The Kroger (NYSE:KR) Q1 2011 Earnings Call June 16, 2011 10:00 AM ET

Executives

David Dillon - Chairman, Chief Executive Officer and Member of Proxy Committee

J. Schlotman - Chief Financial Officer and Senior Vice President

Rodney McMullen -

Cindy Holmes - Director of Investor Relations

Analysts

Edward Kelly - Crédit Suisse AG

John Heinbockel - Guggenheim Securities, LLC

Scott Mushkin - Jefferies & Company, Inc.

Mark Wiltamuth - Morgan Stanley

Karen Short - BMO Capital Markets U.S.

Robert Ohmes - BofA Merrill Lynch

Deborah Weinswig - Citigroup Inc

Stephen Grambling - Goldman Sachs Group Inc.

Charles Cerankosky - Northcoast Research

Operator

Good day, ladies and gentlemen, and welcome to the First Quarter 2011 Kroger Earnings Conference Call. My name is Tanya, and I will be your operator for today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes. I would now like to hand the conference over to Cindy Holmes, Director of Investor Relations.

Cindy Holmes

Good morning, and thank you for joining us. Before we begin, I want to remind you that today's discussion will include forward-looking statements. We want to caution you that such statements are predictions and actual events or results can differ materially. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings, but Kroger assumes no obligation to update that information. Both our first quarter press release and our prepared remarks from this conference call will be available on our website at www.kroger.com. After our prepared remarks, we look forward to taking your questions. [Operator Instructions]

I will now turn the call over to Dave Dillon, Chairman and Chief Executive Officer of Kroger.

David Dillon

Thank you, Cindy, and good morning, everyone. Thank you for joining us today. With me to review Kroger's First Quarter 2011 Results are Rodney McMullen, Kroger's President and Chief Operating Officer; and Mike Schlotman, Senior Vice President and Chief Financial Officer.

We are very pleased with the exceptional overall results the Kroger team achieved in the first quarter. Our associates delivered on all facets of our Customer 1st strategy. We achieved strong sales, earnings and cash flow growth. Needless to say, Kroger continued to grow market share in the first quarter. In some, we successfully managed our strategy throughout the quarter, which drove solid performance in all of the areas that are important to our business.

Identical supermarket sales increased 4.6% without fuel during the quarter. This continues Kroger's industry-leading trend of positive identical sales growth for 30 consecutive quarters. I want to thank all of our associates for their hard work to produce such outstanding results.

Our first quarter performance was broad-based. Each of the 18 retail divisions had positive identical sales excluding fuel. We're particularly pleased with sales in our deli/bakery, grocery and natural foods departments. These overall results have given us confidence to increase the original guidance we issued in March, which Mike will outline for you in a few minutes.

Our guidance for the year reflects the balance we strived to achieve across our business, including strong identical sales growth and outstanding cost control, as well as increased earnings and earnings per share. Our Customer 1st strategy is clearly connecting with customers. We have shown that our focus on people, products, prices and shopping experience is meaningful to customers through both good and challenging times. Our strategy positioned us well to weather the recession, and will continue to differentiate Kroger from our competitors whatever the operating environment.

I'd like to touch on 2 themes that will have the most impact on our business over the course of the year. The first is our commitment to Customer 1st strategy that we discussed. We want to reduce the overall cost of running our business, and doing it in a way that does not negatively impact our customers. We then reinvest those savings in our customers to drive higher sales, which in turn will increase earnings. The second theme is made up of several external factors that will influence Kroger's business this year. We discussed these 5 factors in March, and I'd like to briefly update you on where we are seeing each of these areas today.

First, as you know, the weak economy continues to present significant challenges for most households. The promising signs of the improvement we saw earlier this year seems to have stagnated. Unemployment remains high in most of our markets, and food stamp and other government program use continues at high levels. As predicted, rising prices for food and fuel are affecting customer spending behavior. Rodney will have more to say about food inflation shortly.

The overall retail environment is generally rational but strong competition for customer's limited dollars remains. Our price check show that most competitors are passing higher costs on to customers. We expect approximately $200 million of incremental expense from rising pension and healthcare costs for the year. Continued cost reduction in other areas is helping us offset these expenses, so we can invest in areas that matter most to our customers. And finally, during the quarter, our retail fuel operations generated the same earnings per share this year as last year. Because fuel is volatile, we should expect variability over the next few quarters. Even so, fuel remains a meaningful offering for our customers.

Of these factors, only one had a negative effect on our business this quarter, the rising price of fuel. This is because nearly $1 per gallon increase takes a big chunk of household budgets, perhaps as much as $100 a month, which forces families to make choices that change spending behavior. The other factors had a neutral to positive effect on our performance for the quarter. We expect these factors will have a dynamic effect on the overall operating environment this year. We will continue to follow our business strategy, and we'll make tactical adjustments as needed to weather these influences.

Rodney will now offer some insight into Kroger's strong business trends in the first quarter. Rodney?

Rodney McMullen

Thank you, Dave, and good morning, everyone. The Kroger team did a great job during the quarter to set the stage for the rest of the year. Our associates' efforts to control expenses enabled us to maintain a compelling price position, relative to both discount and traditional grocery competitors, even as we continued to pass on cost increases. We are particularly pleased with our associates' dedication to connecting with our customers. This will truly differentiate Kroger from our competitors.

One measure of that connection is our total household growth which is up for the quarter. Our loyal household growth count grew at a faster rate than total household growth, indicating that our best customers are the primary beneficiary of the investments we are making in the 4 key areas of our Customer 1st strategy. We continue to reward our best customers for their increased loyalty. Customers visited our stores more frequently this quarter and purchased more total units compared to the same quarter last year. Price per unit was higher in the first quarter compared to a year ago, reflecting the effect of price increases from our vendors. The combination of more households, more visits per household, more total units purchased and higher retail prices drove sequential improvement in identical sales.

When we dive deeper into Kroger's results for the quarter, we see that identical sales were positive for both total household and loyal households. Identical sales growth among loyal households was stronger than the overall results. Kroger continued to see positive tonnage growth throughout the quarter, which comes on top of strong unit movement last year. Our promotional and pricing strategies are designed to deliver these sustainable results. The initiatives we implement focus on building long-term loyalty and expanding Kroger's competitive advantage.

Kroger's first quarter results reflect the power of offering our customers a choice of both corporate brands and national brands. Millions of loyal households shop with us, and 99.9% of them bought at least one corporate brand item per quarter. We're still working on that 0.1%. This is particularly important today as shoppers continue to watch their spending and look for quality items at good prices.

For the first quarter, corporate brands represent approximately 26% of grocery department sales dollars and 33% of grocery department units sold. These figures compare with 26% and 34%, respectively, for the first quarter last year. Growth in national brand categories where Kroger does not have a presence was the primary driver of this decline. Corporate brand share overall continues to be well in excess of the prerecession levels.

A highlight of the quarter was the launch of our new homes essentials brand, Kroger Home Sense, with 200 reformulated or rebranded products. The collection of smart simple solutions helps customers get great results everywhere in their home. You'll find our new brand in paper towels, facial tissue, paper housewares and more. We also introduced new artisan-inspired Private Selection, hearth-baked pizzas in the first quarter. And I can tell you at least the barbecue chicken one tastes delicious. My wife and I had it for dinner last night.

These new offerings and others like them will help ensure our customers continued loyalty through our exclusive preferred brand. As Dave mentioned earlier, rising food costs are affecting consumer behavior. For the quarter, we estimated product cost inflation, excluding fuel, was approximately 3.5%. We saw inflation in all categories including grocery.

Grocery product cost inflation approached 2.1% excluding milk. Last quarter, we mentioned that rising costs for many agricultural commodities were driving higher retail prices for packaged goods in our grocery department. While that continues, inflation is disproportionately affecting our perishable departments especially seafood. We expect this trend to continue as well.

We are passing along product cost increases from suppliers and we plan to continue to do so. At the same time, we will continue to invest aggressively in our 4 keys, our pricing, people, products and customer shopping experience. Our customers continue to seek value in this economy. With inflation and rising gas prices, customers' budgets are stretched. The value we offer them through lower everyday prices, weekly features and personalized rewards to our loyal customers, continue to resonate with them.

We estimate we are currently saving our customers $2.1 billion per year. This demonstrates that while we are passing on inflation, we continue to provide significant value to our customers including price. We have done a lot of work over the last several years to integrate sustainable business practices in our everyday business operation.

Next week, we will publish our fifth Sustainability Report. As a preview, I'd like to highlight some of our most successful initiatives. Five of our manufacturing plants have achieved the impressive goal of sending 0 waste to landfills. That means that every ounce of raw material that arrives in our plant is either used for product, turned into energy or recycled by our associates. We're on the way to achieving 0 waste in our other manufacturing facilities as well.

Since 2009, our manufacturing division has reduced our monthly waste to landfills by more than 50%. Improved bagging techniques and increased use of reusable bags translated into saving an additional 159 million plastic bags in 2010. This puts more than -- puts us more than 35% of the way towards reaching our goal of saving 1 billion plastic bags by 2014.

I am proud to announce that our stores have now reduced their overall energy consumption by 30% since 2000. That's enough electricity to power every single family home in Fort Worth, Texas for one year. I'd like to thank our associates for helping reduce Kroger's energy consumption through their individual actions every day. These efforts by our associates are helping make the world a better place to live.

Turning now to labor relations. We completed successful contract negotiations for our associates in Fort Wayne, Indiana. And negotiations continue in Southern California and with the Teamsters who represent some of our associates in distribution and manufacturing operations in the Midwest. We will soon begin contract discussions in West Virginia as well as the Memphis area. Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and compensation packages that provide good wages, high-quality affordable healthcare, job security and retirement benefits for our associates.

It is worth noting that our pension and healthcare costs attributable to labor contracts in Southern California are extraordinarily high, making those negotiations particularly challenging. The labor and benefit costs in this market has had an impact on results, and we are not enjoying the same level of success there as we have in the rest of the company. We are hopeful that both sides will continue their hard work to find mutually acceptable solutions.

Now Mike will offer more details on the first quarter and Kroger's financial strategy. Mike?

J. Schlotman

Thanks, Rodney, and good morning, everyone. As Dave mentioned earlier, our identical supermarket sales without fuel increased 4.6% in the first quarter. Those sales drove strong first quarter net earnings we reported earlier today, totaling $432.3 million or $0.70 per diluted share. Net earnings in the same period last year were $373.7 million or $0.58 per diluted share. Excluding retail fuel operations, FIFO gross margin decreased 4 basis points. While this was helped by favorable shrink results, it was partially offset by higher diesel fuel costs.

Kroger's first quarter OG&A rate, excluding fuel, was 36 basis points lower than the same period last year. The benefits of leverage from strong sales, productivity improvements and outstanding costs control more than offset rising credit card fees, healthcare and pension costs. Our objective is to invest in all 4 keys of our Customer 1st strategy, identifying and delivering sustainable operating cost reductions allows us to make those investments consistently over time.

Our strong nonfuel sales allowed us to leverage rent and depreciation to provide a slight boost of about 7 basis points to the nonfuel operating margin. While we saw a strong increase in the first quarter operating margin, excluding fuel, we believe it is most beneficial to view operating margin over an annualized timeframe. On a rolling 4 quarters basis, our operating margin, excluding fuel, increased by 12 basis points.

With our expectations of earnings per share near the top of our guidance, we would expect fiscal year 2011 nonfuel operating margin to be slightly lower than this. It plays hand-in-hand with our strategy to continue to invest in gross margin as we're able to realize reductions on the OG&A line. We do expect to continue investments in our Customer 1st strategy during the year.

Turning now to Kroger's retail fuel operations. In the first quarter, our supermarket fuel centers and convenient stores produced solid identical gallon growth. These outlets earned approximately $0.124 per gallon compared to $0.117 in the same quarter last year. As Dave noted earlier, strong fuel margins did not enhance Kroger's first quarter earnings per share on a year-over-year basis. This was primarily due to higher credit card fees which increased as retail fuel prices rise. We need the higher margins to cover this expense. We continue to expect margins of approximately $0.115 per gallon for fiscal 2011.

I'll now update you on our long-term financial strategy. We're very focused on allocating the substantial cash flow of Kroger's business to reward shareholders both today and in the future. During 2011, Kroger plans to use cash flow from operations and cash on hand to fund capital expenditures, repurchase shares, pay dividends to shareholders and maintain our current debt rating. Capital investment, excluding acquisitions and purchases of leased facilities, totaled $573.1 million for the first quarter compared with $532.2 million for the same period last year. We expect capital investment for the year to be consistent with our original guidance of $1.7 billion to $1.9 billion.

Kroger saw a nice improvement in working capital during the quarter. One item that helped was higher fuel costs. We sell fuel before we have to pay for it so it lowers our working capital. Additionally, we have implemented systemic improvements that will advance our progress in this area.

During the first quarter, we invested $544.3 million to repurchase 23.1 million shares of stock at an average price of $23.55 per share. At the end of the first quarter, approximately $602.7 million remained under the $1 billion stock repurchase program authorized in March. We expect to use the full $1 billion during fiscal 2011.

Net total debt was $7.1 billion, an increase of $47.3 million from a year ago. On a rolling 4 quarters basis, Kroger's net total debt-to-EBITDA ratio, adjusted for impairment charges in 2010 and 2009, was 1.79 compared with 1.91 during the same period last year. Just as the first quarter results position us well to continue to invest in our Customer 1st strategy this year, they also position us for a better year than we originally thought. Therefore, we are increasing our identical supermarket sales and earnings guidance for fiscal 2011.

We now expect identical supermarket sales growth, excluding fuel, of 3.5% to 4.5% for the year. The previous guidance range was 3% to 4%. Kroger increased its earnings guidance for the year to $1.85 to $1.95 per diluted share. Based on the current operating environment, the company expects to achieve results near the top end of this range. The increase reflects the strength of our first quarter results and the higher estimated LIFO charge of $150 million for the full year. The original guidance was $1.80 to $1.92 per share. Additionally, we now expect product cost inflation to be in the 3% to 4% range. The previous range was 1% to 2%. Keep in mind the factors Dave mentioned, that will continue to influence Kroger's sales and earnings performance throughout the year. The pace of the economic recovery, the impact of rising gasoline and food prices on customer spending, the competitive environment, higher pension and healthcare costs and retail fuel margins. As Dave said, most of these were favorable in the first quarter and it's too early in the year to know if that will continue.

Earnings per share growth rates in the second and third quarters will be near the low end of our full year earnings per share growth expectations. This is primarily the result of the $0.02 per share tax benefit recorded in each of these quarters last year. This is consistent with the annual guidance we've provided in March.

Our long-term growth model is to generate 6% to 8% annual earnings per share growth rate over a 3- to 5-year time horizon. Including dividends, the total shareholder return rate is 8% to 10%. We aim to produce this with less volatility than the S&P 500 over the same timeframe. We're not opposed to a year occasionally exceeding this range, which is what we now expect to deliver in 2011.

Now I will turn it back over to Dave.

David Dillon

Mike, thank you. This was a very strong quarter for Kroger. As a result of our associates' hard work, we strengthened our connection with our customers who in turn are spending more with us. Our Customer 1st strategy is producing positive results and will drive increased sales and earnings growth well into the future. We now look forward to your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of John Heinbockel with Guggenheim Securities.

John Heinbockel - Guggenheim Securities, LLC

Sure. First thing, I want to drill down a little bit on the consumer. So if you look at kind of the consumables part of your mix, with the vast majority, it looks like we're seeing modest -- very modest demand dampening and modest trading down. Is that fair? And then I also want to talk about discretionary part of the business too. But is it the consumer reaction modest to date in terms of how they are trading down or cutting the number of items they buy?

David Dillon

John, we are seeing some modest change. And modest would be the right word, it's really not very much. We're seeing some change in mix, some trading down perhaps, some choices being made, some of the areas that are discretionary areas. Several of those are still a bit challenged compared to our overall results. But our tonnage is still solid and that tells us that it's really modest changes that we're seeing.

J. Schlotman

The only other thing I'd add on top of that, John, is in a few places, you can see a little bit of where people are trading down to a lower expensive item or buying a little more on promotion. But I would echo what Dave said is it's very modest and very early. So whether it's a trend or just a little bump in the road, it's hard to say.

John Heinbockel - Guggenheim Securities, LLC

And then shifting gears, if you look at Fred Meyer and marketplace and some of the other discretionary items -- because it also looks like really across retail, there's some crowding out, people were out, right, buying food and gas and maybe buying a lot less discretionary product. Are you seeing that too in discretionary stuff you sell?

David Dillon

We would. Now I would never say -- I wouldn't say that it's ever been robust as we come through the recession but it's gradually improved. And I would say the improvement has slowed down. It's still improving but the improvement is definitely slower than what it was.

John Heinbockel - Guggenheim Securities, LLC

Okay, and then finally unless...

J. Schlotman

John, sorry to interrupt you. One other thing I'd add too is one of the things that makes it a little difficult in that area to know for sure is the weather in the first quarter was very challenging. And so it was either wet or too cold, so people weren't in the spring and planting mood, so that showed up on buying apparel and some of those things. It's picked up recently as the weather's improved. But how much of that is trend and how much of it is the weather, I don't know. That was one other thing I'd want to add on top of the comment I made before. Sorry to interrupt you.

John Heinbockel - Guggenheim Securities, LLC

Okay. And then finally, if you think about your gas business, maybe to talk a little bit about -- just if you look at your comp and the separation you've got from some others, and it looks like gas is certainly playing a role in that. So talk about the growth in gas, how that's impacting the in-store part of your business and then the support you're getting from vendors for gas-related programs because it looks like that's a competitive advantage.

David Dillon

Well, I'll comment on the overall view of gas. We've been pretty bullish on the idea. We've added lots of fuel stations over time. We continue to do so. And that's because we believe that the combination of having gas near our supermarkets is a very strong convenience. Customers also like the tie-in with our store sales, our store purchasing program. But I think that convenience is a real important aspect, so we're quite bullish. Our gallonage increases at a time when gallons in the U.S. are basically flat. So we think we're picking up a little market share there. But on the other hand, we have been adding for the last several years, and so I think that's part of the reason we've done that. I don't know that I'd have any comment about vendor tie-ins. Really, we have a lot of promotions but I wouldn't think that there's anything specific there that would be noteworthy.

Operator

Our next question comes from the line of Edward Kelly with Crédit Suisse.

Edward Kelly - Crédit Suisse AG

First question for you on your ID. Can you just kind of discuss the cadence of your IDs throughout the quarter, and how sales are trending so far in the second quarter?

David Dillon

Sure. It's a little hard to read sometimes when you have a holiday that changes dates, with Easter in the quarter. But trying to adjust for that, it looked like our sales gradually improved through the quarter and have continued to gradually improve into and through the first 3.5 weeks this quarter. So I mean gradual though, it's not a big difference. But it has gently risen and it's continued through the quarter and into the current quarter.

Edward Kelly - Crédit Suisse AG

And let me -- on the pricing and promotional environment, I think there's plenty of concerns out there amongst investors about how the second half of this year is going to look, particularly given what we heard out of Dollar General. And I think investors are generally concerned that Wal-Mart will eventually have to get promotional to drive sales. What are you assuming from the promotional environment in the back half of the year? What's your expectation in terms of -- I mean, you actually said that you're going to continue to pass through inflation, but the success that you're going to have there, and how realistic do you think your expectations are?

David Dillon

Ed, I think our expectations are pretty realistic. I don't try to guess what competitor behavior will be. I have some general assumptions about what it's been most recently. And I tend to think that, that's a projection of what it will look like in the near term. But there's always a few surprises out there. I think way too much is being made of Dollar General's statement, personally. They are not as big of factor in the food industry as you might guess. And even though they tend to be a deep discount kind of an operation, the kind of things that they sell don't particularly push us on competitive pricing that much. So I just think it's overplayed. In terms of Kroger behavior though, I think that we are very predictable. In fact, we try to make ourselves predictable for our customers primarily. And you see that we are not trying to become overly promotional. And in fact, we're trying to invest in those things that we think can be sustainable. And we use the term to mean things we can keep doing for a very long time. And so it is our intention to do more of the same that we've been doing. Find places to save, as we showed in the first quarter, reinvest those savings in ways that matter to the customer and then let our sales grow from there. We also have said in the comments I had that we think it's a reasonably rational market right now. A little bit of inflation I think has helped that. I suspect that we'll see some improvement and some sales at other operators as well because of that inflation. And that tends to bring some rationality to the blade. So that's how I'd sum it up. Rodney, you might have some comments?

Rodney McMullen

Yes, the only other thing I would add is one of the things we always want to make sure is that we have the flexibility to deal with over how the market changes. But what we have found is, when you look at our strategy overall, by focusing on people, products, shopping experience and price, the whole offering for the customer is a very broad offering that the customer enjoys. And we believe that, that will continue to gain share over time, and it's more than just price. Then our associates do an awful lot of work every day to make sure our customers have a total experience to the whole equation. So I think it's a broader discussion than price alone. And then I also think you want to make sure when you look at some of those competitors, look at equivalent type prices per unit, per ounce of volume and stuff. Some competitors may have a better price reputation than their prices really are.

Edward Kelly - Crédit Suisse AG

That makes sense. And if I could just squeeze one more in on fuel. It seems to me like you're managing this business slightly differently now. And what I mean by that is that if I looked at the slope of the curve in terms of wholesale prices this quarter, I would have thought that your gross profit for gallon would have been a lot lower than what it was. Has there been some change in terms of how you're managing the pricing in that business, which is allowing you to make a little bit more money than you traditionally would have in an environment where wholesale prices are rising the whole quarter?

David Dillon

I wouldn't read an awful lot into that either frankly, because fuel is actually -- of all the items we sell, is really pretty much determined by the market. The retail price is what the market is going to be. If you try to undercut the market, the market goes with you. If you try to go too high, the market stays where it is and you lose gallonage. So the market is just what it is. And sometimes, in times of rising price, you end up making a little bit margin. Sometimes it actually works the other way. The thing that seems to work the most is, in volatility, it seems to improve margins. But overall, we're going to see some quarters that don't produce much in margin and we're going to see quarters that produce good margin. We think that's why we like to look at it for a year. And frankly, you can even look at it over 2 years and get a cleaner picture because sometimes it's just going to be unpredictable. Rodney, do you want to add?

Operator

Our next question comes from the line of Deborah Weinswig with Citi.

Deborah Weinswig - Citigroup Inc

So in terms of thinking about your new ID guidance and your change in your focus in terms of, well, where you think your core inflation is going from 1% to 2% to 3% to 4%, might your ID guidance be conservative?

David Dillon

Well, it's hard to say because we don't know fully what lies ahead. I think one of the things we were guarding against or guarding for, looking out for, was trend changes, people trading down or buying fewer discretionary items if things got a little tight. Because as we said, that while -- what we've seen is things have stagnated a little bit in the economy and behavior has sort of just plateaued there. And so the recovery that we had hoped to achieve may not be quite what we had hoped would be achieved. And so we're trying to leave room for that.

J. Schlotman

The only thing I would add is we just want to make sure that we're beginning to see some switching of people buying something that's a little cheaper in a category. And obviously, that's fine on units, but we want to make sure from an identical sales standpoint that, that's reflected. If we end up incorrect and this is just a little bump in the road, then I wouldn't disagree with your comment but time will tell on that.

Rodney McMullen

Deb, the other thing is that the 3.5% in the quarter and our guidance for the year. Keep in mind that if you look at produce and meat and seafood, they were huge drivers of that overall inflationary -- some of those and a couple of those were in double-digit inflation rates. And our grocery category, which is 1/2 of our sales, was still 2.1% without milk. And you have to kind of look at that inflationary compared to what items we're actually selling at those different inflation rates as well. My point is a lot of you all like to take our IDs minus the inflation and come to that answer. And with the disparate results of inflation in those kind of categories, it's even more difficult to do that this quarter.

David Dillon

That approach works a little better with grocery than it does with the other categories. And grocery was without milk was 2.1%, is that what it was?

Rodney McMullen

Yes, approaching.

David Dillon

At roughly.

Deborah Weinswig - Citigroup Inc

And then with regards to OG&A line, I think the last quarter, you talked about the ongoing implementation of operating efficiencies and in this quarter, you talked about outstanding cost control. Can you maybe dive a little bit deeper into some of what you're doing to really manage your expenses?

David Dillon

Rodney can give us some more particular but the main thing that I'd want you to remember is that we had, in this quarter in particular -- I mean, with a 36 basis point decline, we had just about everything going our way. We had good productivity improvement. We had really good focus by our associates. We had some lucky things that came out where in some healthcare cost that we might have expected didn't turn out quite as we had expected them in the quarter. Some things like that. But on the whole, we are very pleased with where that came out and it was strong. And I'm not sure it's predictive though of future quarters at least to that magnitude. Rodney, do you want to comment?

Rodney McMullen

Well the only thing I would add on top of that, it's very broad-based, and it really is our associates across our stores, our plants, our warehouses, our offices, focusing on every little $0.01 they can help save or make sure that we're executing well on the programs we have in place. So I really give the credit, broad-based, to them, and it really is in a lot of different places. And I'm very pleased with what everybody is doing.

Deborah Weinswig - Citigroup Inc

Okay, and then just adding and finishing up, you talked about investments in Customer 1st, what types of investments might those be?

David Dillon

Well, the examples that we usually, is obviously is one of them, is pricing. But as Rodney was quick to point out earlier and he's right, is that it's actually far more broad than that. It's everything from training associates in areas that would be meaningfully important to our customers to working on customer service on the front end of our stores to improving out of stocks on the shelf. All of those require often systems or training or process change. And each of those we think is an investment that the customers appreciate.

Rodney McMullen

And the only other thing I would add, we're using more hours on our front end today than a year ago and 2 years ago and those kind of things. And all of those obviously improves the customers' checkout experience. Dave mentioned training. We're spending quite a bit more money on training to make sure our associates understand what we're trying to get done and why. We continue to focus on trying to improve the freshness of our products and making sure that the customer has the absolute freshest product they can. Obviously, there's costs involved in executing all of those pieces. And it's just trying to make sure that we get savings in places so that we can reinvest in those that really matters to the customer.

Operator

Our next question comes from the line of Robbie Ohmes with Bank of America.

Robert Ohmes - BofA Merrill Lynch

I want to follow up a little bit on Deborah's question. I mean, it sounds like you're running ahead of the comp range this quarter, to date. You mentioned Dollar General not a factor. Gas prices at the moment probably aren't going to be the worse of a drag in your consumer than they were in the first part. I think you guys called out natural and organic at the beginning of the call, and you're saying sales continue to gradually improve. Can you just contrast all that with maybe the comment that the early improvement seems to be stagnating? I'm confused. Are things accelerating or are they stagnating? And maybe help me get maybe a better picture of what you guys feel is generally going on at the moment?

David Dillon

I think that the stagnation that we're describing is the overall environment that the customer is operating in. And we can see it in small ways in the behavior, that some of the trading down and exchanges that we described. Our relative performance within that overall market though has been strong. And as a result, it may not show quite as much in our performance, as it will overall, is that you won't see the industry recover quickly, rapidly just because of what's happening with food purchasing in my opinion. So I'm very pleased with where we are. The thing I would remind you though, we went through 5 factors that are basically external factors. But we identified March that we talked about today, those 5. The only one that really went against us in the quarter and the quarter ended middle of March -- I mean, middle of May, roughly. The only thing that really went against us was the high price of fuel which caused customers to have less money in their pockets, which we think drove a little bit of behavior change. The other areas tended to work in our favor. If some of those other areas were to turn south, we think that, that could have a little bit of a dampening effect on our positioning going forward into the rest of the year. So things like if food inflation got more wild than where it is, causing a shift in behavior, that's when it actually becomes a little more problematic for us, I think. Something like that could do that. You could have a change in competitive environment which we were already asked about before. I don't foresee that right at the moment but you just never know. Those are some of the examples and I think it changed the picture.

Robert Ohmes - BofA Merrill Lynch

And just near term, as you guys head into the July 4 weekend, Wal-Mart's made it clear they're not repeating any of those rollbacks last year. Can you just sort of give us your sort of anticipation about what the environment is going to look like heading into that period and how you guys feel about that versus last year?

David Dillon

We plan to have a solid 4th of July selling time, and we plan to do it in a way that's consistent with the way we've been doing it for the last several years, not just that holiday but every holiday, just try to meaningfully give customers what we think they want, in a way that we can keep doing it. So we've tried not to be overly promotional. And that's the kind of thing that you can't sustain because then the next year, you got to be more than that in order to make it work. So I think that's our forecast for July 4. We're pretty excited about it.

Operator

Our next question comes from the line of Scott Mushkin with Jefferies & Company.

Scott Mushkin - Jefferies & Company, Inc.

So I think Rodney touched on Southern California, I think, in his prepared remarks. Our sources are saying things are getting pretty testy down there. Any thoughts on the likelihood of repeating '03 at this stage, or you think that's just kind of off the table that there's not a chance?

David Dillon

We had some comments in how we saw Southern California and the challenges relative to healthcare and pension and that sort of thing and the comments that Rodney made and so I won't repeat those. But I will say to that, and this is about all I want to say about negotiations, is that both sides in the negotiations are showing the patience needed to solve the problems at the bargaining table. So we're really very hopeful that the process will eventually result in an agreement.

Scott Mushkin - Jefferies & Company, Inc.

Okay. And then, I know we touched on it before, but our recent surveys are showing that some of the people that are a little sharper on price have started to drag their feet in some cases. And actually, you guys had actually put that bucket in some markets. Do you think that's, that's accurate, that some people have started to drag their feet a little bit and are trying to push their own competitive advantage to gain share? I know you've made some comments to Robbie's question that you think that you guys are benefiting maybe in the environment. Is this market with high gas prices and the advantage of your business really kind of Kroger's time to shine?

David Dillon

One of the advantages we have in times with high gas prices, and it's not just true for us but it's true for us too is that you hear a lot written about consumers making fewer shopping trips. And yet, the data we've seen now and what we saw before is we see more trips. And when we see more trips, and we're looking at households now as opposed to customer count, although customer count went up too, but we're really looking at households. And the households show more visits and the best we can figure based on talking to customers, what we think is happening is people are making fewer trips overall. But as they make those trips overall, they are shopping at Kroger more often. So Kroger is convenient to every one of those trips they make. And since we're convenient to every trip they make, they shop in us more often. That's an advantage that actually shows up about now.

Scott Mushkin - Jefferies & Company, Inc.

And finally, I just one, one last one. It's more long term. So besides same-store sales which are obviously fantastic, you guys are gaining shares, been happening for years, how do you grow this business?

David Dillon

I hate it when you give us a setup to talk about our strategy. But you did, so I will. Our strategy actually is pretty simple. It's been the same now for a long time. It's really trying -- genuinely trying to recognize that our earnings growth comes from better sales at Kroger. And our better sales come from connecting with customers better than we previously did. And so, we're focusing all of our efforts on trying to do that. We know we need to find a way to afford to do that. And so the way we have chosen to try to afford to do that is reducing costs and reinvesting those in the things that we discussed a little earlier. I think that's the story going forward. I think that's what you'll see the rest of this year from us. I think that's what you'll see for several years and to the future from us.

J. Schlotman

Scott, the only thing I'd mention is when we talked about market share in March, keep in mind there's been 40% share available held by none of what we call, large players in those markets. And driving some of that year, every year is clearly part of our strategy. And with that amount of share available in the markets we operate, we think we have the ability to continue to grow in our markets.

David Dillon

And I think that's -- I'm glad you added that, Mike. That's a really important concept as there is a lot of business out there and we don't think of it as s sum-0 gain. We look at our customers who are in our stores already and the amount of business that they don't give us for a variety of reasons. Sometimes we're not convenient. Sometimes we don't carry the item they want, lots of other reasons. But for whatever reason, there's a large amount of their business that they don't give us that they could give us. And we're focused on trying to improve on that. And we think we could grow our IDs at meaningful numbers for a long time and not run out of runway on that theme.

Operator

And next question comes from the line of Adrianne Shapira with Goldman Sachs.

Stephen Grambling - Goldman Sachs Group Inc.

This is actually Stephen on for Adrianne. Just had quick follow-up on kind of the consumer spending patterns that you're seeing and any kind of color that you could give us on the bifurcation between your lower-end consumer, the value points versus the higher-end consumers within the dunnhumby data that you look at?

Rodney McMullen

If you go back and look for most of the first quarter, clearly, the behavior of higher income customers, they were spending more and changing the behavior more than the lower income, was continuing, really focused on their budget. If you look at recent data, and that's the just the last few weeks, we're starting to see some behavior changes even in the higher-income customers. And a lot of that is driven by our stuff is showing people are eating out less. Now, obviously, when people eat out less, that's a benefit for us because they're going to get their meals from us versus going out to a restaurant. And we're starting to see that behavior change and we're starting to see that behavior change in all categories, not just the lower-income customer. One other thing on lower-income customers, if you look at like food stamps and WIC and those types of things, they continue to grow but not quite at the same level it was growing, which would be something that's on the other side, where it would suggest things are getting a little better. But during the quarter, we actually are beginning to see some changes later in the quarter which has caused us to make some of the comments we have. But even with that said, we think we're very, very well positioned to address if it ends up becoming a little softer because of our convenience store and our bigger value we offer for the customer.

Stephen Grambling - Goldman Sachs Group Inc.

And just as a quick follow-up to that question. So as gas prices have come down at the end of the second quarter, would you expect that to reverse? Or I guess you're not seeing that yet. I guess just any kind of thoughts on how that could change as gas prices come down?

Rodney McMullen

As you know, we've been in the Gas business for years. And we found one of the smartest things to do on gas is never predict it. And what we've -- when we look at the business overall, what we're really focused on is trying to add convenience for our customers to make it just a little easy for their shopping trip. We, seriously, we do not try to predict where gas prices are going to go because I get a kick out of, what was it, 3 weeks ago, I cut out a headline where gas prices are going to $5 a gallon. And then I think, it was yesterday or day before, the headline was that gas has hit its high point and it's going down from here and this is by very reputable newspapers that are making those comments. So we really don't try to predict. The only thing we do know is it will be volatile. And at the end of the day, volatility actually helps us but it's no fun along the way.

Stephen Grambling - Goldman Sachs Group Inc.

Okay. Thanks for the color.

Operator

Our next question comes from the line of Karen Short with BMO Capital.

Karen Short - BMO Capital Markets U.S.

Just to clarify on that last question in terms of you saying that the higher income customer looks like they're changing their behavior or they just started to change their behavior a little bit? I guess I'm not clear. Is that to your benefit or not? Because it sounds like you're implying they were maybe trading back into you from eating out?

J. Schlotman

That's just beginning, and it's one of those things -- when you get so much information, at some point, you don't know whether it's just a blip for a few weeks or if it's a trend change and that's the reason why we're a little cautious on it. At the end of the day, we think it will benefit us. But if it actually happens, we do think at some point behavior will change. And if you think about if inflation got stronger at some point, people are going to stop having as much money to spend on food, some of those kind of things. But it's early on. So we didn't want to try to suggest that it's a complete trend change, but there's just a couple of things that would cause us to pause that we thought would be important to point out.

Karen Short - BMO Capital Markets U.S.

Okay, and sorry the middle- to lower-income customer, you would say, has taken a step down?

David Dillon

No, they really haven't changed behavior but they never changed behavior as the economy got better either.

Karen Short - BMO Capital Markets U.S.

Okay. Got it. And then just to clarify, when you are talking about competitors passing on inflation, does that in include Wal-Mart?

J. Schlotman

Yes, we would not separate any specific competitor. When we look at it, we look at competitors of the basket overall and individually, so we would not separate any competitor out from the rest.

Karen Short - BMO Capital Markets U.S.

And then I guess obviously, there was a lot of noise with price increases that kind of took place more specifically in this quarter. Did that have any impact on your strategy from an investing and price perspective? Because I mean, obviously, the selling gross margin, we look at it on a 2-year basis, but I'm just wondering if you maybe held off a little bit this quarter just because there was too much noise with pricing?

David Dillon

There would certainly be categories where we modified our approach based on what was happening from an inflation standpoint. And in some cases, that might be changing what we did earlier, some cases, it might be waiting later to what we had planned to do, but there's no doubt we changed our strategy. And as you know, that's one of the things we try to make sure we keep the flexibility and modify as we go along from a tactical standpoint.

Karen Short - BMO Capital Markets U.S.

Okay, and then I guess turning to more financial-related questions. On your share repurchase, obviously, you did quite a bit of share repurchases this quarter and you still have some left on your existing facility. But what are your thoughts on increasing that amount during the year?

J. Schlotman

We have $600 million left, so I think we have a bit of a runway before we would need to worry about addressing that question with our Board. And as we said, we do expect to use the $1 billion this fiscal year.

Karen Short - BMO Capital Markets U.S.

Okay; and then on the tax rate, I was just wondering what -- you raised it a little bit. Is it probably to 36% or something?

J. Schlotman

That's just that our current estimate of where we think the year is going to be, as you look at all the ins and outs on the tax rate, it wasn't dramatic. It's just a refinement of what we believe the effective rate's going to be.

Operator

Our next question comes from the line of Mark Wiltamuth with Morgan Stanley.

Mark Wiltamuth - Morgan Stanley

I wanted to ask about how the inflation built into your comps for the guidance because previously, you were thinking 1% to 2% inflation with a 3% to 4% comp. And now, you think inflation will be 3% to 4% but the comp guidance is only 3.5% to 4.5%. Are you building in some cushion in case volume slows?

Rodney McMullen

The way we do we would estimate inflation -- the estimated inflation number is really a point in time estimate. So it's not the average for the year that we expect a higher rate. It's really the point in time estimate. And it's more driven on terms of how we use it for our LIFO reserve. If you look at the average for the year, it would not be as high. What we find is that inflation within our business always lags in terms of, as it flows through. But it happens, it just lags a little slow. I don't know, Mike or Dave.

J. Schlotman

No, I agree with you. The other thing we keep in mind, Mark, is we are cognizant of -- as we went through the recession and there was mixed change because of the recession and some inflation that our tonnage stayed very strong but the price points people traded to were a little bit lower which could affect reported IDs. But the underlying health of the business, we would expect to stay there and that weighed on our mind, as well. And I want to go back again and remind you that the first quarter for grocery was just over 2% without milk. So 1/2 of our sales still are not very far outside that original 1% to 2% expectation range.

Mark Wiltamuth - Morgan Stanley

Okay, and is the 3% to 4%, is that what you expect to be by the end of the year is what you're saying?

J. Schlotman

Correct.

Mark Wiltamuth - Morgan Stanley

Okay, and then just to switch topics a little bit. We've seen a lot of news in the headlines about change in the debit card fees. Could you talk about what that could mean for you? And would you pass it through to the consumer, or would you let it flow to the bottom line.

David Dillon

Well, debit card fees, we've talked a lot about credit card and debit card fees in the past. You know that the overall fees have been challenging to the industry and us in particular. We view it as an expense of the business, part of our OG&A. And as we find ways, even if it's the legislature that helps us, as we find ways to reduce our costs, it is our intention to take those costs saved and invest them in things that matter to the customer. So the answer is yes, we plan to pass that through in one form or another in ways that matter to the customer.

Mark Wiltamuth - Morgan Stanley

And any way of quantifying how big that could be? Is it going to be a big reinvestment for the customer?

David Dillon

We don't have an estimate that we want to make public at this time.

J. Schlotman

Yes, and the other thing to remember on the credit card side, we have increased usage of credit card which to that extent continues to grow. So it's just not -- you got to look at the total together. You can't just look at one piece by itself.

Mark Wiltamuth - Morgan Stanley

How much of your tender is debit card swipe right now?

J. Schlotman

It would be a meaningful percentage but it's highly variable across the country. So -- and it's the type of highly variable across this country. So what do they say, all short statements and economics are wrong. And it's one of those things where really is very high variance across the country.

Operator

Our next question comes from the line of Chuck Cerankosky with Northcoast Research.

Charles Cerankosky - Northcoast Research

I want to look at a couple of the smaller parts of the business, but I think it might be telling how do the C-stores do? And how did the jewelry stores do? And maybe you could talk about the customer behavior in the jewelry stores. And also, have you -- could you report a supermarket gallon growth -- gasoline gallon growth number on this call?

David Dillon

On the C-stores, a good quarter. About 1/2 or -- between 1/3 and 1/2 of our C-store divisions overlap with our supermarket. So they really are tying together where we go to market together as one entity rather than 2 separate companies, which I think is helping provide customers a bit better value. So overall, a good quarter. The numbers wouldn't be that much different than the supermarket side from a gallon growth or that type of stuff. On jewelry, I would say the thing on jewelry is it's volatile from week to week. Overall, it was a solid quarter, I wouldn't have said a great quarter but a solid quarter but volatile across the quarter.

Charles Cerankosky - Northcoast Research

So what does that tell us about customer behavior, Rodney?

Rodney McMullen

It's a good question, Chuck. I think what it's telling you is that customers are still awfully nervous. But when they get a little money in their pocket, they want to do something. Or if there's an event, they want to do something. And it's trying to make sure that you're ready when the customer wants to do the something. I still think they're cautious but they've done without for so long, they do try to splurge when they can.

Charles Cerankosky - Northcoast Research

All right. Any numbers you can give us on same-store gas gallons at the supermarket?

David Dillon

You asked about the gallons, and the gallons in supermarkets and C-stores, the ID stores were both positive, in low single digits, I guess.

J. Schlotman

C-stores were low single digits. Supermarkets would be mid-single digits but pretty close to one another, depends where you want to draw the line on low and mid.

David Dillon

And the importance of that I think is that based on everything we read anyway is that the gallon usage across the U.S. is essentially flat. And that suggests we're growing share in our ID stores, so that we're very pleased with that.

David Dillon

Well, before we end the call today, I would like to share some additional thoughts with all of our associates who we encourage to listen on. First, I want to thank you for your contributions to a solid start to a new -- to the new fiscal year. You continue to delight and connect with our customers, and you achieved outstanding cost control in the first quarter. Your actions everyday make a real difference.

I also want to recognize associates in several retail divisions for their heroic efforts during the recent severe storms. For example, in Paducah, Kentucky, a team of nearly 100 associates and customers built a levy around our Kroger store #414 to keep water from rising and flooding the store.

When tornadoes hit Huntsville, Alabama, our store and logistics associates along with manufacturing and facility engineering and many others kept our stores opened and stocked even without power and without hot water, for customers who need food and supplies in the town that was in serious trouble.

And our team at Dillon stores 105 in Joplin, Missouri also deserve special recognition, led by our co-manager, John Gallahue [ph], 35 associates and customers took shelter in the produce cooler when the tornado swept through the community. Remarkably that produce cooler was about the only part of the store left standing after the storm passed. John and his team had just a few minutes to react, and because they had implemented the emergency procedures they were trained for, every person in the store survived.

Many other locations had impacts, too long to list here, but it included places like Cleveland, Tennessee and others who should be recognized. So we want to express our deepest appreciation to all our associates who helped respond to these storms and to serve our customers through this difficult time. And frankly, we're looking out for each other. You are truly great people. Kroger is an amazing family. That completes our call today. Thank you all for joining us.

Operator

Thank you for attending today's conference. This concludes the presentation. You may now disconnect and have a great day.