Kroger Co. (NYSE:KR) Q1 2018 Results Conference Call June 21, 2018 10:00 AM ET

Executives

Rebekah Manis - Director, IR

Rodney McMullen - Chairman & CEO

Mike Schlotman - EVP & CFO

Analysts

Michael Lasser - UBS

Edward Kelly - Wells Fargo

Karen Short - Barclays

Ken Goldman - JPMorgan

John Heinbockel - Guggenheim Securities

William Kirk - RBC Capital Markets

Judah Frommer - Credit Suisse

Rupesh Parikh - Oppenheimer

Vincent Sinisi - Morgan Stanley

Operator

Good morning and welcome to The Kroger Company's First Quarter Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Rebekah Manis, Director of Investor Relations. Please go ahead.

Rebekah Manis

Thank you, Laura. Good morning and thank you for joining us. Before we begin, I want to remind you that today's discussions 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, that Kroger assumes no obligation to update that information.

Both our first quarter press release and our prepared remarks from this conference call will be available on our website at ir.kroger.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 question and one follow-up question, if necessary. Thank you.

I will now turn the call over to Kroger's Chairman and Chief Executive Officer, Rodney McMullen.

Rodney McMullen

Thank you, Rebekah, and congratulations on your recent promotion to Director of Internal Relations. Mike and I really look forward to working with you in your new role in a closer basis.

Good morning everyone and thank you for joining us. With me today to review Kroger's first quarter 2018 results, is Executive Vice President and Chief Financial Officer, Mike Schlotman.

Restock Kroger is off to a great start, I am especially proud of our team's execution of process changes that led to strong cost controls. We are committed to knowing and serving our customers so well that Kroger serves all of their shopping needs. Our most fundamental strategy remains unchanged as customers' tastes change and their shopping habits evolve we will be there for them.

That means we will make the investments needed to provide our customers with the best full service grocery experience in America. Plus, we are investing in our associates more than ever before and seeing improvements in retention. We are creating a seamless environment where our customers can choose how to engage with us both in-store and online.

We are actively improving the store experience. Our space optimization work is ahead of schedule and our brands achieved another period of record growth while at the same time growing our digital sales by more than 66% in the first quarter, which was due to our ongoing expansion of ClickList, our delivery initiative and identical growth.

Our first quarter results enabled us to raise the low end of our EPS guidance for the year while also setting us up well to deliver to deliver on our identical sales target range for 2018. As you know, Restock Kroger is our three-year plan to create shareholder value by redefining how America eats.

We are making progress in each of the four main drivers, redefining the grocery customer experience, partner for customer value, develop talent and live our purpose. Using our deep insights and experience, Kroger is imagining the future of retail by building on our core business plus adding exciting and innovative partnerships like Ocado and our planned merger with Home Chef.

We believe the future of retail will include both physical and digital customer experiences. Everything we are doing today will enhance our ability to provide everyone in America with convenience of shopping for anything, anytime, anywhere. We are incredibly excited that it is Kroger who is bringing Ocado technology to the U.S. for the first time.

The platform includes online ordering automated fulfillment and home delivery capabilities, so it's a perfect fit with our vision and strategy. We look forward to innovating together with Ocado to enhance Kroger's digital and robotics capabilities. And we are already working to identify the first three sites for development of the new automated warehouse facilities in the U.S. to deploy Ocado's proprietary technology and distribution expertise.

Customers want convenience, simplicity and personalized food experience. Our planned merger with Home Chef will accelerate our ability to deliver exactly this. There is a lot that we admire about Home Chef, their creativity and entrepreneurial energy, and their use of data to connect with customers to name just a few. We believe that by taking over Kroger's meal solutions portfolio, Home Chef will bring our customers even more innovation and delicious offerings so customers can be the hero at meal time.

Pat and his team at Home Chef will be able to leverage Kroger assets both our physical stores and data to drive their business even more, and by joining forces, we can grow bigger together than either of us could have done alone. We continue to execute our digital strategy through our core business as well.

As I said before, the households that participate in our seamless offerings, those who engage with our digital platforms and our physical stores spend more per week than households that do not. And households that purchase from us online spend even more.

We've aggressively growing our existing seamless coverage to reach approximately 75% of our customers. This includes our network of ClickList locations, stores offering home delivery through Instacart and other partners, as well as ship to home capabilities. Our goal is to reach a 100% of our customers with seamless experience and over time to reach all across America. All the changes we are making to transform our business will make it even easier for families to share meals together, this business strategy enables us to live our Kroger purpose because we know that family who spend share meals together have even a better relationship and if they have children they do better in all aspects of their lives.

Our brand is another example of how we are redefining the grocery customer experience. Kroger customers choose to put more of our brand in their basket and pantries every day. Our brands grew faster than the national brands in nearly every department and gain significant share overall. In the first quarter, our brands made up 28.7% of unit sales and 26.7% of sales dollars. In fact, our brands set the record for the highest ever retail dollar share in our history. Our brands achieved a 5.1% sales growth at a 3.4% unit growth in the first quarter led by double digit growth again in our popular Simple Truth and Simple Truth Organic lines.

Last quarter, we said that the Federal Tax Cuts and Jobs Act would enable us to accelerate investments and Restock Kroger. This is possible because we are taking a balanced approach to how we are spending and investing the benefits. It’s distributed evenly between our associates, our customers and our shareholders. This approach is in line with Kroger's purpose and is helping us make strategic investments and Develop Talent.

We are investing more than ever before in our associate experience. It all starts with the $0.5 billion investment in wages for many store associates that is part of Restock Kroger. We’re also increasing the Company's 401 contribution match to help associates retire with more money in their pockets plus expanding associate discounts to keep more money in their pockets today.

The one piece that I am most excited about is Feed Your Future, our new offer of up to $3,500 in annual tuition assistance to any associate who wants to attend classes to build a better future for themselves, whether they're interested in completing a GED or an undergraduate degree, an MBA or professional certification, associates can take advantage of up to $21,000 in total assistance as long as they’ve been with us for at least six months, and that’s on whether they’re full time or part time employee.

And someone who got their start stocking shelves on the night shift in Lexington, Kentucky for Kroger in 1978, I can attest education’s life-changing power. I worked my way through college and upon graduation, I was so proud to accept a full-time job with Kroger. The incredible learning experiences and work that makes a difference in people's daily lives has kept me here ever since. Kroger has always been a place where people can come for a job and stay for their career.

We believe that making education benefits available to more associates and at more generous levels than ever before, is the best way to support their career and their future professional growth. And as part of Restock Kroger, we fully expect these investments will have an ROI that will create shareholder value. We are in the process of transforming our business, so that in the future we can connect with customers in ways that add more ease and convenience to their lives.

To do this and to do it profitably, we must have an economic model that supports this transformation. Kroger is better positioned than anyone to make this transformation because we have a set of unique and differentiating strengths. Kroger has more data than any of our competitors, which leads us to deep customer knowledge and unheralded personalization. We have incredibly convenient locations and platforms for pickup and delivery within 1 to 2 miles of our customers.

We have a leadership team that combines broad experience with creativity and diversity of thought. We have the scale to win with more than 60 million households shopping with us annually. We connect personally with our associates, customers and community to uplift and improve lives and we have a proven track record of consistently returning capital to shareholders through an increasing dividend and share buyback program.

Because of these strengths we are on track to generate the free cash flow and incremental FIFO operating profit we committed to in Restock Kroger, we are confident in our ability to deliver on both our plan for the year and our long-term vision to serve America through food inspiration and uplift.

Now, here is Mike to share more details on our first quarter and update you on our guidance for 2018. Mike.

Mike Schlotman

Thanks, Rodney, and good morning everyone, we're very pleased with our first quarter ID sales and earnings results. We did slightly better than our internal expectations. We completed the sale of our convenience stores business unit, and as Rodney said, we had one of the best cost control quarters in a long time due to implementing process changes. This is important because over the next three years, Restock Kroger will be fueled by cost savings that we will invest in associates, customers and our infrastructure.

Our goal is to continue generating shareholder value even as we make these strategic investments to grow our business. We expect Restock Kroger to generate $6.5 billion of free cash flow over the next three years. This is before dividends and considers the benefit of the tax plan. We've already reprioritized the way we will invest capital over the next three years by both reducing the amount we spend and optimizing our capital allocation process.

We now look first for sales driving and cost savings opportunities across both brick-and-mortar and digital platforms. Second, we will continue to make sure our logistics and technology platforms keep pace with and scale these demand through continued investment. Finally, we will allocate capital to storing activity. This process has allowed us to use less free cash flow for capital investments.

Our investment in Ocado is a great example of what's possible with our new approach to investing capital. We continue to aggressively managing OG&A costs and implement new programs to reduce our cost of goods sold. A big focus continues to be on store productivity and waste. Our team's controlled shrink in the first quarter, as we said before, we won't leave a penny on the table as we seek to reinvest savings to grow our business.

We plan to generate $400 million in incremental FIFO operating profit through 2020. We're taking advantage of the lower federal taxes under the Tax Cuts and Jobs Act to pull investments forward into 2018, so we can move even faster on Restock Kroger than originally anticipated. Our full forward investments in Restock Kroger began in the last four weeks of the first quarter. While the incremental 401(k) contribution match investment was retroactive the first of the year, costs to support our new associate education program feature future have not begun in earnest.

Our investments and wages will roll in as contracts are negotiated and the education payments will occur over time as associates take advantage of the opportunities to further their education. We will make investments for the rest of the year to drive our strategy and keep prices low to retain our customers. As a reminder since 2000, we've reduced prices to our customers by over $4 billion. We intend to continue investing in price to drive unit and ID sales growth while delivering on bottom line for shareholders.

We manage our business every day to drive shareholder value. Our investments in restock Kroger in defining the grocery customer experience, partnering for customer value and developing talent. We paid for by costs of good savings, strong ID sales and productivity gains. This is precisely where the incremental FIFO operating profit will come from over the next three years.

For ID sales were pleased with the result of the first quarter. Several departments outperformed the Company in the first quarter, most notably Meat, Seafood and our Floral department. Natural Foods continue to generate strong double-digit growth in the first quarter, and during the quarter, we saw growth in households and loyal households as well as unit growth.

As noted in our press release this morning we reported identical supermarket sales without fuel of 1.4%. This result was aligned with our internal expectations for the quarter. When calculating identical sales to be more inclusive of all company business units including Kroger specialty pharmacy and ship to home solutions our ID sales without fuel 1.9% in the first quarter.

We intend to use this calculation going forward as it presents a comprehensive view of our performance as we redefine the grocery customer experience, and is therefore more appropriate measure of performance. We also look at what others include in their ID calculations and have taken the steps to be more consistent with our peers report.

Our space optimization work is right on plan. We had about 30% of our plan, 600 stores completed for 2018. Space optimization will continue to be a headwind to ID sales into late third quarter. By then we will have more stores completed and maturing then in process or not yet started, which is why it will start to be a benefit to sales later in the year.

Retail fuel performance during the quarter was good again, our cents per gallon fuel margin was $18.7 compared to $17.1 in last year's first quarter. The average retail price of fuel was $2.65 versus $2.20 in the same quarter last year. This includes convenience stores for the period prior to the divestiture.

In April, we completed the sale of our convenience store business unit for $2.15 billion. After tax proceeds with total 1.7 billion. We are returning a significant amount of the capital to shareholders through our $1.2 billion accelerated share repurchase program, and we use the balance of the after-tax proceeds to lower our net total debt to adjusted EBITDA ratio compared to the end of fiscal 2017.

Kroger's net total debt to adjusted EBITDA ratio increased to 2.43 on a 52-week basis. Our net total debt to adjusted EBITDA ratio target range is 2.3 to 2.5 times. We expect our net total debt to adjusted EBITDA ratio to increase throughout the year due to increased borrowings to fund our investment in Ocado, our planned merger with Home Chef, and tax payments related to the gain from the sale of our convenience store business unit.

Our financial strategy is to use our free cash flow to drive growth while also maintaining our current investment grade debt rating and returning capital to shareholders. We continually balance the use of cash flow to achieve these goals. Over the last four quarters we used cash to contribute an incremental $1.2 billion pretax to company-sponsored pension plans and $467 million pretax to satisfy withdrawal obligations to the Central States Pension Fund.

Repurchased 110 million common shares for $2.7 billion, which includes 1.1 billion repurchase with the accelerated stock repurchase plan, pay $442 million in dividends and invest $3 billion in capital. At the end of the first quarter we had approximately $546 million remaining under the March share repurchase authorization. Purchases under the ASR will be completed no later than July 6th.

We’re investing an incremental $500 million in our associates in wages, training and development over the next three years through Restock Kroger. This will be in addition to our continued efforts to rebalance pay and benefits while also focusing on certifications and performance incentives, career opportunities and training. We have several major negotiations in 2018, including contracts with the UFCW for store associates at Smith's in Albuquerque, Fred Meyer in Portland and Kroger stores in Richmond and Fort Wayne.

Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and a compensation package to provide solid wages, good quality, affordable healthcare, and retirement benefits for our associates. We continue to strive to make our overall benefit package relevant to today's associates.

Our financial results continue to be pressured by inefficient healthcare and pension costs, which some of our competitors do not face. We continue to communicate with our local unions and the international unions, which represent many of our associates, the importance of growing our business and profitably, which will help us create more jobs and career opportunities and enhance job security for our associates.

Turning now to guidance for 2018, we expect identical sales growth excluding fuel, to range from 2% to 2.5% in 2018. This reflects our updated definition of identical sales and is supported by an expectation for identical supermarket sales that is the same as our original guidance for the year. To be clear if we hadn't updated the ID sales definition we would've confirmed our original guidance for the year this morning.

We have raised the low end of our net earnings guidance range to $3.64 to $3.79 per diluted share for 2018. The previous GAAP range was 3.59 to 3.79. On an adjusted basis, we raised the low end of our net earnings guidance range to $2 to $2.15 per diluted share compared to a $2.95 to 2.15 previously. We feel very good about the year. We plan for the first quarter to be our strongest EPS quarter, which creates a tailwind for the investments we plan the rest of the year.

Our first quarter was a $0.10 outperformance over the consensus forecast, and as I said earlier, was also a little better than our internal expectations. Looking at the consensus forecast for the remainder of the year, we believe the second and fourth quarters are a little high compared to our own expectations and the third quarter looks reasonable.

I am taking the unusual step of commenting on this, because if you simply add the $0.10 to your forecast for the year that would put the consensus above the high side of our guidance range. We are off to a great start to 2018 and are on pace to deliver our $2 to $2.15 net earnings per diluted share guidance range for the year. We continue to expect capital investments, excluding mergers, acquisitions and the purchases of leased facilities to be approximately $3 billion for 2018.

And finally, we expect our 2018 tax rate to be approximately 22%. And now, I'll turn it back to Rodney.

Rodney McMullen

Thanks Mike. When we announced Restock Kroger, we talked about retailers needing to constantly reinvent themselves. It takes time to do this we're now past the halfway point and everything we are doing today is transforming our business for renewed growth. For 2018, we are a little ahead of where we thought we'd be. We're hitting our cost control targets due to process change, improving the associate experience and innovating to create the future of retail.

That innovation is both internal and external. We are joining up with external partners like Ocado and Home Chef to create customer value while quickly expanding our seamless coverage area. We remain confident in our ability to deliver both on our plan for the year and to execute Restock Kroger over the next three years, which will create shareholder value.

Now, we look forward to your questions.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Michael Lasser of UBS.

Michael Lasser

Two questions, one, why is buy versus build the right decision for some of the recent actions you've taken, particularly in the home delivery market that is increasingly competitive and has relatively low barriers to entry? And then I had a second question on the guidance.

Mike Schlotman

I am not sure what you mean by buy versus build on the home delivery. We really haven't -- obviously with Home Chef and the meal kits, we do anticipate merging with them and they have a great process and a great home delivery business of those meal kits. But as Rodney said, they're also going to take over managing the in-store portion of that business as well, so they'll get inside not just a home delivery but also delivering meals to those customers in the brick-and-mortar environment as well.

On other aspects of home delivery, we're actually creating partnerships whether it’s with Instacart as we do today in areas or as we further our relationship with Ocado and start building the sheds here in the U.S. and have that be an avenue for home delivery as well. We think some of these partnerships and the phenomenal technology and proprietary information and processes that Ocado has will accelerate our abilities to do those in the U.S.

Rodney McMullen

Just one additional thing to Mike's comment, I mean we're really looking at what's the blend of both and which one accelerates for us to be able to get a complete as fast as possible in an efficient way of making sure that we maintain and grow in the relationship with the customer. So, it’s really looking at partnership and some things we continue to build on our own if you look at our own ClickList business we're growing on our own, so it's really a blend of both.

Michael Lasser

That's helpful. My follow-up question is on the guidance. Can you give us a little bit more insight into some of the moving pieces? Have you changed what's embedded for operating profit dollars for this year, particularly after it sounds like you're seeing more success with some of the process improvement and process changes that are resulting in SG&A dollar savings even there is -- it's hard for us to tell given what's been provided?

Mike Schlotman

That I would say, we haven't changed our view of where operating profit dollars would trend for the year being consistent view that we would expect overall for 2018 to be a bit of an investment year. Obviously, our share count a lot lower which will help earnings per share calculation. We are off to a great start for the year. I think, we purposely if you look at how we set this year up.

We purposely make sure we had some other savings in the bank from the process changes. We began the pull forward of investments in the business in the last several weeks of the quarter. So, you didn't see a lot of the effect from the investments we're going to making in price and other service elements in the store until very late quarter. Those will start to happen in the second quarter and throughout the rest of the year as well.

Operator

The next question will come from Edward Kelly from Wells Fargo.

Edward Kelly

I want to first just ask about the comps and the outlook. Could you talk about the cadence of the ID's throughout the quarter and what you're seeing so far in Q2? And just as we think about the full year obviously you maintained your ID guidance. It does look like this is going to be less inflation probably than maybe we would have thought about a quarter ago. So I guess it suggests that your outlook on tonnage is probably bit better than what it's been, and clearly just to get to that number right you need an improvement from here. So in addition, thoughts on all that would be helpful.

Mike Schlotman

Sure, Ed. If you look at IDs obviously we're just barely below the guidance range even through old definition and new definition really 10 basis point short of being inside our guidance range for the year. So it's not a huge hill to climb to be inside the guidance range for the year. There are a lot of moving parts to ID sales out there, I would agree with you on inflation. There certainly isn't as much inflation, there is between 1% and 2% inflation in pharmacy the rest of the business would probably be 1/2% to a little less than half percent and in some categories it's actually deflationary, but it's a little bit all over the board.

When you think about as we continue to execute our space optimization strategy that certainly creates a headwind today. We think that headwind will continue to mitigate throughout the second quarter little bit of the lesson will continue to be a headwind. And by the time we get the late third quarter, we would expect that the terms to be a tailwind which we think will help offset some of the headwind we create on our own on the retail cost deflation by the investments and prices were making.

I would say our expectations for ID sales this year were not really predicated on an inflation driven result. It was based on a unit driven result just when you think about the fact we knew we were going to be creating headwinds early in the year with space optimization. And now that we've done the first lot of the pull forward investments we plan to make at the end of this quarter that will create some a bit of a headwind in the near-term as well.

And answer your question about where we are so far in the quarter, I think our expectations from the quarter would be that we would expect to be somewhere in the neighborhood of where in this years in the first quarter, we would expect the second quarter to be comparable to that. We’re slightly below it but to keep in mind, we were probably at the peak of the headwind for space optimization today and will write in the biggest portion of haven't made all the pull forward price investments we made in the last four weeks of the quarter, although the conversion right now.

We continue to be very happy with the unit growth we see and the response from our customers of what we see in reaction to the price investment, a lot of those in our brands and you heard Rodney talk about our brand, unit growth in the first quarter of over 5%, which is it's not only phenomenal product, it's a phenomenal result and even more value for our customers.

Edward Kelly

And just another question for you is on labor and labor negotiations and structuring the contracts. Obviously, it does seem like you're approaching negotiations a little bit differently and trying to structure contracts that provide you with more flexibility within the store, particularly around sort of like who can do what, right. Can you just give a little bit more color on what you're looking to accomplish there? And as we think about the structure of those changes, how does that play into your ability to drive labor cost savings in the stores going forward?

Rodney McMullen

If you look at overall, in terms of the approach, it's really contemporizing the way our associates are paid. And understanding, we have five generations in the workforce and having a pay design that connects with each one of those five generations. So, a big part of every negotiation is understanding, the balance between healthcare and pension. We still have as Mike mentioned one of the most generous healthcare and pension benefits in the industry. Some of our younger associates, that's not as important in making sure that we balance plan designs with wages.

As you know, we've increased starting wages and a lot of the acceleration that's part of Restock Kroger was acceleration of starting wages. And as I mentioned in the prepared remarks, we are seeing improvements in retention. The -- in terms of the ability, you're always working on process changes to improve how the workflows and use direct -- reduce labor, so that our -- we can reinvest that labor in better service, so if you think about today we're investing labor and ClickList, we're investing labor in some of the service department. And what we're able to do is, as our business continues to grow, it also creates more demand on people.

I don’t know Mike anything you want to add to that.

Mike Schlotman

No, I absolutely agree, and one of the exciting things we’re seeing is we’re starting to see the green shoots of the investments and the opening wage rates for our associates and our ability to retain that associate for longer period of time. If we can keep that associate for a full year, we’re actually on the positive side of the investment, because we haven’t invested -- we haven’t had the hire and train and get a new associate up to speed and that cost is actually more than the $1 an hour wage investment for 2,000 in ADRs worked in the year. So, it winds up being very positive for our associates. They can -- they get more pay and it winds being positive for our customers because you have a more experienced and recognizable workforce as well.

Rodney McMullen

And you hear us talk about a lot about opportunity culture and what we find is, when people love people and love working with people and they love food, we’re beautiful place to come and people come here for a job. But as they spent time around people and the fast growing and the ability to understand how they impact people's lives every single day, they fall in love with it, next when it becomes a career. And the nice thing about us is many of people -- over 70% of our store managers, started out as hourly associate. So it’s a great place to come for a job and then make it a career.

Edward Kelly

I guess what I was trying to get at, I think part of the reason that your cost structure is higher is because there are different work rules in the stores relative to some of your non-unionized peers. And those things that you're able to address through restructuring of labor contracts, I think more recently maybe you had done that on one of the contracts that you talked about.

Mike Schlotman

It's certainly a component in every negotiation we have of getting wall-to-wall clerk status in those contracts. So whatever task needs to be completed next, we can manage a workforce that can do all the tasks inside of the store rather than need to have three or four different employees all ready to do the next task in each individual department. That was clearly a component of the Cincinnati negotiation that we completed most recently.

And it's not like flipping the switch for Cincinnati where they immediately understand how to manage the work schedule with a clerk like that after many years of not having that type of a clerk. So those savings continue to grow in the Cincinnati market. But we strive to get that more and more, it's an important component of -- when we have to hire, we have to have fewer people, because I can have one person work 15 or 16 hours a week instead of four people working a few hours in every department.

Operator

The next question comes from Karen Short of Barclays.

Karen Short

So I just want to make sure I'm understanding this. So Mike based on your comments on consensus EPS for 2Q, 3Q and 4Q, it implies operating profit swing from being slightly up in 1Q to being down somewhere in the 20% range 2Q to 4Q. First of all, is that --- that's fair, right?

Mike Schlotman

I don't have that exact math right in front of me. We've been very outspoken about the fact that we expect operating profit dollars to be -- FIFO operating profit dollars to be down this year as compared to last year. That would continue to be our expectation. And as I said earlier in the prepared comments, we continue to make the investments in the business, and maybe came later in the year as well.

Karen Short

And the reason that the swing is so extreme from 1Q into 2Q is as you said, the remodels ramp and price investments ramp pretty meaningfully?

Mike Schlotman

Well, we made a lot of the pull forward price investments we made in the last four weeks of the quarter. We wanted to make sure we had that tailwind and knew that we were going to get the cost savings before we made investments and just hope about it. One other thing I would remind you about the year-on-year comparison is last year had 53 weeks and this year has 52 weeks. So you have to adjust for that as well.

Karen Short

And so just switching gears, I'm just wondering if you could maybe give us an update on how many units you’ve actually or maybe you will have completed on the Restock program by the end of maybe 2Q. And then if there's any early indication you could give us on how you think comps of those stores are performing. And maybe separate out how comps in stores that didn't have optimization are performing versus the ones that did.

Mike Schlotman

Well, I guess I could give you comp by store too. As I said in my prepared remarks, we're about 30% of the way through the 600, so that would mean we’ve got about 200 or so of the stores completed. That doesn't mean that they've gone through the maturation process that it takes a few weeks after the completion for the customer to come back in the store, get familiar with the new layout of the store, make sure -- there are instances where our customer is looking for something and in the near term throws up the white flag until they figure out exactly where everything is located in the new layout.

Now we staff up and have maps and things like that but that takes a while. As I said earlier, we expect over the course of the next couple of periods that the peak amount of the headwind from the space optimization will be occurring. And by the time we get late in the third quarter, we will clearly have more stores completed going through on the upside on the maturation process than stores we have left to start or that are still in process. It's a little early at this point in time to talk about the stores and the lift we're having.

We actually had that conversation yesterday in our meeting, and we would think -- we think that's probably something will address in the second quarter. What I would tell you is what we're seeing so far is exactly the pattern that we would expect it and that we saw on the 20 or so stores we did early in this process to determine it was something worth doing on a broader basis. So we haven't seen any surprises whatsoever.

Karen Short

And then just last question. Has there been any contemplation that maybe you could accelerate opening the Ocado facilities. I mean, I know you've given us the timeline and you're still evaluating the market. But it would seem that maybe an acceleration would be -- something that would be viewed favorably.

Rodney McMullen

Well, we're going to open the facilities as fast as we can. Obviously, there's a certain amount of time that takes to construct a facility and then for Ocado to build it out. So there is plenty of pressure on Ocado and us to get them open as quickly as we can. But there is obviously a certain amount of time in terms of what it takes to actually get the work done.

Rodney McMullen

I just want to point out one thing on your question on operating profit. I would encourage you to look at the tables attached to the press release to understand the adjustment items that are in their, because I think when you pull out the sea stores, when you pull out -- we had a mark to market gain on the Ocado shares we owned before the announcement of the merger that was like $36 million, which is on Table 6 of the earnings release.

I think when you look at operating profit margin dollars apples-to-apples, the dollars were actually down slightly in the quarter as compared to last year not up, which is exactly the trend we expect. But again it goes -- it's all about balance and trying to keep things within the range we have. There were several things that happened in the first quarter that were income that we took out of adjustment items when you look at, I think it's Table 6 in the press release. That will an important table for everybody to look at.

Operator

The next question comes from Ken Goldman of JPMorgan.

Ken Goldman

I just wanted to first clarify. What is outside ID sales now? Is it just new stores, remodels and jewelry, or am I missing something?

Rodney McMullen

Net new stores would not be in, relocations with not be in. Well the stores don’t go in until they’re open in your current state for five full quarters, so expand, relocate or open a new store it’s the fifth quarter where they go in. There are other parts of our businesses that generate revenue and things like 8451 in our data sales, and those items that we don't include in ID sales. What is in ID sales or things we sell directly to a customer, whether it's through a brick-and-mortar store or an online business, that is what's in ID sales today going forward.

Mike Schlotman

Some of our competitors would include expansions, but we do not include expansions in our calculation. We didn’t before and we still don't, Tim.

Ken Goldman

I also wanted to ask a little bit about Rodney's comment about over time reaching all of America. And given that the Northeast has such a dense population and given that you don't really have a presence there. Is that Rodney about how you view the potential of Ocado, going forward? I just wanted to get a sense of what that comment meant, or maybe I misheard it and just wanted some clarification there if I could?

Rodney McMullen

No, you did not mishear it and that is our vision and our aspiration. And obviously, that will be one piece of the puzzle on serving that home chef will also be one piece of serving. And our customers tell us, we do a great job of helping them solve everyday needs in a great way. In any way that we can expand the number of people that can get access to that, that's good for our customers, it's good for our associates and when we do things good for that our shareholders benefit. So you did not misinterpret my comment.

Ken Goldman

One last one if I could just sneak one in, thank you for that is on your corporate brands, your own brands. Do you think -- you talked them up a little bit more than usual, I think. At least the tone seemed to be that way to me. How much of that was due to some of the changes you've made in Restock Kroger in terms of prioritizing private label in certain categories, putting them at the top right in the middle of the shelf? So I just wanted to get an idea of whether there's a correlation there in your mind?

Rodney McMullen

Yes, let me give you a little bit more answer Kent than you probably even want. But one of the things last year that our team did was a very elaborate analysis of our brands versus our competitors', their own brands and we also did taste comparisons and quality comparisons versus national brand. And one of the things that we had underappreciated was the quality of our product stored incredibly well with our customers and potential customers.

So one of the things that Mike and Robert and their teams and Gill, their teams decided to do was based on that insight is to be much more aggressive about telling our customers the quality of what we have and what we have to offer. So really that's what caused us to make our own brand such a key and integral part of Restock Kroger, it's that commitment and drive that our customers are supporting us and it's showing in the result.

Operator

And our next question comes from John Heinbockel with Guggenheim Securities.

John Heinbockel

So I know it's early, but two questions on Ocado. It obviously can do a lot of things for you. But when you think about the ability to do ClickList in a more labor efficient manner, maybe be less disruptive to the stores. So how important is that on the pecking order? And then if it is important just the transition, how would you transition that? And then secondly, when you do Ocado in a market when you don't have brick-and-mortar, is it important -- could you -- would you want to have some brick-and-mortar and does that open the door to partnering with other retailers, or is that just too difficult to do?

Rodney McMullen

I love your questions, and I agree with your comment that it's early in the process. What we're really trying to do is to make sure that we have an overall infrastructure for digital that can support, whether it's 5% of share or 30% of share. If it ends up being 30% of share in grocery as digital then the Ocado, you'll have more sheds and they'll be used to take pressure off of the store, and the store will become more of a distribution point.

So what we're really trying to design is flexibility of a system that can scale based on how the customer changes. We would expect that Ocado would be something that we will pick orders out for stores as the orders in the store becomes high enough percentage that affects the customers' experience.

John Heinbockel

Today, there's no -- because the volume is so modest, there's no evidence that doing ClickList adversely impacts the in store experience. Correct?

Rodney McMullen

Yes, so far it doesn't. But the thing that we don't know, if you look at our sales growth on ClickList or digital overall was in the high 60s, and some of that growth is driven by identical and we're starting to get a pretty good base of identical stores that are on ClickList. If it continues to grow at its pace, we certainly see when you go out a couple of years where it could, and we want to be proactive on be in position to deal with it versus reactive to dealing with it…

John Heinbockel

And then just lastly, the price investments you're making this year compared to prior rounds. What does the elasticity look like? So I imagine there's -- we're getting -- you did the high-volume items first, we're getting to a longer tail. Is the elasticity less significant than prior rounds?

Rodney McMullen

I guess I would -- elasticity is consistent with what we expected it would be. There are certain categories where there is very little elasticity there is others that would have elasticity. So, so far the investments have been consistent with what we would have expected. And you're always balancing a mix between those different items.

Operator

And the next question comes from William Kirk of RBC Capital Markets.

William Kirk

So we've seen some high profile closures at some of your competitors. I guess, the first part of that is, have you seen a material benefit from any of those closures. And second do you expect more closures to come, and in particular, I am thinking the California market. Is there any pending closures that you'd expect in that marketplace?

Rodney McMullen

Well, you can certainly never predict when a competitor is going to wind up closing. And if you look around some of our markets where they've been closures, we've been the beneficiary in a few ways; one, from picking up the business; two, from picking up some of their closed store sites like we did in Indianapolis when Marsh closed and Farm Fresh has exited the Hampton Rose area. We picked up some of those stores and some other folks have as well.

You continue to see those things happening as well. Southeastern Grocers as they emerge from bankruptcy were not obviously very affected by the stores in Florida they closed. But as they repositioned their portfolio of Bi-Lo stores there're certainly a number of those that would've gone up against either a Kroger store or a Harris Teeter store. So those wind up being beneficial. We didn't really pick up much of anything from there. There was only one or two stores that had any interest. And I frankly don't even know if they came to fruition as I sit here right now.

But anytime a store closes in a market it winds up helping. Sometimes our folks say what they're only doing next volume in the business, and I'd say well if you get half of that to buy the sales in the near store, you're talking 3% to 4% ID for that store. So it can be beneficial when those come in on top, because those incremental sales are very valuable.

Mike Schlotman

And broader over time, this isn’t specific to any market. We would expect continued consolidation in our industry and that’s been a trend that’s happened for the last 20-30 years. And I am trying to remember, Mike may have mentioned at this morning on one of the interviews. If you look at competitors in terms of who has market share, almost 30% of the market share is still held by people without our economies scale.

Rodney McMullen

And then separately on the convenience stores, now that that transaction is closed, are there any other assets that would be worth considering divestiture, or is that the streamlining that needs to be done at this time?

Rodney McMullen

We’re constantly looking at our portfolio as we constantly look at closing underperforming stores and reallocating capital. I wouldn't say that specifically want to sell anything or buy anything, but we were cognizant of what might be more valuable to someone else versus us that's really what happened with the convenience store business. It’s a business we have invested a lot of capital in and multiples of EBITDA for the sales of those are pretty much at all-time highs. And it was a prudent time to have that asset and we found a great partner in EG who wound up taking all of our associates. And it’s a process we go through with our board on a regular basis. So they understand which assets that we have or generating a good return on invested capital and which aren’t.

Operator

And the next question comes from Judah Frommer of Credit Suisse.

Judah Frommer

So first maybe just on the competitive and pricing environment, and this is somewhat tied to inflation. But if we look into commentary out of what I would call some smaller players, it sounds like they are seeing some passing on or whatever little inflation there it is to shelf pricing. But that seems less and less important for players like yourselves or larger competitors that are more focused on targeted promotion. So what are you seeing out there and how important is it to continue to invest in pricing environment where maybe some other players are pulling back there.

Rodney McMullen

Well, in our mind as you know, a big portion and a fundamental piece of Restock Kroger is to continue to invest in our business and that take several forms. It's when we say investment in business, everybody mainly goes to price. Price is an important component of it. We are making investments and price in certain categories. I would say we're not opposed to a retail shelf price going up. And sometimes we have to be cognizant as the dominant player in many markets.

If there's price inflation in a particular category, if the big players don't pass on that inflation, it's probably not going to get passed on. So we do make those value judgments day-in and day-out as we look into particular categories where the inflation might be. This is a game of what's -- how do we make sure that our offering resonates with the consumers and we try to balance all facets of that.

Judah Frommer

And then maybe switching gears back to Ocado. If we think about ClickList and home delivery being the key components of online grocery now, and what Ocado has been doing in their home market in terms of better profitability on basket given just fewer picking touches and efficiencies like that. How do you think about the potential for your online grocery business profitability over time as Ocado comes in?

Rodney McMullen

We would certainly view that it's part of the overall equation and improving the profitability over time. But we're -- as you've heard us talk about before, what we’re really focused on is when somebody decides to eat something they can get it from us. And we’re increasingly adding delivery service to markets. We’re using our data that help inspire people on what meal that they will enjoy. So it’s part of that overall ecosystem as we create the retail of the future. So it’s an important component of that, but it’s one piece of the total puzzle.

Operator

And the next question comes from Rupesh Parikh of Oppenheimer.

Rupesh Parikh

So I wanted to touch on your commentary just about better cost controls during the quarter. Is there any more color you can provide in terms of what’s driving those improvements and the process changes, and the benefits on your cost line?

Rodney McMullen

Well, as I mentioned in prepared comments, our strength, folks add, great results in the quarter and continue to get a better result on our waste. And they're looking at it -- really, they don't use the word strength, we use the word strength, because that’s what resonates with all of you. Internally; we talk about waste and they're trying to understand every facet of waste, whether it's not having the product aligned in the back the right way to get on the sales floor before it goes out of code; making sure that back doors are locked, so product only comes in the back door, not out the back door; making sure that the high theft areas of our store are monitored generally electronically; you can go in the stores today and you’ll see visible cameras in high theft areas, like in cosmetics.

They probably saw me this weekend when I waved to one of the cameras when I was in my local Kroger store, they probably wondering that -- now they’re probably going to watch me in every store I go into, but those techniques are out there to prevent the waste. And when you have those kinds of techniques in there, people are less likely to even try. And when they do try and they get caught, that does spread through that community and they stop trying with you. But it goes across the broad spectrum of monitors on cooler doors not being shut in the store. And if it’s open for x seconds, not only there is wasted energy it lets hot air in and the product quality can be diminished.

What was our temperature monitoring process that we actually originally put in as a labor savings initiative in the store. So we didn't have to go about the store and starting to talk like the Brits go about the store, spending a lot of time with Ocado. But go about the store and take temperatures throughout and what you really find is it winds being quite a bit of the waste reduction benefit in keeping the cold chain secure. I’d like to say it used to be -- you didn’t know a ice cream freezer was losing temperature and until you saw the ice cream melt.

Now, we get an alert that that motor and that ice cream case is being inefficient. You can get the product out, get the motor fixed probably get it fixed with a repair instead of a replacement like what we used to have to do in the past, so there's a whole lot of things like that. I highlight waste today, because they’re working really hard and having really great results. And I want to have a little bit of a shout out to that team and thank you for all the hard work they've done, it's starting to show in the results.

Operator

And that final question will come from Vincent Sinisi of Morgan Stanley.

Vincent Sinisi

So wanted to go back, obviously, it's still early, but digital clearly increasing in focus. just wondering with maybe some of 8451 data that you guys have and some of the areas where it's a bit longer. Can you give us any further color on what you are seeing from a customer perspective? So meaning in the stores where some forms of it have been available for a while. How's the progression changing? What's in the basket, ticket frequency, to the store? And maybe also just as you're looking at these first three Ocado facilities, anything at this point that you can provide in terms of thoughts around how much of the geographies or stores that may encompass.

Rodney McMullen

Well, if you look at digital, I think the key point and this is the part that hasn't surprised us at all. When a customer engages with us digitally, we get a higher share of their total household spend. And what we find is the customer still comes into the store, but they come in to it based on when they want to. Or an example I always think of is, if you’ve got a couple of kids at home and they bring their friends over, you probably didn't buy food for their friends and somebody will stop by or get a delivery to their house really quick.

So what we find is the more digitally engaged somebody is the higher their total household spend is. It's not necessarily consistent from week-to-week in terms of your share of how much of its digital and how much of it is physical in the store, the thing that's absolutely critical is to do it in a seamless way. And do it seamlessly from food inspiration or help you eat healthier. We just launched an app called OptUP, and we're able to -- if a customer opts in, we can help a customer eat better on a sugar basis, over time we'll have more functionality. But today it's more minimizing and managing your sugar intake. But all of those things is how do we make your life easier and how do you live your life -- how do we help support you living your life the way you want to. So everything that we're doing -- what we're trying to do is to make sure it’s seamless across all our channels. So that's really the piece that we're working hard on.

On your second question on Ocado, that's one of the things that the Ocado team is actually working with us and modeling, is to understand how far can a shed reach in a market. And as you know, with Ocado, they also have local depots as well that will be part of a shed network. And right now, they are actually modeling, answering your question -- your question is a great one but we are in the middle of modeling that. And so at some point, we'll be able to answer it with more specifics. But at this point, we're still working on that.

Vincent Sinisi

And if I could just fit one more fast one in here if you don't mind, because we get asked about this all the time. I think it's been now two quarters since you had mentioned within some of the gross margin benefit about vendor negotiations. Any updates there, how are some of those conversations going? And maybe just, even as go through the year, I think 3Q just from a compares is the most difficult, so any updates there that you could share -- or just basic thoughts that would be great? Thanks guys.

Rodney McMullen

So our team that negotiates the cost of goods with our vendors continue to have great success using a variety of techniques depending on the category. And keep in mind everything we do on our negotiation process begins with the customer in the forefront and understanding by category what items are important to the customer, what items might be less important to the customer. And that begins the entire negotiation process, and often times playing one vendor off of another when the customer might be indifferent to it.

I would say it's right on track with our expectation and is a big component of our expected savings over the next three years. And I’m thrilled with what that entire team has done and we brought some new talent into that group, and we’re really thrilled with how that group has hit the ground running on, not only cost of goods savings or goods for sale, but also goods not for resale, so supplies and the like and other items that we consume ourselves and doing business every day.

Vincent Sinisi

Perfect, good luck guys, thanks.

Rodney McMullen

We are incredibly confident about the future of Kroger, especially with restock Kroger. One of the exciting things about our earnings call is that many of our Associates listen in to better understand and gain insights into our business and of course, many of our associates, our shareholders as well. So before we end today's call, I'd like to share a few final comments directed toward them.

We are very proud of Kroger's opportunity culture where you can come for a job and stay for a career. And as you know, we took one third of our tax savings to invest in new and enhanced benefits for our associates. We use part of that investment to establish our best in class educational offering, feed your future. I'm thrilled to see so many of you already taking advantage of these new benefits.

Let me tell you a story about one of the first associates to take advantage of Feed Your Future. Lindsey is a pharmacy technician in our Louisville division. She was working her way through college, accumulating student loans and had planned to stop working to focus on school full-time. But after an assistant store manager told her about Feed Your Future, Lindsay decided to stay with Kroger while she finishes her bachelor's degree. And now Lindsay's goal is to pursue a graduate degree with dreams of becoming a physician's assistant for Little Clinic business. Lindsay's story is exactly what we hoped would happen when we introduced Feed Your Future. We believe that when we support our associates and each other and our customers, business and shareholders will benefit. Thank you for all you do for each other and everybody every day. That completes our call for today. Thanks for joining.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.