award, the Participant shall file, within thirty (30) days following the Date of Grant, a copy of such election with the Company and with the Internal Revenue Service, in accordance with the regulations under Section 83 of the Code. The Committee may provide in an Award Agreement that the Restricted Share Award is conditioned upon the Participant's making or refraining from making an election with respect to the Award under Section 83(b) of the Code.
  - 9. Restricted Share Units (including Performance Units).
- 9.1 Grant of Restricted Share Units and Performance Units. A Restricted Share Unit or Performance Unit may be granted to any Eligible Person selected by the Committee. The value of each Restricted Share Unit or Performance Unit is equal to the Fair Market Value of a Common Share on the applicable date or time period of determination, as specified by the Committee. Restricted Share Units and Performance Units shall be subject to such restrictions and conditions as the Committee shall determine. Restricted Share Units and Performance Units shall be non-transferable, except as provided in Section 16.3 hereof.
- 9.2 Vesting. The Subject to Section 5.4, the Committee shall, in its discretion, determine any vesting requirements with respect to Restricted Share Units and Performance Units, which shall be set forth in the Award Agreement. If the vesting requirements of a Restricted Share Unit Award or Performance Unit Award are not satisfied, the Award shall be forfeited.
  - (a) Restricted Share Units. The requirements for vesting of a Restricted Share Unit may be based on the continued Service of the Participant with the Company or a Subsidiary for a specified time period (or periods) and/or on such other terms and conditions as approved by the Committee in its discretion.
  - (b) *Performance Units*. The requirements for vesting of a Performance Unit may be based on the continued Service of the Participant with the Company or a Subsidiary for a specified time period (or periods), on the attainment of a specified performance goal(s) and/or on such other terms and conditions as approved by the Committee in its discretion.
- 9.3 Payment of Restricted Share Units and Performance Units. Restricted Share Units and Performance Units shall become payable to a Participant at the time or times determined by the Committee and set forth in the Award Agreement, which may be upon or following the vesting of the Award. Payment of a Restricted Share Unit or Performance Unit may be made, as approved by the Committee and set forth in the Award Agreement, in cash or in Common Shares or in a combination thereof, subject to applicable tax withholding requirements. Any cash payment of a Restricted Share Unit or Performance Unit shall be made based upon the Fair Market Value of a Common Share, determined on such date or over such time period as determined by the Committee.
- 9.4 Dividend Equivalent Rights. Restricted Share Units and Performance Units may be granted together with a dividend equivalent right with respect to the Common Shares subject to the Award, which may be accumulated and may be satisfied in additional Restricted Share Units and Performance Units that are subject to the same terms and conditions of the applicable Restricted Share Units and Performance Units or may be accumulated in cash, as determined by the Committee in its discretion. Any dividend equivalent rights accumulated with respect to a Restricted Share Unit or Performance Unit shall not be paid until, and only to the extent that, the Award vests,

unless otherwise provided in the Award Agreement. Dividend equivalent rights may be subject to forfeiture under the same conditions as apply to the underlying Restricted Share Units and Performance Units.

9.5 *No Rights as Shareholder.* The Participant shall not have any rights as a shareholder with respect to the shares subject to a Restricted Share Unit or Performance Unit until such time as Common Shares are delivered to the Participant pursuant to the terms of the Award Agreement.

#### 10. Cash Incentive Awards.

- 10.1 *Grant of Cash Incentive Awards*. A Cash Incentive Award may be granted to any Eligible Person selected by the Committee. A Cash Incentive Award may be evidenced by an Award Agreement specifying the performance period and such other terms and conditions as the Committee, in its discretion, shall determine. Cash Incentive Awards shall be non-transferable, except as provided in Section 16.3 hereof.
- 10.2 Payment. Payment amounts may be based on the attainment of specified levels of performance goals, including, if applicable, specified threshold, target and maximum performance levels, and performance falling between such levels. The requirements for payment may be also based upon the continued Service of the Participant with the Company or a Subsidiary during the respective performance period and on such other conditions as determined by the Committee. The Committee shall determine the attainment of the performance goals, the level of vesting or amount of payment to the Participant pursuant to Cash Incentive Awards, if any. Cash Incentive Awards may be paid, at the discretion of the Committee, in any combination of cash or Common Shares, based upon the Fair Market Value of such shares at the time of payment.

#### 11. Share Awards.

- 11.1 *Grant of Share Awards*. A Share Award may be granted to any Eligible Person selected by the Committee. A Share Award may be granted for past Services, in lieu of bonus or other cash compensation, as directors' compensation or for any other valid purpose as determined by the Committee. The Committee shall determine the terms and conditions of such Awards, and, subject to Section 5.4, the such Awards may be made without vesting requirements. In addition, the Committee may, in connection with any Share Award, require the payment of a specified purchase price.
- 11.2 Rights as Shareholder. Subject to the foregoing provisions of this Section 11 and the applicable Award Agreement, upon the issuance of Common Shares under a Share Award the Participant shall have all rights of a shareholder with respect to the Common Shares, including the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto.

## Change in Control.

- 12.1 Effect on Awards. Upon the occurrence of a Change in Control, all outstanding Awards shall either (a) be continued or assumed by the Company (if it is the surviving company or corporation) or by the surviving company or corporation or its parent (with such continuation or assumption including conversion into the right to receive securities, cash or a combination of both), or (b) substituted by the surviving company or corporation or its parent of awards (with such substitution including conversion into the right to receive securities, cash or a combination of both), with substantially similar terms for outstanding Awards (with appropriate adjustments to the type of consideration payable upon settlement of the Awards or other relevant factors, and with any applicable performance conditions adjusted pursuant to Section 13 or deemed achieved at the greater of the target level or actual performance, as determined by the Committee (with the Award remaining subject only to time vesting), unless otherwise provided in an Award Agreement).
- 12.2 Certain Adjustments. To the extent that outstanding Awards are not continued, assumed or substituted pursuant to Section 12.1 upon or following a Change in Control, the Committee is authorized (but not obligated) to make adjustments in the terms and conditions of outstanding Awards, including without limitation the following (or any combination thereof):
  - (a) acceleration of exercisability, vesting and/or payment under outstanding Awards immediately prior to the occurrence of such event or upon or following such event;
  - (b) upon written notice, providing that any outstanding Stock Options and Share Appreciation Rights are exercisable during a period of time immediately prior to the scheduled consummation of the event or such other period as determined by the Committee (contingent upon the consummation of the event), and at the end of such period, such Stock Options and Share Appreciation Rights shall terminate to the extent not so exercised within the relevant period; and

- (c) cancellation of all or any portion of outstanding Awards for fair value (in the form of cash, Common Shares, other property or any combination thereof) as determined in the sole discretion of the Committee; provided, however, that, in the case of Stock Options and Share Appreciation Rights or similar Awards, the fair value may equal the excess, if any, of the value or amount of the consideration to be paid in the Change in Control transaction to holders of Common Shares (or, if no such consideration is paid, Fair Market Value of the Common Shares) over the aggregate exercise or base price, as applicable, with respect to such Awards or portion thereof being canceled, or if there is no such excess, zero; provided, further, that if any payments or other consideration are deferred and/or contingent as a result of escrows, earn-outs, holdbacks or any other contingencies, payments under this provision may be made on substantially the same terms and conditions applicable to, and only to the extent actually paid to, the holders of Common Shares in connection with the Change in Control.
- 12.3 Certain Terminations of Service. Notwithstanding the provisions of Section 12.1 and Section 12.2, if a Participant's Service with the Company and its Subsidiaries is terminated upon or within twenty four (24) months following a Change in Control by the Company without Cause or by the Participant for Good Reason, the unvested portion (if any) of all outstanding Awards held by the Participant shall immediately vest (and, to the extent applicable, become exercisable) and be paid in full upon such termination, with any applicable performance conditions deemed achieved at the greater of the target level or actual performance, as determined by the Committee, unless otherwise provided in an Award Agreement.
- 12.4 Definition of Change in Control. Unless otherwise defined in an Award Agreement, "Change in Control" means, and shall be deemed to have occurred, if:
  - (a) any Person, excluding the Company, any of its Affiliates and any employee benefit plan of the Company or any of its Affiliates, is or becomes the "beneficial owner" (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of securities of the Company representing 20% or more of the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors:
  - (b) consummation of a reorganization, merger, consolidation or sale or other disposition of all or substantially all of the assets of the Company (a "Business Combination"), in each case, unless, following such Business Combination, individuals and entities that were the beneficial owners of outstanding voting securities entitled to vote generally in the election of directors of the Company immediately prior to such Business Combination beneficially own, directly or indirectly, at least 60% of the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors resulting from such Business Combination (including, without limitation, an entity which, as a result of such transaction, owns all or substantially all of the Company or its assets either directly or through one or more Subsidiaries or Affiliates) in substantially the same proportions as their ownership of such securities immediately prior to such Business Combination;
  - (c) during any period of twenty-four (24) consecutive months, individuals who, at the beginning of such period, constitute the Board (the "Incumbent Directors") cease for any reason (including without limitation, as a result of a tender offer, proxy contest, merger or similar transaction) to constitute at least a majority thereof; provided that, any individual becoming a director of the Company whose appointment or election by the Board or nomination for election by the Company's shareholders was approved or recommended by a vote of at least two-thirds of the Incumbent Directors shall also be considered an Incumbent Director; or
    - (d) the consummation of a complete liquidation or dissolution of the Company.

Notwithstanding the foregoing, to the extent necessary to comply with Section 409A of the Code with respect to the payment of "nonqualified deferred compensation," "Change in Control" shall be limited to a "change in control event" as defined under Section 409A of the Code.

- 12.5 *Definition of Person*. "*Person*" means an individual, corporation, partnership, association, trust, unincorporated organization, limited liability company or other legal entity. All references to Person shall include an individual Person or a group (as defined in Rule 13d-5 under the Exchange Act) of Persons.
- 13. Adjustment of Performance Goals. The Committee may provide for the performance goals to which an Award is subject, or the manner in which performance will be measured against such performance goals, to be adjusted in such manner as it deems appropriate, including, without limitation, adjustments to reflect charges for restructurings, non-operating income, the impact of corporate transactions or discontinued operations, events that are unusual in nature or infrequent in occurrence and other non-recurring items, currency fluctuations, litigation or

claim judgements, settlements, and the effects of accounting or tax law changes. In addition, with respect to a Participant hired or promoted following the beginning of a performance period, the Committee may determine to prorate the performance goals in respect of such Participant's Awards for the partial performance period.

#### Forfeiture Events.

- 14.1 *General.* The Committee may specify in an Award Agreement at the time of the Award that the Participant's rights, payments and benefits with respect to an Award are subject to reduction, cancellation, forfeiture or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions of an Award. Such events may include, without limitation, termination of Service for Cause, violation of laws, regulations or material Company policies, breach of noncompetition, non-solicitation, confidentiality or other restrictive covenants that may apply to the Participant or other conduct by the Participant that is detrimental to the business or reputation of the Company.
- 14.2 Termination for Cause; Treatment of Awards. Unless otherwise provided by the Committee and set forth in an Award Agreement, if (i) a Participant's Service with the Company or any Subsidiary shall be terminated for Cause or (ii) after termination of Service for any other reason, the Committee determines in its discretion either that, (1) during the Participant's period of Service, the Participant engaged in an act or omission which would have warranted termination of Service for Cause or (2) after termination, the Participant engages in conduct that violates any continuing obligation or duty of the Participant in respect of the Company or any Subsidiary, such Participant's rights, payments and benefits with respect to an Award shall be subject to cancellation, forfeiture and/or recoupment, as provided in Section 14.3 below. The Company shall have the power to determine whether the Participant has been terminated for Cause, the date upon which such termination for Cause occurs, whether the Participant engaged in an act or omission which would have warranted termination of Service for Cause or engaged in conduct that violated any continuing obligation or duty of the Participant in respect of the Company or any Subsidiary. Any such determination shall be final, conclusive and binding upon all persons. In addition, if the Company shall reasonably determine that a Participant has committed or may have committed any act which could constitute the basis for a termination of such Participant's Service for Cause or violates any continuing obligation or duty of the Participant in respect of the Company or any Subsidiary, the Company may suspend the Participant's rights to exercise any Stock Option or Share Appreciation Right, receive any payment or vest in any right with respect to any Award pending a determination by the Company of whether an act or omission could constitute the basis for a termination for Cause as provided in this Section 14.2.

## 14.3 Right of Recapture.

- (a) General. If at any time within one (1) year (or such longer time specified in an Award Agreement or other agreement with a Participant or policy applicable to the Participant) after the date on which a Participant exercises a Stock Option or Share Appreciation Right or on which a Share Award, Restricted Share Award, or Restricted Share Unit (including Performance Units) vests, is settled in shares or otherwise becomes payable or on which a Cash Incentive Award is paid to a Participant, or on which income otherwise is realized or property is received by a Participant in connection with an Award, (i) a Participant's Service is terminated for Cause, (ii) the Committee determines in its discretion that the Participant is subject to any recoupment of benefits pursuant to the Company's compensation recovery, "clawback" or similar policy, as may be in effect from time to time, or (iii) after a Participant's Service terminates for any other reason, the Committee determines in its discretion either that, (1) during the Participant's period of Service, the Participant engaged in an act or omission which would have warranted termination of the Participant's Service for Cause or (2) after a Participant's termination of Service, the Participant engaged in conduct that violated any continuing obligation or duty of the Participant in respect of the Company or any Subsidiary, then, at the sole discretion of the Committee, any gain realized by the Participant from the exercise, vesting, payment, settlement or other realization of income or receipt of property by the Participant in connection with an Award, shall be repaid by the Participant to the Company upon notice from the Company, subject to applicable law. Such gain shall be determined as of the date or dates on which the gain is realized by the Participant, without regard to any subsequent change in the Fair Market Value of a Common Share. To the extent not otherwise prohibited by law, the Company shall have the right to offset the amount of such repayment obligation against any amounts otherwise owed to the Participant by the Company (whether as wages, vacation pay or pursuant to any benefit plan or other compensatory arrangement).
- (b) Accounting Restatement. If a Participant receives compensation pursuant to an Award under the Plan based on financial statements that are subsequently restated in a way that would decrease the value of such compensation, the Participant will, to the extent not otherwise prohibited by law, upon the written request

of the Company, forfeit and repay to the Company the difference between what the Participant received and what the Participant should have received based on the accounting restatement, in accordance with (i) any compensation recovery, "clawback" or similar policy, as may be in effect from time to time to which such Participant is subject and (ii) any compensation recovery, "clawback" or similar policy made applicable by law including the provisions of Section 945 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the rules, regulations and requirements adopted thereunder by the Securities and Exchange Commission and/or any national securities exchange on which the Company's equity securities may be listed (the "*Policy*"). By accepting an Award hereunder, the Participant acknowledges and agrees that the Policy, whenever adopted, shall apply to such Award, and all incentive-based compensation payable pursuant to such Award shall be subject to forfeiture and repayment pursuant to the terms of the Policy.

15. Transfer, Leave of Absence, Etc. For purposes of the Plan, except as otherwise determined by the Committee, the following events shall not be deemed a termination of Service: (a) a transfer to the service of the Company from a Subsidiary or from the Company to a Subsidiary, or from one Subsidiary to another; or (b) an approved leave of absence for military service or sickness, a leave of absence where the employee's right to reemployment is protected either by a statute or by contract or under the policy pursuant to which the leave of absence was granted, a leave of absence for any other purpose approved by the Company or if the Committee otherwise so provides in writing.

## 16. General Provisions.

- 16.1 Status of Plan. The Committee may authorize the creation of trusts or other arrangements to meet the Company's obligations to deliver Common Shares or make payments with respect to Awards.
- 16.2 Award Agreement. An Award under the Plan shall be evidenced by an Award Agreement in a written or electronic form approved by the Committee setting forth the number of Common Shares, units, or other amounts or securities subject to the Award, the exercise price, base price or purchase price of the Award, the time or times at which an Award will become vested, exercisable or payable and the term of the Award. The Award Agreement also may set forth the effect on an Award of a Change in Control and/or a termination of Service under certain circumstances. The Award Agreement shall be subject to and incorporate, by reference or otherwise, all of the applicable terms and conditions of the Plan, and also may set forth other terms and conditions applicable to the Award as determined by the Committee consistent with the limitations of the Plan. The grant of an Award under the Plan shall not confer any rights upon the Participant holding such Award other than such terms, and subject to such conditions, as are specified in the Plan as being applicable to such type of Award (or to all Awards) or as are expressly set forth in the Award Agreement. The Committee need not require the execution of an Award Agreement by a Participant, in which case, acceptance of the Award by the Participant shall constitute agreement by the Participant to the terms, conditions, restrictions and limitations set forth in the Plan and the Award Agreement as well as the administrative guidelines of the Company in effect from time to time. In the event of any conflict between the provisions of the Plan and any Award Agreement, the provisions of the Plan shall prevail.
- 16.3 No Assignment or Transfer; Beneficiaries. Except as provided in Section 6.6 hereof, Awards under the Plan shall not be assignable or transferable by the Participant, and shall not be subject in any manner to assignment, alienation, pledge, encumbrance or charge. Notwithstanding the foregoing, in the event of the death of a Participant, except as otherwise provided by the Committee in an Award Agreement, an outstanding Award may be exercised by or shall become payable to the Participant's beneficiary as determined under the Company 401(k) retirement plan or other applicable retirement or pension plan. In lieu of such determination, a Participant may, from time to time, name any beneficiary or beneficiaries to receive any benefit in case of the Participant's death before the Participant receives any or all of such benefit. Each such designation shall revoke all prior designations by the same Participant and will be effective only when filed by the Participant in writing (in such form or manner as may be prescribed by the Committee) with the Company during the Participant's lifetime. In the absence of a valid designation as provided above, if no validly designated beneficiary survives the Participant or if each surviving validly designated beneficiary is legally impaired or prohibited from receiving the benefits under an Award, the Participant's beneficiary shall be the legatee or legatees of such Award designated under the Participant's last will or by such Participant's executors, personal representatives or distributees of such Award in accordance with the Participant's will or the laws of descent and distribution. The Committee may provide in the terms of an Award Agreement or in any other manner prescribed by the Committee that the Participant shall have the right to designate a beneficiary or beneficiaries who shall be entitled to any rights, payments or other benefits specified under an Award following the Participant's death.

- 16.4 Deferrals of Payment. The Committee may in its discretion permit a Participant to defer the receipt of payment of cash or delivery of Common Shares that would otherwise be due to the Participant by virtue of the exercise of a right or the satisfaction of vesting or other conditions with respect to an Award; provided, however, that such discretion shall not apply in the case of a Stock Option or Share Appreciation Right that is intended to satisfy the requirements of Treasury Regulations Section 1.409A-1(b)(5)(i)(A) or (B). If any such deferral is to be permitted by the Committee, the Committee shall establish rules and procedures relating to such deferral in a manner intended to comply with the requirements of Section 409A of the Code, including, without limitation, the time when an election to defer may be made, the time period of the deferral and the events that would result in payment of the deferred amount, the interest or other earnings attributable to the deferral and the method of funding, if any, attributable to the deferred amount.
- 16.5 No Right to Employment or Continued Service. Nothing in the Plan, in the grant of any Award or in any Award Agreement shall confer upon any Eligible Person or any Participant any right to continue in the Service of the Company or any of its Subsidiaries or interfere in any way with the right of the Company or any of its Subsidiaries to terminate the employment or other service relationship of an Eligible Person or a Participant for any reason or no reason at any time.
- 16.6 Rights as Shareholder. A Participant shall have no rights as a holder of Common Shares with respect to any unissued securities covered by an Award until the date the Participant becomes the holder of record of such securities. Except as provided in Section 4.4 hereof, no adjustment or other provision shall be made for dividends or other shareholder rights, except to the extent that the Award Agreement provides for dividend payments or dividend equivalent rights. The Committee may determine in its discretion the manner of delivery of Common Shares to be issued under the Plan, which may be by delivery of share certificates, electronic account entry into new or existing accounts or any other means as the Committee, in its discretion, deems appropriate. The Committee may require that the share certificates (if any) be held in escrow by the Company for any Common Shares or cause the shares to be legended in order to comply with the securities laws or other applicable restrictions. Should the Common Shares be represented by book or electronic account entry rather than a certificate, the Committee may take such steps to restrict transfer of the Common Shares as the Committee considers necessary or advisable.
- 16.7 *Trading Policy and Other Restrictions*. Transactions involving Awards under the Plan shall be subject to the Company's insider trading and Regulation FD policy and other restrictions, terms and conditions, to the extent established by the Committee or by applicable law, including any other applicable policies set by the Committee, from time to time.
- 16.8 Section 409A Compliance. To the extent applicable, it is intended that the Plan and all Awards hereunder comply with, or be exempt from, the requirements of Section 409A of the Code and the Treasury Regulations and other guidance issued thereunder, and that the Plan and all Award Agreements shall be interpreted and applied by the Committee in a manner consistent with this intent in order to avoid the imposition of any additional tax under Section 409A of the Code. In the event that any (i) provision of the Plan or an Award Agreement, (ii) Award, payment, transaction or (iii) other action or arrangement contemplated by the provisions of the Plan is determined by the Committee to not comply with the applicable requirements of Section 409A of the Code and the Treasury Regulations and other guidance issued thereunder, the Committee shall have the authority to take such actions and to make such changes to the Plan or an Award Agreement as the Committee deems necessary to comply with such requirements; provided, however, that no such action shall adversely affect any outstanding Award without the consent of the affected Participant. No payment that constitutes deferred compensation under Section 409A of the Code that would otherwise be made under the Plan or an Award Agreement upon a termination of Service will be made or provided unless and until such termination is also a "separation from service," as determined in accordance with Section 409A of the Code. Notwithstanding the foregoing or anything elsewhere in the Plan or an Award Agreement to the contrary, if a Participant is a "specified employee" as defined in Section 409A of the Code at the time of termination of Service with respect to an Award, then solely to the extent necessary to avoid the imposition of any additional tax under Section 409A of the Code, the commencement of any payments or benefits under the Award shall be deferred until the date that is six (6) months plus one (1) day following the date of the Participant's termination of Service or, if earlier, the Participant's death (or such other period as required to comply with Section 409A). For purposes of Section 409A of the Code, a Participant's right to receive any installment payments pursuant to this Plan or any Award granted hereunder shall be treated as a right to receive a series of separate and distinct payments. For the avoidance of doubt, each applicable tranche of Common Shares subject to vesting under any Award shall be considered a right to receive a series of separate and distinct payments. In no event whatsoever shall the Company be liable for any

additional tax, interest or penalties that may be imposed on a Participant by Section 409A of the Code or any damages for failing to comply with Section 409A of the Code.

- 16.9 Securities Law Compliance. No Common Shares will be issued or transferred pursuant to an Award unless and until all then applicable requirements imposed by Federal and state securities and other laws, rules and regulations and by any regulatory agencies having jurisdiction, and by any exchanges upon which the Common Shares may be listed, have been fully met. As a condition precedent to the issuance of Common Shares pursuant to the grant or exercise of an Award, the Company may require the Participant to take any action that the Company determines is necessary or advisable to meet such requirements. The Committee may impose such conditions on any Common Shares issuable under the Plan as it may deem advisable, including, without limitation, restrictions under the Securities Act, under the requirements of any exchange upon which such shares of the same class are then listed, and under any blue sky or other securities laws applicable to such shares. The Committee may also require the Participant to represent and warrant at the time of issuance or transfer that the Common Shares are being acquired solely for investment purposes and without any current intention to sell or distribute such shares.
- 16.10 Substitution or Assumption of Awards in Corporate Transactions. The Committee may grant Awards under the Plan in connection with the acquisition, whether by purchase, merger, consolidation or other corporate transaction, of the business or assets of any corporation or other entity, in substitution for awards previously granted by such corporation or other entity or otherwise. The Committee may also assume any previously granted awards of an employee, director, consultant or other service provider of another corporation or entity that becomes an Eligible Person by reason of such corporation transaction. The terms and conditions of the substituted or assumed awards may vary from the terms and conditions that would otherwise be required by the Plan solely to the extent the Committee deems necessary for such purpose. To the extent permitted by applicable law and the listing requirements of the New York Stock Exchange or other exchange or securities market on which the Common Shares are listed, any such substituted or assumed awards shall not reduce the Share Reserve.
- 16.11 Tax Withholding. The Participant shall be responsible for payment of any taxes or similar charges required by law to be paid or withheld from an Award or an amount paid in satisfaction of an Award. Any required withholdings shall be paid by the Participant on or prior to the payment or other event that results in taxable income in respect of an Award. The Award Agreement may specify the manner in which the withholding obligation shall be satisfied with respect to the particular type of Award, which may include permitting the Participant to elect to satisfy the withholding obligation by tendering Common Shares to the Company or having the Company withhold a number of Common Shares having a value in each case up to the maximum statutory tax rates in the applicable jurisdiction or as the Committee may approve in its discretion (provided that such withholding does not result in adverse tax or accounting consequences to the Company), or similar charge required to be paid or withheld. The Company shall have the power and the right to require a Participant to remit to the Company the amount necessary to satisfy federal, state, provincial and local taxes, domestic or foreign, required by law or regulation to be withheld, and to deduct or withhold from any Common Shares deliverable under an Award to satisfy such withholding obligation.
- 16.12 *Unfunded Plan.* The adoption of the Plan and any reservation of Common Shares or cash amounts by the Company to discharge its obligations hereunder shall not be deemed to create a trust or other funded arrangement. Except upon the issuance of Common Shares pursuant to an Award, any rights of a Participant under the Plan shall be those of a general unsecured creditor of the Company, and neither a Participant nor the Participant's permitted transferees or estate shall have any other interest in any assets of the Company by virtue of the Plan. Notwithstanding the foregoing, the Company shall have the right to implement or set aside funds in a grantor trust, subject to the claims of the Company's creditors or otherwise, to discharge its obligations under the Plan.
- 16.13 Other Compensation and Benefit Plans. The adoption of the Plan shall not affect any other share incentive or other compensation plans in effect for the Company or any Subsidiary, nor shall the Plan preclude the Company from establishing any other forms of share incentive or other compensation or benefit program for employees of the Company or any Subsidiary. The amount of any compensation deemed to be received by a Participant pursuant to an Award shall not constitute includable compensation for purposes of determining the amount of benefits to which a Participant is entitled under any other compensation or benefit plan or program of the Company or a Subsidiary, including, without limitation, under any pension or severance benefits plan, except to the extent specifically provided by the terms of any such plan.
- 16.14 Plan Binding on Transferees. The Plan shall be binding upon the Company, its transferees and assigns, and the Participant, the Participant's executor, administrator and permitted transferees and beneficiaries.

- 16.15 Severability. If any provision of the Plan or any Award Agreement shall be determined to be illegal or unenforceable by any court of law in any jurisdiction, the remaining provisions hereof and thereof shall be severable and enforceable in accordance with their terms, and all provisions shall remain enforceable in any other jurisdiction.
- 16.16 *Governing Law; Jurisdiction.* The Plan and all rights hereunder shall be governed by and interpreted in accordance with the laws of the State of Ohio, without reference to the principles of conflicts of laws, and to applicable federal laws.
- 16.17 No Fractional Shares. No fractional Common Shares shall be issued or delivered pursuant to the Plan or any Award, and the Committee shall determine whether cash, other securities or other property shall be paid or transferred in lieu of any fractional Common Shares or whether such fractional shares or any rights thereto shall be canceled, terminated or otherwise eliminated.
- 16.18 No Guarantees Regarding Tax Treatment. Neither the Company nor the Committee make any guarantees to any person regarding the tax treatment of Awards or payments made under the Plan. Neither the Company nor the Committee has any obligation to take any action to prevent the assessment of any tax on any person with respect to any Award under Section 409A of the Code, Section 4999 of the Code or otherwise and neither the Company nor the Committee shall have any liability to a person with respect thereto.
- 16.19 *Data Protection.* By participating in the Plan, each Participant consents to the collection, processing, transmission and storage by the Company, its Subsidiaries and any third party administrators of any data of a professional or personal nature for the purposes of administering the Plan.
- 16.20 Awards to Non-U.S. Participants. To comply with the laws in countries other than the United States in which the Company or any of its Subsidiaries operates or has employees, Non-Employee Directors or consultants, the Committee, in its sole discretion, shall have the power and authority to (i) modify the terms and conditions of any Award granted to Participants outside the United States to comply with applicable foreign laws, (ii) take any action, before or after an Award is made, that it deems advisable to obtain approval or comply with any necessary local government regulatory exemptions or approvals and (iii) establish subplans and modify exercise procedures and other terms and procedures, to the extent such actions may be necessary or advisable.
  - 17. Term; Amendment and Termination; Shareholder Approval.
- 17.1 *Term.* The Plan shall be effective as of the date of its approval by the shareholders of the Company (the "*Effective Date*"). Subject to Section 17.2 hereof, the Plan shall terminate on the tenth anniversary of the Effective Date.
- 17.2 Amendment and Termination. The Board may from time to time and in any respect, amend, modify, suspend or terminate the Plan; provided, however, that no amendment, modification, suspension or termination of the Plan shall materially and adversely affect any Award theretofore granted without the consent of the Participant or the permitted transferee of the Award. The Board may seek the approval of any amendment, modification, suspension or termination by the Company's shareholders to the extent it deems necessary in its discretion for purposes of compliance with Section 422 of the Code or for any other purpose, and shall seek such approval to the extent it deems necessary in its discretion to comply with applicable law or listing requirements of the New York Stock Exchange or other exchange or securities market. Notwithstanding the foregoing, the Board shall have broad authority to amend the Plan or any Award under the Plan without the consent of a Participant to the extent it deems necessary or desirable in its discretion to comply with, take into account changes in, or interpretations of, applicable tax laws, securities laws, employment laws, accounting rules and other applicable laws, rules and regulations.



\_\_\_\_

# **2018 ANNUAL REPORT**

#### **FINANCIAL REPORT 2018**

#### 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. *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 2, 2019.

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

J. Michael Schlotman

Executive Vice President and
Chief Financial Officer

#### **SELECTED FINANCIAL DATA**

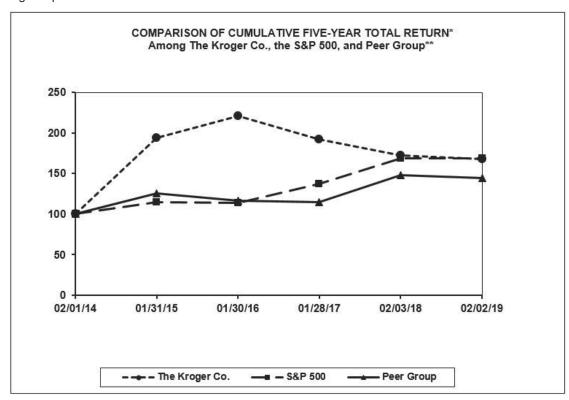
	Fiscal Years Ended					
	February 2,	February 3,	January 28,	January 30,	February 1,	
	2019	2018	2017	2016	2015	
	(52 weeks)	(53 weeks)	(52 weeks)	(52 weeks)	(52 weeks)	
		(In millions,	except per sha	are amounts)		
Sales	\$ 121,162	\$ 122,662	\$ 115,337	\$ 109,830	\$ 108,465	
Net earnings including noncontrolling interests	3,078	1,889	1,957	2,049	1,747	
Net earnings attributable to The Kroger Co.	3,110	1,907	1,975	2,039	1,728	
Net earnings attributable to The Kroger Co. per						
diluted common share	3.76	2.09	2.05	2.06	1.72	
Total assets	38,118	37,197	36,505	33,897	30,497	
Long-term liabilities, including obligations under						
capital leases and financing obligations	16,009	16,095	16,935	14,128	13,663	
Total shareholders' equity — The Kroger Co.	7,886	6,931	6,698	6,820	5,412	
Cash dividends per common share	0.530	0.490	0.450	0.395	0.340	

Our common stock is listed on the New York Stock Exchange under the symbol "KR." As of March 28, 2019, there were 27,037 shareholders of record.

During 2018, we paid two quarterly cash dividends of \$0.125 per share and two quarterly cash dividends of \$0.14 per share. During 2017, we paid two quarterly cash dividends of \$0.12 per share and two quarterly cash dividends of \$0.125 per share. On March 1, 2019, we paid a quarterly cash dividend of \$0.14 per share. On March 14, 2019, we announced that our Board of Directors declared a quarterly cash dividend of \$0.14 per share, payable on June 1, 2019, to shareholders of record at the close of business on May 15, 2019. 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.



	Base	INDEXED RETURNS				
	Period	Years Ending				
Company Name/Index	2013	2014	2015	2016	2017	2018
The Kroger Co.	100	194.06	220.52	192.09	172.11	167.77
S&P 500 Index	100	114.22	113.46	137.14	168.46	168.36
Peer Group	100	125.06	116.69	114.76	148.26	143.99

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.

<sup>\*</sup> Total assumes \$100 invested on February 1, 2014, in The Kroger Co., S&P 500 Index, and the Peer Group, with reinvestment of dividends.

<sup>\*\*</sup> 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. (included through October 19, 2018 when it was acquired by United Natural Foods), Target Corp., 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**

	Total Number of Shares		Average Price Paid	Total Number of Shares Purchased as Part of Publicly Announced Plans or	Value that Purc th	cimum Dollar ue of Shares t May Yet Be chased Under ue Plans or ograms (4)
Period (1)	Purchased (2)	Per Share		Programs (3)	(in millions)	
First period - four weeks						
November 11, 2018 to December 8, 2018	211,696	\$	30.41	192,716	\$	546
Second period - four weeks						
December 9, 2018 to January 5, 2019	147,050	\$	28.84	128,189	\$	546
Third period — four weeks						
January 6, 2019 to February 2, 2019	196,646	\$	28.54	165,094	\$	546
Total	555,392	\$	29.33	485,999	\$	546

<sup>(1)</sup> The reported periods conform to our fiscal calendar composed of thirteen 28-day periods. The fourth quarter of 2018 contained three 28-day periods.

- (2) Includes (i) 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 (ii) 69,393 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 1999 Repurchase Program.
- (4) The amounts shown in this column reflect the amount remaining under the March 2018 Repurchase Program as of the specified period end dates. Amounts available under the 1999 Repurchase Program are dependent upon option exercise activity. The March 2018 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.

#### **BUSINESS**

The Kroger Co. (the "Company" or "Kroger") was founded in 1883 and incorporated in 1902. As of February 2, 2019, 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) 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 2018, 2017 and 2016 are to the fiscal years ended February 2, 2019, February 3, 2018 and January 28, 2017, respectively, unless specifically indicated otherwise.

#### **EMPLOYEES**

As of February 2, 2019, Kroger employed approximately 453,000 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 2, 2019, Kroger operated, either directly or through its subsidiaries, 2,764 supermarkets under a variety of local banner names, of which 2,270 had pharmacies and 1,537 had fuel centers. We offer Pickup (also referred to as ClickList®) and Harris Teeter ExpressLane™— personalized, order online, pick up at the store services — at 1,581 of our supermarkets and provide home delivery service to 91% of Kroger households. Approximately 54% 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 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 and toys.

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.

#### **SEGMENTS**

We operate supermarkets and multi-department stores throughout the United States. Our retail operations, which represent 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 one of our premium quality brands, offering customers culinary foods and ingredients that deliver amazing eating experiences. The Kroger® brand, which represents the majority of our private label items, is designed to consistently satisfy and delight customers with quality products that exceed or meet the national brand in taste and efficacy, as well as with unique and differentiated products. Big K®, Check This Out...® and Heritage Farm® are some of our value brands, designed to deliver good quality at a very affordable price. In addition, we continue to grow natural and organic Our Brands offerings with Simple Truth® and Simple Truth Organic®. Both Simple Truth and Simple Truth Organic are free from a defined list of artificial ingredients that customers have told us they do not want in their food, and the Simple Truth Organic products are USDA certified organic.

Approximately 32% of *Our Brands* units and 43% 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 2, 2019, we operated 37 food production plants. These plants consisted of 17 dairies, 10 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 2, 2019, Kroger is one of the world's largest retailers, as measured by revenue, operating 2,764 supermarkets under a variety of local banner names in 35 states and the District of Columbia. Of these stores, 2,270 have pharmacies and 1,537 have fuel centers. We offer Pickup (also referred to as ClickList®) and Harris Teeter ExpressLane™ — personalized, order online, pick up at the store services — at 1,581 of our supermarkets and provide home delivery service to 91% of Kroger households. We also operate an online retailer.

We operate 37 food production plants, primarily bakeries and dairies, which supply approximately 32% of *Our Brands* units and 43% 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 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 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 97% of our consolidated sales, is our only reportable segment.

On June 22, 2018, we closed our merger with Home Chef by purchasing 100% of the ownership interest in Home Chef, for \$197 million net of cash and cash equivalents of \$30 million, in addition to future earnout payments of up to \$500 million over five years that are contingent on achieving certain milestones. Home Chef is included in our ending Consolidated Balance Sheet for 2018 and in our Consolidated Statements of Operations from June 22, 2018 through February 2, 2019.

On April 20, 2018, we completed the sale of our convenience store business unit for \$2.2 billion. The convenience store business is included in our ending Consolidated Balance Sheet for 2017 and in our Consolidated Statements of Operations in all periods in 2016 and 2017 and through April 19, 2018.

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, 2017 and 2018 and in our Consolidated Statements of Operations from September 2, 2016 through January 28, 2017 and all periods in 2017 and 2018.

See Note 2 to the Consolidated Financial Statements for more information related to our mergers with Home Chef and ModernHEALTH.

## **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 operating net earnings, adjusted operating net earnings per diluted share and Restock 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.

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") charge. Merchandise costs exclude depreciation and rent expenses. FIFO gross margin is an important measure used by management as 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 charge. FIFO operating profit is an important measure used by management as management believes FIFO operating profit is a useful metric to investors and analysts because it measures our day-to-day operational effectiveness.

The adjusted operating net earnings and adjusted operating net earnings per diluted share metrics are important measures used by management to compare the performance of core operating results between periods. We believe adjusted operating net earnings and adjusted operating net earnings per diluted share are useful metrics to investors and analysts because they present more accurate year-over-year comparisons for our net earnings and net earnings per diluted share because adjusted items are not the result of our normal operations. Net earnings for 2018 include the following, which we define as the "2018 Adjusted Items:"

- Charges to operating, general and administrative expenses ("OG&A") of \$155 million, \$121 million net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension fund; \$33 million, \$26 million net of tax, for the revaluation of contingent consideration; and \$42 million, \$33 million net of tax, for an impairment of financial instrument (the "2018 OG&A Adjusted Items"). We had initially received the financial instrument in 2016 with no cash outlay as part of the consideration for entering into agreements with a third party.
- A reduction to depreciation and amortization expenses of \$14 million, \$11 million net of tax, related to held for sale assets (the "2018 Depreciation Adjusted Item").
- Gains in other income (expense) of \$1.8 billion, \$1.4 billion net of tax, related to the sale of our convenience store business unit and \$228 million, \$174 million net of tax, for the mark to market gain on Ocado Group plc ("Ocado") securities.

Net earnings for 2017 include the following, which we define as the "2017 Adjusted Items:"

- Charges to 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"); and \$110 million, \$74 million net of tax, related to the Kroger Specialty Pharmacy goodwill impairment (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").
- A charge in other income (expense) of \$502 million, \$335 million net of tax, related to a companysponsored pension plan termination.

In addition, net earnings for 2017 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").

#### **OVERVIEW**

Notable items for 2018 are:

- Net earnings per diluted share of \$3.76.
- Adjusted operating net earnings per diluted share of \$2.11.
- Identical sales, excluding fuel, increased 1.8% in 2018.
- Digital revenue grew over 58% in 2018, driven by Pickup. Digital revenue primarily includes revenue from all curbside pickup locations and online sales delivered to customer locations.
- Alternative profit increased in 2018, including third party media and our Kroger Personal Finance business, which had combined operating profit growth of approximately 20% in 2018.
- Sold our convenience store business unit for \$2.2 billion.
- Announced Ocado partnership and completed our merger with Home Chef.
- Announced we had entered into a definitive agreement to sell our You Technology business to Inmar.
   On March 13, 2019, we completed the sale of our You Technology business for \$565 million, which includes a long-term service agreement for Inmar to provide us digital coupon services.
- During 2018, we announced we had decided to explore strategic alternatives for our Turkey Hill Dairy business, including a potential sale. On March 19, 2019, we announced a definitive agreement for the sale of our Turkey Hill Dairy business to an affiliate of Peak Rock Capital.
- During 2018, we returned \$2.4 billion to shareholders from share repurchases and dividend payments, which includes \$1.2 billion repurchased under a \$1.2 billion accelerated stock repurchase ("ASR") program using after tax proceeds from the sale of our convenience store business unit.
- Net cash provided by operating activities was \$4.2 billion in 2018 compared to \$3.4 billion in 2017.
- Restock cash flow was \$1.9 billion in 2018 and \$735 million in 2017.

The following table provides a reconciliation of net earnings attributable to The Kroger Co. to adjusted operating net earnings attributable to The Kroger Co. and a reconciliation of net earnings attributable to The Kroger Co. per diluted common share to adjusted operating net earnings attributable to The Kroger Co. per diluted common share, excluding the 2018, 2017 and 2016 Adjusted Items.

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

	2018	2017	2016
Net earnings attributable to The Kroger Co.	\$ 3,110	\$ 1,907	\$ 1,975
Adjustments for pension plan agreements (1)(2)	121	360	71
Adjustment for voluntary retirement offering (1)(3)		117	
Adjustment for Kroger Specialty Pharmacy goodwill impairment (1)(4)	_	74	_
Adjustment for company-sponsored pension plan termination (1)(5)	_	335	_
Adjustment for gain on sale of convenience store business (1)(6)	(1,360)	_	_
Adjustment for mark to market gain on Ocado securities (1)(7)	(174)	_	_
Adjustment for depreciation related to held for sale assets (1)(8)	(11)	(13)	_
Adjustment for contingent consideration (1)(9)	26	(.0)	_
Adjustment for impairment of financial instrument (1)(10)	33	_	_
Adjustment for Tax Act (1)(11)	_	(922)	_
Total Adjusted Items	(1,365)	(49)	71
Total / tajastea items	(1,000)	(43)	
Net earnings attributable to The Kroger Co. excluding the Adjusted Items	\$ 1,745	\$ 1,858	\$ 2,046
	<u>+,</u>	<del>+ 1,000</del>	<del>+ =, = . =</del>
Extra Week adjustment (1)(12)	_	(79)	_
,			
Net earnings attributable to The Kroger Co. excluding the Adjusted Items and the			
Extra Week adjustment	\$ 1,745	\$ 1,779	\$ 2,046
•			
Net earnings attributable to The Kroger Co. per diluted common share	\$ 3.76	\$ 2.09	\$ 2.05
Adjustments for pension plan agreements (13)	0.15	0.40	0.07
Adjustment for voluntary retirement offering (13)	—	0.13	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment (13)	_	0.08	_
Adjustment for company-sponsored pension plan termination (13)	_	0.37	_
Adjustment for gain on sale of convenience store business (13)	(1.65)	<u> </u>	_
Adjustment for mark to market gain on Ocado securities (13)	(0.21)	_	_
Adjustment for depreciation related to held for sale assets (13)	(0.01)	(0.01)	_
Adjustment for contingent consideration (13)	0.03	(0.0.)	_
Adjustment for impairment of financial instrument (13)	0.04	_	_
Adjustment for Tax Act (13)	—	(1.02)	_
Total Adjusted Items	(1.65)	(0.05)	0.07
Total / tajaotoa komo	(1.00)	(0.00)	0.07
Net earnings attributable to The Kroger Co. per diluted common share excluding			
the Adjusted Items	\$ 2.11	\$ 2.04	\$ 2.12
and halfactor items	Ψ 2.11	Ψ 2.01	<del>Ψ 2.12</del>
Extra Week adjustment <sup>(13)</sup>	_	(0.09)	
Extra Proof dajaotinon		(0.00)	
Net earnings attributable to The Kroger Co. per diluted common share excluding			
the Adjusted Items and the Extra Week adjustment	\$ 2.11	\$ 1.95	\$ 2.12
· · · · · · · · · · · · · · · · · · ·			
Average numbers of common shares used in diluted calculation	818	904	958

## Net Earnings per Diluted Share excluding the Adjusted Items (continued)

(\$ in millions, except per share amounts)

- (1) The amounts presented represent the after-tax effect of each adjustment.
- (2) The pre-tax adjustments for the pension plan agreements were \$155 in 2018, \$550 in 2017, and \$111 in 2016.
- (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 gain on sale of convenience store business was (\$1,782).
- (7) The pre-tax adjustment for mark to market gain on Ocado securities was (\$228).
- (8) The pre-tax adjustment for depreciation related to held for sale assets was (\$14) in 2018 and (\$19) in 2017.
- (9) The pre-tax adjustment for contingent consideration was \$33.
- (10) The pre-tax adjustment for impairment of financial instrument was \$42.
- (11)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.
- (12) The pre-tax Extra Week adjustment was (\$119).
- (13) The amount presented represents the net earnings per diluted common share effect of each adjustment.

## **RESULTS OF OPERATIONS**

Sales

# Total Sales (\$ in millions)

	Percentage		2017	Percentage		
	2018	Change (1)	2017	Adjusted (2)	Change (3)	2016
Total sales to retail customers without						
fuel (4)	\$ 104,486	2.1 %	\$ 104,207	\$ 102,290	3.1 %	\$ 99,243
Supermarket fuel sales	14,903	15.5 %	13,177	12,906	14.4 %	11,286
Convenience stores (5)	944	(78.7)%	4,515	4,434	8.3 %	4,096
Other sales (6)	829	10.1 %	763	753	5.8 %	712
Total sales	\$ 121,162	0.6 %	\$ 122,662	\$ 120,383	4.4 %	\$ 115,337

<sup>(1)</sup> This column represents the percentage change in 2018 compared to 2017 adjusted sales, which removes the Extra Week.

Total sales decreased in 2018, compared to 2017, by 1.2%. The decrease in total sales in 2018, compared to 2017, is due to the Extra Week in 2017, partially offset by the increase in 2018 sales, compared to 2017 adjusted sales. Total sales increased in 2018, compared to 2017 adjusted sales, by 0.6%. This increase was primarily due to our increases in total sales to retail customers without fuel and supermarket fuel sales, partially offset by a reduction in convenience store sales due to the sale of our convenience store business unit. The increase in total sales to retail customers without fuel for 2018, compared to 2017 adjusted sales to retail customers without fuel, was primarily due to our merger with Home Chef and our identical sales increase, excluding fuel, of 1.8%. Identical sales, excluding fuel, for 2018, compared to 2017, increased primarily due to changes in product mix, including higher quality products at a higher price point, and Kroger Specialty Pharmacy sales growth, partially offset by our continued investments in lower prices for our customers. Total supermarket fuel sales increased 15.5% in 2018, compared to 2017 adjusted supermarket fuel sales, primarily due to an increase in the average retail fuel price of 13.6% and an increase in fuel gallons sold of 1.5%. The increase in the average retail fuel price was caused by an increase in the product cost of fuel.

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

<sup>(3)</sup> This column represents the percentage change in 2017 adjusted sales compared to 2016.

<sup>(4)</sup> Digital sales, primarily including Pickup, Delivery and pharmacy e-commerce sales, grew approximately 58% in 2018, 90% in 2017 and 49% in 2016, adjusted to remove the Extra Week. These sales are included in the "total sales to retail customers without fuel" line above.

<sup>(5)</sup> We completed the sale of our convenience store business during the first quarter of 2018.

<sup>(6)</sup> Other sales primarily relate to external sales at food production plants, data analytic services, third party media revenue and digital coupon services.

Total sales increased in 2017, compared to 2016, by 6.4%. 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 sales to retail customers without fuel and supermarket fuel sales. The increase in total sales to retail customers without fuel for 2017, adjusted for the Extra Week, compared to 2016, was primarily due to our merger with ModernHEALTH, identical sales increase, excluding fuel, of 0.9%, and an increase in supermarket square footage. Identical 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, Kroger Specialty Pharmacy sales growth 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 supermarket fuel sales increased 14.4% 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 1.9%. The increase in the average retail fuel price was caused by an increase in the product cost of fuel.

We calculate identical sales, excluding fuel, as sales to retail customers, including sales from all departments at identical supermarket locations, Kroger Specialty Pharmacy businesses and ship-to-home solutions. We define a supermarket as identical when it has been in operation without expansion or relocation for five full quarters. Additionally, sales from all acquired businesses are treated as identical as if they were part of the Company in the prior year. Although identical sales is a relatively standard term, numerous methods exist for calculating identical sales growth. As a result, the method used by our management to calculate identical sales may differ from methods other companies use to calculate identical sales. We urge you to understand the methods used by other companies to calculate identical sales before comparing our identical sales to those of other such companies. Certain pharmacy fees recorded as a reduction of sales have been comparatively reflected in the identical sales calculation. Our identical sales results are summarized in the following table. We used the identical sales dollar figures presented below to calculate percentage changes for 2018.

# Identical Sales (\$ in millions)

	2018 (1)	2017 <sup>(2)</sup>
Excluding fuel	\$ 101,928	\$ 100,153
Excluding fuel	1.8 %	0.9 %

<sup>(1)</sup> Identical sales for 2018 were calculated on a 52 week basis by excluding week 1 of fiscal 2017 in our 2017 identical sales base.

#### 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 21.68% in 2018, 22.01% in 2017 and 22.40% in 2016. The decrease in 2018, compared to 2017, resulted primarily from continued investments in lower prices for our customers, a higher LIFO charge, a change in product sales mix and increased transportation and advertising costs, as a percentage of sales, partially offset by growth in *Our Brands* products which have a higher gross margin compared to national brand products, improved merchandise costs, decreased shrink, as a percentage of sales, and a higher gross margin rate on fuel sales.

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.

<sup>(2)</sup> Identical sales for 2017 were calculated on a 53 week basis by including week 1 of fiscal 2017 in our 2016 identical sales base.

Our LIFO charge for 2018 was \$29 million, compared to a LIFO credit of \$8 million in 2017 and a LIFO charge of \$19 million in 2016. In 2018, our LIFO charge primarily resulted from annualized product cost inflation, primarily related to pharmacy. 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.

Our FIFO gross margin rates, which exclude the LIFO charges and credit, were 21.70% in 2018, 22.01% in 2017 and 22.42% in 2016. Our fuel sales lower our FIFO gross margin rate due to the very low FIFO gross margin rate, as a percentage of sales, of fuel sales compared to non-fuel sales. Excluding the effect of fuel and the Extra Week, our FIFO gross margin rate decreased 55 basis points in 2018, compared to 2017. This decrease resulted primarily from our lower gross margin rate, excluding the effect of the LIFO charge and fuel, which has been described above.

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 our lower gross margin rate, excluding the effect of the LIFO credit and charge, fuel and ModernHEALTH which has been described above.

## 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. Certain other income items are classified as a reduction of OG&A expenses. These items include gift card and lottery commissions, coupon processing and vending machine fees, check cashing, money order and wire transfer fees, and baled salvage credits. Rent expense, depreciation and amortization expense, and interest expense are not included in OG&A.

OG&A expenses, as a percentage of sales, were 16.76% in 2018, 17.15% in 2017 and 16.61% in 2016. The decrease in 2018, compared to 2017 resulted primarily from effective cost controls due to process changes, decreased utilities, the 2017 OG&A Adjusted Items, and our incremental contribution of \$111 million, \$69 million net of tax, to the United Food and Commercial Workers ("UFCW") Consolidated Pension Plan in 2017 ("2017 UFCW Contribution"), partially offset by the 2018 OG&A Adjusted Items, investments in our digital strategy and increased incentive plan costs. 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 2018 OG&A Adjusted Items, the 2017 OG&A Adjusted Items, and the 2017 UFCW Contribution, our OG&A rate increased 14 basis points in 2018, compared to 2017. This increase resulted primarily from investments in our digital strategy and increased incentive plan costs, partially offset by effective cost controls due to process changes and decreased utilities.

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. 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 21 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.

## Rent Expense

Rent expense decreased, as a percentage of sales, in 2018 compared to 2017, due to decreased closed store liabilities. 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.

#### Depreciation and Amortization Expense

Depreciation and amortization expense increased as a percentage of sales in 2018, compared to 2017, due to the Extra Week and additional depreciation on capital investments, excluding mergers and lease buyouts, of \$3.0 billion, during 2018, partially offset by higher fuel sales, which decreases our depreciation expense as a percentage of sales.

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.

## Operating Profit and FIFO Operating Profit

Operating profit was \$2.6 billion in 2018, \$2.6 billion in 2017 and \$3.5 billion in 2016. Operating profit, as a percentage of sales, was 2.16% in 2018, 2.13% in 2017 and 2.99% in 2016. Operating profit, as a percentage of sales, increased 3 basis points in 2018, compared to 2017, due to decreased OG&A and rent expenses, as a percentage of sales, partially offset by a lower gross margin rate, increased depreciation and amortization expenses and a higher LIFO charge, as a percentage of sales.

Operating profit, as a percentage of sales, decreased 86 basis points in 2017, compared to 2016, due to a lower gross margin and increased OG&A expense, as a percentage of sales, partially offset by lower depreciation and amortization and rent expenses and a lower LIFO charge, as a percentage of sales.

FIFO operating profit was \$2.6 billion in 2018, \$2.6 billion in 2017 and \$3.5 billion in 2016. FIFO operating profit, as a percentage of sales, was 2.18% in 2018, 2.12% in 2017 and 3.01% in 2016. 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 and the 2018 and 2017 Adjusted Items, decreased 68 basis points in 2018, compared to 2017, due to a lower gross margin and increased OG&A and depreciation and amortization expenses, as a percentage of sales, partially offset by lower rent expense, as a percentage of 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 45 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

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 \$620 million in 2018, \$601 million in 2017 and \$522 million in 2016. The increase in interest expense in 2018, compared to 2017, resulted primarily from a higher weighted average interest rate. 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 for certain local unions of the Central States Pension Fund, partially offset by a lower weighted average interest rate.

#### Income Taxes

Our effective income tax rate was 22.6% in 2018, (27.3)% in 2017 and 32.8% in 2016. The 2018 tax rate differed from the federal statutory rate primarily due to the effect of state income taxes and an IRS audit that resulted in a reduction of prior year tax deductions at pre-Tax Act rates and an increase in future tax deductions at post-Tax Act rates. These 2018 items were partially offset by the utilization of tax credits and deductions, the remeasurement of uncertain tax positions and adjustments to provisional amounts that increased prior year deductions at pre-Tax Act rates and decreased future deductions at post-Tax Act rates. 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-deducible 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 Accounting Standards Update ("ASU") 2016-09, 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 \$3.76 per diluted share in 2018 represented an increase of 79.9% from net earnings of \$2.09 per diluted share in 2017. Adjusted operating net earnings of \$2.11 per diluted share in 2018 represented an increase of 8.2% from adjusted operating net earnings of \$1.95 per diluted share in 2017. The 8.2% increase in adjusted operating net earnings per diluted share resulted primarily from lower income tax expense, higher fuel earnings and lower weighted average common shares outstanding due to common share repurchases, partially offset by lower non-fuel FIFO operating profit, a higher LIFO charge and increased interest expense.

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. Adjusted operating net earnings of \$1.95 per diluted share in 2017 represented a decrease of 8.0% from adjusted operating net earnings of \$2.12 per diluted share in 2016. The 8.0% decrease in adjusted operating 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.

## **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 \$727 million in 2018, \$1.6 billion in 2017 and \$1.7 billion in 2016. On April 20, 2018, we entered and funded a \$1.2 billion ASR program to reacquire shares in privately negotiated transactions.

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 \$83 million in 2018, \$66 million in 2017 and \$105 million in 2016 of our common shares under the stock option program.

The shares repurchased in 2018 were reacquired under two separate share repurchase programs. The first is a series of Board of Director authorizations:

- On June 22, 2017, our Board of Directors approved a \$1.0 billion share repurchase program (the "June 2017 Repurchase Program"). This program was exhausted during the first quarter of 2018.
- 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").

• On April 19, 2018, our Board of Directors approved a \$1.2 billion ASR program to reacquire shares in privately negotiated transactions. This program was exhausted during the second quarter of 2018.

As of February 2, 2019, there was \$546 million remaining under the March 2018 Repurchase Program.

The second share repurchase program is a program that uses the cash proceeds from the exercises of stock options by participants in Kroger's stock option, long-term incentive plans and the associated tax benefits.

During the first quarter through March 28, 2019, we repurchased an additional \$9 million of our common shares under the stock option program and no additional shares under the March 2018 Repurchase Program. As of March 28, 2019, we have \$546 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 2018, \$3.0 billion in 2017 and \$3.7 billion in 2016. Capital investments for mergers totaled \$197 million in 2018, \$16 million in 2017 and \$401 million in 2016. We merged with Home Chef in 2018 and ModernHEALTH in 2016. Refer to Note 2 to the Consolidated Financial Statements for more information on these mergers. Capital investments for the purchase of leased facilities totaled \$5 million in 2018, \$13 million in 2017 and \$5 million in 2016. The table below shows our supermarket storing activity and our total supermarket square footage:

#### **Supermarket Storing Activity**

	2018	2017	2016
Beginning of year	2,782	2,796	2,778
Opened	10	24	50
Opened (relocation)	4	15	21
Acquired	10	3	_
Closed (operational)	(38)	(41)	(32)
Closed (relocation)	(4)	(15)	(21)
End of year	2,764	2,782	2,796
Total supermarket square footage (in millions)	179	179	178

## **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 2018 and 2017 on a 52 week basis (\$ in millions). The 2018 calculation of ROIC excludes the financial position and results of operations of Home Chef, due to the merger in 2018, and the convenience store business, due to the sale in 2018.

	Fiscal Ye	ar Ended
	February 2,	February 3,
	2019	2018
Return on Invested Capital		
Numerator		
Operating profit (53 week basis in fiscal year 2017)	\$ 2,614	\$ 2,612
Extra Week operating profit adjustment	_	(131)
LIFO charge (credit)	29	(8)
Depreciation and amortization	2,465	2,436
Rent (53 week basis in fiscal year 2017)	884	911
Extra Week rent adjustment	_	(17)
Adjustment for merger with Home Chef	28	_
Adjustment for disposal of convenience store business	(21)	_
Adjustment for contingent consideration	33	_
Adjustment for impairment of financial instrument	42	_
Adjustment for Kroger Specialty Pharmacy goodwill impairment	_	110
Adjustments for pension plan agreements	155	550
Adjustment for depreciation related to held for sale assets	(14)	(19)
Adjustments for voluntary retirement offering	` <b>_</b> ′	184
Adjusted operating profit on a 52 week basis	\$ 6,215	\$ 6,628
,	<u> </u>	
Denominator		
Average total assets	\$ 37,658	\$ 36,851
Average taxes receivable (1)	(115)	(181)
Average LIFO reserve	1,263	1,270
Average accumulated depreciation and amortization	21,703	20,287
Average trade accounts payable	(5,959)	(5,838)
Average accrued salaries and wages	(1,163)	(1,167)
Average other current liabilities (2)	(3,571)	(3,363)
Average liabilities held for sale	(155)	(130)
Adjustment for merger with Home Chef	(145)	(100)
Adjustment for disposal of convenience store business	(198)	_
Rent x 8	7,072	7,152
Average invested capital	\$ 56,390	\$ 54,881
•	11.02 %	
Return on Invested Capital	11.02 %	12.08 %

<sup>(1)</sup> Taxes receivable were \$229 as of February 3, 2018 and \$132 as of January 28, 2017. We did not have any taxes receivable as of February 2, 2019.

# **RESTOCK CASH FLOW**

Restock cash flow is an adjusted free cash flow measure calculated as net cash provided by operating activities minus net cash used by investing activities plus or minus adjustments for certain items. We updated our definition of Restock cash flow during 2018 to more closely align with the performance metrics under our Restock Kroger plan. Restock cash flow is an important measure used by management to evaluate available funding for dividends, managing debt levels, share repurchases and other strategic investments. Management believes Restock cash flow is a useful metric to investors and analysts to demonstrate our available funding for dividends, managing debt levels, share repurchases and other strategic investments.

<sup>(2)</sup> Other current liabilities included accrued income taxes of \$60 as of February 2, 2019 and \$1 as of January 28, 2017. We did not have any accrued income taxes as of February 3, 2018. Accrued income taxes are removed from other current liabilities in the calculation of average invested capital.

The following table provides a calculation of Restock cash flow for 2018 and 2017 (\$ in millions).

	Fiscal Ye	ar Ended
	February 2, 2019	February 3, 2018
Net cash provided by operating activities	\$ 4,164	\$ 3,413
Net cash used by investing activities	(1,186)	(2,707)
Difference	2,978	706
Adjustment for payments for lease buyouts	5	13
Adjustment for purchases of Ocado securities	392	_
Adjustment for purchases of stores	44	_
Adjustment for net proceeds from sale of business, net of tax	(1,709)	_
Adjustment for payments for acquisitions, net of cash acquired	197	16
Restock cash flow	\$ 1,907	\$ 735

#### **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 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.

# 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 \$56 million in 2018, \$71 million in 2017 and \$26 million in 2016. 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.

#### **Business Combinations**

We account for business combinations using the acquisition method of accounting. All the assets acquired, liabilities assumed and amounts attributable to noncontrolling interests are recorded at their respective fair values at the date of acquisition once we obtain control of an entity. The determination of fair values of identifiable assets and liabilities involves estimates and the use of valuation techniques when market value is not readily available. We use various techniques to determine fair value in such instances, primarily including the income approach. Significant estimates used in determining fair value include, but are not limited to, the amount and timing of future cash flows, growth rates, discount rates and useful lives. The excess of the purchase price over fair values of identifiable assets and liabilities is recorded as goodwill. See Note 3 for further information about goodwill.

#### Goodwill

Our goodwill totaled \$3.1 billion as of February 2, 2019. 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 other consolidated 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 ("KSP") reporting unit totaling \$110 million, \$74 million net of tax, resulting in a remaining goodwill balance of \$243 million. The 2018 fair value of our KSP reporting unit was estimated primarily based on a discounted cash flow model resulting in a percentage of excess fair value over carrying value of approximately 3%. The annual evaluation of goodwill performed in 2018 and 2016 did not result in impairment for any of our reporting units. 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 except for our KSP reporting unit.

For additional information relating to our results of the goodwill impairment reviews performed during 2018, 2017 and 2016, 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 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.

# 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 \$358 million in 2018, \$954 million in 2017 and \$289 million in 2016. The increase in 2017, compared to 2018 and 2016 is due to the \$467 million pre-tax payment we made in 2017 to satisfy withdrawal obligations for certain local unions of 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. 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 for the withdrawal of certain local unions from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2018, we incurred a \$155 million charge, \$121 million net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension fund.
- 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.

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, 2018. 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, 2018, 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 \$3.1 billion, \$2.4 billion net of tax. This represents an increase in the estimated amount of underfunding of approximately \$800 million, \$600 million net of tax, as of December 31, 2018, compared to December 31, 2017. The increase in the amount of underfunding is primarily attributable to lower expected 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.

#### RECENTLY ADOPTED ACCOUNTING STANDARDS

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 in 2017 of \$110 million, \$74 million net of tax, related to our Kroger Specialty Pharmacy reporting unit.

On February 4, 2018, we adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which superseded previous revenue recognition guidance. Topic 606 is a comprehensive new revenue recognition model that requires a company to recognize revenue 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. We adopted the standard using a modified retrospective approach with the adoption primarily involving the evaluation of whether we act as principal or agent in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. We will continue to record revenue and related costs on a gross basis for the arrangements. The adoption of the standard did not have a material effect on our Consolidated Statements of Operations, Consolidated Balance Sheets or Consolidated Statements of Cash Flows.

In March 2017, the Financial Accounting Standard's Board ("FASB") issued ASU "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07)." 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. We adopted ASU 2017-07 on February 4, 2018 and retrospectively applied it to all periods presented. As a result, retiree benefit plan interest expense, investment returns, settlements and other non-service cost components of retiree benefit expenses are excluded from our operating profit subtotal as reported in our Consolidated Statements of Operations, but remain included in net earnings before income tax expense. Due to the adoption, we reclassified \$527 million for 2017 and \$16 million for 2016, of non-service company-sponsored pension plan costs from operating profit to other income (expense) on our Consolidated Statements of Operations. Information about retiree benefit plans' interest expense, investment returns and other components of retiree benefit expenses can be found in Note 15 to our Consolidated Financial Statements.

In January 2016, the FASB issued "Financial Instruments—Overall (Topic 825)," which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments (ASU 2016-01). We adopted this ASU on February 4, 2018. As a result of the adoption, we recorded a mark to market gain on Ocado securities, for those securities we owned as of the end of 2018, within the Consolidated Statements of Operations as opposed to a component of Other Comprehensive Income on our Consolidated Statements of Comprehensive Income.

#### RECENTLY ISSUED ACCOUNTING STANDARDS

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. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance will be effective for us in the first quarter of our fiscal year ending February 1, 2020. We will apply the transition package of practical expedients permitted within the standard, which allows us to carryforward our historical lease classification, and will apply the transition option which does not require application of the guidance to comparative periods in the year of adoption. We estimate adoption of the standard will result in recognition of right of use assets and lease liabilities of approximately \$6.7 billion as of February 3, 2019. When combined with our existing capital leases, our total lease assets will be approximately \$7.4 billion and our total lease liabilities will be approximately \$7.6 billion as of February 3, 2019. We do not expect adoption to have a material impact on our consolidated net earnings or cash flows. We believe our current off-balance sheet leasing commitments are reflected in our investment grade debt rating.

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 Cuts and Jobs Act. In addition, under ASU 2018-02, we may be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the effect of this standard on our Consolidated Financial Statements.

#### LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Information

## Net cash provided by operating activities

We generated \$4.2 billion of cash from operations in 2018, compared to \$3.4 billion in 2017 and \$4.3 billion in 2016. The increase in net cash provided by operating activities in 2018, compared to 2017, resulted primarily from an increase in net earnings including noncontrolling interests, a decrease in the non-cash adjustment for deferred income taxes, positive changes in working capital and reduced contributions to the company sponsored pension plans, partially offset by non-cash adjustments for the expense for company-sponsored pension plans, the gain on sale of our convenience store business unit and the mark to market gain on Ocado securities.

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.

Cash provided (used) by operating activities for changes in working capital was \$580 million in 2018, (\$164) million in 2017 and (\$492) million in 2016. The increase in cash provided by operating activities for changes in working capital in 2018, compared to 2017, was primarily due to the following:

- A lower increase, over the prior year, of store deposits in-transit in 2018, compared to 2017;
- A decrease in prepaid medical benefit costs at the end of 2018, compared to 2017;
- Increases in accrued incentive plan costs; and
- Positive working capital related to income taxes receivable and payable as a result of an overpayment
  of our fourth quarter 2017 estimated taxes and our estimated taxes on the gain on sale of our
  convenience store business unit; partially offset by

- Higher third-party payor receivables due to increasing pharmacy sales and the timing of third-party payments; and
- Increased inventory purchases due to change in inventory mix and new distribution centers.

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 guarter 2017 estimated income taxes, and
- An increase in store deposits in-transit due to increased sales in the last few days of 2017.

Cash paid for taxes increased in 2018, compared to 2017, primarily due to the payment of estimated taxes on the gain on sale of our convenience store business unit and lower estimated tax payments in 2017 due to the \$1 billion, \$650 million net of tax, pension contribution made in 2017.

#### Net cash used by investing activities

Cash used by investing activities was \$1.2 billion in 2018, \$2.7 billion in 2017 and \$3.9 billion in 2016. The amount of cash used by investing activities decreased in 2018 compared to 2017 primarily due to the net proceeds from the sale of our convenience store business unit, partially offset by the payment for our merger with Home Chef and the purchases of Ocado securities. 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.

## Net cash used by financing activities

Cash used by financing activities was \$2.9 billion in 2018, \$681 million in 2017 and \$352 million in 2016. The increase in the amount of cash used for financing activities in 2018 compared to 2017 was primarily due to increased payments on long-term debt and commercial paper and increased share repurchases, partially offset by an increase in proceeds from issuance of long-term debt. We used a portion of the proceeds from the sale of our convenience store business unit to pay down outstanding commercial paper borrowings and fund a \$1.2 billion ASR program, which was completed in the second quarter of 2018. 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.

#### Debt Management

Total debt, including both the current and long-term portions of capital leases and lease-financing obligations, decreased \$360 million to \$15.2 billion as of year-end 2018 compared to 2017. The decrease in 2018, compared to 2017, resulted primarily from net payments on commercial paper borrowings of \$1.3 billion and payments of \$1.3 billion on maturing long-term debt obligations, partially offset by the issuance of (i) \$600 million of senior notes bearing an interest rate of 4.50%, (ii) \$600 million of senior notes bearing an interest rate of 5.40% and (iii) our \$1.0 billion term loan that has a variable interest rate. The variable interest rate on the term loan was 3.37% as of February 2, 2019. The combined \$1.2 billion senior notes issuance has a higher weighted average interest rate than the \$1.3 billion maturing long-term debt obligations it replaced. As a result, we expect a higher weighted average interest rate in 2019 which may contribute to increased interest expense. The sale of our convenience store business unit allowed us to pay down debt and fund our ASR program.

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.

# Liquidity Needs

We estimate our liquidity needs over the next twelve-month period to approximate \$6.4 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 2018. 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 \$1.3 billion of senior notes, \$800 million of commercial paper and the \$1.0 billion term loan maturing in the next twelve months, which are included in the \$6.4 billion of estimated liquidity needs. We expect to satisfy these obligations using cash generated from operations, proceeds from the sale of our You Technology and Turkey Hill Dairy businesses and through issuing additional senior notes, a term loan or commercial paper. On March 15, 2019, we repaid our \$1.0 billion term loan through increased commercial paper borrowings, which have a lower interest rate. We believe we have adequate coverage of our debt covenants to continue to maintain our current investment grade 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 2, 2019, we had \$800 million 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. "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. As of March 28, 2019, we had \$810 million 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 2.64 to 1 as of February 2, 2019. 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 4.17 to 1 as of February 2, 2019. 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 2018.

The tables below illustrate our significant contractual obligations and other commercial commitments, based on year of maturity or settlement, as of February 2, 2019 (in millions of dollars):

	2019	2020	2021	2022	2023	Thereafter	Total
Contractual Obligations (1)(2)							
Long-term debt (3)	\$ 3,103	\$ 720	\$ 793	\$ 896	\$ 595	\$ 8,244	\$ 14,351
Interest on long-term debt (4)	529	475	441	412	392	4,952	7,201
Capital lease obligations	103	89	86	82	81	766	1,207
Operating lease obligations	948	880	773	649	556	3,197	7,003
Financed lease obligations	5	6	5	5	5	17	43
Self-insurance liability (5)	228	142	98	64	42	122	696
Construction commitments (6)	672	_	_	_	_	_	672
Purchase obligations (7)	566	277	149	55	42	12	1,101
Total	\$ 6,154	\$ 2,589	\$ 2,345	\$ 2,163	\$ 1,713	\$ 17,310	\$ 32,274
Other Commercial Commitments							
Standby letters of credit	\$ 349	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 349
Surety bonds	406	_	_	_	_	_	406
Total	\$ 755	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 755

- (1) The contractual obligations table excludes funding of pension and other postretirement benefit obligations, which totaled approximately \$218 million in 2018. This table also excludes contributions under various multiemployer pension plans, which totaled \$358 million in 2018.
- (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 2, 2019, we had \$800 million of commercial paper and no borrowings under our credit facility.
- (4) Amounts include contractual interest payments using the interest rate as of February 2, 2019, 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 2, 2019, 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 2, 2019, we had \$800 million of outstanding commercial paper and no borrowings under our revolving credit facility. The outstanding letters of credit that reduce funds available under our credit facility totaled \$3 million as of February 2, 2019.

In addition to the available credit mentioned above, as of February 2, 2019, we had authorized for issuance \$1.3 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 "achieve," "affect," "believe," "committed," "continue," "could," "effect," "estimate," "expects," "future," "growth," "intends," "likely," "may," "plan," "range," "result," "strategy," "strong," "trend," "vision," "will, and "would," 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 sales growth, excluding fuel, to range from 2.0% to 2.25% in 2019.
- We expect net earnings to range from \$2.15 to \$2.25 per diluted share for 2019.
- We expect FIFO operating profit to range from \$2.9 billion to \$3.0 billion for 2019.
- We expect capital investments, excluding mergers, acquisitions, and purchases of leased facilities, to range between \$3.0 and \$3.2 billion in 2019.
- We expect our 2019 tax rate to be approximately 22%.
- We expect a higher weighted average interest rate in 2019 which may contribute to increased interest expense.

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, incremental FIFO operating profit, and free 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, changes in tariffs, 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 uncertain pace of economic growth; 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 ability to execute on Restock Kroger; and the successful integration of merged companies and new partnerships.
- Our ability to achieve these 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 2019.

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 (the "Company") as of February 2, 2019 and February 3, 2018, 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 2, 2019, 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 2, 2019, 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 2, 2019 and February 3, 2018, and the results of its operations and its cash flows for each of the three years in the period ended February 2, 2019 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 2, 2019, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

# Change in Accounting Principle

As discussed in Note 19 to the consolidated financial statements, the Company changed the manner in which it accounts for revenues from contracts with customers in 2018.

## **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 under Item 9A. 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.

Cincinnati, Ohio April 2, 2019

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

Pricewaterhouse Coopers LLP

# THE KROGER CO. CONSOLIDATED BALANCE SHEETS

(In millions, except par amounts)	February 2, 2019		February 3, 2018	
ASSETS				
Current assets				
Cash and temporary cash investments	\$	429	\$	347
Store deposits in-transit		1,181		1,161
Receivables		1,589		1,637
FIFO inventory		8,123		7,781
LIFO reserve		(1,277)		(1,248)
Assets held for sale		166		604
Prepaid and other current assets		592		835
Total current assets		10,803		11,117
Property, plant and equipment, net		21,635		21,071
Intangibles, net		1,258		1,100
Goodwill		3,087		2,925
Other assets		1,335		984
Total Assets	\$	38,118	\$	37,197
1 5 1 3 1 7 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5	<u> </u>	00,110	<u> </u>	01,101
LIABILITIES				
Current liabilities				
Current portion of long-term debt including obligations under capital leases and				
financing obligations	\$	3,157	\$	3,560
Trade accounts payable		6,059		5,858
Accrued salaries and wages		1,227		1,099
Liabilities held for sale		51		259
Other current liabilities		3,780		3,421
Total current liabilities		14,274		14,197
Long-term debt including obligations under capital leases and financing obligations		12,072		12,029
Deferred income taxes		1,562		1,568
Pension and postretirement benefit obligations		494		792
Other long-term liabilities		1,881		1,706
Total Liabilities		30,283		30,292
Commitments and contingencies see Note 13				
SHAREHOLDERS' EQUITY				
Preferred shares, \$100 par per share, 5 shares authorized and unissued		_		_
Common shares, \$1 par per share, 2,000 shares authorized; 1,918 shares issued in 2018				
and 2017		1,918		1,918
Additional paid-in capital		3,245		3,161
Accumulated other comprehensive loss		(346)		(471)
Accumulated earnings		19,681		17,007
Common shares in treasury, at cost, 1,120 shares in 2018 and 1,048 shares in 2017		(16,612)		(14,684)
, .,	_	( , )		( , )
Total Shareholders' Equity - The Kroger Co.		7,886		6,931
Noncontrolling interests		(51)		(26)
Tabel Carribs		7.005		0.005
Total Equity		7,835		6,905
Total Liabilities and Equity	\$	38,118	\$	37,197

# THE KROGER CO. CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(In millions, except per share amounts)		2018 weeks)		2017 8 weeks)		2016 weeks)
Sales	<b>\$</b> 1	21,162	\$ 1	22,662	\$ 1	15,337
Operating expenses						
Merchandise costs, including advertising, warehousing, and						
transportation, excluding items shown separately below		94,894		95,662		89,502
Operating, general and administrative		20,305		21,041		19,162
Rent		884		911		881
Depreciation and amortization		2,465		2,436		2,340
Operating profit		2,614		2,612		3,452
Other income (expense)		()		/ / \		/
Interest expense		(620)		(601)		(522)
Non-service component of company-sponsored pension plan costs		(26)		(527)		(16)
Mark to market gain on Ocado securities		228				
Gain on sale of business		1,782				
		0.070		4 404		0.044
Net earnings before income tax (benefit) expense		3,978		1,484		2,914
L		000		(405)		057
Income tax (benefit) expense		900		(405)	_	957
NI-4tototo-dis		0.070		4 000		4.057
Net earnings including noncontrolling interests		3,078		1,889		1,957
Net loss attributable to noncontrolling interests		(32)	_	(18)		(18)
Not coming attributable to The Kraner Co	•	2 4 4 0	ф	1.007	Φ.	1.075
Net earnings attributable to The Kroger Co.	\$	3,110	\$	1,907	\$	1,975
N. C. T. C. T. C.	•	0.00	Φ.	0.44	Φ.	0.00
Net earnings attributable to The Kroger Co. per basic common share	\$	3.80	\$	2.11	\$	2.08
According to the second of the		040		005		0.40
Average number of common shares used in basic calculation		810		895		942
Not coming attributable to The Kranav Co. now diluted common above	•	2.76	ф	2.00	Φ.	2.05
Net earnings attributable to The Kroger Co. per diluted common share	\$	3.76	\$	2.09	\$	2.05
Average number of common shares used in diluted as sulation		010		004		050
Average number of common shares used in diluted calculation		818		904		958

# THE KROGER CO. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

	2018	2017	2016
(In millions)	(52 weeks)	(53 weeks)	(52 weeks)
Net earnings including noncontrolling interests	\$ 3,078	\$ 1,889	\$ 1,957
Other comprehensive income (loss)			
Realized gains and losses on available for sale securities, net of income tax (1)	(4)	4	(20)
Change in pension and other postretirement defined benefit plans, net of income			
$tax^{(2)}$	147	214	(64)
Unrealized gains and losses on cash flow hedging activities, net of income tax(3)	(23)	23	47
Amortization of unrealized gains and losses on cash flow hedging activities, net			
of income tax (4)	5	3	2
Total other comprehensive income (loss)	125	244	(35)
		-	
Comprehensive income	3,203	2,133	1,922
Comprehensive loss attributable to noncontrolling interests	(32)	(18)	(18)
Comprehensive income attributable to The Kroger Co.	\$ 3,235	\$ 2,151	\$ 1,940

<sup>(1)</sup> Amount is net of tax expense (benefit) of \$(1) in 2018, \$1 in 2017 and \$(16) in 2016.

<sup>(2)</sup> Amount is net of tax expense (benefit) of \$45 in 2018, \$83 in 2017 and \$(39) in 2016. (3) Amount is net of tax expense (benefit) of \$(8) in 2018, \$0 in 2017 and \$27 in 2016.

<sup>(4)</sup> Amount is net of tax expense of \$3 in 2018 and \$3 in 2017 and \$0 in 2016.

# THE KROGER CO. CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(In millions)	<u>(5</u> :	2018 2 weeks)		2017 8 weeks)	<u>(52</u>	2016 ! weeks)
Cash Flows from Operating Activities:		0.070	•	4.000	•	4.057
Net earnings including noncontrolling interests	\$	3,078	\$	1,889	\$	1,957
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by						
operating activities: Depreciation and amortization		2,465		2,436		2,340
LIFO (credit) charge		2,403		(8)		19
Stock-based employee compensation		154		151		141
Expense for company-sponsored pension plans		76		591		94
Goodwill impairment charge		_		110		_
Deferred income taxes		(45)		(694)		201
Gain on sale of business		(1,782)		`′		_
Mark to market gain on Ocado securities		(228)		_		_
Other		116		79		(2)
Changes in operating assets and liabilities net of effects from mergers and disposals of businesses:						
Store deposits in-transit		(20)		(265)		13
Receivables		(208)		61		(110)
Inventories		(354)		(23)		(382)
Prepaid and other current assets		244		41		(172)
Trade accounts payable		213		158		16
Accrued expenses		416		(40)		(118)
Income taxes receivable and payable		289		(96)		261
Contribution to company-sponsored pension plans		(185)		(1,000)		
Other	_	(94)		23	_	14_
Net cash provided by operating activities	_	4,164		3,413	_	4,272
Cash Flows from Investing Activities:						
Payments for property and equipment, including payments for lease buyouts		(2.967)		(2,809)		(3,699)
Proceeds from sale of assets		85		138		132
Proceeds on settlement of financial instrument		235		_		_
Payments for acquisitions, net of cash acquired		(197)		(16)		(401)
Purchases of stores		(44)		_		—
Net proceeds from sale of business		2,169		_		_
Purchases of Ocado securities		(392)		_		_
Other	_	(75)		(20)	_	93
Net cash used by investing activities		(1,186)		(2,707)		(3,875)
		(1,111)		(=,: ;: )		(=,===)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		2,236		1,523		2,781
Payments on long-term debt		(1,372)		(788)		(1,355)
Net (payments) borrowings on commercial paper		(1,321)		696		435
Dividends paid		(437)		(443)		(429)
Proceeds from issuance of capital stock		65		51		68
Treasury stock purchases		(2,010)		(1,633)		(1,766)
Other	_	(57)		(87)	_	(86)
Net cash used by financing activities		(2,896)		(681)	_	(352)
Net increase in cash and temporary cash investments		82		25		45
Cash and temporary cash investments:						
Beginning of year		347		322		277
End of year	\$	429	\$	347	\$	322
Reconciliation of capital investments:						
Payments for property and equipment, including payments for lease buyouts	\$	(2,967)	\$	(2,809)	\$	(3,699)
Payments for lease buyouts	Ψ	(2,307)	Ψ	13	Ψ	(5,099)
Changes in construction-in-progress payables		(56)		(188)		72
Total capital investments, excluding lease buyouts	\$	(3,018)	\$	(2,984)	\$	(3,622)
Total dapital infootinonia, excitating reade payouts	Ψ	(0,010)	Ψ	(2,304)	φ	(0,022)
Disclosure of cash flow information:						
Cash paid during the year for interest	\$	614	\$	656	\$	505
Cash paid during the year for income taxes	\$	600	\$	348	\$	557

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

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

			Additional			Accumulated Other			
	Comm	non Stock	Paid-In		sury Stock		Accumulated	Noncontrolling	
(In millions, except per share amounts)	Shares	Amount	Capital	Shares	Amount	Gain (Loss)	Earnings	Interest	Total
Balances at January 30, 2016	1,918	\$ 1,918	\$ 2,980	951	\$ (11,409)	\$ (680)	\$ 14,011	\$ (22)	\$ 6,798
Issuance of common stock:			(4)	(5)	00				07
Stock options exercised Restricted stock issued	_	_	(1)	(5)	68 57	_	_	_	67 (59)
Treasury stock activity:			(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				•	(100)				(100)
compensation	_	_	141	_	_	_	_	_	141
Other comprehensive loss net of									
income tax of \$(28)	_	_	_	_	_	(35)	_	_	(35)
Other	_	_	66	_	(68)	<u> </u>	_	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:				(4)					F.4
Stock options exercised			(4.40)	(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					(00)				(00)
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
Issuance of common stock:				(4)	0.5				0.5
Stock options exercised	_	_		(4)	65	_	_	_	65
Restricted stock issued	_		(119)	(3)	74				(45)
Treasury stock activity:									
Treasury stock purchases, at cost				76	(1,927)				(1,927)
Stock options exchanged				3	(83)	_			(83)
Share-based employee		_	_	3	(00)	_	_	_	(00)
compensation	_	_	154	_	_	_	_	_	154
Other comprehensive gain net of			104						104
income tax of \$39	_	_	_	_	_	125	_	_	125
Other	_	_	49	_	(57)	_	_	7	(1)
Cash dividends declared (\$0.545 per					(3.)				(.,
common share)	_	_	_	_	_	_	(436)	_	(436)
Net earnings (loss) including non-									
controlling interests							3,110	(32)	3,078
Balances at February 2, 2019	1,918	\$ 1,918	\$ 3,245	1,120	<u>\$ (16,612)</u>	\$ (346)	\$ 19,681	<u>\$ (51)</u>	\$ 7,835

#### 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 2, 2019, 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 other consolidated entities. Intercompany transactions and balances have been eliminated.

Refer to Note 19 for a description of changes to the Consolidated Statements of Operations for a recently adopted accounting standard regarding the presentation of the non-service component of company-sponsored pension plan costs.

#### Fiscal Year

The Company's fiscal year ends on the Saturday nearest January 31. The last three fiscal years consist of the 52-week period ended February 2, 2019, 53-week period ended February 3, 2018 and 52-week period ended January 28, 2017.

#### 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 90% of inventories in 2018 and 93% of inventories in 2017 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 \$1,277 at February 2, 2019 and \$1,248 at February 3, 2018. 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 \$2,465 in 2018, \$2,436 in 2017 and \$2,340 in 2016.

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 other consolidated 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 reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. Results of the goodwill impairment reviews performed during 2018, 2017 and 2016 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 \$56, \$71 and \$26 in 2018, 2017 and 2016, 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 ("OG&A") expense.

## Accounts Payable

The Company has an agreement with a third party to provide an accounts payable tracking system which facilitates participating suppliers' ability to finance payment obligations from the Company with designated third-party financial institutions. Participating suppliers may, at their sole discretion, make offers to finance one or more payment obligations of the Company prior to their scheduled due dates at a discounted price to participating financial institutions. The Company's obligations to its suppliers, including amounts due and scheduled payment dates, are not affected by suppliers' decisions to finance amounts under this arrangement.

## Contingent Consideration

Certain Company business combinations involve potential payment of future consideration that is contingent upon the achievement of certain performance milestones. The Company records contingent consideration at fair value at the date of acquisition based on the consideration expected to be transferred, estimated as the probability-weighted future cash flows, discounted back to present value using a discount rate determined in accordance with accepted valuation methods. The liability for contingent consideration is remeasured to fair value at each reporting period using Level 3 inputs, and the change in fair value, including accretion for the passage of time, is recognized in earnings until the contingency is resolved. In 2018, an adjustment to increase the contingent consideration liability as of year-end 2018 was recorded for \$33 in OG&A 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"). The Company has elected to measure defined benefit plan assets and obligations as of January 31, which is the month-end that is closest to its fiscal year-ends, which were February 2, 2019 for fiscal 2018 and February 3, 2018 for fiscal 2017.

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 or over the service period in the case of automatic contributions. 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.

## 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 2, 2019, 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 2, 2019.

	2018	2017	2016
Beginning balance	\$ 695	\$ 682	\$ 639
Expense	229	247	263
Claim payments	(228)	(234)	(220)
Ending balance	696	695	682
Less: Current portion	(228)	(234)	(229)
Long-term portion	\$ 468	\$ 461	\$ 453

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

#### Sales

The Company recognizes revenues from the retail sale of products, net of sales taxes, at the point of sale. Pharmacy sales are recorded when the product is provided to the customer. Digital channel originated sales are recognized either upon pickup in store or upon delivery to the customer and may include shipping revenue. 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. For merchandise sold in one of the Company's stores or online, tender is accepted at the point of sale. The Company acts as principal in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. The Company records revenue and related costs on a gross basis for these arrangements. Effective February 4, 2018, the Company prospectively reclassified certain pharmacy fees of \$250 for 2018 from merchandise costs to be recorded as a reduction to sales on the Company's Consolidated Statements of Operations. For pharmacy sales, collection of third party receivables is typically expected within three months or less from the time of purchase. The third-party receivables from pharmacy sales are recorded in Receivables in the Company's Consolidated Balance Sheets and were \$645 as of February 2, 2019 and \$571 as of February 3, 2018.

#### Gift Cards and Gift Certificates

The Company does not recognize a sale when it sells its own gift cards and gift certificates (collectively "gift cards"). Rather, it records a deferred revenue liability equal to the amount received. A sale is then recognized when the gift cards are redeemed to purchase the Company's products. The Company's gift cards do not expire. While gift cards are generally redeemed within 12 months, some are never fully redeemed. The Company recognizes gift card breakage under the proportional method, where recognition of breakage income is based upon the historical run-off rate of unredeemed gift cards. The Company's gift card deferred revenue liability was \$100 as of February 2, 2019 and \$90 as of February 3, 2018.

## Disaggregated Revenues

The following table presents sales revenue by type of product for the year-ended February 2, 2019, February 3, 2018, and January 28, 2017:

	201	8	201	7	2016		
	Amount	% of total	Amount	% of total	Amount	% of total	
Non Perishable (1)(5)	\$ 60,649	50.1 %	\$ 60,872	49.6 %	\$ 58,828	51.0 %	
Fresh (2)(5)	29,089	24.0 %	29,141	23.8 %	27,666	24.0 %	
Supermarket Fuel	14,903	12.3 %	13,177	10.7 %	11,286	9.8 %	
Pharmacy (5)	10,617	8.8 %	10,724	8.7 %	10,421	9.0 %	
Convenience Stores (3)	944	0.8 %	4,515	3.7 %	4,096	3.6 %	
Other (4)(5)	4,959	4.0 %	4,233	3.5 %	3,040	2.6 %	
Total Sales	\$ 121,162	100 %	\$ 122,662	100 %	\$ 115,337	100 %	

- (2) Consists primarily of produce, floral, meat, seafood, deli, bakery and fresh prepared.
- (3) The Company completed the sale of its convenience store business unit during the first quarter of 2018.
- (4) Consists primarily of sales related to food production plants to outside parties, data analytic services, third party media revenue, other consolidated entities, specialty pharmacy, in-store health clinics, digital coupon services and other online sales not included in the categories above.
- (5) Digital sales, primarily including Pickup, Deliver and pharmacy e-commerce sales, grew approximately 58%, 90% and 49% in 2018, 2017 and 2016, respectively, adjusted to remove the impact of the 53<sup>rd</sup> week in 2017. These sales are included in the non perishable, fresh, pharmacy, and other line items above.

#### 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 OG&A 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 advertising costs totaled \$752 in 2018, \$707 in 2017 and \$717 in 2016. The Company does not record vendor allowances for co-operative advertising as a reduction of advertising expense.

## Operating, General and Administrative Expenses

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 throughout the United States. The Company's retail operations, which represent 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. 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 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.

## 2. MERGERS AND PARTNERSHIP AGREEMENTS

# Merger Agreement

On June 22, 2018, the Company finalized the merger with Home Chef, a meal kit delivery company. The merger will allow the Company to increase the availability of meal kits and expand its offerings to customers. The Company completed the merger by purchasing 100% of the ownership interest in Home Chef, for \$197 net of cash and cash equivalents of \$30, in addition to future earnout payments of up to \$500 over five years that are contingent on achieving certain milestones. The contingent consideration is based on future performance of both the online and offline business and the related customer engagement. The fair value of the earnout liability in the amount of \$91 recognized on the acquisition date was measured using unobservable (Level 3) inputs and is included in "Other long-term liabilities" within the Consolidated Balance Sheet. The Company estimated the fair value of the earnout liability by applying a Monte-Carlo simulation method using the Company's projection of future operating results for both the online and offline businesses related to the Home Chef merger and the estimated probability of achievement of the earnout target metrics. 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 the earnout liability. Changes in the fair value of the earnout liability in future periods will be recorded in the Company's results in the period of the change.

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 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 following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at the acquisition date.

	June 22, 2018
ASSETS	2010
Total current assets	\$ 36
Property, plant and equipment	6
Other assets	1
Intangibles	143
Total Assets, excluding Goodwill	186
LIABILITIES	
Total current liabilities	(28)
Other long-term liabilities	(94)
T 6 11: 1200	(100)
Total Liabilities	(122)
Total Coll No.	2.4
Total Identifiable Net Assets	64
Goodwill	163
Total Purchase Price	\$ 227

The preliminary purchase price allocation for the Home Chef acquisition is based upon a preliminary valuation which is subject to change as the Company obtains additional information with respect to income taxes during the measurement period. The allocation will be completed by the second quarter of 2019.

Of the \$143 allocated to intangible assets, the Company recorded \$99 and \$44 related to customer relationships and the trade name, respectively. The Company will amortize the customer relationships, using the cash flow trended method over seven years. The goodwill recorded as part of the merger was attributable to the assembled workforce of Home Chef and operational synergies expected from the merger. The merger was treated as a 30% stock purchase and 70% partnership interest purchase for income tax purposes. The tax basis of the assets acquired and liabilities assumed for the portion of the transaction treated as a partnership interest purchase was stepped up, and the related goodwill is deductible for tax purposes. The assets acquired and liabilities assumed for the portion treated as a stock purchase did not result in a step up of tax basis, and goodwill is not expected to be deductible for tax purposes. The Company determined the Home Chef results of operations are not material. Therefore the pro forma information is not required for fiscal year 2018 and 2017.

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.

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:

		tember 2, 2016
ASSETS		
Total current assets	\$	82
Property, plant and equipment		8
Intangibles		136
		<u></u>
Total Assets, excluding Goodwill		226
-		
LIABILITIES		
Total current liabilities		(68)
Fair-value of long-term debt including obligations under capital leases and financing obligations		(1)
Deferred income taxes		(33)
	-	
Total Liabilities		(102)
Total Identifiable Net Assets		124
Goodwill		283
Total Purchase Price	\$	407

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.

# Partnership Agreement

On May 17, 2018, the Company entered into a Partnership Framework Agreement with Ocado International Holdings Limited and Ocado Group plc ("Ocado"). Under this agreement, Ocado will partner exclusively with the Company in the U.S., enhancing the Company's digital and robotics capabilities in its distribution networks. As part of the agreement, the Company provided a letter of credit for \$180, which supports its commitment to contract with Ocado to build a number of fulfilment centers. The balance of the letter of credit will reduce over time with the construction of each fulfilment center.

In addition, on May 17, 2018, the Company entered into a Share Subscription Agreement with Ocado, pursuant to which the Company agreed to purchase 33.1 million ordinary shares of Ocado for an aggregate purchase price of \$243. The Company completed the purchase of these 33.1 million shares on May 29, 2018. This is in addition to 8.1 million Ocado shares purchased earlier in the first quarter of 2018, and 6.5 million additional shares purchased in the second quarter of 2018. The equity investment in Ocado is measured at fair value through earnings. The fair value of all shares owned, which is measured using Level 1 inputs, was \$620 at February 2, 2019 and is included in "Other assets" in the Company's Consolidated Balance Sheets. The Company recorded an unrealized gain of \$228 in 2018, none of which was realized during the period as the Company did not sell any Ocado securities.

#### 3. GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the changes in the Company's net goodwill balance through February 2, 2019.

	2018	2017
Balance beginning of year		
Goodwill	\$ 5,567	\$ 5,563
Accumulated impairment losses	(2,642)	_(2,532)
Subtotal	2,925	3,031
	<del></del>	
Activity during the year		
Mergers	163	18
Impairment losses	_	(110)
Held for sale adjustment	(1)	(14)
Balance end of year		
Goodwill	5,729	5,567
Accumulated impairment losses	(2,642)	(2,642)
Total Goodwill	\$ 3,087	\$ 2,925

In 2018, the Company acquired all of the outstanding shares of Home Chef (see Note 2) resulting in additional goodwill totaling \$163. Certain assets and liabilities including goodwill totaling \$1 and \$14, respectively for 2018 and 2017 were classified as held for sale in the Consolidated Balance Sheet (see Note 17).

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. The annual evaluation of goodwill and indefinite-lived intangible assets was performed during the fourth quarter of 2018 and 2016 and 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.

The following table summarizes the Company's intangible assets balance through February 2, 2019.

	2018			2017			
		s carrying mount	Accumulated amortization <sup>(1)</sup>		ross carrying amount		cumulated ortization <sup>(1)</sup>
Definite-lived favorable leasehold interests	\$	160	\$ (47)	\$	174	\$	(53)
Definite-lived pharmacy prescription files		316	(92)		238		(70)
Definite-lived customer relationships		186	(88)		93		(67)
Definite-lived other		103	(55)		99		(44)
Indefinite-lived trade name		685	_		641		_
Indefinite-lived liquor licenses		90		_	89		_
Total	\$	1,540	\$ (282)	\$	1,334	\$	(234)

<sup>(1)</sup> 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 OG&A expense and depreciation and amortization expense.

In 2018, the Company acquired definite and indefinite lived intangible assets totaling approximately \$143, excluding goodwill, as a result of the merger with Home Chef (see Note 2). Additionally, the majority of the Company's pharmacy prescription file purchases for 2018 were completed in a single transaction for \$75.

Amortization expense associated with intangible assets totaled approximately \$80, \$59 and \$63, during fiscal years 2018, 2017 and 2016, respectively. Future amortization expense associated with the net carrying amount of definite-lived intangible assets for the years subsequent to 2018 is estimated to be approximately:

2019	\$ 87
2020	83
2021	67
2022	59
2023	47
Thereafter	 140
Total future estimated amortization associated with definite-lived intangible assets	\$ 483

# 4. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consists of:

	2018	2017
Land	\$ 3,254	\$ 3,201
Buildings and land improvements	12,245	12,072
Equipment	14,277	13,635
Leasehold improvements	10,306	9,773
Construction-in-progress	2,716	2,050
Leased property under capital leases and financing obligations	1,066	1,000
Total property, plant and equipment	43,864	41,731
Accumulated depreciation and amortization	(22,229)	(20,660)
Property, plant and equipment, net	\$ 21,635	\$ 21,071
Property, plant and equipment, net	φ Z1,033	φ Z1,U/1

Accumulated depreciation and amortization for leased property under capital leases was \$345 at February 2, 2019 and \$354 at February 3, 2018.

Approximately \$169 and \$177, net book value, of property, plant and equipment collateralized certain mortgages at February 2, 2019 and February 3, 2018, respectively.

#### 5. TAXES BASED ON INCOME

The provision for taxes based on income consists of:

	2018	2017	2016
Federal			
Current	\$ 775	\$ 309	\$ 721
Deferred	(3)	(747)	158
Subtotal federal	772	(438)	879
State and local			
Current	108	15	51
Deferred	20	18	27
Subtotal state and local	128	33	78
Total	\$ 900	\$ (405)	\$ 957

A reconciliation of the statutory federal rate and the effective rate follows:

	2018	2017	2016
Statutory rate	21.0 %	33.7 %	35.0 %
State income taxes, net of federal tax benefit	2.6	1.7	1.6
Credits	(1.3)	(2.5)	(1.1)
Resolution of issues	0.5	_	(0.5)
Domestic manufacturing deduction	_	(1.1)	(0.7)
Excess tax benefits from share-based payments	(0.3)	(0.4)	(1.6)
Effect of Tax Cuts and Jobs Act	_	(60.8)	_
Impairment of goodwill	_	2.3	_
Other changes, net	0.1	(0.2)	0.1
	22.6 %	(27.3)%	32.8 %

The 2018 tax rate differed from the federal statutory rate primarily due to the effect of state income taxes and an IRS audit that resulted in a reduction of prior year tax deductions at pre-Tax Act rates and an increase in future tax deductions at post-Tax Act rates. These 2018 items were partially offset by the utilization of tax credits and deductions, the remeasurement of uncertain tax positions and adjustments to provisional amounts that increased prior year deductions at pre-Tax Act rates and decreased future deductions at post-Tax Act rates. In accordance with SAB 118, the Company has completed accounting for the Tax Act resulting in no measurement period adjustments.

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-deducible 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 Accounting Standards Update ("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 tax effects of significant temporary differences that comprise tax balances were as follows:

		2018	:	2017
Deferred tax assets:		,		
Compensation related costs	\$	350	\$	348
Lease accounting		81		78
Closed store reserves		41		45
Net operating loss and credit carryforwards		110		146
Other		55		54
		,		
Subtotal		637		671
Valuation allowance		(54)		(62)
Total deferred tax assets		583		609
Deferred tax liabilities:				
Depreciation and amortization	(	(1,850)	(	1,892)
Insurance related costs		(38)		(32)
Inventory related costs		(257)		(253)
Total deferred tax liabilities	(	(2,145)	(	2,177)
Deferred taxes	\$ (	(1,562)	\$ (	1,568)

At February 2, 2019, the Company had net operating loss carryforwards for state income tax purposes of \$1,208. These net operating loss carryforwards expire from 2019 through 2038. 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 2, 2019, the Company had state credit carryforwards of \$47, most of which expire from 2019 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 2, 2019, the Company had federal net operating loss carryforwards of \$2. These net operating loss carryforwards expire from 2036 through 2037. 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 2, 2019, February 3, 2018 and January 28, 2017, the total valuation allowance was \$54, \$62 and \$50, 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:

	2018	2017	2016
Beginning balance	\$ 180	\$ 177	\$ 204
Additions based on tax positions related to the current year	7	11	10
Reductions based on tax positions related to the current year	(1)	(1)	(1)
Additions for tax positions of prior years	23	6	3
Reductions for tax positions of prior years	(22)	(8)	(30)
Settlements	(10)	_	(2)
Lapse of statute	(3)	(5)	(7)
Ending balance	\$ 174	\$ 180	\$ 177

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 2, 2019, February 3, 2018 and January 28, 2017, the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$72, \$88 and \$73 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 2, 2019, February 3, 2018 and January 28, 2017, the Company recognized approximately \$2, \$8 and \$(1), respectively, in interest and penalties (recoveries). The Company had accrued approximately \$30, \$28 and \$20 for the payment of interest and penalties as of February 2, 2019, February 3, 2018 and January 28, 2017, respectively.

As of February 2, 2019, 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 2, 2019	February 3, 2018
1.50% to 8.00% Senior Notes due through 2048	\$ 12,097	\$ 12,201
5.63% to 12.75% Mortgages due in varying amounts through 2027	14	22
1.68% to 2.63% Commercial paper borrowings due through		
February 2019	800	2,121
3.37% Term Loan due 2019	1,000	_
Other	440	443
Total debt, excluding capital leases and financing obligations	14,351	14,787
Less current portion	(3,103)	(3,509)
Total long-term debt, excluding capital leases and financing		
obligations	\$ 11,248	\$ 11,278

In 2018, the Company issued \$600 of senior notes due in fiscal year 2029 bearing an interest rate of 4.50% and \$600 of senior notes due in fiscal year 2049 bearing an interest rate of 5.40%. In connection with the senior note issuances, the Company also terminated forward-starting interest rate swap agreements with an aggregate notional amount of \$750. 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 fourth quarter of 2018. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized gain of \$39, \$30 net of tax, has been deferred in Accumulated Other Comprehensive Loss and will continue to amortize to earnings as the interest payments are made. The Company also repaid, upon maturity, \$300 of senior notes bearing an interest rate of 6.80%, \$300 of senior notes bearing an interest rate of 7.00% and \$500 of senior notes bearing an interest rate of 2.30%, with proceeds from the senior notes issuances.

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 and 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 2018, the Company obtained a \$1,000 term loan 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. On March 15, 2019, the Company paid the \$1,000 term loan through increased commercial paper borrowings.

On August 29, 2017, the Company entered into an amended, extended and restated \$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 2, 2019, the Company had \$800 of commercial paper borrowings, with a weighted average interest rate of 2.63% and no borrowings under the Credit Agreement. 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 February 2, 2019, the Company had outstanding letters of credit in the amount of \$363, of which \$3 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 2018, and for the years subsequent to 2018 are:

2019	\$ 3,103
2020	720
2021	793 896 595
2022	896
2023	595
Thereafter	8,244
Total debt	<u>\$ 14,351</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 amount that represents 25% of the carrying value of the Company's debt portfolio 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. We have no outstanding interest rate derivatives classified as fair value hedges as of February 2, 2019.

		2017	
	Р	Pay	
	Flo	ating	Fixed
Notional amount	\$	100	\$ —
Number of contracts		2	_
Duration in years		0.88	_
Average variable rate		7.23 %	_
Average fixed rate		6.80 %	_
Maturity	Decem	ber 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 2018 and 2017 were as follows:

	Year-To-Date					
	Februar	y 2, 2019	February	/ 3, 2018		
	Gain/(Loss) on	Gain/(Loss) on	Gain/(Loss) on	Gain/(Loss) on		
Consolidated Statements of Operations Classification	Swaps	Borrowings	Swaps	Borrowings		
Interest Expense	\$ 1	\$ —	\$ —	\$ —		

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

	Asset Derivatives		
	Fair Value		
	February 2,	February 3,	
Derivatives Designated as Fair Value Hedging Instruments	2019	2018	Balance Sheet Location
Interest Rate Hedges	\$ —	<b>\$</b> (1)	Other long-term liabilities

## Cash Flow Forward-Starting Interest Rate Swaps

As of February 2, 2019, the Company had five forward-starting interest rate swap agreements with a maturity date 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 2020. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of February 2, 2019, the fair value of the interest rate swaps was recorded in other assets for \$33 and accumulated other comprehensive income for \$20 net of tax.

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. 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.

During 2018, the Company terminated nine forward-starting interest rate swaps with maturity dates of January 2019 with an aggregate notional amount totaling \$750. 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 fourth quarter of 2018. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized gain of \$39, \$30 net of tax, has been deferred in AOCI and will be amortized to earnings as the interest payments are made.

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.

The following table summarizes the effect of the Company's derivative instruments designated as cash flow hedges for 2018 and 2017:

	Amount of Gain/(Loss) in					nount of	Gain/(L	_oss)	
	AOCI on Derivative				Reclassified from AOCI into				Location of Gain/(Loss)
Derivatives in Cash Flow Hedging	(Effective Portion)			on)	Income (Effective Portion)				Reclassified into Income
Relationships	2018		2017		2018		2017		(Effective Portion)
Forward-Starting Interest Rate Swaps,									
net of tax*	\$	6	\$	24	\$	(5)	\$	(3)	Interest expense

<sup>\*</sup> The amounts of Gain/(Loss) in AOCI on derivatives include unamortized proceeds and payments from forwardstarting interest rate swaps once classified as cash flow hedges that were terminated prior to end of 2018 and 2017, 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 2, 2019 and February 3, 2018, 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 2, 2019 and February 3, 2018:

				Net Amount		Gross Amounts Not Offset in the Balance Sheet					
February 2, 2019 Assets	Gross Amou Recognized		Gross Amounts Offset in the Balance Sheet	Presented Balance S		Finan Instrun		Cash Colla	ateral_	Net An	nount
Cash Flow Forward- Starting Interest Rate Swaps	\$ 33	3 \$	\$ —	\$	33	\$	_	\$	_	\$	33

			Net Amount		Gross Amounts Not Offset in the Balance Sheet					
February 3, 2018 Assets	 Amount ognized	 Amounts Offset Balance Sheet		sented in the lance Sheet		nancial ruments	Cas	sh Collateral	Net	Amount
Cash Flow Forward- Starting Interest Rate Swaps	\$ 103	\$ _	\$	103	\$	_	\$	_	\$	103
Liabilities										
Fair Value Interest Rate Swaps	\$ 1	\$ _	\$	1	\$	_	\$	_	\$	1

# 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 2, 2019 and February 3, 2018:

February 2, 2019 Fair Value Measurements Using

	Active for	ed Prices in ve Markets Identical Assets Level 1)	Observa	cant Other able Inputs	Unob In	nificant servable puts evel 3)	Total
Trading Securities	\$	671	\$		\$		\$ 671
Other Investment		_		_		22	22
Interest Rate Hedges				33			 33
Total	\$	671	\$	33	\$	22	\$ 726

### February 3, 2018 Fair Value Measurements Using

	Quoted	Prices in					
	Active	Markets			Sigr	ificant	
	for Id	lentical	Signifi	cant Other	Unob	servable	
	As	sets	Observ	able Inputs	In	puts	
	(Le	vel 1)	(L	evel 2)	(Le	vel 3)	Total
Trading Securities	\$	64	\$	_	\$	_	\$ 64
Available-For-Sale Securities		25		_		_	25
Interest Rate Hedges		_		102		_	102
Total	\$	89	\$	102	\$	_	\$ 191

In 2018, realized 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 2018, long-lived assets with a carrying amount of \$85 were written down to their fair value of \$29, resulting in an impairment charge of \$56. 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 2018, the Company entered into an agreement with a third party. As part of the consideration for entering the agreement, the Company received a financial instrument of \$22.

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 2, 2019, the fair value of total debt was \$14,190 compared to a carrying value of \$14,351. At February 3, 2018, the fair value of total debt was \$15,167 compared to a carrying value of \$14,787.

## Contingent Consideration

As a result of the Home Chef merger, the Company recognized a contingent liability of \$91 on the acquisition date. The contingent consideration was measured using unobservable (Level 3) inputs and is included in "Other long-term liabilities" within the Consolidated Balance Sheet. The liability is remeasured to fair value at each reporting period, and the change in fair value, including accretion for the passage of time, is recognized in net earnings until the contingency is resolved. In 2018, an adjustment to increase the contingent consideration liability as of year-end 2018 was recorded for \$33 in OG&A expense.

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 \$58, which was recorded as a reduction of the cost method investment. In the fourth quarter of 2018, a transaction occurred that resulted in the settlement of the financial instrument. As a result of the settlement, the Company received cash proceeds of \$235. The Company recognized an impairment of financial instrument of \$42 in OG&A in the fourth quarter of 2018.

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 2, 2019 and February 3, 2018, the carrying and fair value of long-term investments for which fair value is determinable was \$155 and \$176, respectively. At February 2, 2019 and February 3, 2018, the carrying value of notes receivable for which fair value is determinable was \$146 and \$170, respectively.

#### 9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table represents the changes in AOCI by component for the years ended February 2, 2019 and February 3, 2018:

	Cash Flow Hedging Activities <sup>(1)</sup>	 ailable for sale Securities <sup>(1)</sup>	Р	Pension and ostretirement efined Benefit Plans <sup>(1)</sup>	Total <sup>(1)</sup>
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)
Balance at February 3, 2018	\$ 24	\$ 4	\$	(499)	\$ (471)
OCI before reclassifications <sup>(2)</sup>	(23)	(4)		104	77
Amounts reclassified out of AOCI <sup>(3)</sup>	5	<u> </u>		43	48
Net current-period OCI	(18)	(4)		147	125
Balance at February 2, 2019	\$ 6	\$ 	\$	(352)	\$ (346)

<sup>(1)</sup> All amounts are net of tax.

<sup>(2)</sup> 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. Net of tax of \$(8), \$(1) and \$32 for cash flow hedging activities, available for sale securities and pension and postretirement defined benefit plans, respectively, as of February 2, 2019.

<sup>(3)</sup> 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. Net of tax of \$13 and \$3 for pension and postretirement defined benefit plans and cash flow hedging activities, respectively, as of February 2, 2019.

The following table represents the items reclassified out of AOCI and the related tax effects for the years ended February 2, 2019, February 3, 2018 and January 28, 2017:

	For the year ended February 2, 2019	For the year ended February 3, 2018	For the year ended January 28, 2017
Cash flow hedging activity items			
Amortization of gains and losses on cash flow hedging activities (1)	\$ 8	\$ 6	\$ 2
Tax expense	(3)	(3)	_
Net of tax	5	3	2
Available for sale security items			
Realized gains on available for sale securities (2)	_	_	(27)
Tax expense			13
Net of tax			(14)
Pension and postretirement defined benefit plan items Amortization of amounts included in net periodic			
pension expense (3)	56	69	53
Tax expense	(13)	(20)	(20)
Net of tax	43	49	33
Total reclassifications, net of tax	\$ 48	\$ 52	\$ 21

<sup>(1)</sup> Reclassified from AOCI into interest expense.

# 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:

	2018	2017	2016
Minimum rentals	\$ 967	\$ 1,005	\$ 973
Contingent payments	19	19	16
Tenant income	(102)	(113)	(108)
Total rent expense	\$ 884	\$ 911	\$ 881

<sup>(2)</sup> Reclassified from AOCI into operating, general and administrative expense.

<sup>(3)</sup> Reclassified from AOCI into non-service component of company-sponsored pension plan costs. These components are included in the computation of net periodic pension expense.

Minimum annual rentals and payments under capital leases and lease-financed transactions for the five years subsequent to 2019 and in the aggregate are listed below. Amounts in the table only include payments through the noncancelable lease term.

	Capital Leases	Operating Leases	Lease- Financed Transactions
2019	\$ 103	\$ 948	\$ 5
2020	89	880	6
2021	86	773	5
2022	82	649	5
2023	81	556	5
Thereafter	766	3,197	17
Total	\$1,207	\$ 7,003	\$ 43
		<u> </u>	
Less estimated executory costs included in capital leases	_		
,,	•	•	
Net minimum lease payments under capital leases	1,207		
Less amount representing interest	372		
Loos amount reprocessing mercot	- 012		
Present value of net minimum lease payments under capital			
leases	\$ 835		
100000	Ψ 000		

Total future minimum rentals under noncancellable subleases at February 2, 2019 were \$183.

#### 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:

	For	the year ended	I	For	the year ended	l	For the year ended January 28, 2017			
	Fe	bruary 2, 2019		Fe	bruary 3, 2018					
			Per			Per			Per	
	Earnings	Shares	Share	Earnings	Shares	Share	Earnings	Shares	Share	
(in millions, except per share amounts) Net earnings attributable to The Kroger Co. per basic common share	(Numerator) \$ 3,076		<u>Amount</u>			<u>Amount</u> \$ 2.11	(Numerator) \$ 1,959		* 2.08	
Dilutive effect of stock options		8			9			16		
Net earnings attributable to The Kroger Co. per diluted common share	\$ 3,076	818	\$ 3.76	\$ 1,890	904	\$ 2.09	\$ 1,959	958	\$ 2.05	

The Company had combined undistributed and distributed earnings to participating securities totaling \$34, \$17 and \$16 in 2019, 2018 and 2017, respectively.

The Company had stock options outstanding for approximately 10.1 million, 15.6 million and 7.1 million shares, respectively, for the years ended February 2, 2019, February 3, 2018, and January 28, 2017, 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 option 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 2, 2019, approximately 22 million common shares were available for future option grants under the 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 2, 2019, approximately 6 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 2018 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	Weighted-
	subject	average
	to option	exercise
	(in millions)	
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
Granted	2.7	\$ 27.88
Exercised	(4.4)	\$ 15.34
Canceled or Expired	(0.9)	\$ 28.05
Outstanding, year-end 2018	34.1	\$ 23.42

A summary of options outstanding, exercisable and expected to vest at February 2, 2019 follows:

	Number of shares	Weighted-average remaining contractual life	ghted-average xercise price	Aggregate intrinsic value
	(in millions)	(in years)		(in millions)
Options Outstanding	34.1	5.73	\$ 23.42	229
Options Exercisable	22.7	4.50	\$ 20.95	201
Options Expected to Vest	11.2	8.14	\$ 28.33	27

#### Restricted stock

Changes in restricted stock outstanding under the restricted stock plans are summarized below:

	Restricted shares outstanding (in millions)	We	ighted-average grant-date fair value
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	9.2	\$	26.78
Granted	4.6	\$	27.99
Lapsed	(4.4)	\$	25.93
Canceled or Expired	(0.6)	\$	26.57
·			
Outstanding, year-end 2018	8.8	\$	27.86

The weighted-average grant date fair value of stock options granted during 2018, 2017 and 2016 was \$6.78, \$4.71 and \$7.48, 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 increase in the fair value of the stock options granted during 2018, compared to 2017, resulted primarily from an increase in the Company's share price, which decreased the expected dividend yield, an increase in the weighted average expected volatility and the weighted average risk-free interest rate also contributed to the increase in fair value. 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 following table reflects the weighted-average assumptions used for grants awarded to option holders:

	2018	2017	2016
Weighted average expected volatility	24.50 %	22.78 %	21.40 %
Weighted average risk-free interest rate	2.82 %	2.21 %	1.29 %
Expected dividend yield	2.00 %	2.20 %	1.40 %
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 2018, 2017 and 2016 was \$154, \$151 and \$141, respectively. Stock option compensation recognized in 2018, 2017 and 2016 was \$25, \$32 and \$28, respectively. Restricted shares compensation recognized in 2018, 2017 and 2016 was \$129, \$119 and \$113, respectively.

The total intrinsic value of stock options exercised was \$58, \$55 and \$105 in 2018, 2017 and 2016, respectively. The total amount of cash received in 2018 by the Company from the exercise of stock options granted under share-based payment arrangements was \$65. As of February 2, 2019, 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 \$30, \$29 and \$28 in 2018, 2017 and 2016, 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 2018, the Company repurchased approximately three 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 2, 2019. 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.

## 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 \$727, \$1,567 and \$1,661 under these repurchase programs in 2018, 2017 and 2016, respectively. On April 20, 2018 the Company entered and funded a \$1,200 accelerated stock repurchase ("ASR") program to reacquire shares in privately negotiated transactions. The final delivery under the ASR program occurred during the second quarter of 2018, which included the settlement of the remaining 2.3 million Kroger Common shares. In total, the Company invested \$1,200 to repurchase 46.3 million Kroger common shares at an average price of \$25.91 per share.

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 \$83, \$66 and \$105 under the stock option program during 2018, 2017 and 2016, 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. The Company has elected to measure defined benefit plan assets and obligations as of January 31, which is the month-end that is closest to its fiscal year-ends, which were February 2, 2019 for fiscal 2018 and February 3, 2018 for fiscal 2017.

Amounts recognized in AOCI as of February 2, 2019 and February 3, 2018 consists of the following (pre-tax):

	Pension	Benefits	Other E	Benefits	Total			
	2018	2017	2018	2017	2018	2017		
Net actuarial loss (gain)	\$ 837	\$ 1,040	\$ (130)	\$ (130)	\$ 707	\$ 910		
Prior service credit			(66)	(77)	(66)	(77)		
Total	\$ 837	\$ 1,040	\$ (196)	\$ (207)	\$ 641	\$ 833		

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	Othe	r Benefits		Total
	20	19		2019	2019	
Net actuarial loss (gain)	\$	53	\$	(10)	\$	43
Prior service credit				(11)		(11)
Total	\$	53	\$	(21)	\$	32

Other changes recognized in other comprehensive income (loss) in 2018, 2017 and 2016 were as follows (pretax):

	Pe	nsion Bene	Ot	her Benef	its	Total			
	2018	2017	2016	2018	2017	2016	2018	2017	2016
Incurred net actuarial loss (gain)	\$ (126)	\$ 322	\$ 165	\$ (10)	\$ (20)	\$ (9)	\$ (136)	\$ 302	\$ 156
Amortization of prior service credit	`	_	_	11	8	8	11	8	8
Amortization of net actuarial gain	<b>,</b> >	<b>/</b> \	<i>-</i>					<b>,</b> \	
(loss)	(77)	(88)	(71)	10	11	10	(67)	(77)	(61)
Settlement recognition of net actuarial loss	_	(502)	_	_	_	_	_	(502)	_
Other	_	` —	_	_	(28)	_	_	(28)	_
Total recognized in other comprehensive income (loss)	(203)	(268)	94	11	(29)	9	(192)	(297)	103
Total recognized in net periodic benefit cost and other comprehensive income (loss)	<u>\$ (127)</u>	\$ 323	<u>\$ 188</u>	<u>\$ 5</u>	<u>\$ (30)</u>	<u>\$ 10</u>	<u>\$ (122)</u>	\$ 293	<u>\$ 198</u>

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:

		Pension E				
	Qualific	ed Plans	Non-Quali	ified Plans	Other E	Benefits
	2018	2017	2018	2017	2018	2017
Change in benefit obligation:						
Benefit obligation at beginning of fiscal year	\$ 3,235	\$ 4,140	\$ 328	\$ 316	\$ 202	\$ 243
Service cost	35	53	2	2	7	8
Interest cost	124	163	12	13	8	9
Plan participants' contributions	_	_	_	_	13	12
Actuarial (gain) loss	(134)	126	(13)	15	(9)	(20)
Plan curtailments	(92)	_	(6)	_	_	_
Plan settlements	_	(1,040)	_	_		
Benefits paid	(174)	(202)	(24)	(21)	(21)	(23)
Other		(5)	(1)	3		(27)
Benefit obligation at end of fiscal year	\$ 2,994	\$ 3,235	\$ 298	\$ 328	\$ 200	\$ 202
Change in plan assets:						
Fair value of plan assets at beginning of fiscal year	\$ 2,943	\$ 3,138	\$ —	\$ —	\$ —	\$ —
Actual return on plan assets	46	210	_	_	_	_
Employer contributions	185	1,000	25	21	8	11
Plan participants' contributions		_	_	_	13	12
Plan settlements	_	(1,198)	_	_	_	_
Benefits paid	(174)	(202)	(24)	(21)	(21)	(23)
Other	10	(5)	(1)	_	_	_
				<u> </u>		
Fair value of plan assets at end of fiscal year	\$ 3,010	\$ 2,943	\$ —	\$ —	\$ —	\$ —
Funded status and net asset and liability recognized at						
end of fiscal year	\$ 16	\$ (292)	\$ (298)	\$ (328)	\$ (200)	\$ (202)

As of February 2, 2019, other assets and other current liabilities include \$47 and \$35, respectively, of the net asset and liability recognized for the above benefit plans. As of February 3, 2018, other current liabilities include \$30 of net liability recognized for the above benefit plans.

In 2018, the Company contributed \$185, \$117 net of tax, to the company-sponsored pension plan. This contribution was designated to the 2017 tax year in order to deduct the contributions at the previous year tax rate. The Company announced changes to certain non-union company-sponsored pension plans. The Company will freeze the compensation and service periods used to calculate pension benefits for active employees who participate in the affected pension plans as of December 31, 2019. Beginning January 1, 2020, the affected active employees will no longer accrue additional benefits for future service and eligible compensation received under these plans. The financial effects of these changes are not material to the financial statements for the year ended February 2, 2019.

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 2, 2019 and February 3, 2018, pension plan assets do not include common shares of The Kroger Co.

	Pen	sion Benefit	ts	Other Benefits				
Weighted average assumptions	2018	2017	2016	2018	2017	2016		
Discount rate — Benefit obligation	4.23 %	4.00 %	4.25 %	4.19 %	3.93 %	4.18 %		
Discount rate — Net periodic benefit								
cost	4.00 %	4.25 %	4.62 %	3.93 %	4.18 %	4.44 %		
Expected long-term rate of return on								
plan assets	5.90 %	7.50 %	7.40 %					
Rate of compensation increase —								
Net periodic benefit cost	3.03 %	3.07 %	2.71 %					
Rate of compensation increase —								
Benefit obligation	3.04 %	3.03 %	3.07 %					

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 4.23% and 4.19% discount rates as of year-end 2018 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 2, 2019, by approximately \$362.

The Company's 2018 assumed pension plan investment return rate was 5.90% compared to 7.50% in 2017 and 7.40% in 2016. The value of all investments in the company-sponsored defined benefit pension plans during the calendar year ended December 31, 2018, net of investment management fees and expenses, decreased 2.4% and for fiscal year 2018 investments increased 1.9%. Historically, the Company's pension plans' average rate of return was 8.1% for the 10 calendar years ended December 31, 2018, 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 6.10%. At the beginning of 2018, to determine the expected rate of return on pension plan assets held by the Company for 2018, the Company considered current and forecasted plan asset allocations as well as historical and forecasted rates of return on various asset categories.

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 February 2, 2019, the Company adopted an updated assumption for generational mortality improvement, based on additional years of published mortality experience.

The funded status increased in 2018, compared to 2017, due to the \$185 contribution made in 2018 to the qualified plans, the increase in discount rate from 2017 to 2018 and the announced plan freeze to certain non-union company-sponsored pension plans as of December 31, 2019.

The following table provides the components of the Company's net periodic benefit costs for 2018, 2017 and 2016:

	Pension Benefits																	
	Qualified Plans						Non-	-Qua	lified	Plans	S	Other Benefits						
	2	2018	2	017	2	016	2	018	2	017	20	016	20	018	20	)17	20	)16
Components of net periodic benefit																		
cost:																		
Service cost	\$	35	\$	53	\$	68	\$	2	\$	2	\$	2	\$	7	\$	8	\$	9
Interest cost		124		163		177		12		13		14		8		9		10
Expected return on plan assets	(	(174)	(	(233)	(	238)		_		_		_		_		_		_
Amortization of:						•												
Prior service credit		_		_		_		_		_		_		(11)		(8)		(8)
Actuarial (gain) loss		69		79		60		8		9		8	(	(10)	(	(11)	(	10)
Settlement loss recognized		_		502		_		_		_		_		_		_		_
Other		_		_		3		_		3		_		_		1		_
Net periodic benefit cost	\$	54	\$	564	\$	70	\$	22	\$	27	\$	24	\$	(6)	\$	(1)	\$	1

The following table provides the projected benefit obligation ("PBO"), accumulated benefit obligation ("ABO") and the fair value of plan assets for those company-sponsored pension plans with accumulated benefit obligations in excess of plan assets.

	Qualifi	ed Plans	Non-Qualified Plans			
	2018	2017	2018	2017		
PBO at end of fiscal year	\$ 295	\$ 3,051	\$ 298	\$ 328		
ABO at end of fiscal year	\$ 293	\$ 2,916	\$ 291	\$ 313		
Fair value of plan assets at end of year	\$ 263	\$ 2.755	\$ —	\$ —		

The following table provides information about the Company's estimated future benefit payments.

	Pe	nsion	O	ther	
	Ве	nefits	Benefits		
2019	\$	193	\$	13	
2020	\$	199	\$	14	
2021	\$	204	\$	15	
2022	\$	212	\$	15	
2023	\$	205	\$	16	
2024 —2028	\$ 1	074	\$	82	

The following table provides information about the target and actual pension plan asset allocations as of February 2, 2019.

		Actu	al
	Target allocations	Allocat	tions
	2018	2018	2017
Pension plan asset allocation			
Global equity securities	2.0 %	4.2 %	2.2 %
Emerging market equity securities	1.0	2.3	1.7
Investment grade debt securities	80.0	73.2	53.3
High yield debt securities	4.0	3.5	3.7
Private equity	10.0	9.5	9.6
Hedge funds	_	4.5	17.4
Real estate	3.0	2.8	3.2
Other	_	_	8.9
Total	100.0 %	100.0 %	100.0 %

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 2018 were established in 2018 in conjunction with the continuation of the Company's transition to a LDI strategy, which began in 2017. 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 2018, the Company contributed \$185, \$117 net of tax, to the company-sponsored defined benefit plans and the Company is not required to make any contributions to these plans in 2019. If the Company does make any contributions in 2019, 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 2019 expense for company-sponsored pension plans to be approximately \$41.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The Company used a 5.80% 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	1% F	Point
	Increase	Decr	ease
Effect on total of service and interest cost components	\$ 2	\$	(2)
Effect on postretirement benefit obligation	\$ 19	\$	(17)

The following tables, set forth by level, within the fair value hierarchy, the Qualified Plans' assets at fair value as of February 2, 2019 and February 3, 2018:

# Assets at Fair Value as of February 2, 2019

	Quoted	Prices in	in Significant							
	Active M	arkets for	Signifi	cant Other	Unobservable			Assets		
	Identica	al Assets	Observ	able Inputs	Inputs	Inputs		Measured		
	(Lev	/el 1)	(Le	evel 2)	(Level 3)		at NAV			Total
Cash and cash equivalents	\$	126	\$	_	\$	_	\$	_	\$	126
Corporate Stocks		66		_		—		_		66
Corporate Bonds		_		896		_		_		896
U.S. Government Securities		_		240		_		_		240
Mutual Funds/Collective Trusts		257		_		_		805		1,062
Hedge Funds		_		_		49		85		134
Private Equity		_		_		_		285		285
Real Estate		_		_		67		19		86
Other		_		115		_		_		115
Total	\$	449	\$	1,251	\$	116	\$	1,194	\$	3,010

# Assets at Fair Value as of February 3, 2018

	Quote	ed Prices in							
	Active	Markets for	Si	gnificant Other	ificant Other Unobservable			Assets	
	Ident	ical Assets	Ob	servable Inputs	Inputs		Measured		
	(L	_evel 1)	(Level 2)		(Level 3)		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
Total	\$	476	\$	1,122	\$	124	\$	1,221	\$ 2,943

The fair value of asset groupings changed significantly beginning in 2017 and continuing into 2018 due to the LDI transition that began in 2017 as described above.

For measurements using significant unobservable inputs (Level 3) during 2018 and 2017, a reconciliation of the beginning and ending balances is as follows:

	Hedge Funds	Real Estate
Ending balance, January 28, 2017	\$ 67	65
Contributions into Fund	13	11
Realized gains	1	3
Unrealized losses	5	8
Distributions	(30)	(19)
Ending balance, February 3, 2018	56	68
Contributions into Fund	_	9
Realized gains	1	12
Unrealized gains	4	(5)
Distributions	(16)	(15)
Other	4	(2)
Ending balance, February 2, 2019	\$ 49	\$ 67

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 \$263, \$219 and \$215 to employee 401(k) retirement savings accounts in 2018, 2017 and 2016, 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 \$358 in 2018, \$954 in 2017 and \$289 in 2016. The increase in 2017, compared to 2018 and 2016, is primarily due to the \$467 pre-tax payment to satisfy withdrawal obligations of certain local unions of the Central States Pension Fund and the 2017 United Food and Commercial Workers ("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 the IBT that provided certain local unions of the Company to withdraw from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2018, the Company incurred a \$155 charge, \$121 net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension plan fund.
- 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.

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 2018 and 2017 is for the plan's year-end at December 31, 2017 and December 31, 2016, 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, 2017 and December 31, 2016. The multi-employer contributions listed in the table below are the Company's multi-employer contributions made in fiscal years 2018, 2017 and 2016.

The following table contains information about the Company's multi-employer pension plans:

			Protection	Status				
	EIN / Pension					iployer Cor		Surcharge
Pension Fund	Plan Number	2018	2017	Implemented	2018	2017	2016	Imposed (5)
SO CA UFCW Unions & Food								
Employers Joint Pension Trust								
Fund <sup>(1) (2)</sup>	95-1939092 - 001	Yellow	Yellow	Implemented	\$ 71	\$ 66	\$ 60	No
Desert States Employers &								
UFCW Unions Pension Plan <sup>(1)</sup>	84-6277982 - 001	Green	Green	No	19	18	18	No
Sound Retirement Trust (formerly								
Retail Clerks Pension Plan)(1)(3)	91-6069306 - 001	Green	Green	Implemented	23	20	18	No
Rocky Mountain UFCW Unions								
and Employers Pension Plan <sup>(1)</sup>	84-6045986 - 001	Green	Green	No	20	19	16	No
Oregon Retail Employees								
Pension Plan <sup>(1)</sup>	93-6074377 - 001	Green	Green	No	9	9	8	No
Bakery and Confectionary								
Union & Industry International								
Pension Fund <sup>(1)</sup>	52-6118572 - 001	Red	Red	Implemented	11	11	10	No
Retail Food Employers & UFCW								
Local 711 Pension <sup>(1)</sup>	51-6031512 - 001	Yellow	Yellow	Implemented	10	10	9	No
Denver Area Meat Cutters and				•				
Employers Pension Plan (9)	84-6097461 - 001	Green	Green	No	_	_	3	No
United Food & Commercial								
Workers Intl Union — Industry								
Pension Fund <sup>(1)(4)</sup>	51-6055922 - 001	Green	Green	No	32	33	37	No
Western Conference of								
Teamsters Pension Plan	91-6145047 - 001	Green	Green	No	34	34	33	No
Central States, Southeast &								
Southwest Areas Pension Plan								
(7)	36-6044243 - 001	Red	Red	Implemented	18	492	23	No
UFCW Consolidated Pension								
Plan <sup>(1)</sup>	58-6101602 - 001	Green	Green	No	55	201	34	No
IBT Consolidated Pension								
Plan <sup>(1) (6) (7)</sup>	82-2153627 - 001	N/A	N/A	No	37	_	_	No
Other (8)					19	41	20	
Total Contributions					\$ 358	\$ 954	\$ 289	

<sup>(1)</sup> The Company's multi-employer contributions to these respective funds represent more than 5% of the total contributions received by the pension funds.

<sup>(2)</sup> The information for this fund was obtained from the Form 5500 filed for the plan's year-end at March 31, 2018 and March 31, 2017.

<sup>(3)</sup> The information for this fund was obtained from the Form 5500 filed for the plan's year-end at September 30, 2017 and September 30, 2016.

<sup>(4)</sup> The information for this fund was obtained from the Form 5500 filed for the plan's year-end at June 30, 2017 and June 30, 2016.

<sup>(5)</sup> 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 2, 2019, the collective bargaining agreements under which the Company was making contributions were in compliance with rehabilitation plans adopted by the applicable pension fund.

<sup>(6)</sup> The information for this fund was obtained from the Form 5500 filed for the plan's first year beginning February 20, 2017 and year-end December 31, 2017.

<sup>(7)</sup> In 2017, the Company ratified a new contract with the IBT that provided certain local unions to withdraw from this pension fund and form the IBT consolidated pension fund.

<sup>(8)</sup> The increase in 2017, compared to 2018 and 2016, in the "Other" funds is due primarily to withdrawal settlement payments for certain multi-employer funds in 2017.

<sup>(9)</sup> As of June 30, 2016, the Denver Area Meat Cutters and Employers Pension Plan merged with the Rocky Mountain UFCW Unions and Employers Pension Plan. The final Form 5500 for this plan was for the period of January 1, 2016 through June 30, 2016 (the date of the Merger). Prior to the merger, the Company's multi-employer contributions to this fund represented more than 5% of the total contributions received by the 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.

	Expiration Date	Most Significant Collective						
	of Collective		Bargaining Agreements <sup>(1)</sup>					
	Bargaining		(not in millions)					
Pension Fund	Agreements	Count	Expiration					
SO CA UFCW Unions & Food Employers Joint Pension Trust Fund	March 2019 to June 2020	2	March 2019 to June 2020					
UFCW Consolidated Pension Plan	January 2019 (2) to August 2022	8	February 2019 to August 2021					
Desert States Employers & UFCW Unions Pension Plan	October 2020 to February 2022	1	October 2020					
Sound Retirement Trust (formerly Retail Clerks Pension Plan)	April 2019 to April 2020	3	May 2019 to August 2019					
Rocky Mountain UFCW Unions and Employers Pension Plan	January 2019 (2) to February 2019	1	January 2019 (2)					
Oregon Retail Employees Pension Plan	August 2018 (2) to April 2022	3	August 2018 (2) to June 2019					
Bakery and Confectionary Union & Industry International Pension Fund	July 2018 (2) to July 2022	4	August 2019 to June 2021					
Retail Food Employers & UFCW Local 711 Pension	June 2017 (2) to April 2020	1	March 2019					
Denver Area Meat Cutters and Employers Pension Plan	January 2019 (2) to February 2019	1	January 2019 (2)					
United Food & Commercial Workers Intl Union — Industry Pension Fund	February 2019 to August 2022	2	April 2019 to March 2021					
Western Conference of Teamsters Pension Plan	April 2019 to July 2021	5	April 2019 to July 2021					
International Brotherhood of Teamsters Consolidated Pension Fund	September 2019 to September 2022	3	September 2019 to September 2022					

<sup>(1)</sup> 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.

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 \$1,282 in 2018, \$1,247 in 2017 and \$1,143 in 2016.

# 17. HELD FOR SALE AND DISPOSAL OF BUSINESS

During the second quarter of 2018, the Company announced that as a result of a review of its assets, the Company has decided to explore strategic alternatives for its Turkey Hill Dairy business, including a potential sale. Additionally during the fourth quarter of 2018, the Company announced that it had entered into a definitive agreement to sell its You Technology business.

<sup>(2)</sup> Certain collective bargaining agreements for each of these pension funds are operating under an extension.

The following table presents information related to the major classes of assets and liabilities of all business that were classified as assets and liabilities held for sale in the Consolidated Balance Sheet as of February 2, 2019 and February 3, 2018:

(In millions)	February 2, 2019		February 3, 2018	
Assets held for sale:				
Cash and temporary cash investments	\$	1	\$ 1	
Store deposits in transit		-	15	
Receivables		64	49	
FIFO inventory		21	95	
LIFO reserve		(1)	(36)	
Prepaid and other current assets		3	13	
Property, plant and equipment, net		77	441	
Intangibles, net		-	11	
Goodwill		1	14	
Other assets			 1	
Total assets held for sale	\$	166	\$ 604	
	·			
Liabilities held for sale:				
Trade accounts payable	\$	26	\$ 119	
Accrued salaries and wages		8	14	
Other current liabilities		17	85	
Other long-term liabilities		_	41	
Total liabilities held for sale	\$	51	\$ 259	

Subsequent to February 2, 2019, the Company completed the sale of its You Technology business unit and announced a definitive agreement for its Turkey Hill Dairy business unit. 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.

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. On April 20,2018, the Company completed the sale of its convenience store business unit for \$2,169. The Company recognized a net gain on this sale for \$1,782, \$1,360 net of tax, in 2018.

#### 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

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 in 2017 of \$110, \$74 net of tax, related to the Kroger Specialty Pharmacy reporting unit.

On February 4, 2018, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which superseded previous revenue recognition guidance. Topic 606 is a comprehensive new revenue recognition model that requires a company to recognize revenue 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. The Company adopted the standard using a modified retrospective approach with the adoption primarily involving the evaluation of whether the Company acts as principal or agent in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. The Company will continue to record revenue and related costs on a gross basis for the arrangements. The adoption of the standard did not have a material effect on the Company's Consolidated Statements of Operations, Consolidated Balance Sheets or Consolidated Statements of Cash Flows.

In March 2017, the Financial Accounting Standard's Board ("FASB") issued ASU "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07)." 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. The Company adopted ASU 2017-07 on February 4, 2018 and retrospectively applied it to all periods presented. As a result, retiree benefit expenses are excluded from the Company's operating profit subtotal as reported in the Company's Consolidated Statements of Operations, but remain included in net earnings before income tax expense. Due to the adoption, the Company reclassified \$527 for 2017 and \$16 for 2016, of non-service company-sponsored pension plan costs from operating profit to other income (expense) on its Consolidated Statements of Operations. Information about retiree benefit plans' interest expense, investment returns and other components of retiree benefit expenses can be found in Note 15 to the Company's Consolidated Financial Statements.

In January 2016, the FASB issued "Financial Instruments—Overall (Topic 825)," which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments (ASU 2016-01). The Company adopted this ASU on February 4, 2018. As a result of the adoption, the Company recorded a mark to market gain on Ocado securities, for those securities the Company owned as of the end of 2018, within the Consolidated Statements of Operations as opposed to a component of Other Comprehensive Income on the Company's Consolidated Statements of Comprehensive Income.

#### 20. RECENTLY ISSUED ACCOUNTING STANDARDS

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. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance will be effective for the Company in the first quarter of its fiscal year ending February 1, 2020. The Company will apply the transition package of practical expedients permitted within the standard, which allows the Company to carryforward its historical lease classification, and will apply the transition option which does not require application of the guidance to comparative periods in the year of adoption. The Company estimates adoption of the standard will result in right of use assets and lease liabilities of approximately \$6,700 as of February 3, 2019. When combined with the Company's existing capital leases, the Company's total lease assets and liabilities will be approximately \$7,400 and \$7,600, respectively, as of February 3, 2019. The Company does not expect adoption to have a material impact on the Company's consolidated net earnings or cash flows.

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 Cuts and Jobs Act. In addition, under ASU 2018-02, the Company may be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for fiscal 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 this standard on the Company's Consolidated Financial Statements.

# 21. QUARTERLY DATA (UNAUDITED)

The two tables that follow reflect the unaudited results of operations for 2018 and 2017.

				Qu	arter					
2018		irst Veeks)		econd 2 Weeks)	(1	Third 2 Weeks)		Fourth 2 Weeks)		otal Year 2 Weeks)
Sales	\$ 37	7,530	\$ 2	27,869	\$	27,672	\$	28,091	\$ 1	21,162
0 " "										
Operating Expenses										
Merchandise costs, including advertising, warehousing, and transportation, excluding items										
shown separately below	20	,362		21,930		21,699		21,902		94,894
Operating, general and administrative		5,122	· · ·	4,612		4,556		5,013		20,305
Rent		276		204		200		204		884
Depreciation and amortization		741		574		570		581		2,465
•										
Operating profit	1	,029		549		647		391		2,614
Other income (expense)		(400)		(4.4.4)		(4.40)		(4.40)		(000)
Interest expense Non-service component of company sponsored		(192)		(144)		(142)		(142)		(620)
pension plan costs		(10)		(4)		(6)		(7)		(26)
Mark to market gain (loss) on Ocado securities		36		216		(100)		75		228
Gain on sale of business	1	1,771		11		(.cc)		_		1,782
		,			_					,
Net earnings before income tax expense	2	2,634		628		399		317		3,978
Income tax expense		616		127		91		66		900
NI-A		0.40		F04		200		054		0.070
Net earnings including noncontrolling interests  Net loss attributable to noncontrolling interests		2,018		501		308		251		3,078 (32)
Net loss attributable to floricontrolling interests	_	(8)	_	(7)		(9)		(8)	_	(32)
Net earnings attributable to The Kroger Co.	\$ 2	2,026	\$	508	\$	317	\$	259	\$	3,110
That darnings attributable to The Prioger Co.	<u> </u>	,020	<u>*</u>		Ψ_		Ψ		Ψ	0,110
Net earnings attributable to The Kroger Co. per										
basic common share	\$	2.39	\$	0.63	\$	0.39	\$	0.32	\$	3.80
	,			·						
Average number of shares used in basic calculation		839		797		797		798		810
Net earnings attributable to The Kroger Co. per	Φ.	0.07	Φ.	0.00	Φ.	0.00	•	0.00	Φ.	0.70
diluted common share	\$	2.37	\$	0.62	\$	0.39	\$	0.32	\$	3.76
Average number of shares used in diluted										
calculation		846		805		807		806		818
		J-10		000		007		000		010
Dividends declared per common share	\$ 0	).125	\$	0.140	\$	0.140	\$	0.140	\$	0.545

Annual amounts may not sum due to rounding.

Net earnings for the first quarter of 2018 include a reduction to OG&A expenses of \$13, \$10 net of tax, for adjustments to obligations related to certain local unions withdrawing from the Central States multi-employer pension fund, a reduction to depreciation and amortization expenses of \$14, \$11 net of tax, related to held for sale assets, gains in other income (expense) of \$1,771, \$1,352 net of tax, related to the sale of the convenience store business unit and \$36, \$27 net of tax, for the mark to market gain on Ocado securities.

Net earnings for the second quarter of 2018 include gains in other income (expense) of \$11, \$8 net of tax, related to the sale of the convenience store business unit and \$216, \$164 net of tax, for the mark to market gain on Ocado securities.

Net earnings for the third quarter of 2018 include a loss in other income (expense) of \$100, \$77 net of tax, for the mark to market loss on Ocado securities.

Net earnings for the fourth quarter of 2018 include charges to OG&A expenses of \$168, \$131 net of tax, for obligations related to certain local unions withdrawing from the Central States multi-employer pension fund, \$33, \$26 net of tax, for the revaluation of contingent consideration and \$42, \$33 net of tax, for an impairment of financial instrument, a gain in other income (expense) of \$75, \$59 net of tax, for the mark to market gain on Ocado securities.

	Quarter									
2017		First Weeks)		Second 2 Weeks)	(12	Third Weeks)		Fourth 3 Weeks)		otal Year 3 Weeks)
Sales	\$ 3	36,285	\$	27,597	\$ 2	27,749	\$	31,031	\$ 1	22,662
0 6 5										
Operating Expenses  Merchandise costs, including advertising, warehousing, and transportation, excluding items										
shown separately below	2	28,281		21,609		21,532		24,240		95,662
Operating, general and administrative		6,367		4,517		4,701		5,456		21,041
Rent		270		225		196		220		911
Depreciation and amortization		736		562		573		565		2,436
- · · · · · · · · · · · · · · · · · · ·										
Operating profit		631		684		747		550		2,612
Other income (expense)										
Interest expense		(177)		(138)		(136)		(148)		(601)
Non-service component of company sponsored		( ,		(100)		( ,		(110)		()
pension plan costs		(9)		(6)		(7)		(506)		(527)
Net earnings (loss) before income tax (benefit) expense		445		540		604		(104)		1,484
Income tax expense (benefit)		148	_	189		215	_	(957)		(405)
No. 4. a complete of the character of the complete of the comp		007		054		200		0.50		4 000
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 carriings attributable to The Noger Go.	Ψ	303	Ψ	333	Ψ	331	Ψ	00+	Ψ	1,307
Net earnings attributable to The Kroger Co. per basic										
common share	\$	0.33	\$	0.39	\$	0.44	\$	0.97	\$	2.11
common charc	Ψ	0.00	Ψ_	0.00	Ψ_	0.11	Ψ_	0.01	Ψ_	
Average number of shares used in basic calculation		914		897		887		875		895
Ŭ										
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
				2.125						2 125
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 OG&A 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, 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.

#### 22. SUBSEQUENT EVENTS

On March 13, 2019, the Company completed the sale of its You Technology business to Inmar for total consideration of \$565, including \$400 received upon closing. The transaction includes a long-term service agreement for Inmar to provide the Company digital coupon services. The sale resulted in a gain and will be included in "Gain on sale of business" in the Consolidated Statements of Operations in the first quarter of 2019.

On March 22, 2019, the Company announced a definitive agreement for the sale of its Turkey Hill Dairy business to an affiliate of Peak Rock Capital, subject to customary closing conditions and any regulatory reviews. The transaction will result in a gain and it is expected to close in the first quarter of 2019.



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.

FINANCIAL INFORMATION: Call (513) 762-1220 (option "1") 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.

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.

#### EXECUTIVE OFFICERS

Mary Ellen Adcock Senior Vice President

Jessica C. Adelman Group Vice President

Stuart Aitken Senior Vice President

Robert W. Clark Senior Vice President

Yael Cosset Senior Vice President and Chief Information Officer

Michael J. Donnelly Executive Vice President and Chief Operating Officer

Carin L. Fike Vice President and Treasurer Todd A. Foley

Vice President and Controller

Joseph A. Grieshaber, Jr. Senior Vice President

Christopher T. Hjelm Executive Vice President

Calvin J. Kaufman Senior Vice President

Timothy A. Massa Senior Vice President

Stephen M. McKinney Senior Vice President

W. Rodney McMullen Chairman of the Board and Chief Executive Officer Gary Millerchip
Senior Vice President and
Chief Financial Officer

J. Michael Schlotman
Executive Vice President

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** Atlanta Division

Jerry Clontz Mid-Atlantic Division

**Zane Day** Nashville Division

Daniel C. De La Rosa King Soopers/City Market

**Ken DeLuca** Michigan Division

Peter M. Engel Fred Meyer Jewelers

**Liz Ferneding** Ruler Foods

Monica Garnes Fry's Food & Drug Dennis R. Gibson Fred Meyer Stores

Scott Hays Cincinnati Division

Colleen Juergensen Dillons Food Stores

Bryan H. Kaltenbach Food 4 Less

Joe Kelley Houston Division

Kenneth C. Kimball Smith's

Colleen R. Lindholz Pharmacy and The Little Clinic

Pamela J. Matthews Central Division

Michael Marx Roundy's **Domenic A. Meffe** Specialty Pharmacy

Suzy Monford QFC

Michael R. Murphy Ralphs

Ann M. Reed Louisville Division

Tom Schwilke Dallas Division

Victor Smith Delta Division

Nicholas Tranchina Murray's Cheese

Kate Ward Kroger Personal Finance

Dana Zurcher Columbus Division



www.thekrogerco.com

# The Kroger Co.

1014 Vine Street  $\,\cdot\,$  Cincinnati, Ohio 45202  $\,\cdot\,$  513-762-4000



