The Kroger (NYSE:KR) Q4 2011 Earnings Call March 1, 2012 10:00 AM ET

Executives

Cindy Holmes - Director of Investor Relations

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

W. Rodney McMullen - President, Chief Operating Officer and Director

J. Michael Schlotman - Chief Financial Officer and Senior Vice President

Analysts

John Heinbockel - Guggenheim Securities, LLC, Research Division

Kenneth Goldman - JP Morgan Chase & Co, Research Division

Karen F. Short - BMO Capital Markets U.S.

Mark Wiltamuth - Morgan Stanley, Research Division

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Deborah L. Weinswig - Citigroup Inc, Research Division

Operator

Good day, ladies and gentlemen, and welcome to the Fourth Quarter 2011 The Kroger Company Earnings Conference Call. My name is Fab, and I'll be your operator for today. [Operator Instructions] I would now like to turn the conference over to Cindy Holmes, Director of Investor Relations. Please proceed.

Cindy Holmes

Thank you, Fab. Good morning, everyone, 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 fourth 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. [Operator Instructions] Thank you.

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

David B. Dillon

Thank you, Cindy, and good morning, everyone. Thank you for joining us today. With me to review Kroger's fourth quarter and full year 2011 results are Rodney McMullen, our company President and Chief Operating Officer; and Mike Schlotman, our Senior Vice President and Chief Financial Officer.

We are very pleased with Kroger's outstanding performance in fiscal year 2011 and strong fourth quarter financial results. That we were able to raise earnings per share and identical sales guidance through the year and achieve those higher results demonstrates the strength of our business strategy and momentum for a strong 2012.

Kroger's strong performance rewarded shareholders in 2011. We delivered adjusted earnings of $2 per diluted share, a 15% increase in earnings over

2010. We hit the high end of guidance despite a much higher LIFO charge. We increased our quarterly dividend payment by almost 10%, and we implemented an aggressive stock buyback program using Kroger's strong free cash flow to repurchase 67 million shares. Later, Rodney and Mike will provide more details on our full year performance. I'd like to highlight several of the commitments that our teams successfully delivered on in 2011.

Kroger increased identical supermarket sales. We grew market share. We effectively used free cash flow to reward shareholders and invested wisely to continue to win customer loyalty. Importantly, we also balanced cost reductions with investments in our Customer 1st strategy to increase FIFO operating margin for the year. Kroger is off to a healthy start for the year ahead, and we expect earnings per share growth in 2012 to exceed our business model.

Kroger had strong performance in the fourth quarter. Identical supermarket sales for the quarter increased 4.9%, excluding fuel. More loyal and total households are shopping with us, and identical sales are up among both groups. This consistent sales performance contributed to Kroger's market share gains in fiscal 2011. And we achieved the high end of growth estimates for both earnings per share and identical sales growth.

Our operating performance was broad-based and consistent across the company. Every operating division achieved positive identical sales for the quarter, and every supermarket department achieved positive identical sales. Our natural food, pharmacy, produce and deli departments posted the strongest results. I'm very proud of our associates for bringing customer -- the Customer 1st strategy to life for our customers. Our relentless focus on our 4 keys, our people, prices, products and shopping experience, is why Kroger has achieved an industry-leading 33 consecutive quarters of positive identical supermarket sales results. Our associates work to please and delight our shoppers inspires customer loyalty, which grows our business and generates shareholder returns. Simply put, we put our Customer 1st -- when we put our customers first, shareholders win.

Well, as we look to 2012, we expect the external environment to be a little better than 2011. All of the data we're seeing suggests the overall economy and customer sentiment are improving. Both give us reason to be optimistic about the year ahead. We're also mindful that consumer sentiment is fragile. And as we've seen over the last few years, it can be affected by external factors such as rising gas prices and geopolitical issues. So we will continue to carefully monitor the pace of economic recovery, higher gas prices and the slowing of the rate of inflation. And while these factors will influence all retailers, our success will come from making tactical adjustments as needed throughout the year, just as we did throughout 2011.

Rodney will now offer insight into Kroger's strong business trends in the fourth quarter and 2011 market share statistics. Rodney?

W. Rodney McMullen

Thank you, Dave, and good morning, everyone. Our focus on building loyal customer base continues to increase sales and reward shareholders. Today, close to 50% of all U.S. households carry one of our loyalty cards. That percentage obviously is much higher in the markets where we operate.

One of the ways we create value for our customers is by leveraging scale and position as a share leader in most of the markets in which we operate. Even with Kroger's deep market penetration, we have a tremendous opportunity to increase incremental spending among our loyal customers, who on average spend about $0.50 of every food dollar with Kroger. Kroger's partnership with dunnhumby is another powerful way we build our loyal household base. The unique customer insights gained from our loyalty data help us reward our most loyal customers with highly relevant, personalized offers for the products they like and buy regularly.

In the fourth quarter, the number of loyal households shopping with us increased, as did the total number of households. Loyal household unit purchases and price per unit sold were both up in the fourth quarter compared to the same time last year as well. While our loyal customers are buying fewer items each trip, they are buying more on a monthly basis. A key indicator that our loyal customer strategy is working is that our identical sales growth among loyal households outpaced the growth for total households. For the full year, our number of loyal households continued to increase as did the number of their visits. Total household shopping at our stores also increased year-over-year.

We still anticipate inflation in 2012, but we expect to end the year with a rate of inflation lower than at the beginning of the year. The increase in food costs moderated slightly in the fourth quarter, with year-over-year product cost inflation of approximately 5.4%, excluding retail fuel. Higher prices have taken a toll on all customers, but our very price-sensitive customers continue to suffer disproportionately. Most departments experienced inflation during the quarter. The produce department ran counter to this trend in the fourth quarter, experiencing deflation. We are passing along product cost increases from national brand suppliers and plan to continue to do so. At the same time, we slightly increased our penny profit per item in the grocery category in the fourth quarter versus the prior year. As always, our popular corporate brand products continue to offer customers thousands of quality, affordable choices to fit into any budget.

Looking at unit sales. Similar to the third quarter, tonnage was essentially flat and slightly improving as we ended this year. We expect to see improving trends in tonnage growth as the economic conditions improve and inflation moderates. While the industry as a whole experienced the effects of consumer caution and higher food prices, Kroger performed exceptionally well by staying relevant and providing value when and where customers needed it most.

For example, when we saw customers under pressure in the second quarter, we accelerated investments to alleviate some of that pressure. Even as inflation forced shoppers to be more budget-conscious, our customers continued to experience Kroger's unique value proposition, a convenient and superior shopping experience, low prices and with hot weekly promotions, personalized rewards developed through our dunnhumby partnership and our popular Fuel Points savings program. That collection of benefits, teamed with our high-quality, competitively priced corporate brand offering, positions Kroger to win in the marketplace today while investing for the future.

Kroger's strong corporate brands continued to gain share in the fourth quarter. Corporate brands represented approximately 27% of the grocery department sales dollars and 35% of the grocery department units sold. Corporate brand sales dollars were up more than national brand sales dollars for the quarter as well. As Dave said, one of our fastest growing departments is natural foods. Our customers told us they want organic and natural products that are easily identified and affordable. So we launched our new Simple Truth Natural and Simple Truth Organic brands in November, focusing first on milk and eggs, with plans to expand into other categories throughout 2012. Another successful growth category for corporate brands is yogurt. We've leveraged our manufacturing competitive advantage to accelerate the growth of our corporate brand Greek yogurts. Greek yogurt sales have doubled in each of the last 3 years, with Kroger's offering outpacing the category in unit and dollar growth.

Now turning to market share for 2011. We look at market share the way customers look at it, where they spend their money. According to Nielsen Homescan data, Kroger's overall share of products we sell in the markets where we operate grew approximately 50 basis points during fiscal 2011. This data also indicates that our share increased in 13 of the 19 marketing areas outlined by the Nielsen report and declined in 6 areas. Walmart Supercenters are our primary competitor in 17 of the 19 marketing areas outlined by the Nielsen report. Kroger's overall product sales in those 17 markets grew approximately 40 basis points during fiscal 2011. This Nielsen Homescan data is generated by customers who self-report their grocery purchases to Nielsen. This includes all retail outlets that sell the same products that we do.

Next, I'd like to give you an update on labor relations. As you realized, our associates play a big part in building customer loyalty. Kroger's commitment to our associates include our dedication to safety, significant investments in training, solid wages and good-quality, affordable health care. We have to deliver this in ways that allow us to operate competitively with the nonunion retailers in each of the markets that we serve. Kroger financial results continue to be pressured by rising health care and pension costs. Cooperation between Kroger and the local unions that represent many of our associates is essential. We have a shared objective, growing Kroger's business, and profitability will help us create more jobs and career opportunities for all of our associates.

We are pleased that our associates ratified a master agreement with the Teamsters covering 3 distribution centers and 2 dairies. Currently, negotiations are under way with the UFCW for store associates in Memphis and Las Vegas. In 2012, we had labor contracts expiring in Dayton and Columbus, Ohio; Indianapolis; Louisville; Nashville; Phoenix and Portland.

Now Mike will offer more detail on Kroger's 2011 financial results and our 2012 guidance. Mike?

J. Michael Schlotman

Thanks, Rodney, and good morning, everyone. Including the effect of the UFCW pension plan consolidation, Kroger reported a net loss for the fourth quarter that totaled $306.9 million or $0.54 per diluted share. Excluding the effect of the pension consolidation, adjusted earnings for the quarter were $283.8 million or $0.50 per diluted share. It is important to keep in mind LIFO was $31 million or $0.03 per diluted share, higher than we expected at the beginning of the quarter.

Net earnings in the same period last year were $278.8 million, or $0.44 per diluted share. FIFO gross margin as reported was 21.13% of sales for the fourth quarter of fiscal -- of the year. Excluding retail fuel operations, FIFO gross margin decreased 47 basis points from the same period last year. As I said earlier, our LIFO charge was higher than expected, totaling $73.4 million. This compares to $18.8 million in the fourth quarter of 2011.

Excluding retail fuel operations and the pension consolidation, our OG&A, including rent and depreciation, declined 21 basis points. OG&A declined 8 basis points, rent declined 3 basis points and depreciation declined 10 basis points. Identifying and executing sustainable operating cost reductions allows us to invest in all 4 elements of our Customer 1st strategy: our great people, our product offering, our customer shopping experience and lower prices for our customers.

Before I move on to discuss Kroger's full year 2011 results, I'll share some data on our retail fuel operations. In the fourth quarter, Kroger's retail fuel operation has generated identical gallon growth. These outlets earned approximately $0.124 per gallon compared to $0.102 in the final quarter of fiscal 2010. This part of our business benefited Kroger's year-over-year net earnings per share increase for the fourth quarter by $0.02. For the full year, the cents per gallon fuel margin was roughly $0.139 in 2011 compared with $0.122 in 2010.

Turning now to Kroger's full year fiscal results for 2011 and excluding the effect of the pension consolidation, earnings for 2011 were $1.2 billion or $2 per diluted share. Including the effect of the pension consolidation, fiscal year 2011 earnings were $602.1 million or $1.01 per diluted share. Full year net earnings in the prior year were $1.74 per diluted share. Our original earnings guidance -- or our original earnings per diluted share guidance for the year was $1.80 to $1.92. This contemplated a LIFO charge of $50 million to $75 million. As the year progressed, we ultimately revised our EPS expectations to $1.95 to $2, even with the LIFO charge at the time that was expected to be $185.5 -- $185 million. That we hit the high end of our increased earning expectations with a full year LIFO charge of $216 million speaks loudly to Kroger's strong underlying performance. Excluding fuel and the pension consolidation, FIFO operating margin increased by 5 basis points. This is the fourth consecutive rolling 4-quarter period with an expanded operating margin.

Now I'll provide a little color on the effect of the pension consolidation. The charge totaled $590.7 million after tax. This affected the fourth quarter by $1.04 per diluted share and the full year by $0.99 per diluted share. The difference is due to having fewer shares outstanding in the quarter versus the year. The charge is higher than the $0.73 per diluted share we discussed in December. Our commitment under the agreement is to fund the full December 31, 2011, underfunded balance. The amount we discussed in December only addressed the cash contribution we made. For multi-employer pension plans, cash contributions and expense are usually the same. However, since we have a contractual obligation to fund a specific amount, we need to expense that incremental commitment. We have committed to fund the remaining obligation by the end of 2018. At the time it is funded, no additional expense will be incurred. We met our additional -- we made our initial funding of $650 million on January 20, 2012, $50 million of which was attributed to 2012 plan year contributions.

Under Kroger's share repurchase program during fiscal 2011, we invested $1.5 billion to repurchase 66.5 million shares of Kroger stock at an average price of $23.24 per share. Since the end of the fourth quarter and through the close of the market yesterday, Kroger has $379 million remaining under the $1 billion stock repurchase program announced in September of 2011.

We focus on identical sales growth, excluding fuel, because it is the best measure of performance to let us know that we are delivering for both our customers and shareholders. 33 quarters of consistent identical sales growth tells us that our Customer 1st strategy continues to connect meaningfully with our customers. That connection enhances customer loyalty and grows market share, which increases earnings and generates free cash flow that reward our shareholders. Customer 1st drives shareholder returns.

Kroger's business model is structured to produce annual earnings per share growth averaging 6% to 8% plus a dividend of 1.5% to 2%, for a total shareholder return of approximately 8% to 10%. We expect this total shareholder return to compare favorably to the S&P 500 over a rolling 3- to 5-year time horizon. Annual earnings per share growth for fiscal 2012 will be higher than this due to a combination of the benefit of the 53rd week, a lower expected LIFO charge, our ability to aggressively repurchase stock during 2011 and benefits from the pension consolidation.

Now I would like to outline our specific growth objectives for fiscal 2012. For the full year, we anticipate identical supermarket sales growth, excluding fuel, of approximately 3% to 3.5%. This guidance contemplates the effect of several prescription drugs coming off patent during the year, which will reduce sales. As Rodney said, we expect units to increase if inflation moderates, so this should offset any effect of lower inflation. Full year net earnings are expected to range from $2.28 to $2.38 per diluted share. This guidance assumes the benefit of the extra week, lower LIFO, the benefit of our stock buyback program during 2011, the benefit of our pension plan consolidation and some benefit from Express Script transfers. Kroger's quarterly dividend enhances total shareholder return by approximately 1.5% to 2%.

I'd like to provide some additional insight on our identical sales and earnings per share expectations on a quarterly basis as well. For earnings per share, we expect the first quarter to pose the biggest challenge. Last year's first quarter presents a tough comparison, and the expected lower LIFO charge will not affect year-over-year comparisons until later in the fiscal year. Conversely, we expect identical sales to start the year stronger and trend down as prescription drugs come off patent. The generic prescriptions, which generate higher gross profit rates, along with the benefit of expected lower LIFO as the year progresses, will cause stronger earnings per share growth in the third and fourth quarter. The fourth quarter will also benefit from the 53rd week. As a result, we expect earnings per share growth in the first quarter to be flat to slightly positive, a growth rate in quarter 2 that is in line with our business model and a strong performance in the third and fourth quarters.

We expect Kroger's full year FIFO operating margin rate in 2012, excluding fuel, to expand slightly compared to fiscal 2011 results. We expect to expand Kroger's nonfuel operating margin rate over time, and it remains our goal to do so. We expect our full year LIFO charge to range between $140 million and $190 million. During fiscal 2012, Kroger plans to use cash flow from operations to fund capital expenditures, repurchase shares, pay dividends to shareholders and maintain its current debt rating. We expect capital expenditures to be in the $1.9 billion to $2.2 billion range for the year.

This morning, we filed an 8-K summarizing the guidance and financial strategy that I just discussed, along with some additional items, including pension contributions and expense and our tax rate.

Now I will turn it back to Dave.

David B. Dillon

Thanks, Mike. I am very proud of our associates for delivering such outstanding results in 2011. Our consistent performance is one of the reasons that Kroger has created more than 29,000 jobs in the past 5 years. Kroger is rewarding shareholders, and we are looking forward to another year of consistent industry-leading performance and growth. We now look forward to your questions.

Question-and-Answer Session

Operator

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

John Heinbockel - Guggenheim Securities, LLC, Research Division

A couple of things interrelated. If you look at, Mike, the details you gave quarter-to-quarter, to what degree does that bake in anything specific with regard to moving around programs, promotions, et cetera? And I'm wondering because you talked about the second quarter last year and some of that pressure that consumers were under was fuel-related, how do you guys look at the current run-up in gas and where we might be in the spring? And is there a need to do something more this year to offset that new pressure on the consumer? So have you built that in explicitly, do you think that's something that may have to happen?

J. Michael Schlotman

Well, as we've begun the year, we certainly have a plan laid out of how we expect to invest in the elements of our Customer 1st strategy, and it does contemplate what we see out there. But as we said in the prepared comments, we did make tactical adjustments throughout 2011 to react to the world around us, and we would expect to continue to do that in 2012 as well. And I think it proved out beneficial for everybody in 2011, given our results.

W. Rodney McMullen

And those tactical changes -- John, this is Rodney, won't necessarily be the same every year. And so there wouldn't necessarily -- just because of what we did last year doesn't mean we'll do the same thing this year. And it really depends on what our insights tell us that is important to our customers.

John Heinbockel - Guggenheim Securities, LLC, Research Division

Do you think the customer will be under less pressure for whatever reason? Let's say, gas is $4, $4.25, Memorial Day, less pressure this year than last year because the macro's better? Or same pressure, more pressure, what do you think?

David B. Dillon

Well, John, those are, of course, all the right factors. And how they weigh out is going to be hard to judge. Certainly, on the plus side, the economy is clearly improving. And except for the very price-sensitive customers, which Rodney mentioned are still suffering disproportionately, otherwise, it's holding up quite well and we're very pleased with that. And customer sentiment, which is also important in how people feel about things, is also improving. Those are both good signs. So even with higher gas prices, it's possible that those factors end up overweighing that. And as you know, there are some pluses of higher gas prices for us, one is our gas promotion has a good effect. And the other is that a lot of our stores are located within a couple of miles of where customers live, and that becomes a very convenient place for them to shop when prices get high. So it's not like it's all bad news. There are certainly some bad news with it because it's less money in their pocket. But on the whole, we remain optimistic.

John Heinbockel - Guggenheim Securities, LLC, Research Division

All right. And then just as a follow-up to that is I don't know what inflation number -- it sounds like it might be like a mid-3s number or something like that, that's baked into your LIFO charge. But is that right? And then secondly, obviously, if it comes down in the back half of the year, you'll end up with some significant adjustments in the second half. Just talk about just tactically, if LIFO ends up being $50 million, $70 million, some large number lower than you think, can that be effectively reinvested in the business or it's hard to do that effective -- productively?

J. Michael Schlotman

Well, a couple of things on LIFO. I think I've proved my inability to project LIFO throughout the year this year. And it's a very difficult thing to do. The other thing, John, to keep in mind is LIFO is a noncash charge, and it doesn't use cash or create cash when I book that charge. So if it goes up or down, it really doesn't affect my ability to have money to invest to reward our customers. Does it affect earnings per share? Absolutely, but it really doesn't give me any incremental dollars to invest somewhere else.

John Heinbockel - Guggenheim Securities, LLC, Research Division

Okay. And then just one last thing. The 6 markets where you lost share or didn't gain share, I guess, I assume that was not a material loss of share. And was that because you didn't comp well or because some competitors may have comped particularly well for whatever reason?

J. Michael Schlotman

Yes. Well, when you look at those 6 markets, it's extremely modest. But a 0.1 is a 0.1 because we do take it literal in terms of what the report says. So it's not necessarily a reflection because it could actually be rounding -- but the numbers are what they are. In every market, we're very pleased with our identicals. And as Dave said, our identicals for the quarter were very broad-based across the whole country and very broad-based across all departments. And we felt very good about where we are overall.

Operator

Your next question will come from the line of Ken Goldman with JPMorgan.

Kenneth Goldman - JP Morgan Chase & Co, Research Division

In the last couple of months, Nielsen data, food manufacturers, some of your competitors, they've pointed to an accelerated channel shift out of traditional into some alternatives. And your numbers seem to be bucking this trend. I know you touched on how you did this, and I do appreciate that color. Just one follow-up. In your mind, are you avoiding the loss of customers that some other supermarkets have seen across-the-board? Or maybe are you losing some customers in the bottom end? As they go to some limited assortment channels, maybe you're making that up on the top end, as you gain from some consumers finding your value proposition more attractive? I'm just hoping you can sort of add a little bit more color as to how you were able impressively, frankly, to do this when some of your competitors have not.

David B. Dillon

Well, let me ask the question slightly differently. We think of market share -- and we've thought about this for years now, I'd say 15 years at least, maybe 20. Instead of looking at our traditional supermarkets, we look at the pie as being a lot bigger than that. We were looking, as Rodney said, where our customers spend their money. And because we look at it that way, our battle has been for a market share of that bigger pie. And that attitude, that viewpoint, has caused us to address it, I think, differently than some of the other traditional supermarket operators. There are some out there who have done it maybe similar in their thinking, but our objective is to solve what the customer needs solved and not to solve maybe what is a traditional supermarket equation. And that line of thinking actually has led us down this path of Customer 1st. We've talked a lot about it, and it sounds more like marketing words, but actually, we genuinely mean it. We look at the 4 elements of Customer 1st. We invest in those in the ways that we believe are meaningful to our customers. We save money in places that don't matter to the customer and reinvest it in the places that do. And I think it's that approach that has created the results that you described. I would agree with your viewpoint, we think we have not suffered the same channel changes that others have, but we've had to live in the same channel changes that others have had to live with. And we just had to address it in a different way.

W. Rodney McMullen

The only thing, Ken, that I would add -- and I agree with everything that Dave said. And I think increasingly it's probably one of the things that people look at Kroger probably incorrectly because they try to put people into channels. And if you look at what a traditional supermarket would be, and you go into our stores today, it's nothing like what that traditional supermarket used to be. And it really -- there really is a new category that we're in that we're satisfying the needs based on what customers are telling us they want that Dave outlined. And I really do think it's one of the things where, we, along with our investors, probably try to stick things into channels, and it really is what we're trying to create with our customers, a channel that's completely different than anything out there. And I think our customers are showing it and our associates are executing against it for our customers that show that, that's actually happening.

David B. Dillon

We've actually described internally what you're talking about in saying that the grocery industry as we all grew up in it really doesn't exist anymore. And we'll occasionally use the term traditional grocery because it helps relate to things that you all will describe and that you're describing now. But we don't think of that as our industry. We don't have a real good name from it other than food, but it is a broader industry than just that traditional food industry.

Kenneth Goldman - JP Morgan Chase & Co, Research Division

And sorry, just one follow-up. That's all very helpful. But how would you describe the major differences between you and a traditional grocer at this point? Because to me, and maybe I'm seeing this incorrectly, you clearly have differences but you're still selling mostly food. I mean, the prices are cheaper and you have other offerings and you have fuel and so forth, but it's more close than not. So perhaps help me understand where I'm maybe not seeing the differences.

David B. Dillon

Well, your list was right and the so forth is a longer list, too. Just contrast us with ourselves instead of looking at what you're comparing to. Look at ourselves in the 1990s to now. And even though we had good earnings growth during that time, our sales were not strong. We were losing our relevancy with customers. And we were really more focused on just producing earnings. When we moved to a point of view that says we've got to solve issues for customers, putting our customers first, that in effect, indirectly gave us a stronger result for our shareholders. And we felt it would and it has proven to be true. And sometimes in life, and I think it's definitely true in business, if you go after something directly, you may get it for a while but you won't get it forever. But if you go at it indirectly by serving the broader goal, the broader goal for us is our customer relevancy, then you end up serving the shareholders as well. And I think that's what we've seen happen. So I would prefer to contrast us with ourselves. And all of the things you described are true. Each of the 4 keys has specific things about them that we have done. We've talked about many of those over the last several years. But we've worked hard on each of the 4. It's not any one of them, it's all of them. So I don't know if that's help you anymore, but...

Operator

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

Karen F. Short - BMO Capital Markets U.S.

I'm just wondering -- a couple of questions here. I don't know if you commented on this, but what are -- I'm assuming comps are, I think, kind of trending in line with the fourth quarter results and the quarter-to-date. Is that fair?

David B. Dillon

Let me just give you a summary on it. We had, through last week, which is 4 weeks, our identical sales without fuel would be comparable to where we where in the fourth quarter. We did not update it to this week because this week frankly is not comparable because with the leap year day that we added, we now have a bigger shift in first of the month than normal. So it's not a comparable week. And we are still seeing this year and last year high variability from the beginning of the month to the end of the month, and so that enters into it, too. But through the 4 weeks anyway, I'd say the identical sales were comparable.

Karen F. Short - BMO Capital Markets U.S.

Okay, great. And then I guess, just looking at -- I know you've veered away from talking about thi,s, but just directionally, looking at selling gross margin. Earlier in fiscal 2011 when you were still kind of talking about it, you were discussing the cadence on a 2-year basis because there was a lot of volatility. I guess, maybe can you just give me your directional thoughts on selling gross trends into fiscal '12, same kind of level of investment in '11, a little lower, any color?

David B. Dillon

Well, first, we're not going to put it in terms of selling gross margin. While it's still an important concept for us to think of in running our business, we think it adds too much confusion to the discussion. But directionally, you've heard us say we work backwards. We said that we expect our FIFO operating margin rate to slightly improve in 2012, so that we put it in the K and described that already -- or in the 8-K we filed today. So you start with that, and everything else works back from that. You should expect, as we've said before, some additional investment in our gross margin -- FIFO gross margin. And as we do that, though, you should also expect over the course of the year, that we'll have savings that will offset that so that we end up with a slight gain in operating profit margin. I don't know if that helps, but we do expect some investment certainly.

Karen F. Short - BMO Capital Markets U.S.

Similar to last year, is it fair to say that you will find the savings at the early part of the year to then spend it slightly more towards latter?

David B. Dillon

I think the only comment I'd make on that is just refer back to what Mike said about the flow of the quarters through the year. That contains -- that guidance on as you think about the quarters gives you the best feel we have for the way we currently expect it to flow. But as we've pointed out, we also make tactical adjustments as the year go on. And if we've done that, we'll try to identify that if it's meaningful.

Karen F. Short - BMO Capital Markets U.S.

Okay. And then just the last question. Looking at your share repurchases in fiscal '12, I guess, obviously, this is a high year. But in '12, what do you consider kind of a more normalized cadence on the share repurchases or maybe in terms of free cash flow allocation?

J. Michael Schlotman

Yes. If you look at it over time in years where we haven't done an aggressive buyback like '11, it's typically been in the $400 million to $600 million range. We like to do enough to offset dilution, and it's relatively steady throughout the year. Don't have a particular target in mind as I sit here today because some of it is driven by all of the forces around us and what other opportunities we have to invest in cash. I'm happy with my debt rating, my guidance on -- our guidance on CapEx is a little bit higher because we continue to see some phenomenal store sites come our way and some technology projects that we think will be attractive returns for the long haul.

Operator

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

Mark Wiltamuth - Morgan Stanley, Research Division

Wanted to dig in a little bit here on the OG&A line. Are there any health care and pension increases kind of embedded in that number that you're going to have to overcome throughout the year?

J. Michael Schlotman

Throughout next year?

Mark Wiltamuth - Morgan Stanley, Research Division

Yes.

J. Michael Schlotman

Well, I mean, the pension -- if you look at the pension overall, if you set the contracts aside where we consolidated the pension plans, the remaining plans would have some increases in them, and all OG&A would certainly have increases in them. If you look at UFCW pension plan expense overall, because of what we did in December, that contribution and expense should decline overall in 2012. And we talked about that benefit back in December when we announced the consolidation.

Mark Wiltamuth - Morgan Stanley, Research Division

Okay. And moving over to your gasoline business. Are we still seeing that effect when rising gasoline prices are occurring that you get a margin drag? Because you seemed to have a pretty good margin performance this quarter and for the year.

W. Rodney McMullen

Mark, yes, that would typically be the case.

Mark Wiltamuth - Morgan Stanley, Research Division

Okay. And so far in the first quarter, do you feel like there's dramatic weather difference versus last year which might be helping? Or how does that stack up?

W. Rodney McMullen

If you look at the weather so far, weather definitely was a bigger help last year than this year. We've had very few snowstorms this year. And obviously, when there's snowstorms, kids stay home and they eat at home versus at school. So we really haven't -- we didn't have those -- very limited benefits in the fourth quarter. We've had very little of those benefits in the first quarter also.

Operator

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

Scott Andrew Mushkin - Jefferies & Company, Inc., Research Division

First, just a curiosity. I know you guys have a huge pharmacy. Are you seeing any benefits from the Express, Walgreen dispute? And do you think it's going to be additive to your first quarter EPS?

W. Rodney McMullen

If you look at the guidance that Mike outlined for the year, we included some benefit for Express Script transfers to Kroger. If you look at where we're trending right now, our increases are a little bit more than what we were expecting. So to the extent that it's better than what we had built in, yes, it would be a positive. Obviously, if they settled tomorrow, that would also affect the number. The other thing that we will plan to do is at the end of each quarter, give you some insight in terms of what the Express business helped us by, so you could have some insight and get a feel for that, but we did include some. But right now, we're actually doing better than what we included.

Scott Andrew Mushkin - Jefferies & Company, Inc., Research Division

And did you guys quantify -- and maybe, Mike, I missed this. Did you quantify for the first quarter what you thought it would add to your EPS?

J. Michael Schlotman

We did not.

Scott Andrew Mushkin - Jefferies & Company, Inc., Research Division

Did not. Is it going to be -- is it meaningful or no?

J. Michael Schlotman

We did not quantify it.

Scott Andrew Mushkin - Jefferies & Company, Inc., Research Division

Okay. Switching gears a little bit because we've covered a lot on this call. I'm just kind of curious with the acquisition strategy. I know we talk about it every once in a while. It seems like maybe you could do some maybe larger accretive transactions. And I was just wondering, is it time to get a little bit more aggressive? And would you ever think of deploying your capital? I know you talked about the dividends and the share repurchases more aggressively in M&A.

David B. Dillon

If I had the script from the last time we answered that question, I would just replay the tape for you because it's the same answer. We're always interested, always looking, highly selective...

J. Michael Schlotman

And don't need them to make the numbers...

David B. Dillon

Yes, we don't need them to make our numbers. Lots of companies that give forecasts for the year assuming they'll make acquisitions. We never do that.

Scott Andrew Mushkin - Jefferies & Company, Inc., Research Division

But no consideration right now of getting a little bit more aggressive, given you guys are doing well, the channel seems to be suffering?

J. Michael Schlotman

We're not opposed to them, like Dave said, but we're not going to change the metrics we look at and stretch to do something because of the current environment. If it meets our metrics, we would certainly look at it. And if it doesn't, we won't.

Operator

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

Meredith Adler - Barclays Capital, Research Division

I was wondering if you could talk a little bit about competition. I think everybody is saying that it's been quite rational. And I think having positive comps for many people because of inflation helps the psychology for retailers. But maybe you could talk a little bit about any thoughts you might have, if we end up with really modest inflation at the end of the year, do you think there's some risk that there's going to be a pickup in competition?

David B. Dillon

Well, first, I would agree with you, Meredith, that the competition has been rational. It doesn't mean it's not significant. It's been quite significant. And last year was just like we've seen in previous years, lots to address, and we fully expect that going forward. I do think there's a psychological effect when identical sales are positive that cause people to be a little bit more rational than they might have otherwise been. But actually, when we saw a deflation a couple of years ago, behavior was -- for the most part, there were some moments, but for the most part, it was more rational. We called out a few times in the quarter calls where we saw some blips and differences, but generally, it wasn't too bad. And that was with deflation. But what you described and what we certainly are forecasting is not a deflationary environment but one that's just a little less inflationary than it is currently. And so I would not expect to see an environment that was much different than what we've been seeing, fiercely competitive but certainly rational.

W. Rodney McMullen

The only other thing I would add to that, Meredith, is we also expect the economy to improve a little bit, and we do think the improvement in the economy would help everybody's volume go up a little bit and spend on an item, a little more expensive items and those kind of things. So I think that is also in the background.

Meredith Adler - Barclays Capital, Research Division

Okay. And then I have a question. You clearly are doing a very good job of managing expenses. The FIFO gross margin was up, which it hasn't been for a while. Is there any particular area of expense, shrink transportation, that stands out as a positive for you guys in 2011?

David B. Dillon

Yes, you want to comment on it, Rodney?

W. Rodney McMullen

Yes. One of the things we're really pleased about is it's really broad-based. And there isn't just one place where you can go and say half the savings is being created by this one item. It really is all across -- all the departments. Shrink results were very solid, our warehouse and transportation group did a nice job. And when you adjust for fuel, it's even better. If you look at our store teams, they did a very nice job of, and Dave mentioned it earlier, really identifying things to make work more efficiently, where the customer is not -- it doesn't benefit the customer, and then we reinvest some of that to help the customer, other places we help to invest in lower pricing. So it's really very broad-based, which is one of the things we're very pleased about.

Meredith Adler - Barclays Capital, Research Division

And that's great. And my final question would be about the labor negotiations. I looked at the 8-K, and there was actually commentary that said there's a bunch of markets you're going to be renegotiating, and the negotiations are going to be challenging. I was just wondering if you could talk about what happened in 2011. And in general, because obviously, every market is different, how did the course of those conversations go between wages and health care and pension?

David B. Dillon

I'll let Rodney maybe comment in a second. But the language we used in the 8-K and that we use today is actually pretty consistent with how we've seen the world for a long time, that there's lots of pressures that need to be addressed. And on one hand, as an employer, we genuinely want to provide positive wages, good wages that are viewed in the market as good wages and good solid benefits. I mean, those things actually matter to us that we can provide that. At the same time, we recognize we have to be cost-competitive, and so we work hard on that. But that's not a new phenomenon. And the challenge of the negotiations is also not new because there are some structural legacy issues in contracts generally that need to be generally addressed. So as to the specifics, though, I'll let Rodney comment on that.

W. Rodney McMullen

Yes. The only other thing, when you look at '11, I don't think there's anything specific. One of the things I've been very pleased with, the union and our labor negotiators is just sticking with it. Because the things that you've outlined, obviously, it's a great deal of difficulty. Dave outlined we want to make sure that we have a very solid wage benefit and health care benefit package that's extremely competitive in the marketplace. And I've really been impressed with everybody's commitment and persistence in just trying to keep talking about it, working through it, engaging our associates, trying to understand what really works and allows us to stay competitively. So that piece, I would give both parties high marks on sticking with it. But outside of that, I don't think there's anything unusual to talk about on '11. Obviously, as you look forward, you have the new health care laws that start changing a lot in 2013. And how that affects and what uncertainties that creates will be a lot of the discussion, I think, in '12, too.

David B. Dillon

Meredith, the pension agreement we reached last year is a really good example of what Rodney was describing, of people sticking with it, working through it, trying to find a way to make that all work. I think that took us, I don't know, 1.5 years...

J. Michael Schlotman

18 months.

David B. Dillon

To work through. Yes. So it just illustrates that point. That was a good question, though.

Operator

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

Charles Edward Cerankosky - Northcoast Research

If we looked at Fred Meyer and your jewelry store business separately in the quarter, fourth quarter, can you talk about how those businesses performed? And I'm thinking about what kind of seasonal kick they had versus management's expectations?

W. Rodney McMullen

If you look on the, I would say the grocery side, but it's broader than just grocery at Fred Meyer, it was phenomenal. When you look at the nonfood side and jewelry, I would say it was a solid year. If you look at our performance versus the publicly reported companies, we've outperformed most of those companies, so it was solid but it wasn't something that was spectacular. So overall, we felt really good about it. But it wasn't something that was just blow-away-good that it really drove the numbers in a different level.

Charles Edward Cerankosky - Northcoast Research

Now when you say jewelry was solid or the nonfood side of Fred Meyer was solid, I think you described both as solid, was that upsales and earnings versus a year ago?

W. Rodney McMullen

Up on sales. If you look at the 2 combined, up on earnings -- not necessarily up on earning, jewelry would've been not up on earnings.

Charles Edward Cerankosky - Northcoast Research

All right. And then if you -- I want to go back to comps and look at it a different way. If you sort of took your households and divide it in 3 economic or demographic tranches, how were comps between high, low and middle groups?

David B. Dillon

Well, if you did it based upon their sensitivity to price, which is one of the ways we look at it, the tier that is most sensitive to price was challenged, and it's suffered disproportionately. And we think it's a direct result of retail prices on food being higher and them not having any more money in their wallet to spend. So the units went down and those numbers were not very pretty. All of the other segments were -- would've been good and strong and up and positive. We ought to also comment that corporate brands had a terrific quarter and a terrific year. We noted the 35% of grocery units, that's back up to the peak that we've ever achieved, and that's where we're just about 1.5 years or 2 ago.

J. Michael Schlotman

And that does sort of detemper the identical sales number, because it can be the same number of units, but it's a lower retail price. And that strong offering can actually show up in that way, and it may look like the ID number in a certain category is worse than it really is and you have to factor that in.

David B. Dillon

I agree with that. And let me add one other thing. This might give you a little bit of color. We've often identified a few categories or products or brands and so forth that have done well. And let me just highlight those and maybe a few others. We've, obviously, in several quarters past, talked about natural foods and organic produce, sushi, Boar's Head, Starbucks, prepared foods, all of those had really good results. But we would add to that list, floral -- and we had, by the way, a good Valentine's Day, a strong Valentine's Day. Greeting cards are actually up, cosmetics are up. Those are areas that we've seen some improvements in. And that would give you a little sense of the optimism that we have is that we're seeing a little broader customer recovery than what we'd seen before. But still that bottom group that is most price-sensitive is definitely a challenge right now.

Operator

Your next question will come from the line of Charles Grom with Deutsche Bank.

Charles X. Grom - Deutsche Bank AG, Research Division

If I take your comments there, Dave, just on the broader customer recovery and the quarter-to-date comp trends that are up, say, 5% and with the Express Scripts benefit coming in a little bit stronger so far, can you kind of help me triangulate back to that 3% to 3.5% comp guidance as we think about the full year?

David B. Dillon

Sure, I'd be happy to and Mike and Rodney may have some additional thoughts, too. But first, when you think about 3% to 3.5%, it could initially give you a feeling that we're not very optimistic about the year. But don't think that at all. In fact, it's just the opposite. Those numbers reflect a surprisingly high impact of moving some drugs off of patent and into the generic prescription world. And it is, quite frankly, impactful on our total company numbers. And that's the primary thing that's driving that. And so I want to make sure you see that we feel pretty optimistic about what this future looks like. It certainly includes our view that the economy is going to improve. It also includes our view that the customers' world is improving. And it includes our view that inflation will moderate a bit as we get later into the year. You want to add anything more to that, Mike?

J. Michael Schlotman

The other thing is, is that the 3% to 3.5% won't be smooth throughout the year. We expect higher numbers in the first part of the year, and it will decline as the year goes on as a result of what Dave said with those generics going off-patent. And there's a couple of reasons for that. I don't want this to be a pharmacy call, although Lincoln Lutz may like that, but the first 6 months that we have -- that those drugs go on off-patent, there is an exclusive generic provider, so that's a step down in sales a little bit. And then after 6 months, it steps down again. I don't mind sharing that specifically that impact that Dave talked about. Our estimate of the effect of the drugs coming off-patent and going to generic on our total book of business is 50 basis points. That's not 50 basis points on pharmacy sales, that's the overall reduction in business for the company. That doesn't really -- but they come at little bit of higher gross profit rate. And that's one of the reasons I went into the detail I did on explaining how the year is. So that's going to have a disproportionate effect in the back half of the year. But we don't believe our profits will suffer because the gross profit rate on those is higher. And it will stand a little counterintuitive to the model we've espoused for so long, but we're just trying to give some transparency into how we see the year shaking out.

Charles X. Grom - Deutsche Bank AG, Research Division

Okay. No, that's actually very helpful. And then just if I could follow up on the first quarter guidance, say, a little bit better than $0.70, $0.71 for EPS. If we think about, say, a high 4% comp and SG&A leverage consistent with what you did -- can you just help me out on the LIFO charge for 1Q? It would really appear that there's going to be another step-down on the core FIFO in 1Q. I just want to make sure if my view is correct.

J. Michael Schlotman

Yes. I don't think that's necessarily the case. That's potentially possible. But keep in mind, last year's first quarter was just a phenomenal quarter. Everything that could possibly go right went right. And my comment on the LIFO, when you look at where we were on LIFO early in the year last year, it's that kind of in the range or close to the range that we're expecting for the full year this year. So we had to increase our LIFO throughout the year in 2011. And so we won't get any benefit on earnings per share from a significantly lower -- or from a potentially lower LIFO charge until later in the year when we had to catch up the full year.

Operator

Your next question will come from the line of Robby Ohmes with Bank of America Merrill Lynch.

Kelly A. Bania - BofA Merrill Lynch, Research Division

This is Kelly Bania actually in for Robby Ohmes. I was wondering if you kind of broadly look back at the year how you would characterize the level of price investments. Was it maybe above normal or normal? And as you think about next year, you talked about the external environment improving. What would you be planning in terms of price investments? And how could the benefit of the shift to generics possibly help fund some of that gross margin investment next year?

David B. Dillon

Well, let me first comment on last year. I feel like some of our investment in gross margin certainly was on price programs. But some of it was with a high rate of inflation. A higher rate of inflation tends to bring the gross profit rate down just a little bit, unless you try to chase the percentage, which we typically have not done. And that's a little part of it, too. So I wouldn't try to subscribe that all of the gross investment last year was purely based on our price programs and things we were trying to invest in like that. And as for this year looking forward, I think it would be very similar to that kind of thinking. I don't see it as a big difference, although I do think that the inflation's going to change a little, it will moderate a little bit. And so the impact from the inflation might be a little less pronounced during the year. Rodney, you want to add more color to it than that?

W. Rodney McMullen

Yes. The only other thing I would add is I always think that you have to separate the grocery and drug/GM departments away from the fresh departments in terms of meat, produce. And those departments are heavily influenced by commodity prices. And if you look at 2011, certainly from a commodity price inflation standpoint, it was significantly more than normal, which caused more-than-normal to get passed to the customer. But at the same time, there were times when we paid our fair share of that cost. So I really think you have to separate it into 2 buckets. And when you look at just the grocery departments in those, it was a pretty normal year. We would expect '12 to be pretty much staying along the same lines. On the fresh part of the business, that's much more commodity-driven.

Kelly A. Bania - BofA Merrill Lynch, Research Division

Great. And then just another question on market share. Thanks for all the color there. I was wondering if you could elaborate on fourth quarter market share trends versus Walmart. I think you mentioned you were up 40 basis points for the year. Wondering if that's changed at all in the fourth quarter? It sounds like Walmart's getting a little more price-aggressive. I'm wondering if you saw that or if there was any change.

W. Rodney McMullen

We really don't talk about by quarter-by-quarter because when you look at it within quarters, and this has been true for the last, I don't know, 5 or 10 years or however long we've tracked it, a lot more variability across quarter-to-quarter just because how the quality of how people report the data and all that. So there's a lot more volatility from quarter-to-quarter, so we really don't talk about it. We felt very good about where we were across the year and by quarter. And that's really the only thing that I would talk about.

Operator

Your last question will come from the line of Deborah Weinswig with Citi.

Deborah L. Weinswig - Citigroup Inc, Research Division

So Rodney, I think you said something really interesting with regards to -- the third quarter tonnage was essentially flat and slightly improving as you ended the year. Was there anything unique that you did at the end of 2011 to improve the tonnage, in your opinion?

W. Rodney McMullen

Nothing more than normal things that you would do. I mean, it really is trying to understand what's connecting and what's not and you modify along the way. But I wouldn't say it was one big, one item that caused it. I really think it's just you continue to learn and just getting a little bit better about on the things you're doing.

Deborah L. Weinswig - Citigroup Inc, Research Division

And then also in the prepared remarks, there was a comment, loyal customers spend about 50% of their food dollars with Kroger and that there was opportunity to grow that. Are there any current initiatives focused specifically on growing that dollar with the loyal customers?

David B. Dillon

All of them. Rodney, do you want to add to that?

W. Rodney McMullen

Yes, I mean, I'm not going to be able to be any more insightful than what Dave is. There are a lot of things that we're doing. It really is -- if you think about a football analogy, it's one play at a time. And it's fascinating, those customers would tell us they spend more than what they actually spend with us. And it really is trying to understand each customer segment and what's important to them and delivering better against that.

Deborah L. Weinswig - Citigroup Inc, Research Division

Okay. And then lastly, there was mention with regards to answering one of the questions that there's several technology projects that you're looking at that should be attractive for the long haul. Can you elaborate on what those might be?

J. Michael Schlotman

Probably wouldn't go into the list of them. But as you know, whenever you get into any kind of technology projects, they typically consume a bit of capital. And we want to make sure that we have the appropriate amount allocated and budgeted for that, and it does affect where CapEx winds up coming in.

David B. Dillon

Thank you very much. And so before we end the call today, I would like to share some additional thoughts with our associates who are listening in today. Because of your hard work in 2011, it was a big success. We made solid progress in connecting more with our customers, especially by offering better and faster service, and making sure that we have the products our customers want in stock. We worked hard to keep costs under control in ways that are meaningful to the business but not distracting to our customers. And we have successfully reinvested the costs that you saved. Our customers say that they can feel the difference. Thank you and keep up that great work.

This week, we invited 38 Kroger associates from across the entire company to join us in Cincinnati for a special celebration. These associates live our values and leadership model in their daily work. Together, this talented group has shown remarkable leadership, innovation and courage, each in his or her own special way. Our honorees this year include managers who lead strong and engaged store teams, associates whose new ideas have made a big difference, community service award winners, the associates who have joined the I Can Do That fitness challenge and made a healthy lifestyle change. We are inspired by their efforts to make our company better. Please help us congratulate and thank these associates. You can learn more about them by watching our quarterly broadcast tomorrow or reading on Great People.me in the coming weeks. That completes the call today. Thank you all for joining us.

Operator

Thank you all for your participation in today's conference. This does conclude the presentation. You may now disconnect. Have a wonderful day.