The Kroger (NYSE:KR) Q2 2011 Earnings Call September 9, 2011 10:00 AM ET

Executives

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

Rodney McMullen -

J. Schlotman - Chief Financial Officer and Senior Vice President

Unknown Executive -

Cindy Holmes - Director of Investor Relations

Analysts

Edward Kelly - Crédit Suisse AG

Meredith Adler - Barclays Capital

John Heinbockel - Guggenheim Securities, LLC

Scott Mushkin - Jefferies & Company, Inc.

Karen Short - BMO Capital Markets U.S.

Mark Wiltamuth - Morgan Stanley

Alton Stump - Longbow Research LLC

Deborah Weinswig - Citigroup Inc

Charles Cerankosky - Northcoast Research

Operator

Good day, ladies and gentlemen, and welcome to the Second Quarter 2011 Kroger Co. Earnings Conference Call. My name is Janita, 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 turn the conference over to your host for today, Ms. Cindy Holmes, Director of Investor Relations. Please proceed.

Cindy Holmes

Thank you, Janita. 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 second quarter press release and our prepared remarks from this conference call will be available on our website at www.thekrogerco.com. After our prepared remarks, we look forward to taking your questions. In order to cover a broad range of topics from as many of you as we can, we ask that you please limit yourself to one topic with one question and one follow-up question if necessary.

Thank you. 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. With me today to review Kroger second 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 pleased with Kroger's strong performance this quarter, which we believe is the outcome of our consistent approach to managing the business and executing our Customer 1st strategy. Our ongoing investments in the 4 keys, or people, products, prices and shopping experience, continue to enhance our connection with customers and drive positive identical sales growth.

Identical supermarket sales for the second quarter increased 5.3%, excluding fuel. This is Kroger's 31st consecutive quarter of positive identical sales growth. These industry-leading results are due to the efforts of our associates to delight our customers while at the same time, delivering good savings on expenses.

Kroger's second quarter performance was broad based across the country and supermarket departments. Each of our 18 retail divisions produced positive identical sales growth, excluding fuel. Every supermarket department also experienced positive identical sales growth in the quarter with the strongest increases in natural foods, deli bakery, produce and meat.

Overall, the second quarter results reflect the balance we strive for in our business. We want to consistently deliver value to both our customers and shareholders. Despite the stagnant economy, our sales grew, tonnage remained positive and both total and loyal household counts are up. Fuel performed better and we maintained good cost control.

In keeping with those solid measures of our performance, we also delivered earnings and earnings per share growth right in line with our internal expectations. In March and again in June, we discussed 5 external factors that are shaping the overall operating environment this year. I'd like to briefly update you on how we're managing our business in the context of these 5 factors.

First, the sluggish economy continues to strain household budgets while increasing consumer anxiety. In fact, customers tell us their expectation for the economy are more pessimistic now than at any time this year. And for the first time, customers list instability of the financial markets as one of the top economic concerns. These examples illustrate how consumer sentiment changed during the quarter and are important because most discretionary spending is based on what people feel or perceive about the economy.

Second, food and fuel prices increased again this quarter. In June, Rodney noted that we were beginning to detect slight changes in consumer behavior due to the increased variability of the economy and food inflation. We read this shifting sentiment correctly, which played out this quarter. Our market share continues to grow as we benefit from the credit customers give us for the investments we've made and continue to make to lower the overall pricing of items in our stores. Rodney will have more to say about how food inflation is affecting shopping behavior shortly.

Third, the overall competitive retail environment is rational and our price check show that most competitors are passing higher costs onto consumers, particularly in the center of the store. There are some exceptions to this. One example is produce. During the quarter, retails did not rise at the same pace as costs because of the shortages in product due to the late growing season.

Fourth, in the last quarter, we told you we expected to see an increase in pension and healthcare costs for this year. The increase will be slightly less than originally projected, but remains a significant challenge.

And finally, during the second quarter, our retail fuel operations generated higher earnings per share compared to last year. Fuel is an important part of our business and as you know, has a high level of variability.

We'll continue to follow our business strategy and make adjustments as needed to manage these factors which, along with our commitment to Customer 1st strategy, are having the most impact on our business over the course of this year. The goal of our Customer 1st strategy is to consistently reduce the overall cost of running our business, and do it in a way that does not negatively impact our customers. And then reinvest those savings in our customers to drive higher sales, which in turn will increase earnings. Our strategy generated positive momentum and financial results that met our goals in the second quarter.

Rodney will now offer some insight into Kroger's business trends this quarter. Rodney?

Unknown Executive

Thank you, Dave. And good morning, everyone. The customer is going through a lot of change right now, and we are doing everything we can to minimize the impact on them of higher food costs. Dave just discussed how we are working our strategy in the context of the broader operating environment. Associates are working hard to cut cost and we are finding ways to help customers save even as product cost increases are passed on. We estimate we have lowered our customer's shopping bill by $2.1 billion per year. Also in keeping with our strategy, as it became clear during the quarter that the $0.05 earnings per share tax benefit was coming, we accelerated several investments in our 4 keys.

Looking at quarter and year-to-date results, we have made many investments to deliver value today and invest for the future. One of the most important measures of our business is loyal household growth because it lets us know how well we are connecting with our best customers. Loyal household growth is also a convincing indicator of the strength of our Customer 1st strategy because our best customers are the primary beneficiaries of the investments we are making in our 4 keys.

For the quarter, our loyal household count grew at a faster rate than total household growth, which is also up for the quarter. Similarly, we achieved positive identical sales for both total household and loyal households. Identical sales growth among loyal households was stronger than the total household result.

While customers visited our stores slightly more often this quarter, they are purchasing smaller baskets on each visit. Price per unit was higher in the second quarter compared to a year ago, reflecting the effect of price increases from our vendors. I'll talk a bit more about how we're managing through that in a few minutes.

Sequential improvement in identical sales was driven primarily by the combination of more households and higher price per unit. Kroger saw a slightly positive tonnage growth for the quarter compared to last year. This is significant in light of the factors Dave discussed earlier and the trend towards smaller baskets for the quarter. We continue to balance tonnage growth with the pass-through of higher product costs.

In the second quarter, corporate brands share grew more than national brands. Corporate brands represented approximately 27% of grocery department sales dollars and 34% of the grocery department units sold. These figures compare to 26% and 34%, respectively, for the second quarter last year. When you look at these trends compared to our first quarter results, corporate brand dollars and total units each increased by 100 basis points.

Our multibillion dollar corporate brand portfolio is a competitive advantage because it gives our customers more choices and variety and value to complement the broad assortment of national brand products we offer. This is particularly important today as many shoppers continue to watch expenses and look for quality items at affordable prices.

In addition to assisting customers on their quest for value, we also want our corporate brand products to appeal to a diverse customer base. We do this by providing the right products at the right price in our stores and also by communicating with our customers in the right way for them.

We launched our first bilingual website, comfortsforbaby.com, this quarter. The website provides parents a choice, a place to discover the high-quality products offered under the Comforts brand, and the Spanish language version of the site even includes content specifically tailored to Hispanic parents.

We are also expanding our selection of Big K brands soda flavors to appeal to diverse customer taste. We are launching several new flavors based on customer feedback including apple, pineapple, passion fruit, watermelon, kiwi, blackberry, citrus and mandarin.

As Dave said, rising food costs are affecting consumer behavior. While our estimated product cost inflation, excluding fuel, was approximately 5.2% for the quarter, we were able to slightly increase our $0.01 profit per item in the grocery category. Rising product costs continued to affect all departments. Inflation continues to be higher in our perishable department, including meat, produce and especially seafood.

Last quarter, we were beginning to read the shift in consumer sentiment, which translated into more obvious behavior changes this quarter. Customers are even more value conscious when they shop, are buying smaller baskets and are selecting some lower cost items, including our low -- our corporate brand products. This has made the value we offer our customers through lower every day prices, weekly promotions and personalized rewards to loyal households even more compelling. We will continue to pass along product cost increases from suppliers. At the same time, we will continue to invest for the future in pricing, people, products and customer shopping experience.

We continue to make good progress in our sustainability efforts. I am pleased to announce that 7 of our manufacturing facilities have achieved their goal of sending 0 waste to landfills. Zero waste means that every ounce of raw material that arrives in a plant is either used for product, turned into energy or recycled by our associates. we're all very proud of these plants.

Turning now to labor relations. We have a number of unsettled labor contracts currently past their original expiration dates, including negotiations in Southern California and Southeastern Ohio and with the Teamsters at our distribution center in Washington state. These negotiations are challenging because of our efforts to manage the increase of healthcare and other costs, a sluggish economy and our need to compete against non-union retailers with lower cost structures are contributing factors as well.

Our objective in every negotiation is to find a fair and reasonable balance between competitive cost and compensation packages that provide good wages, high-quality affordable healthcare and retirement benefits for our associates. We are hopeful that both sides will continue their hard work to find mutually acceptable solutions. Contracts in Charleston, West Virginia area and the Memphis area are set to expire during the third quarter.

Now Mike will discuss our second quarter results and Kroger's financial strategy in detail. Mike?

J. Schlotman

Thanks, Rodney. And good morning, everyone. As we reported earlier today, Kroger's second quarter net earnings totaled $280.8 million or $0.46 per diluted share. Net earnings in the same period last year were $261.6 million or $0.41 per diluted share. Both the current and prior year quarters benefited from certain tax adjustments. Without the benefit of these adjustments, earnings per share would have been $0.41 in the second quarter this year and $0.38 in the second quarter last year. This 7.9% increase is consistent with Kroger's expectations for the quarter, and long-term earnings growth expectations of 6% to 8%.

FIFO gross margin, excluding retail fuel operations, decreased 53 basis points. This decline was mostly offset by improvements in our OG&A rate of 20 basis points, rent of 6 basis points and depreciation of 10 basis points. Our FIFO operating margin therefore declined 17 basis points. Our LIFO operating margin without fuel declined by 30 basis points due to the 13 basis point effect of our higher LIFO charge. The reduction of 20 basis points in OG&A demonstrates the leverage of our strong identical food store sales and cost control efforts in the face of rising credit card fees, pension and healthcare expenses.

Also, as a result of current expected operating performance for the year, our incentive plans are estimated to pay off at a higher rate than last year. Collectively, credit card fees, pension, healthcare and incentive plans have increased 30 basis points with incentive plans being the largest of these. Additionally, we increased our general liability reserves and incurred warehouse startup costs, which together, increased our OG&A rate by 10 basis points.

We continue to believe it is most beneficial to look at operating margin over an annualized timeframe. Excluding fuel on a rolling 4-quarter basis, the company's operating margin increased 10 basis points. For the full year, we expect the operating margin change to be less than this.

Kroger's retail fuel operations in the second quarter earned approximately $0.174 per gallon compared to $0.143 in the same quarter last year. For the latter half of the year, we expect margins of approximately $0.115 per gallon.

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 our shareholders both today and in the future. During 2011, Kroger is using 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 $428.5 million for the second quarter compared with $402.5 million for the same period last year. We expect capital investment for the year to be slightly above $1.9 billion, excluding acquisitions and purchases of leased facilities.

Kroger saw a strong improvement in working capital during the quarter. We have implemented systematic improvements that will advance our progress in this area. In addition, higher fuel cost has helped us improve working capital by $152 million. We also saw a strong EBITDA return on net operating assets or ERONOA of 19.91%, which is an increase of 106 basis points from a year ago. This is the metric we use internally to measure our operating units. It represents rolling 4 quarters EBITDA divided by net operating assets, and we are very pleased with the increase in this important metric.

During the second quarter, we invested $258.6 million to repurchase 10.6 million shares of stock at an average price of $24.30 per share during the quarter. At the end of the second quarter, approximately $403.4 million remain under the $1 billion stock repurchase program announced in March of 2011. Since the end of the quarter, Kroger has purchased 4.5 million shares of stock at an average price of $22.87 per share for a total of $103.5 million. We expect to use the full billion dollars during fiscal 2011.

Net total debt was $6.9 billion, a decrease of $49 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 1.71 compared with 1.87 during the same period last year. Based on the second quarter results, we are increasing our identical supermarket guidance for fiscal 2011. We now expect identical supermarket sales growth, excluding fuel of 4% to 5% per year. The previous guidance range was 3.5% to 4.5%.

Kroger maintained its full year earnings guidance of $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. We continue to expect product cost inflation to be in the range of 3% to 4% for the year. 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 consumer spending, the competitive environment, higher pension and healthcare costs and retail fuel margins.

Our long-term growth model is to generate 6% to 8% annual earnings per share growth over a rolling 3- to 5-year time horizon, including the dividend yield of 1.5% to 2% to total shareholder return rate into the 8% to 10% range. We aim to produce this with less volatility than the S&P 500 over that same timeframe. We are not opposed to a year occasionally exceeding this range, which is what we expect to deliver in 2011.

Now I'll return it back to Dave.

David Dillon

Thank you, Mike. Kroger had a solid quarter because our associates delivered strong results in line with our Customer 1st strategy and consistent with our expectations. The economy is sluggish, one of Kroger's strengths is our insight into our customers. As a result, we're able to adjust our offerings to meet the customers' changing needs. Whatever the environment, our Customer 1st strategy will maintain the right balance for our customers and shareholders, growing customer loyalty and delivering earnings and earnings per share growth consistently. We will continue to deliver value today and invest for the future.

Now we look forward to your questions.

Question-and-Answer Session

Operator

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

John Heinbockel - Guggenheim Securities, LLC

A couple of things. Can you shed a little more light on the accelerated investments? I know you're not going to say specifically, but generally speaking, where did those fall? And is that sort of an acceleration heavily weighted toward the quarter, or something that's going to be ongoing at that rate in the back half of the year?

David Dillon

John, these were investments that we often talk about in investments we make with the customers, things that we think will appeal to them. They are investments that we had planned to make at later times in the year that will be ongoing. We simply moved it up a little bit in time.

J. Schlotman

And the items that were selected based on the work that was done with dunnhumby as it always is in terms of identifying what's most important to the customer and the environment that we're in, and making sure those match against what the customer desires are.

John Heinbockel - Guggenheim Securities, LLC

So that was all in FIFO gross, x fuel FIFO gross. And the -- so down 53 is not necessarily representative, some of that was pulled forward. Because I guess the other question is, are there any other issues with timing of pass-through? It doesn't sound like that's as much of a problem.

J. Schlotman

In the prepared comments, one of the things, it's one of the reasons we want to make sure, if you look in the grocery department, the profit per item actually improved slightly during the quarter. And we thought it was really important for everybody to understand that we were able to pass those cost increases through. And we actually, if you look at profit per item, it's slightly improve. It's not huge, but a little bit. Obviously in periods of inflation, the inflation itself will drive a little lower margin.

John Heinbockel - Guggenheim Securities, LLC

And then I guess as a follow-up to that, you talked about the sort of state of the consumer. Last time, you have talked about where the higher end consumer was thinking about eating out less, pulling in a little bit. Has that continued with that higher end customer getting more skittish?

David Dillon

Well, the customers obviously are segmented in this kind of the economy even more maybe than normal. And we're seeing that the higher end, more affluent customers, we're seeing their behavior actually continue pretty much what we've seen in the first quarter. So we're seeing good solid growth in areas that you might expect, same things we identified last time. Things like organic produce and sushi and Starbucks and Boar's Head meats and some of those areas are all performing solidly and continue to do so.

Rodney McMullen

And that customer is behaving as we would hope. But they continue to tell us they're more and more concerned about the economy, the stock market and eating out less. So what they're doing and what they're saying is a little inconsistent. But usually, eventually, it will catch up with what they say.

John Heinbockel - Guggenheim Securities, LLC

And then just one more final thing. How do you guys analytically get your arms around -- sentiment has nothing to do with the economy, it has to do with grid lock in Washington and stuff like that impacting the consumer and how long it lasts and how that alters their behavior. Is that possible to analytically get your arms around that or not really?

David Dillon

Well, first, don't get me started on that. This group's holding me back because I have some rather strong opinions on the subject. But the point you're really making is that we don't need to be economists to try to understand what's happening with the customers. We need to ask our customers, and we need to look at their actual behavior as it shows itself in the store. And by trying to do that, while there's not a way to quantify it with great precision, you can get a pretty good feel. And we've tried to give you some color to that, give you a sense of what we're seeing and I think we've done that. And I think, actually, I feel very comfortable that we have a good feel for what our customers go through. Part of it is driven really by our own associates who live every day in the communities that they serve. They themselves go through the same kinds of feeling, and then they of course live it through their own friends, neighbors, family and everyone else. And that gets reflected back in our thinking as well as the dunnhumby data, as well as the panel work that we do with our customers.

Operator

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

Deborah Weinswig - Citigroup Inc

So number one, can you remind us how you define a loyal household?

David Dillon

Rodney?

Rodney McMullen

It's a combination of number of visits and how much a customer spends. And some customers will come every day, other customers will come once every 2 weeks. Both can be loyal, and it really depends on their behavior and activity. And then we've done an awful lot of work of understanding where else they shop to understand how loyal they are to us versus other retailers.

David Dillon

Think of it as a grid that you have -- as opposed to metrics that go together to determine whether they're classified as loyal.

Deborah Weinswig - Citigroup Inc

And as you've obviously seen this change in shopping behavior, can you maybe provide some insights in terms of the more personalized reward program?

J. Schlotman

Well, if you look, it's something that we measure obviously every time we make a one-on-one marketing decision. Customers continue to react better and better in terms of as defined about their editorial feedback they give us and the actual usage of what we do on a targeted basis. Now we've been doing this for, I don't know, I guess 6 years now. And if you look at the trend over time, we've had tremendous improvement in terms of being able to engage with the customer in a way that they appreciate and need better and better. And it's something that every quarter we get better, but we're constantly working with dunnhumby and our merchandising teams to figure how to even get better from where we are.

Deborah Weinswig - Citigroup Inc

Okay. And then I just wanted to elaborate onto one of John's questions. But the 53 basis points in terms of the investment that we saw this quarter with regards to gross margin, we shouldn't think of that as being consistent over the next 2 quarters for this year, is that correct?

David Dillon

I would look at -- what we've tried to do is try to look at where we are in balancing investments in gross margin and money that we save in our overall expenses. And so it's that combination which produces the operating profit, is the way we think about it. And this quarter is a little unusual, frankly, and that's why we actually gave more color than usual. Because while the investment in gross was partly driven by when you have periods of high inflation, you're going to naturally have some of that, and then of course some of the things that we've done and chosen to invest. But the second thing is and we identified a lot more color on this was the various components of our OG&A and other expenses. We tried to show you that because there were several items that are unusual. And I won't call them onetime items, but I would call them things that aren't necessarily reoccurring. And examples of that is the incentive pay, is a good illustration, because it was a particularly low last year. And we're accruing based upon what we have given you as guidance for the year this year. So if we produced those results, then the expenses we've shown will be true. And if we don't produce those results, then we'll back some of those expenses out in later quarters. So if you take things like incentive pay, if you take some things like the additional accrual, general liability or the logistics expenses that we identified, you actually have much more savings in OG&A. The 20 basis points, in my mind, was the bigger issue and it was lower than it should have been. But if you take those other issues into account, it actually ended up being a higher number. So the difference between our gross investment and the expenses in the quarter was, in terms of our ongoing business, was much narrower than these numbers imply.

J. Schlotman

And the focus, as Dave has mentioned, the focus is really making sure we balance the OG&A reduction with the gross margin change. And if you look at the second quarter, as you look forward, we're working really hard to make sure that those stay completely in balance. There were a couple of unusual situations in the second quarter that made that difficult and that's what Mike highlighted.

Operator

Your next question comes from the line of Ed Kelly with Credit Suisse.

Edward Kelly - Crédit Suisse AG

Can you guys tell us what you're selling gross margin was this quarter? I know that you omitted that from the press release this time around.

David Dillon

Yes, it was down 78 basis points. We had a really good solid expense control and some of the expenses that are embedded in the gross, in particular shrink really had a good performance. We didn't use it because we actually think it's -- we think it's more relevant for the way you all look at the business to look from the gross profit and the OG&A and the other expenses and then the operating profit. But you're certainly welcome to it.

Edward Kelly - Crédit Suisse AG

Okay. And I'm just trying to understand what you're saying about the pulling forward of price investments. Because I look at your guidance, right, and your guidance hasn't changed, but the tax rate is obviously going to be lower because of what happened this quarter, which would imply that you're doing more than just pulling forward some price investments. I mean it would seem to me like that means that you're investing a bit more than what you would've thought last quarter. So what am I missing?

David Dillon

Well, if you look at what we would've had in our internal estimates or budgets, there may have only been 4 periods, or 5 months or 6 months of pricing investments. By moving them forward, we'll end up with 9 or 10 months of expense this year. And some of that will be additional expense in the dollars in 2011. Now the flip side, most of the things that we find, the lines would cross where the gross profit dollars actually improve over time. And those are the things that we would expect that would happen in 2012. So that would be one of the reasons for not the change in the adjustment. The other thing is, remember, a year ago we also had a tax credit over change in reserves that helped a couple of cents, too. And we had one in the third quarter as well.

Edward Kelly - Crédit Suisse AG

Okay. And can I just ask about the decision to invest the tax savings into lower prices? And the reason I'm asking this question is because you look at this quarter and your IDs grew 5.3% yet EBITDA was up only 2.7. And last quarter it was 4.6 and EBITDA was up 11.6. And historically, you've had a lot of volatility, I should say, in these numbers, which is frustrating investors, I think, right, because you look at your stock today and what it's doing. And I guess the real question is, how do you balance the decision to pull forward investments and the near-term volatility that creates versus what it's going to get for the business as well as what you're looking to do for shareholders? And then also, how confident are you that you're going to get the return on this investment? The return in my mind would be that, going forward, the EBITDA growth would be better than ID growth maybe in the back half, and should we think about it that way?

David Dillon

Well, it may help you to know that our bonus plan, mine specifically but all of ours, is based upon, in part, based upon EBITDA. So you know that we pay close attention to that number. So that's the first thing I would tell you. Second is that we look at this over a longer time span. I don't think a quarter timeframe gives you a good enough feel generally. Sometimes it does, but generally doesn't give you enough feel for market. And one thing that we have tried to do, in fact I'd have to say -- I would want to say that we pride ourselves in doing, is try to give you an objective, as objective as an insider can give, an objective view of what we really think is happening inside our business. And that's the reason we tried to add some of this color about what was happening with the expenses because I actually feel the quarter was quite solid. I am very pleased with the way it balanced out. There were a couple of anomalies that were raised some concerns that you mostly addressed. For instance, we got the benefit of tax on one hand. We did choose to advance some spending on some items that was going to happen anyway, it's just a question of when we chose to put it in place. And we thought we'd get some benefits this year by going ahead, and we wanted to try to get those benefits in the second half so that's why we got started a little earlier. And then we had some expenses that were really the kind of that don't reoccur. The logistics expense, the general liability we've already mentioned. And then of course the incentive, if we had a decent year last year the comparison wouldn't have been as great. And then I haven't even mentioned the LIFO at all. But when you add up a sharp turn in inflation compared to where we were last year, if I can remember right, I think in the second quarter last year we had a deflation in grocery, I believe.

J. Schlotman

A little inflation. Very slight.

David Dillon

Slight inflation. And as a result, it was a totally different picture, so we had a big increase then in the LIFO charge this quarter, too, which as you know, just an accounting entry. So I feel better about it than what I think you're describing. And I would look at a longer-term horizon than just a single quarter and take the first quarter, second quarter and third and fourth and look at our guidance.

Edward Kelly - Crédit Suisse AG

Okay. So if in the back half we see some re-acceleration in EBITDA growth, that would suggest that the investment was worth it, and if we don't, then maybe not?

David Dillon

Well, I think the thing I would judge based on is what happens with our sales, what happens with our household growth and then what happens with earnings per share. If we hit the guidance that we've given you, and that's what we're saying we believe it will achieve, and we think that will be a quite solid year particularly. In any year, I think it'd be a quite solid year, but particularly given how sluggish the economy is.

Operator

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

Scott Mushkin - Jefferies & Company, Inc.

I just wanted to check on my notes here. Did you say cost inflation ran 5.2 in the quarter, and it's going to decelerate to the 3 to 4 rate? Did I get that right?

Rodney McMullen

Yes, we said it was 5.2 in the quarter. We still expect for the year to be 3 to 4. And remember those numbers are year-on-year. And when you go back, we started seeing some inflation late last year.

Scott Mushkin - Jefferies & Company, Inc.

So this goes to kind of the meat of my question. In the back half of the year, I guess, kind of inflation expectations cost. And also, if we could get some thought on just the cadence during the quarter and how the current sales run rates are. And it sounds like the consumer weakened up quite a bit maybe through your quarter, and maybe some current tonnage thoughts?

David Dillon

Well, I'll give you a few observations. First is the sales had some, I would say, modest growth through the quarter period to period to period. My personal opinion is that was driven more by the change of inflation and the change of retail pricing than it was driven by greater activity by the customer. So start with that. Second is if you look at the quarter so far and we're into this current quarter by what, 3 weeks?

J. Schlotman

And a few days.

David Dillon

Yes, 3 and a few days, and we are running in sales approximately the same as to what we did last quarter. So really, you'd have to say so far this is consistent with the trend we saw last quarter. As per tonnage, tonnage was positive. It was slightly positive. It wasn't strongly positive. And I think that's a clear result of higher pricing and people are buying fewer items as a result of higher pricing. And that's true not just with us, but I think that's a universal statement that would be true really with just about every retailer. In fact, my personal opinion is, is that the overall market in terms of if you can put your arms around items that are sold in the overall market, I think those items are down on the whole. And the fact that we are positive suggests, and I think it's absolutely true, is that we're growing market share and the market just seems to be contracting just a bit. So that's how I'd size that part up. We saw a slight shift more in the direction of Kroger brand products, not a big surprise. Sort of a reminder of maybe a year or so ago, maybe 2 years ago, as customers got more concerned about the economy, there was a little more shift towards our products. We're, of course, pleased with that because we think we have outstanding Kroger brand products. So I think that's a thumbnail sketch that I would leave you with.

Scott Mushkin - Jefferies & Company, Inc.

And so you're still currently slightly positive on the tonnage, Dave?

David Dillon

Yes, it will be very similar to what we had in the third quarter.

J. Schlotman

Yes, I don't see it much different right now than what it was in the quarter.

Scott Mushkin - Jefferies & Company, Inc.

And then one follow up. On the onetime expenses that you guys highlighted logistics and a couple of others, were those expected expenses even though they're onetime? Were they expected when you thought about the year or were they unexpected? And then I'll yield.

David Dillon

I'll talk about both of them. The logistics expense, we expected some expense. But we've actually run into some, just system operational issues that we've just got to work through that produced some higher costs. And sometimes logistics projects and other projects like that are really big infrastructure kinds of things and so the dollars can be quite large. But our confidence in terms of what it will ultimately produce is very strong. It's just that we ended up with some short-term costs that we hadn't planned on. General liability is an example. We review those, I think twice a year, actually, we look at them. But midyear every year, we look at where our reserves are and we just found that our reserves hadn't been high enough on some previous year expenses and so we've increased those. You want to add anything to that, Rod?

Rodney McMullen

I mean the general liability is primarily driven by our -- an increase in the cost per claim over what we had been trending and it caused us to raise our reserves for several prior years. So the short answer to your question is the 10 basis points we called out, neither one of those expenses would've been in our original expectations for the year, which is why we did call them out in the quarter. We don't want to make a bunch of excuses, but they are there.

David Dillon

Nor do I necessarily expect them next year.

Rodney McMullen

Right, exactly.

Operator

Your next question comes from the line of Meredith Adler with Barclays Capital.

Meredith Adler - Barclays Capital

I got a couple of questions. Maybe we can just start by talking about inflation in perishables. Everybody we talked to says that the highest inflation, and you said it, too, meat, produce, or the meat, dairy and seafood. And you talked about passing along higher inflation in dry grocery. But what's happening with perishables? I think you said in produce, it wasn't all being passed along? So I'm a little...

David Dillon

Well, I've generally made a big distinction on these calls in discussing inflation between center of the store and the perishable areas. And the reason really isn't so much competitive behavior, but it's because of customer behavior. In the grocery side of things, in the center of the store side of things, it actually is pretty clear-cut. We have been passing that along. I think all of our competitors have been passing that along. You see some tonnage change and the CPG companies, manufacturers and even retailers have to decide what's the right price for the tonnage. And so that's how grocery works out. But the perishables, customers shift what they buy in a nanosecond. I mean walk into produce, just as an example, and if bananas happen to be high this week, you start switching and say, I think I'll buy apples this week. So there are plenty of other things to shift to, so the rate of inflation and where the movement goes is really a totally interesting computer puzzle. And as a result, I would say that, generally, you wouldn't see a direct connection between what we're able to achieve in sales in a department and what happens with the rate of inflation in a department. And I think in produce, for instance, in that case it wasn't so much -- wasn't anything, really, other than the growing season changed. And as a result, product was short at certain points of the time, which meant the pricing was high at certain parts of the time, which meant customers didn't buy that product as much as they would have otherwise. So it ended up being a case where our gross profit in produce wasn't as strong as we thought it might have otherwise been, but for that spike in pricing.

Rodney McMullen

And the only thing I would add, if you expect something to go up in cost for 4 weeks or 6 weeks, many times you won't even -- you won't be able to pass that cost through because if it's going to come right back down in 6 weeks, it just doesn't make much sense to do that, especially if the market doesn't allow you to do that. So you really have to look at each category area specifically for that, and that would be one of the reasons in produce that you wouldn't see the same pass-through there as what you would see in grocery, because if Jiff raises the price of peanut butter, it's going to probably be that way for 6 months or a year or whatever.

David Dillon

Or even 5 years. It's very much more predictable in grocery. I think he's absolutely right.

Meredith Adler - Barclays Capital

Okay. Now I want to go back to what I know is a dead horse, but I'm going to beat it anyway. I'm still confused about accelerating certain investments. I understand what you did, but I'm not sure I understand what it means for the rest of the year. You believe you'll get a benefit in the second half? And do you also mean that you're keeping the amount that you spend for the year fixed, so you moved it up in the second quarter but the full year will be the same?

J. Schlotman

If you look at the total dollars we would expect to spend in investments, we would expect them to increase because you'll end up with 9 or 10 months or 8 or 9 months of dollar investments, where before, we may have only had 4 or 5 months in the budget. So if you look at the dollars that we would expect to invest in pricing for the year, or services in some cases, you would end up with more dollars. In terms of the second half, the expectation, assuming that we picked the right things to accelerate the pricing on, is we would expect first the tonnage will improve nicely as a result of that. Then over time, the gross profit dollars will actually increase. But the gross profit dollars, in terms of them actually increasing, is different for different items, and that elasticity really is different for different categories. And that's the work with dunnhumby in terms of trying to make sure we understand that.

Meredith Adler - Barclays Capital

Okay, and just real quickly. In the past when you've had unusually high margin in fuel, you've seen that as the kind of windfall similar to the tax windfall. Did you look at it that way this quarter?

Rodney McMullen

I mean on the fuel margin, we wouldn't have looked at it any different. As you know, we're much more focused on fuel margin for the year because any particular month you'll have volatility both directions. The fuel margin happened, was better than we expected, a little faster than we expected. We would not expect that to continue going forward.

Meredith Adler - Barclays Capital

You didn't invest that money?

Rodney McMullen

Not really, no.

Operator

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

Charles Cerankosky - Northcoast Research

Can you give us some idea on how gallons performed, fuel gallons performed?

David Dillon

I don't have that in front of me, but they were up.

J. Schlotman

The fuel gallons in total were up. On an identical basis, slightly up, but not as much as what they would have been in the past.

Charles Cerankosky - Northcoast Research

Does that suggest a reduced reaction to the rewards program? Any insight into that?

David Dillon

No, I think it's really more if you look overall everything that we can find, total gallon usage across the country continues to decline. And we continue to gain share. Also we would have some, we'd call it sister store impacts, but obviously impacts when you open a new fuel site on others. Some would also be as we expanded the Shell program, some customers that would've come for us before for a reward would go to Shell if the Shell location is more convenient.

Charles Cerankosky - Northcoast Research

All right, I understand. Looking at your movement of some of these price promotion programs up in the year and higher overall spending, does that mean perhaps that something comes out of fiscal 2012 as a result of this?

David Dillon

We think that everything we do in any given year helps build for the next year, so the answer is yes. And we have -- we've given now, given you our long term kind of forecast of where we see the company. And that's one of the ways we produce continued growth in sales and continued growth in earnings by setting things up to cause the customer to keep coming next year.

Rodney McMullen

Chuck, I want to make sure we're answering the exact question you asked. It sounded to me like you asked the question, does this mean there was something we have planned in 2012 that we're not going to do now because we moved something into '11 so we have less investment in '12?

Charles Cerankosky - Northcoast Research

That's right.

David Dillon

Oh, okay. Well, that's not what I was answering, no.

Rodney McMullen

And I don't think that is what we would expect. We have a, as we've described regularly, we have 12 to 18 months visibility in how we want to invest dollars in all 4 keys of our Customer 1st strategy. And as we move things around, if we have the ability like we did with the tax benefit to move something up to balance our earnings per share growth, we will look at what we want, how we want to balance overall spending in '12 as well.

J. Schlotman

But overall, we would be very focused on consistently delivering the 6% to 8% earnings per share growth plus the dividend of 1.5% to 2% for a total of 8% to 10%. And we would look at what we can do in '12 in the context of making sure that we can deliver that.

Charles Cerankosky - Northcoast Research

And looking at the tax rate as sort of funding, which you did in the most recent quarter, what were you reacting to? Was it a slowdown in the basket size, shrinkage in the basket size as you indicated? Was it something competitive out there that you needed to respond to?

David Dillon

Well, I think it's really 2 things. First is we look at tax like that as certainly not something that is replicable. It's not in our plan to have that every quarter. Love to have it every quarter, but not likely. And so it's a onetime thing, so we would not spend it in something that is new and ongoing. So I wouldn't incur some big new expense in the second quarter that's going to be a big new expense in the third quarter, if the way in which I thought of was going to pay for it was a onetime event. So all we really did was slide earlier some of the expenses that we were going to already be incurring. Second is, I think we read the economy as we've described it. It's sluggish and we thought any extra help that we could give to customers at this time would be appreciated. It was not in reaction to any competitive situation at all. In fact, I think the markets are quite rational right now.

Charles Cerankosky - Northcoast Research

And last question, Mike, you talked about the share repurchase. You plan to use the full $1 billion. Bump this over to you, Dave. Do you see it perhaps going above that this year with the increased board authorization perhaps occurring?

J. Schlotman

Chuck, at this point we have a little around $300 million remaining that we can spend. And we think that's comfortably going to keep us in the market for several months as we go forward here. And at this point, don't see any need to comment on whether or not we would increase the authorization with the $300 million remaining.

David Dillon

I do appreciate the question but that's a discussion actually for our board room, not for this call.

Operator

Your next question comes from the line of Alton Stump with Longbow Research.

Alton Stump - Longbow Research LLC

I guess just one quick follow-up on the pass-through discussion in perishables. Any outlook as you move into the back half of the year if that gets any better with the pass-through, or is that a concern to have for the next 2 quarters continuing?

J. Schlotman

Right now, we would expect probably, it wouldn't be so much the pass-through getting better but the inflation pressures would be a little less. Now if you look at dairy, we would expect a little less inflation there. If you look at produce, we would expect less inflation there. If you look at meat, we would not see much change in meat and seafood. So I don't think it's so much the pressure from pass-through as it's just the cost pressure, on the cost pressure side.

Operator

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

Mark Wiltamuth - Morgan Stanley

So Wal-Mart has made some comments that they'd like to widen the price gap with the grocers. Have you noticed them dragging their feet more on inflation, holding the line while others have raised, or any change in their behavior in the last quarter or so?

David Dillon

Well, Mark, I'm not going to comment on a competitor specifically. The comment we'll make is that we see the market as rational, and we see our competitors have followed a similar strategy to what we have. Generally, they pass through cost increases if they've gotten them.

Mark Wiltamuth - Morgan Stanley

Okay. And with your greater gross margin investment this quarter, did you notice others reacting to your move?

David Dillon

Again, I'd say the market was pretty rational and I would not characterize our gross profit investment as a promotional pricing that would generally cause the market to react. That wasn't our objective and I didn't see that happening.

Mark Wiltamuth - Morgan Stanley

Okay. And then if you look at the overall inflation number of 5.2, what do you think the center of store inflation looks like right now?

David Dillon

Let see. Do you have that in front of you? We'll look that up, but...

Rodney McMullen

Total grocery that includes dairy would be slightly higher than that. With dairy, I think it's probably a little lower than that -- without dairy, I mean. It's probably right at or a little lower than the overall blended rate. It's about 5% without dairy. Now one of the things I want to -- and I'm not going too long into this, I'd be happy to talk about it later. But the inflation number we give out is a volume-weighted calculation based on how our product is sold and bought by our -- or how our customers buy our product. So we volume-weight the way in which a customer buys an item when we calculate the inflation number that we talk about. It's an entirely different inflation calculation than we use for LIFO, which is just purely the cost of product this year and how many items we have this year and last. And I don't know -- a lot of times people want to compare our inflation with other people's inflation, and all I know is how we calculate our inflation. We try to do it based on what our customers are seeing and feeling on how they shop, and I don't know how other people do their inflation calculation. So that's important to keep in mind.

Mark Wiltamuth - Morgan Stanley

Well, some of the other inflation numbers being called out are actual price inflation as opposed to the cost inflation you're calling out.

Rodney McMullen

Right.

Mark Wiltamuth - Morgan Stanley

Okay. I think that's fairly clear. That's it for me.

Operator

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

David Dillon

And I think we'll make this our last question, Karen.

Karen Short - BMO Capital Markets U.S.

Okay. So just housekeeping to clarify. Your guidance for the full year that was made to earnings guidance that was maintained, that reflects a $0.46 earnings quarter, not the $0.41, I assume?

David Dillon

That's correct.

J. Schlotman

Correct.

Karen Short - BMO Capital Markets U.S.

I guess, again, to the selling gross margin here. I mean I understand what you did and why you did it. And obviously, you're doing this for the benefit of the customer and the shareholder in the long term. But I guess the more cynical view would be you did have an opportunity to flow some of it to the shareholder and chose not to. And I guess along those lines, maybe help you understand why this may not be a situation that you ended up in, in '09. When you have invested in a category and your competitors reacted much more aggressively than you expected and that caused a 109 and 126 basis points deterioration in those 2 quarters. Can you kind of give a little color on that and why you feel comfortable that, that won't will happen again?

David Dillon

Sure. I think what we did not anticipate back then was the competitive environment that, really, had I been in a competitor shoes, I would've needed to become more aggressive. It wasn't so much back then that we did something that sparked a reaction. It was all of the operating environment was set up in such a way that you almost had to go after sales because we were all -- not we were all, we weren't, but many of our competitors were running negative identical sales and that generally produces a different kind of reaction. Well, in an inflationary environment like this, I'd be shocked if most of our competitors didn't have better sales than what they have had before, and we have better sales than what we had before. And it often is actually a little easier to manage. Now sometimes inflation gets a little too high. But it's a little easier to manage because you have inflation in your product cost, but you don't have it quite as much as you have in the expenses. So that's why I think that situation is different. I don't actually see them as parallel. And certainly not on our part any kind of a competitive move that we think is going to give us an upper hand or something. We think of the business longer term than quarter-to-quarter. We're looking at business over the course of a year and 2 years and 3 years, and we're trying to build. And so it shouldn't shock you ever that we reinvest in places that we think are meaningful to the customer. But at the same time, you should keep holding us accountable to find places to save to help fund that investment. And in this particular quarter, we did not do that and we've identified the reasons why. We think they are short duration. And as a result, felt like it was an acceptable and appropriate way for us to pursue a longer-term strategy.

J. Schlotman

I just would add one small point. If you look at earnings per share without the tax and other items, it's $0.41 versus $0.38, which is a 7.9% increase. If you look at the $1.95 on the top side of the range, that's an 11% increase in earnings per share for the year. And then obviously, add the dividend on top of that, which is close to 2% right now. So all 3 of those numbers are very, very strong looking out for the shareholder and delivering for the shareholder a return.

Karen Short - BMO Capital Markets U.S.

Right. Okay, and then just a last question. What was traffic up in the quarter, same store?

David Dillon

Well, let's see. The traffic we have is total and it's not same store, right? And it was up about 1%. And the average sale was up about 4%.

J. Schlotman

Yes, but remember we had 39 fewer stores this year than a year ago. So our ID sales are actually higher than our non-ID sales because of that.

David Dillon

Thank you. And before we have everybody hang up, we do have a few comments we want to share particularly with our associates who we encourage to listen into the call. I want to remind you all that Sunday, this

Sunday, is the 10th anniversary of the tragic attacks of September 11. We have asked that all of our supermarkets pause for a moment of silent reflection to remember the victims in honor of the heroes of 9/11. Kroger supermarkets in the Eastern time zone will pause for a moment of silence at 8:46 a.m. this Sunday, marking the time when the American Airlines Flight 11 struck the World Trade Centers North Tower 10 years ago. Because of the time difference, stores operated by Kroger in other parts of the country will do the same thing later that morning.

We can do much more to honor the memory of those who perished and many of our associates will join in a special remembrances where they work. Our King Soopers Store Manager, Tim Dowdell, whose brother, Lt. Kevin Dowdell, was among the 343 firefighters who lost their lives in New York on 9/11. He displays the flag prominently at his store every day. And I love that.

I also encourage you to join in our local efforts throughout the month of September to recognize and thank our everyday heroes, whether it's a special celebration, a gift of a meal, a simple thank you. You can help show your deep appreciation to the men and women who help keep our families, communities and stores safe.

Thank you, all, for joining us today. Goodbye.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.