The Kroger Co. (NYSE:KR) Q3 2016 Earnings Conference Call December 1, 2016 10:00 AM ET

Executives

Michael Schlotman - Executive Vice President and Chief Financial Officer

Rodney McMullen - Chairman and Chief Executive Officer

Analysts

Ken Goldman - JPMorgan

Steven Forbes - Guggenheim Securities

Ed Kelly - Credit Suisse

Scott Mushkin - Wolfe Research

Zachary Fadem - Wells Fargo Securities, LLC

Shane Higgins - Deutsche Bank

Andrew Ruben - Morgan Stanley

Rupesh Parikh - Oppenheimer

Robby Ohmes - Bank of America Merrill Lynch

William Kirk - RBC Capital Markets

Operator

Good morning, and welcome to The Kroger Company's Third Quarter Earnings Conference Call. All participants will be in 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 Mike Schlotman, Executive Vice President and CFO. Please go ahead.

Michael Schlotman

Thanks. Kate couldn't be with us here this morning, so I will wish you the good morning and thank you for joining us.

Before we begin, I want to remind you that today's discussion will include forward-looking statements. We want to caution you that such statements are predictions and actual events or results can differ materially. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings, but Kroger assumes no obligation to update that information.

Both our third 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 for that.

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

Rodney McMullen

Thank you, Mike. Good morning, everyone, and thank you for joining us today. To start, I want to say all that I'm proud of our associates for their continuing objective and connecting with our customers in a very difficult operating environment. Their efforts helped us grow both total households and loyal households during the third quarter.

As expected, deflation persisted during the third quarter. And as we've said before, transition periods create a difficult operating environment. This is the third time we've had deflation in 30 years; and in previous instances, deflation lasted from three to five quarters in a row. We're in the middle of the cycle right now, and it's not fun, still our tonnage continues to grow, our total market share continues to expand, and we're focused on executing our strategy.

A silver lining of deflationary environments is that, it reveals to us how we can run our business better by shining the light on areas we can improve. It is really tough when you're in it, but we'll be in a position to benefit from changes we're making today once we're out of this cycle.

We are firmly focused on our long-term strategy of improving our connection with customers and associates, and continuing to work on process changes to lower costs. We don't change our strategy based on quarterly swings in results. We remain committed to delivering on our long-term earnings per share growth rate target of 8% to 11% plus an increasing dividend on a three to five-year time horizon. We will continue to try to win every customer meal by driving our strategy and reacting appropriately to the environment.

Looking at the broader economy and the customer shopping behavior, what we're seeing is mixed. Typically, our data shows our customers' economic concerns mirror what they see in the headlines. For example, healthcare cost continued to be a worry for customers. Consumer confidence retreated during the quarter with customers telling us they expect the economy to get worse in the next three months. It's important to remember, this survey was completed in October, and it's too early to say what the mood of our customers is since then.

Natural, organic and health and wellness continued to be a food megatrend, and we're writing these trends well. Our natural and organic sales continue to outpace total sales growth. Simple Truth continued its strong double digit growth. Simple Truth, organic kombucha is a very – is very popular as more customers focus on digestive health.

We’ve also recently launched a 24 pack Simple Truth Vapor Distilled Water with Electrolytes. It’s priced fantastically. It’s a great product and it’s selling really well. Our produce, fresh prepared and deli packaged departments, sushi, Starbucks, wine and liquor sales all saw comparatively strong growth during the quarter as well. If you can drink it or snack on it, it’s selling.

A few on-trend examples are protein snacks, such as Simple Truth – Private Selection and Simple Truth Paninos, which are imported cured meats wrapped around a creamy cheese, as well as hand crafted in real sugar sodas.

As I said at our investor conference here in Cincinnati four weeks ago, Kroger’s earnings growth has outpaced our peers over both the last five years and last 10 years, and we still see incredible growth potential as we look forward. We can clearly identify where we have a $100-plus billion in market share growth opportunities in our existing markets alone.

But good enough today won’t be good enough tomorrow. That is why we’re both embracing change and accelerating change. For example, 8451 is helping us spot trends and create unique customer experiences to drive growth. We continue to focus on solving customer needs on their terms.

We now offer ClickList in more than 550 stores, that is 50 more locations than we were operating just four weeks ago. We’re connecting with tens of millions of customers digitally, online and through our mobile app. Customers have now downloaded more than 3.5 billion digital offers.

We know that the typical customer eats 35 to 45 times per week. Increasingly, we are positioning ourselves to solve for all of those meals or snacks in addition to our historical model of solving for meals at home. We’ve built a strong customer first foundation over the last 15 years, upon which we can confidently accelerate change. And doing so, we can deliver even better results for our customers, associates, and shareholders.

Now, Mike will offer more details on Kroger's third quarter financial results and discuss our guidance for the fourth quarter and 2017. Mike?

Michael Schlotman

Thanks, Rodney, and once again good morning, everyone. I want to also thank our associates for their hard work and focus on connecting with customers. As a result, both household and unit growth were up during the quarter as was market share. As we said at the Investor Conference, the last two weeks of the quarter would drive our identical supermarket sales results and our IDs came in at the low-end of our expectations for the quarter.

Deflation has not only persisted, but has increased with overall deflation, excluding pharmacy, growing from 1.3% in the second quarter to 1.5% in the third quarter. Additionally, pharmacy inflation declined to 130 basis points to 3.3% during the third quarter.

Over the last four quarters, we have relocated or expanded 49 strong performing stores. This takes them out of our identical supermarket sales calculation. Further, we have opened 42 new stores over the same timeframe. Both of these create a headwind to identical food store sales.

By way of comparison, last year there were 19 new stores open that affected nearby stores. Operating costs, excluding fuel, Roundy's, and an $80 million contribution to the UFCW Consolidated Pension Plan in the third quarter of 2015 grew by 19 basis points, of which 15 basis points were related to depreciation due to increases in our capital program.

We can clearly do better and we're redoubling our efforts to reduce these costs as rate of sales over time. While the environment is difficult, managing operating expenses is something that is in our control. Our customer-first strategy is funded by saving costs in areas of the business that customers don't see in order to return value to our customers in the form of lower prices on products they want, improved service, and the shopping experience that makes them want to return. We are and will continue to look at a variety of options to improve processes and lower costs as a rate of sales in a strategic and conscientious way.

Now, for an update on retail fuel. In the third quarter, our cents per gallon fuel margin was approximately $0.179 compared to $0.238 in the same quarter last year. On a rolling four quarters basis, we were at $0.17 this year compared to $0.188 last year.

During the third quarter, corporate brands represented approximately 28.1% of total units sold and 25.5% of sales dollars, excluding fuel and pharmacy. As Rodney said earlier, Simple Truth continues to have an impressive growth rate. Our net total debt to adjusted EBITDA ratio increased to 2.35 compared to 1.99 during the same period last year. This is a result – this result is due to the mergers with ModernHEALTH and Roundy’s, Inc.

At year-end, Kroger expects net total debt to adjusted EBITDA to be near the high-end of the company’s targeted range of 2 to 2.2 times. It’s worth noting that over a longer time horizon, we do expect our net total debt to EBITDA ratio to grow if we continually – if we continue to successfully negotiate restructuring their troubled multiemployer pension plan obligations to help stabilize associates’ future benefits, as we did in the second quarter.

We would not expect this increase to adversely affect our credit rating, as the rating agencies already factored in our multiemployer pension plan obligations in their evaluations of our credit rating. When we take on additional debt to fund these plans, this reduces the off-balance sheet amount of our estimate in multiemployer pension plan obligations.

Over the last four quarters, Kroger has used cash to repurchase $1.4 billion in common shares, paid $418 million in dividends, invest $3.8 billion in capital in line with our commitment to reduce planned capital expenditures for the year. Merger with Roundy’s for $866 million and merger with ModernHEALTH for approximately $390 million. The flexibility to return value to shareholders is a core strength of our financial strategy. Return on invested capital for the third quarter was 13.63%, excluding Roundy's compared to 14.16% for the third quarter of 2015.

I will now provide a brief update on labor relations. We recently agreed a new contract with UFCW covering Fry's associates in Arizona. We're currently negotiating contracts covering store associates in Atlanta, Michigan and North Carolina, and we're also negotiated a new contract with the Teamsters for our Roundy's distribution center.

Our objective in every negotiation is to find a fair and reasonable balance between competitive costs and compensation packages that provide solid wages, good quality, affordable healthcare, and retirement benefits for associates. Kroger's financial results continue to be pressured by rising healthcare and pension costs, which some of our competitors do not face.

Kroger continues to communicate with our local unions, which represent many of our associates the importance of growing Kroger's business and profitability, which will help us create more jobs, incur opportunities, and enhance job security for our associates.

Turning now to our guidance for the remainder of the year, we narrowed our net earnings guidance to a range of $2.03 to $2.08 per diluted share for 2016. The previous guidance was $2.03 to $2.13. On an adjusted net earnings guidance range per diluted share for the year is $2.10 to $2.15, which excludes the $0.07 charge from the company's commitment to restructure certain multiemployer pension plan obligations in the second quarter. The previous adjusted guidance range was $2.10 to $2.20

For the fourth quarter of 2016, Kroger expects slightly positive identical supermarket sales growth, excluding fuel. The persistent and increasing deflation has caused us to adjust our view of identical store sales for the fourth quarter. We continue to expect capital investments of $3.6 billion to $3.9 billion for the year, excluding mergers, acquisitions and purchases of leased facilities. And we expect Kroger's full-year FIFO operating margin in 2016, excluding fuel to decline compared to 2015 fifteen results.

Finally, I want to take a moment to look ahead to 2017. We're completing our business plan process for 2017 now and we'll provide specific guidance in March, as we normally do. We anticipate, both positive identical supermarket sales and net earnings per diluted share growth, excluding the 53rd week.

Net earnings growth will likely be below the low-end of the company's 8% to 11% net earnings per diluted share long-term growth rate guidance. We expect the operating environment in the first-half of 2017 to be similar today. The second-half of 2017 should show improvement as we cycle the current environment.

As you know, we define long-term a over a three to five-year time horizon and we're committed to achieving our net earnings per diluted share growth rate guidance of 8% to 11% plus a growing dividend. We expect 2017 capital investments of $3.6 billion to $3.9 billion, excluding mergers, acquisitions and purchases of leased facilities. We will continue to make investments to reward our customers and will increase our intensity in finding cost savings for these investments.

Now, I'll turn it back to Rodney.

Rodney McMullen

Thanks, Mike. We are both clear eyed about the challenges before us and optimistic about Kroger's future. Transitions are no fun, but they do create opportunities to improve the way we run our business. We will continue to focus relentlessly on our customers and our associates.

We'll continue to accelerate our adoption of technology to deliver additional value, to provide convenience for and to our customers, and take costs out, as Mike mentioned. All these things set us up to grow our business. We have a unique opportunity for strong growth in the $1.5 trillion dollar U.S. food market. Our best days are still ahead of us.

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 comes from Ken Goldman of JPMorgan. Please go ahead.

Ken Goldman

Hi, good morning.

Rodney McMullen

Good morning.

Michael Schlotman

Good morning, Ken.

Ken Goldman

Just one quick question for clarification. I know, you wrote this, but I have received a couple of questions on it. When you're guiding to the low 8% EPS growth in fiscal 2017, is it reasonable to assume that's on a like-for-like basis, which excludes the benefit of the 53rd week?

Michael Schlotman

Well, it does exclude the benefit of the 53rd week. Basically, the way we business plan is just like you said like-for-like and then we go in and estimate what the 53rd week will ultimately add to that result. I'm not going to go to – am I going to be at 8% or 9% with the 53rd week, because that would tell you what we're thinking about without the 53rd week. But the below – the only guidance we're giving is on a 52-week basis, we would be below the 8%.

Ken Goldman

Got it, okay. And then, Mike, I wanted to follow up on CNBC, you were sort of, at least, to my ears talking about maybe deflation having a little bit here, you were pointing to some commodities maybe rising, but you're also guiding, I guess, to a similar operating environment well into fiscal 2017. So I just wanted to kind of make sure I understood, if deflation is the primary reason for the challenging environment today. And if you think deflation is going to get less bad, then why wouldn't early 2017's operating environment be a little bit less bad than what we're kind of seeing right now?

Rodney McMullen

Yes, what I was going through on CNBC is where some of the raw material markets are trending over the last four weeks. A lot of those when you look at them on year-on-year, they're still quite negative. But there's some trend in some of those categories, the input costs over the last four weeks, but still down on the prior year. Milk and cheese looks like it may be bottoming, but that doesn't mean things turnaround on a dime as raw material input cost change.

There's usually a lag from that bottom and a slight blip up in those costs until you start to see any effect on retail pricing. So we would expect this to persist. Some of that is just based on the last two cycles of inflation and deflation we've had, and we have a five-year rolling average chart that we look out a lot, and if you think about the waves of where that happens with inflation and deflation, this cycle looks very similar to the last couple, maybe a little closer to 2002 versus 2009, which was a little bit more persistent, but that's what's in the back of our minds.

Ken Goldman

Thanks, Mike.

Rodney McMullen

Yep.

Michael Schlotman

Thank you, Ken.

Operator

Our next question comes from John Heinbockel of Guggenheim Securities. Please go ahead.

Steven Forbes

Hey, guys, Steve Forbes on for John today.

Rodney McMullen

Good morning, Steve.

Steven Forbes

Good morning. Given the pace of the ClickList and ExpressLane roll out thus far this year and the uptick over the past couple of weeks you mentioned, can you touch on what your thoughts are for 2017 as it relates to these initiatives?

Rodney McMullen

We wouldn't see at this point sharing specifics, but obviously it's something that continues to be important and we'll continue to roll it out. Now, at some point, it will slowdown a little bit just because the stores that are easy to add, we will have added them. We have identified overall how many stores we think makes sense and it's a – it's over half of our stores, we think would make sense to have ClickList. But obviously, as you do the easier ones first, and it will slowdown just because of the difficulty getting installed.

Steven Forbes

And then as a follow-up, maybe kind of a bigger picture question about what you've seen historically as it relates to the return to an inflationary cycle right, if you think about the competitive environment today, how do you think about 2017, right, if we do get that eventual reinflation cycle after such an extended period of deflation, I mean, do you foresee yourself being competitors rapidly passing through price increases once inflation returns, or in the context of what we've experienced in the past and what we're experiencing now, is there any risk that price increases occur on a slower basis than we may expect?

Rodney McMullen

It's a great question, and obviously looking back over the last 20 years or so, what do they say every short statements in economics is wrong. So, part of it depends on how does it come back? Does it come back with a vengeance, or is it just 2% or 3%. At this point, we would expect for the inflation, when it becomes inflationary for it to be pretty modest on the things that we're seeing. But remember, that comment, we're very early, so that would be a very early expectation. But you don't know until you're in it. I think everybody from a competitive standpoint is looking at what's going on in the market. So typically, you'll lag a little bit at the front-end, but then everybody will pass it through. And that's the reason why you'll always hear me talk about the transition periods are difficult, both going in and coming out of inflation/deflation.

Steven Forbes

But the pace of increase, and I guess, what do you expect as you look out 2017, is very dependent on where the absolute level of inflation returns to?

Rodney McMullen

Absolutely, right now like on the things that are grain-based, obviously, those crops for the most part haven't been planted yet. You'll have some winter wheat that's in that process. But crops will be a heavy driver of that inflation, and it's still way too early. I think what in 2016 it appears that this will be a record crop for five years in a row. At some point, you're going to not have a great weather.

Michael Schlotman

Never had six.

Rodney McMullen

I don't think we've ever had high before it's done, so you never know. But there isn't anything that we see out there that would cause us to have a different point of view. Now, obviously, in produce that is – that will change very quickly depending – the growing seasons are much shorter there.

Steven Forbes

Thanks, guys.

Rodney McMullen

Thanks, Steve.

Operator

The next question comes from Ed Kelly of Credit Suisse. Please go ahead.

Ed Kelly

Yes. Hi, guys, good morning.

Rodney McMullen

Good morning.

Ed Kelly

So can I just start asking about guidance and just a little bit more color. So at the Analyst Day you reaffirmed full-year guidance. But openly admit it right at the end of Q3 was difficult to judge. Today you ended up lowering the outlook a bit. I guess, what's changed since the Analyst Day, if you can sort of like provide a bit more detail there? Is it really just the conclusion that the end of Q3 was softer than really what you were thinking? And then how is Q4 shaping up so far quarter to-date on IDs, or are you are you at that point of low, up low single digits?

Michael Schlotman

So if you think about the – where we've been through – at the – from the Analyst Day transitioning through that, I would actually encourage you to step back a bit from that and look at it a little bit bigger wins. It takes about $23 million of sales to move our IDs by 10 basis points.

When you're plus or minus $23 million on a two or three-day timeframe or even $40 million on a two or three-day timeframe, when you're at 4% or 4.5% idents, it's a blip on the radar screen. When you're between zero – when you're at between flat and 50 basis points of identicals, it's a huge percentage move in where your identicals can be. And when you think about $23 billion a quarter in ID sales, so $1.5 billion to $2 billion a week.

The potential for a couple of days to move by $20 million is a very real. You've all heard me at different times talk about, if you saw our deli sales when calendar shifts and holiday shifts, you would understand why grocers get gray hair early in their careers. And those kinds of things just happen and it's a big effect. The effect of milk eggs and cheese continues to be a big. It's a big headwind, tie these sales this year versus last year, a meaningful percentage. I won't necessarily give the exact amount, but it's a meaningful amount, broadly shrugging their shoulders up.

So it's as much as 50 basis points effect to ID sales in the quarter just those three commodities because of the deflation this year versus last year. So these kinds of things are real. You've often heard us talk about milk being elastic when there's deflation. When it's deflation on deflation, the elasticity happens when you first break that $2 barrier and then demand flattens out. So you don't get a two-year bump in it.

Rodney McMullen

Yes, I would just add a little bit to Mike's comment. When Mike shared the guidance at our Analyst Day, he did talk about the uncertainty because of the calendar shifts. So there is what – where we ended up was exactly consistent with what how Mike outlined in terms of the uncertainty for the balance of the few days. When you look at quarter to-date in the fourth quarter, we would be slightly negative. But if you look at last year – last year's – the first four weeks of last year's fourth quarter were by far the strongest and they kept getting weaker during the quarter.

So we will start cycling numbers from a year ago that look a lot different than what we've been cycling so far this year. So that's the reason why we were comfortable on giving the guidance in terms of been slightly positive for the fourth quarter.

Ed Kelly

Great. And just a follow-up, on the gross margin, I guess, Rodney and Mike, your gross margin in this period of this deflationary cycle, I guess, has been, I guess, remarkably resilient, given sort of like what you've seen historically in terms of the relationship between the margin and and IDs. In the competitive environment from what we hear right sounds like it's more difficult.

Can you just give us a sense as to what's really going on in the underlying gross margin. I mean, I know, you continually invest in price. But it doesn't seem like you're being – is impacted by the competitive environment as what we've seen at other places and any color there would be great and sort of like how would you think about that over the next few quarters as well?

Rodney McMullen

Yes, I'll make a couple of comments and let Mike finish it. First of all, when you look at having Roundy's and not having Roundy's, that affected – affect some of the year-on-year change, because Roundy's has the higher gross margin than the Kroger-based Kroger company.

The other thing is that our buying teams have done a ton of work on changing the way we buy product in terms of cost of goods. And if you look, we have a lot of corporate brand products, where we buy direct. So a lot of those changes have really been helpful in terms of making improvement in cost of goods too, which has helped some on the cost, the gross margin line. And then Mike, you – I'm sure, you have a couple other comments you want to add.

Michael Schlotman

I think the one I would go a little deeper on is the corporate brands. And as we continue to have an expansion of our private selection line, when you look at Simple Truth continuing to grow nearly basically double digits, those kinds of products contain higher gross margins, as well. And as they continue to become a higher and higher portion of our mix, that somewhat the historical reference. The numbers are a little bit difficult to interpret this quarter because of the fact of a very complex, because such a high percentage of the dairy complexes is corporate brands.

The other thing that's in there is the fresh mix. You've heard Rodney talk a lot about being on top of the foody trends in snacking and things like that. Those departments do come with a higher gross margin. Now, their contribution to overhead of their operating profit may not be as strong as other departments, because there's a lot of labor costs and more shrink in those categories and more fixed costs like electricity and things like that.

So it's a combination of all of those leading to it. Rest assured, we do continue to invest in price and continue to drive value to our customers, and it's something that we've our cornerstone for the last 14 years.

Ed Kelly

Great. Thanks, guys.

Rodney McMullen

Thanks, Ed.

Operator

Our next question comes from Scott Mushkin of Wolfe Research. Please go ahead.

Scott Mushkin

Hey, guys. Thanks for taking the questions.

Rodney McMullen

Good morning.

Scott Mushkin

Good morning. So I wanted to kind of take a different direction here a little bit and talk more about the non-fresh, maybe even the branded side, the brand at which some of the data coming out lately shown volumes are just negative in the measure channel and also inquire about e-commerce has obviously seen Walmart by Jet.com, Amazon is making some big inroads all of a sudden into some of these consumable categories – these everyday essential categories. And just in that context get your guys' perspective on what's going to happen with margins? What's going to happen with these categories? And how do you react to an environment it seems to be changing pretty quickly?

Rodney McMullen

Well, there's about 10 questions within that. So I'll try to…

Michael Schlotman

So you don't get a follow-up, Scott.

Rodney McMullen

I'll try to summarize this in such a way that is helpful. When you look at our relationships with the CPGs, it would be – our business for – with most of those CPG partners would continue to grow. And the trends that they would be seen overall for the most part the trends we would be seeing is different.

In terms of, at our Analyst Day, we increasingly see competition much broader than we would have in the past. And we're really focused on how do we give the customer what they want, when they want it in a way they want it. And Amazon is one way of doing that, but not every customer wants to have 10 boxes of stuff setting in front of their door all day.

What we find is a lot of customers love having groceries picked – picking it up, and we're starting to test, obviously, we're partnering with third parties to deliver. So, for us, we're really focused on the customer and letting the customer to decide how to engage and doing it in a way that's seamless.

We've always said that we believe margins over time will continue to decline from a gross profit margin standpoint. And that's the reason why we worked so hard to get costs out, partner with 8451 using – partnering with our technology teams to fundamentally change the way we do work to get costs up. I don't know, Mike, anything you want to add.

Michael Schlotman

No, one of the things, I agree it 100% what's Rodney on the e-commerce relative to deliveries and being on your porch and where we're situated. Our customers live within two or three miles of the store they most regularly shop in. And it's extremely convenient for them to order online and make that stop by the store in a way to and from either work with daily activities. And they use this way to see if the retailer is excited about something is are they doing more of it or less of it, and as Rodney said, we continue to roll more ClickList locations out.

Operator

Our next question comes from Karen Short of Barclays. Please go ahead.

Unidentified Analyst

Hi, this is Sean [ph] on for Karen. Thanks for taking my questions.

Rodney McMullen

Hi.

Unidentified Analyst

Could you guys provide – hey, how is it going? Can you provide some color on tonnage trends this quarter versus the first two quarters of the year?

Michael Schlotman

The tonnage trends continue to be positive for the quarter. I would – there was some softening from the second quarter, the third quarter in tonnage. But overall, where we continue to have positive tonnage and we continue to grow our share. And in some of the categories, we're very pleased with the tonnage growth we're seeing. It's – tonnage is a – it's a little bit of a difficult animal to get your arms around, because there are so many pack size changes.

Today, used to be, you bought it, that's – while you did buy bottled water and then you bought a 12 pack of bottled water, then you bought a 24 pack of bottled water, now you buy a 32 back of bottled water, all of those are one unit even though we're selling more bottled water units. And there's a lot of multi-packs and bigger packs that are trending to that kind of an opportunity.

You also see some of that with ClickList and categories that customers are finding convenient to buy bigger packs, because they don't have to fill up their bass cart [ph] with it. We do that for them and put it in their trunk. So they maybe buying a 12 pack of paper towels instead of four pack of paper towels, because they don't have to worry about space in the bass cart, it's just as long as their trunk can hold or that's okay. We continue to be pleased with our tonnage growth. It's something we know as the fundamental piece of what it – what is core to our business.

Unidentified Analyst

Okay, that's helpful. And then, I guess, my follow-up would be just some color on extra week next year and the impact earnings per share, we went back and looked at 2012 that sort of proxy for that and thought that the margin through it may be equates about $0.09 a share, just wondering if you could give some comments on that?

Rodney McMullen

Well, one extra week out of 52 is 1. – a little over 1.9%. The gives and takes of that and what happens inside that week drive what the benefit of it is. But historically, it's – I would agree that it's somewhere in that range, but it's difficult to understand what's going to happen in the first week of late January early February of 2018.

We do always try to break that out and provide that insight, because we don't take credit for that extra week in terms of achieving numbers. As we mentioned in our prepared comments, we are in the middle of our business plan process and just wanted to give you a little bit of flavor of what we're seeing next year shape up to be and letting people know that the 53rd week, we're not taking credit for achieving the numbers.

Unidentified Analyst

All right. Thanks, guys.

Rodney McMullen

Yep. Thanks, Sean.

Operator

Our next question comes from Zach Fadem of Wells Fargo. Please go ahead.

Zachary Fadem

Hey, good morning, guys.

Rodney McMullen

Hi.

Zachary Fadem

You mentioned several times during the call just a focus going forward on taking costs out. Can you talk a little bit about what this means for things like employee costs, wages, healthcare, store productivity initiatives, pension, stuff like that?

Rodney McMullen

I would say probably all those – all of the above are things that we're working on. One of the things that we've been able to do over the last several years is through process change – changing the way work is done. And we continue to see great opportunities there, and we're really working hard on partnering with our R&D team and our technology team to take things – to change the way we do work.

And I know, Mike, at our Investor Meeting talked a little bit about temperature monitoring. And temperature monitoring, for example, is something that we developed internally with our R&D team. We've rolled it out and it saves about $25 billion a year in terms of just what it cost to execute it, obviously, it takes capital to do that.

So the first year doesn't create too much value, but the second year and beyond is great value. So labor is always the area where there's the most opportunity. We will do those savings there through process changes, we think is incredibly important.

Zachary Fadem

Okay. And just a follow-up, I know it's still early days here. But are there any metrics you can provide on the performance of your ClickList stores? Maybe is there data to suggest that sales are incremental, and do you view ClickList as a potential driver of market share, or rather just an added convenience for your customers over time?

Rodney McMullen

Yes, the – I'll try to – obviously, we're very, very early. So I won't be able to answer all of the questions you asked, the great question is just that we're so early in the process. It would be some growing share and some just one more convenience for the customer. And it's really a mix of both and each customer would be a different combination of that mix.

What we believe over time is, it starts teaching us how do we deliver what the customer wants the way they want it, when they want it. So we think it's something that's even more important than just ClickList per se in terms of teaching us how to connect with the customer even deeper in a better way for them. Some of the business is incremental, it's a reasonably high range when you look across the company.

If you look at the financial performance, it's a headwind initially. If you go back and look at some of the original locations that Harris Teeter had before we merged, it becomes where you're in different whether somebody shops the ClickList or in the store. But the – if you look at the stores overall, it's still a reasonable significant ahead in terms of rolling out ClickList from a financial standpoint.

Zachary Fadem

Got it. Thanks, Rodney. I appreciate the color.

Rodney McMullen

Thanks, Zach.

Operator

Our next question comes from Shane Higgins of Deutsche Bank. Please go ahead.

Shane Higgins

Hey, good morning and thanks for taking the questions.

Rodney McMullen

Good morning.

Shane Higgins

Good morning. I just wanted to drill down a little bit on your ID sales by region. Did you guys see any significant regional differences in ID sales during the quarter? Anything that you could call out?

Michael Schlotman

We always see ID sales ranges by region. When we're 30 something states plus D.C., it's like anything else or somebody that's at the top the list and somebody at the bottom of the list. We typically don't go into specific geographic descriptions of where we say it's all relative strength and where we saw relative weakness, if you will, or towards the bottom end.

Broad-based, again, it's – I would say, the story is pretty much the same for all the regions with the persistent deflation and their continued focus on trying to drive tonnage is the story that we're trying to drive home with all of our geographies.

Shane Higgins

Okay, that's helpful. And I know you guys earlier in the year, you talked about Roundy's is being a 30 basis point headwind to the comp, but obviously, going to cycle that in the fourth quarter. Is that, first of all, is that about right? Was it – has it been around 30 basis points, and as we do cycle that you guys expect that to help contribute to the comp improvement as the fourth quarter progresses?

Michael Schlotman

Yes, if you think about Roundy's even more broadly than that, it is still in that same kind of a range. We've talked about that we've gone into 13 stores in Wisconsin and have done those stores the way we want them done and we continue to be very pleased with the sales and tonnage growth inside those stores. We've also converted those 13 stores to our – to the Kroger systems, which for us relative to a merger is lightning speed, because we want to get them integrated into our all of our processes as quickly as possible.

We remain very excited about that merger and the potential we see, particularly, the Wisconsin assets, I think is the, is – if you will, if you think about it in purely economic terms, is the optionality of that merger getting into Chicago for the cost of the entire merger was a – was great. And as Wisconsin was Michael Marx and his team running Wisconsin, that will continue to be a very positive thing for us in the future. It's not going to turn on a dime, it's a lot of hard work. But the team up there is up to the challenge.

Rodney McMullen

Yes, the one thing that you've heard me say this before, the thing that I've really been pleased with and Mariano's and the Wisconsin stores what they can save and cops and Metro are the engagement of our store associates and how part – how supportive they've been, and how excited they've been. And the changes that we're making, we're seeing a little bit more improvement in tonnage than we are in identical sales results just because some of the changes deflate the retail pricing. But I'm just thrilled and delighted with our teams and the way our teams are engaging and excited about being part of the Kroger team and much much more so than I would have expected this early in the process.

Shane Higgins

All right. I appreciate that color. So just in terms of kind of thinking over the next year or two, this is going to be something that obviously, Mike, you said, you guys have done some conversions, you still have a lot more to go. So this will be something or probably be a multi-quarter effort when we shouldn't expect to see any significant tailwinds than from Roundy's over the next couple of quarters?

Michael Schlotman

Yes, it's clearly something that it's – we're coming up on the one year anniversary of the closer of the merger. I think it was December 18 of last year. So it's very new part of our book of business. And it is going to be something that over time we'll continue to be worked on. I wouldn't – I can tell you part of our business plan process is not a tailwind from Wisconsin in 2017, individual stores, yes, but overall no.

Shane Higgins

Yes, thanks so much.

Rodney McMullen

Thanks, Shane.

Operator

Our next question comes from Vincent Sinisi of Morgan Stanley. Please go ahead.

Andrew Ruben

Hi, this is Andrew Ruben on for Vinnie. I just had a question on deflation. Now bigger picture you characterized being in mid-cycle on. Just curious what drives that characterization and given that you've been through a few of these cycles, as you referenced, any color on how the cycle that ran compares to the few you've experienced over the past 30 years?

Rodney McMullen

Well, the bigger picture is that, it probably looks the most like the one in 2002, that one really, it was about five quarters. And if you look at when it was the worst just in the middle of it and that's kind of where we are. Part of it will – part of it determines why – I'm trying to think about how to word this in a way that's helpful.

The cycle coming out will be driven by what cause you to go in and how do you end up coming out of it? Everything that we can see the reason what we would expect today were – would be a modest increase once we cycle on the other side of it, is most of it is supply-oriented. So if you look at like 2008 and 2009, it was as much driven by the economy and everything going on.

If you look at 2002, it was more supply-driven, because there was a lot of supply in the market. Unless, there would just be a terrible crop year in 2017, we would expect this to look much more like 2002. Remember, once and Mike talked about it a little bit like on dairy, if you have $3 a gallon milk and it goes to $2 a gallon milk, when you cycle that to next year and if milk is still at $2 a gallon, you're cycling $2 on $2 versus $2 on $3, and that's the reason why the pressures decreases. I don't know, Mike, anything else you'd want to add to that?

Michael Schlotman

No.

Rodney McMullen

Andrew, does that helpful?

Andrew Ruben

That is. Thank you.

Operator

Our next question comes from Rupesh Parikh of Oppenheimer. Please go ahead.

Rupesh Parikh

Good morning and thank you for taking my question.

Rodney McMullen

Good morning.

Rupesh Parikh

So the first question I had was just on traffic. In your press release, it sounds like in your press release you don't have a positive household – loyal households growth. I just want to get a sense of, if you look your tropic this quarter, or this or just Q3, were there any changes versus what you saw in Q2 and I just want to get a sense on how tropic laid off versus your expectations?

Rodney McMullen

Yes, if you look at it versus expectations, it's pretty similar, it continues to be positive. In terms of playing out, you always want more traffic than you had, but I would have said that every quarter. I don't know, Mike, from your perspective. I think it pretty well played out the way we would expect.

Michael Schlotman

I agree with it.

Rodney McMullen

We felt like third quarter would be a very tough quarter, given everything that was going on. And – but you start cycling some of those things as well.

Rupesh Parikh

Okay, great. And then for gas margins. I just want to get a sense where your outlook is for the balance of the year? And if you think about where gas – fuel margins could end up for this year, do you expect to be back at your historical average on the fuel margin line?

Michael Schlotman

Fuel has certainly been a wild ride the last few years and even in the last few even days and weeks is the, is OPEC going to do something, is OPEC not going to do something, and they ultimately did the $32.5 billion or 1 billion gallon decline barrel declines $32.5 million barrel with this good to be on the dollar – the number instead of the barrel. That equates to 500,000 barrels a day. And to see the wild swings down a $1.51 day up almost $4 the next day is kind of confusing on what's – when you look at that relative the worldwide supply of oil is relatively modest amount of production guidance.

That said, volatility – up and down volatility is generally very positive for us, because we have many, many fuel centers at our supermarket locations that get not just a delivery a day, but some of them get a couple of deliveries a day. So when there's daily volatility like that, it allows us to take advantage of market fluctuations.

Rodney McMullen

Yes. When we do our business planning process, we always just use a five-year rolling average. We find that's just close as anything else. I think, Mike mentioned, if you look at over a rolling four quarter to rolling four quarter fuel margins are down just shy of a couple of cents. But for us, anybody's guess is as good as anybody else's and I always get a kick out of it.

If gas is at a $100 a barrel, it's going to $150, and if it's at $50, it's going to $20 neither of which have ever been right. But we just in terms of the way we do our planning process, we look at a five-year rolling average. When we look at do our shareholders get a return for us being in that business, we also do the same thing.

Michael Schlotman

We essentially business plan, the non-fuel business had a fuel business on and then, of course, this week more than add the 53rd week on.

Rupesh Parikh

Okay, great. Thank you.

Rodney McMullen

Thanks for your question.

Operator

Our next question comes from Robby Ohmes of Bank of America Merrill Lynch. Please go ahead.

Robby Ohmes

Hey, good morning, guys.

Rodney McMullen

Good morning.

Michael Schlotman

Good morning.

Robby Ohmes

Rod, for people like me who were not covering this industry back in 2002, I was hoping you could maybe give us some insights. How does this deflation in promo environment change the way your customer is shopping, or does it like, for example, you called out snacks and drinks, maybe some color on other categories or also does sort of the balance of fill-in versus stock-up change. How does the reaction of promos change in sort of a multi-quarter deflationary environment? And maybe some more color on what happens in center of store when you're in an environment like this?

And I have to ask, because I don't think anybody did, but just the question you love getting what's Walmart doing right now promotionally? Are they investing more and more in price in the markets you're in? Thanks.

Rodney McMullen

Okay. Well, if you look at the 2002 versus today, probably the biggest change from a customer standpoint would be, I guess, would be two things. One, obviously, they buy food that's already prepared much more. And when we shared everything at our Investor Day, you could see a lot of the changes that we've done in terms of having food that you can come to one of our stores and eat at the store, or take home and eat. That obviously is a huge change today versus 2002.

If you look at the things that are and I guess, the other big change is customers shop more frequently, but smaller baskets. So if you go back then and we didn't have a loyalty card and we didn't have the analysis we do today. But everything we could find, the customer would – the purchase – the basket would be bigger on an individual basis, but if you look at a monthly basis, it's bigger today.

In terms of the cycle comments, the things that we think are the same or more the materials and raw mat ingredients-based, where if you look at, yes, beef and pork and chicken the biggest component of that is corn price. And chicken that cycle is much quicker than it is on pork and beef and that hasn't changed now versus 2002.

So it's really what's the raw materials themselves and how is the growing crops doing and how does that flow through the supply chain and that would have the biggest effect on some of the proteins and some of the center store components. I don't know, Mike, on inflation anything that…

Michael Schlotman

I think you…

Rodney McMullen

Both of us were round in 2002, as well. We had different jobs.

Michael Schlotman

I think you covered the landscape where you did I didn't.

Robby Ohmes

And then maybe guys just on, if you think back to 2002, I don't know if you can remember. But in terms of promotionally how the competition reacted, has that changed a lot? Is it – is there more in-store signage, or is it more circulars, or what are the promotional tactics that that are being used right now there and is it similar or different than 2002 from the competition?

Rodney McMullen

Well, on the promotional stuff, the – you would, in 2002 and this is going off of a lot of memory without having the data in front of me. But competitors then didn't have as much insights. And they didn't know if it was just, because somebody was getting their sales, or if it was deflation.

Today, people have a much better data. So they understand its things that's going on in the overall marketplace, it's not some competitor getting the business. So all of us reacted in a different kind of way and it's a front-end of deflation back then, because you thought a competitor was getting the business.

Michael Schlotman

That parallels Rodney's comment on basket size. Historically, all we would see is, what's the average transaction per customer. And if that's softening back in 2002, when you didn't have the data, you didn't know that that household was coming more times on a monthly basis and wound up spending more with you on a month, because we simply didn't have that technology back then.

Robby Ohmes

Got it. That's helpful. And just quickly, Walmart, any color on any changes in their level of price investment?

Michael Schlotman

No, it would be similar to what we seen before in terms of our comments. As you know, we won't talk too much about specific competitors. We have a ton of respect for them, there's no doubt, they continue to improve. But that's the same comments I made at the Investor call and I made at the last quarter. And all of us would have different approaches in different regions of the country.

Robby Ohmes

Got it. Thanks so much, guys.

Michael Schlotman

Okay.

Rodney McMullen

We have time for one more question.

Operator

And our last question will come from William Kirk of RBC. Please go ahead.

William Kirk

Thanks, everyone. So I'm still a little confused about the end of the third quarter, if ID sales have been running at essentially 0.5 with two weeks left and finished at 0.1, does that imply the last two weeks were down 2%? And then taking the calendar commentary, does that imply Halloween sales, or sales associated with Halloween are down two banks to moving from a weekday to a or moving from a weekend to a weekday? Thanks.

Michael Schlotman

Yes, I don't know, if I'll get that precise in answering the question, because daily fluctuations are always dangerous because of things like you cited Halloween moving between days. I don't think we said that, we were absolutely at the low-end of our 50 basis points to 150 basis points ID guidance, we said we were near it. And it actually, in our original guidance for that, we expected that the third quarter to not get to the low-end, but the fourth quarter to be above the low-end to bring us inside that range. And we didn't end up the third quarter drastically different than we did. And I think it's maybe it was my communication skills back on November 2, and people were hearing that we're near the low-end just assuming that that you're at the low-end.

I go back to, it takes $20 million in a quarter to move ID sales by 10 basis points. So the fluctuations when you're in this range, if I missed – if I missed those four days that were left by $20 million, that because my ID sales and half of it was a 20 basis points, from a 4%, it goes to 3.9% and it's not a very big deal.

William Kirk

Okay, that clarification is very helpful. Thank you.

Michael Schlotman

Yep.

Rodney McMullen

Thanks, William. Before we end today's call, I'd like to share some additional thoughts with our associates listening in today. Being part of millions of family celebrations this holiday season is a great honor and privilege. Our customers count on us to have what they need and more and you make it all happen.

Just last week nearly 10.5 million customers shopped with us on Tuesday and 13.5 million on Wednesday before Thanksgiving. That’s incredible, a huge thank you. No matter where you work, you make the holiday special for our customers, our communities and each other.

I also want to thank our store teams for their outstanding response to our National Hiring Event in November for all military veterans and family members. We hired 4,000 veterans and family members in one day, which is nearly 3,000 more than last year’s event.

We are delighted to welcome them to our Kroger family, as part of our continuing commitment to active-duty troops and the nation’s 23 million veterans. Thank you for all you do every day. Merry Christmas and happy holidays to you and your family. That completes our call today. Thanks for joining.

Operator

The conference is now concluded. Thank you for attending today’s presentation. You may now disconnect your lines. Have a great day.