

KROGER CO
Form 10-K
April 02, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended February 2, 2019.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-303

THE KROGER CO.

(Exact name of registrant as specified in its charter)

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Ohio (State or Other Jurisdiction of Incorporation or Organization)	31-0345740 (I.R.S. Employer Identification No.)
1014 Vine Street, Cincinnati, OH (Address of Principal Executive Offices)	45202 (Zip Code)

Registrant's telephone number, including area code (513) 762-4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock \$1 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§299.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter (August 18, 2018). \$25.0 billion.

The number of shares outstanding of the registrant's common stock, as of the latest practicable date. 798,327,065 shares of Common Stock of \$1 par value, as of March 28, 2019.

Documents Incorporated by Reference:

Portions of Kroger's definitive proxy statement for its 2019 annual meeting of shareholders, which shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference into Part III of this Report.

PART I

FORWARD LOOKING STATEMENTS.

This Annual Report on Form 10-K contains forward-looking statements about our future performance. These statements are based on our assumptions and beliefs in light of the information currently available to us. These statements are subject to a number of known and unknown risks, uncertainties and other important factors, including the risks and other factors discussed in “Risk Factors” and “Outlook” below, that could cause actual results and outcomes to differ materially from any future results or outcomes expressed or implied by such forward looking statements. Such statements are indicated by words such as “achieve,” “affect,” “believe,” “committed,” “continue,” “could,” “effect,” “estimate,” “expects,” “future,” “growth,” “intends,” “likely,” “may,” “plan,” “range,” “result,” “strategy,” “strong,” and “would, and similar words or phrases. Moreover, statements in the sections entitled Risk Factors, Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) and Outlook, and elsewhere in this report regarding our expectations, projections, beliefs, intentions or strategies are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended.

ITEM 1. BUSINESS.

The Kroger Co. (the “Company” or “Kroger”) was founded in 1883 and incorporated in 1902. As of February 2, 2019, we are one of the largest retailers in the world based on annual sales. We also manufacture and process some of the food for sale in our supermarkets. We maintain a web site (www.thekrogerco.com) that includes additional information about the Company. We make available through our web site, free of charge, our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and our interactive data files, including amendments. These forms are available as soon as reasonably practicable after we have filed them with, or furnished them electronically to, the SEC.

Our revenues are predominately earned and cash is generated as consumer products are sold to customers in our stores, fuel centers and via our online platforms. We earn income predominantly by selling products at price levels that produce revenues in excess of the costs to make these products available to our customers. Such costs include procurement and distribution costs, facility occupancy and operational costs and overhead expenses. Our fiscal year ends on the Saturday closest to January 31. All references to 2018, 2017 and 2016 are to the fiscal years ended February 2, 2019, February 3, 2018 and January 28, 2017, respectively, unless specifically indicated otherwise.

EMPLOYEES

As of February 2, 2019, Kroger employed approximately 453,000 full- and part-time employees. A majority of our employees are covered by collective bargaining agreements negotiated with local unions affiliated with one of several

different international unions. There are approximately 360 such agreements, usually with terms of three to five years.

STORES

As of February 2, 2019, Kroger operated, either directly or through its subsidiaries, 2,764 supermarkets under a variety of local banner names, of which 2,270 had pharmacies and 1,537 had fuel centers. We offer Pickup (also referred to as ClickList®) and Harris Teeter ExpressLane™—personalized, order online, pick up at the store services — at 1,581 of our supermarkets and provide home delivery service to 91% of Kroger households. Approximately 54% of our supermarkets were operated in Company-owned facilities, including some Company-owned buildings on leased land. Our current strategy emphasizes self-development and ownership of real estate. Our stores operate under a variety of banners that have strong local ties and brand recognition. Supermarkets are generally operated under one of the following formats: combination food and drug stores (“combo stores”); multi-department stores; marketplace stores; or price impact warehouses.

The combo store is the primary food store format. They typically draw customers from a 2 — 2.5 mile radius. We believe this format is successful because the stores are large enough to offer the specialty departments that customers desire for one-stop shopping, including natural food and organic sections, pharmacies, general merchandise, pet centers and high-quality perishables such as fresh seafood and organic produce.

Multi-department stores are significantly larger in size than combo stores. In addition to the departments offered at a typical combo store, multi-department stores sell a wide selection of general merchandise items such as apparel, home fashion and furnishings, outdoor living, electronics, automotive products and toys.

Marketplace stores are smaller in size than multi-department stores. They offer full-service grocery, pharmacy and health and beauty care departments as well as an expanded perishable offering and general merchandise area that includes apparel, home goods and toys.

Price impact warehouse stores offer a “no-frills, low cost” warehouse format and feature everyday low prices plus promotions for a wide selection of grocery and health and beauty care items. Quality meat, dairy, baked goods and fresh produce items provide a competitive advantage. The average size of a price impact warehouse store is similar to that of a combo store.

SEGMENTS

We operate supermarkets and multi-department stores throughout the United States. Our retail operations, which represent 97% of our consolidated sales, is our only reportable segment. We aggregate our operating divisions into one reportable segment due to the operating divisions having similar economic characteristics with similar long-term financial performance. In addition, our operating divisions offer customers similar products, have similar distribution methods, operate in similar regulatory environments, purchase the majority of the merchandise for retail sale from similar (and in many cases identical) vendors on a coordinated basis from a centralized location, serve similar types of customers, and are allocated capital from a centralized location. Our operating divisions are organized primarily on a geographical basis so that the operating division management team can be responsive to local needs of the operating division and can execute company strategic plans and initiatives throughout the locations in their operating division. This geographical separation is the primary differentiation between these retail operating divisions. The geographical basis of organization reflects how the business is managed and how our Chief Executive Officer, who acts as our chief operating decision maker, assesses performance internally. All of our operations are domestic. Revenues, profits and losses and total assets are shown in our Consolidated Financial Statements set forth in Item 8 below.

MERCHANDISING AND MANUFACTURING

Our Brands products play an important role in our merchandising strategy. Our supermarkets, on average, stock over 15,000 private label items. Our Brands products are primarily produced and sold in three “tiers.” Private Selection® is one of our premium quality brands, offering customers culinary foods and ingredients that deliver amazing eating experiences. The Kroger® brand, which represents the majority of our private label items, is designed to consistently satisfy and delight customers with quality products that exceed or meet the national brand in taste and efficacy, as well as with unique and differentiated products. Big K®, Check This Out...® and Heritage Farm® are some of our value brands, designed to deliver good quality at a very affordable price. In addition, we continue to grow natural and organic Our Brands offerings with Simple Truth® and Simple Truth Organic®. Both Simple Truth and Simple Truth

Organic are free from a defined list of artificial ingredients that customers have told us they do not want in their food, and the Simple Truth Organic products are USDA certified organic.

Approximately 32% of Our Brands units and 43% of the grocery category Our Brands units sold in our supermarkets are produced in our food production plants; the remaining Our Brands items are produced to our strict specifications by outside manufacturers. We perform a “make or buy” analysis on Our Brands products and decisions are based upon a comparison of market-based transfer prices versus open market purchases. As of February 2, 2019, we operated 37 food production plants. These plants consisted of 17 dairies, 10 deli or bakery plants, five grocery product plants, two beverage plants, one meat plant and two cheese plants.

SEASONALITY

The majority of our revenues are generally not seasonal in nature. However, revenues tend to be higher during the major holidays throughout the year. Additionally, significant inclement weather systems, particularly winter storms, tend to affect our sales trends.

EXECUTIVE OFFICERS OF THE REGISTRANT

The disclosure regarding executive officers is set forth in Item 10 of Part III of this Form 10-K under the heading “Executive Officers of the Company,” and is incorporated herein by reference.

COMPETITIVE ENVIRONMENT

For the disclosure related to our competitive environment, see Item 1A under the heading “Competitive Environment.”

ITEM 1A.RISK FACTORS.

There are risks and uncertainties that can affect our business. The significant risk factors are discussed below. The following information should be read together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the “Outlook” section in Item 7 of this Form 10-K, which include forward-looking statements and factors that could cause us not to realize our goals or meet our expectations.

COMPETITIVE ENVIRONMENT

The operating environment for the food retailing industry continues to be characterized by intense price competition, expansion, increasing fragmentation of retail and online formats, entry of non-traditional competitors and market consolidation. In addition, evolving customer preferences and the advancement of online, delivery, ship to home, and mobile channels in our industry enhance the competitive environment.

We believe our Restock Kroger plan provides a balanced approach that will enable us to meet the wide-ranging needs and expectations of our customers. However, we may be unsuccessful in implementing Restock Kroger, including our alternative profit strategy and our cost savings initiatives, which could adversely affect our relationships with our customers, our market share and business growth, and our operations and results. The nature and extent to which our competitors respond to the evolving and competitive industry by developing and implementing their competitive strategies could adversely affect our profitability.

PRODUCT SAFETY

Customers count on Kroger to provide them with safe food and drugs and other merchandise. Concerns regarding the safety of the products that we sell could cause shoppers to avoid purchasing certain products from us, or to seek alternative sources of supply even if the basis for the concern is outside of our control. Any lost confidence on the part of our customers would be difficult and costly to reestablish. Any issue regarding the safety of items we sell, regardless of the cause, could have a substantial and adverse effect on our reputation, financial condition, results of operations, or cash flows.

LABOR RELATIONS

A majority of our employees are covered by collective bargaining agreements with unions, and our relationship with those unions, including a prolonged work stoppage affecting a substantial number of locations, could have a material adverse effect on our results.

We are a party to approximately 360 collective bargaining agreements. Upon the expiration of our collective bargaining agreements, work stoppages by the affected workers could occur if we are unable to negotiate new contracts with labor unions. A prolonged work stoppage affecting a substantial number of locations could have a material adverse effect on our results. Further, if we are unable to control health care, pension and wage costs, or if we have insufficient operational flexibility under our collective bargaining agreements, we may experience increased operating costs and an adverse effect on our financial condition, results of operations, or cash flows.

DATA AND TECHNOLOGY

Our business is increasingly dependent on information technology systems that are complex and vital to continuing operations, resulting in an expansion of our technological presence and corresponding risk exposure. If we were to experience difficulties maintaining or operating existing systems or implementing new systems, we could incur significant losses due to disruptions in our operations.

Through our sales and marketing activities, we collect and store some personal information that our customers provide to us. We also gather and retain information about our associates in the normal course of business. Under certain circumstances, we may share information with vendors that assist us in conducting our business, as required by law, or otherwise in accordance with our privacy policy.

Our technology systems are vulnerable to disruption from circumstances beyond our control. Cyber-attackers may attempt to access information stored in our or our vendors' systems in order to misappropriate confidential customer or business information. Although we have implemented procedures to protect our information, and require our vendors to do the same, we cannot be certain that our security systems will successfully defend against rapidly evolving, increasingly sophisticated cyber-attacks as they become more difficult to detect and defend against. Further, a Kroger associate, a contractor or other third party with whom we do business may in the future circumvent our security measures in order to obtain information or may inadvertently cause a breach involving information. In addition, hardware, software or applications we may use may have inherent defects or could be inadvertently or intentionally applied or used in a way that could compromise our information security.

Our continued investment in our information technology systems may not effectively insulate us from potential attacks, breaches or disruptions to our business operations, which could result in a loss of customers or business information, negative publicity, damage to our reputation, and exposure to claims from customers, financial institutions, regulatory authorities, payment card associations, associates and other persons. Any such events could have an adverse effect on our business, financial condition and results of operations and may not be covered by our insurance. In addition, compliance with privacy and information security laws and standards may result in significant expense due to increased investment in technology and the development of new operational processes and may require us to devote significant management resources to address these issues.

Additionally, on October 1, 2015, the payment card industry shifted liability for certain transactions to retailers who are not able to accept Europay, MasterCard, Visa (EMV) transactions. We completed the implementation of the EMV technology for our supermarket transactions, and have a plan in place to complete implementation for our fuel centers prior to the liability shift for fuel centers, which will occur in 2020.

INDEBTEDNESS

Our indebtedness could reduce our ability to obtain additional financing for working capital, mergers and acquisitions or other purposes and could make us vulnerable to future economic downturns as well as competitive pressures. If debt markets do not permit us to refinance certain maturing debt, we may be required to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness. Changes in our credit ratings, or in the interest rate environment, could have an adverse effect on our financing costs and structure.

LEGAL PROCEEDINGS AND INSURANCE

From time to time, we are a party to legal proceedings, including matters involving personnel and employment issues, personal injury, antitrust claims and other proceedings. Other legal proceedings purport to be brought as class actions on behalf of similarly situated parties. Some of these proceedings could result in a substantial loss to Kroger. We estimate our exposure to these legal proceedings and establish accruals for the estimated liabilities, where it is reasonably possible to estimate and where an adverse outcome is probable. Assessing and predicting the outcome of these matters involves substantial uncertainties. Adverse outcomes in these legal proceedings, or changes in our evaluations or predictions about the proceedings, could have a material adverse effect on our financial results. Please also refer to the “Legal Proceedings” section in Item 3 and the “Litigation” section in Note 13 to the Consolidated Financial Statements.

We use a combination of insurance and self-insurance to provide for potential liability for workers' compensation, automobile and general liability, property, director and officers' liability, and employee health care benefits. Any actuarial projection of losses is subject to a high degree of variability. Changes in legal claims, trends and interpretations, variability in inflation rates, changes in the nature and method of claims settlement, benefit level changes due to changes in applicable laws, insolvency of insurance carriers, and changes in discount rates could all affect our financial condition, results of operations, or cash flows.

MULTI-EMPLOYER PENSION OBLIGATIONS

As discussed in more detail below in "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies-Multi-Employer Pension Plans," Kroger contributes to several multi-employer pension plans based on obligations arising under collective bargaining agreements with unions representing employees covered by those agreements. We believe that the present value of actuarially accrued liabilities in most of these multi-employer plans substantially exceeds the value of the assets held in trust to pay benefits, and we expect that Kroger's contributions to those funds will increase over the next few years. A significant increase to those funding requirements could adversely affect our financial condition, results of operations, or cash flows. Despite the fact that the pension obligations of these funds are not the liability or responsibility of the Company, except as noted below, there is a risk that the agencies that rate our outstanding debt instruments could view the underfunded nature of these plans unfavorably, or adjust their current views unfavorably, when determining their ratings on our debt securities. Any downgrading of our debt ratings likely would adversely affect our cost of borrowing and access to capital.

We also currently bear the investment risk of two multi-employer pension plans in which we participate. In addition, we have been designated as the named fiduciary of these funds with sole investment authority of the assets of these funds. If investment results fail to meet our expectations, we could be required to make additional contributions to fund a portion of or the entire shortfall, which could have an adverse effect on our business, financial condition, results of operations, or cash flows.

INTEGRATION OF NEW BUSINESS

We enter into mergers, acquisitions and strategic alliances with expected benefits including, among other things, operating efficiencies, procurement savings, innovation, sharing of best practices and increased market share that may allow for future growth. Achieving the anticipated benefits may be subject to a number of significant challenges and uncertainties, including, without limitation, whether unique corporate cultures will work collaboratively in an efficient and effective manner, the coordination of geographically separate organizations, the possibility of imprecise assumptions underlying expectations regarding potential synergies and the integration process, unforeseen expenses and delays, and competitive factors in the marketplace. We could also encounter unforeseen transaction and integration-related costs or other circumstances such as unforeseen liabilities or other issues. Many of these potential circumstances are outside of our control and any of them could result in increased costs, decreased revenue, decreased synergies and the diversion of management time and attention. If we are unable to achieve our objectives within the anticipated time frame, or at all, the expected benefits may not be realized fully or at all, or may take longer to realize than expected, which could have an adverse effect on our business, financial condition and results of operations, or

cash flows.

FUEL

We sell a significant amount of fuel, which could face increased regulation and demand could be affected by concerns about the effect of emissions on the environment as well as retail price increases. We are unable to predict future regulations, environmental effects, political unrest, acts of terrorism and other matters that may affect the cost and availability of fuel, and how our customers will react, which could adversely affect our financial condition, results of operations, or cash flows.

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ECONOMIC CONDITIONS

Our operating results could be materially impacted by changes in overall economic conditions that impact consumer confidence and spending, including discretionary spending. Future economic conditions affecting disposable consumer income such as employment levels, business conditions, changes in housing market conditions, the availability of credit, interest rates, tax rates, the impact of natural disasters or acts of terrorism, and other matters could reduce consumer spending. Increased fuel prices could also have an effect on consumer spending and on our costs of producing and procuring products that we sell. We are unable to predict how the global economy and financial markets will perform. If the global economy and financial markets do not perform as we expect, it could adversely affect our financial condition, results of operations, or cash flows.

WEATHER AND NATURAL DISASTERS

A large number of our stores and distribution facilities are geographically located in areas that are susceptible to hurricanes, tornadoes, floods, droughts and earthquakes. Weather conditions and natural disasters could disrupt our operations at one or more of our facilities, interrupt the delivery of products to our stores, substantially increase the cost of products, including supplies and materials and substantially increase the cost of energy needed to operate our facilities or deliver products to our facilities. Adverse weather and natural disasters could materially affect our financial condition, results of operations, or cash flows.

GOVERNMENT REGULATION

Our stores are subject to various laws, regulations, and administrative practices that affect our business. We must comply with numerous provisions regulating, among other things, health and sanitation standards, food labeling and safety, equal employment opportunity, minimum wages, and licensing for the sale of food, drugs, and alcoholic beverages. We cannot predict future laws, regulations, interpretations, administrative orders, or applications, or the effect they will have on our operations. They could, however, significantly increase the cost of doing business. They also could require the reformulation of some of the products that we sell (or manufacture for sale to third parties) to meet new standards. We also could be required to recall or discontinue the sale of products that cannot be reformulated. These changes could result in additional record keeping, expanded documentation of the properties of certain products, expanded or different labeling, or scientific substantiation. Any or all of these requirements could have an adverse effect on our financial condition, results of operations, or cash flows.

ITEM 1B.UNRESOLVED STAFF COMMENTS.

None.

ITEM 2.PROPERTIES.

As of February 2, 2019, we operated approximately 2,800 owned or leased supermarkets, distribution warehouses and food production plants through divisions, subsidiaries or affiliates. These facilities are located throughout the United States. While our current strategy emphasizes ownership of real estate, a substantial portion of the properties used to conduct our business are leased.

We generally own store equipment, fixtures and leasehold improvements, as well as processing and food production equipment. The total cost of our owned assets and capitalized leases at February 2, 2019, was \$43.9 billion while the accumulated depreciation was \$22.2 billion.

Leased premises generally have base terms ranging from ten-to-twenty years with renewal options for additional periods. Some options provide the right to purchase the property after the conclusion of the lease term. Store rentals are normally payable monthly at a stated amount or at a guaranteed minimum amount plus a percentage of sales over a stated dollar volume. Rentals for the distribution, food production and miscellaneous facilities generally are payable monthly at stated amounts. For additional information on lease obligations, see Note 10 to the Consolidated Financial Statements.

ITEM 3.LEGAL PROCEEDINGS.

Various claims and lawsuits arising in the normal course of business, including suits charging violations of certain antitrust, wage and hour, or civil rights laws, as well as product liability cases, are pending against the Company. Some of these suits purport or have been determined to be class actions and/or seek substantial damages. Any damages that may be awarded in antitrust cases will be automatically trebled. Although it is not possible at this time to evaluate the merits of all of these claims and lawsuits, nor their likelihood of success, we believe that any resulting liability will not have a material adverse effect on our financial position, results of operations, or cash flows.

We continually evaluate our exposure to loss contingencies arising from pending or threatened litigation and believe we have made provisions where it is reasonably possible to estimate and where an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involves substantial uncertainties. We currently believe that the aggregate range of loss for our exposures is not material. It remains possible that despite our current belief, material differences in actual outcomes or changes in our evaluation or predictions could arise that could have a material adverse effect on our financial condition, results of operations, or cash flows.

ITEM 4.MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5.MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the New York Stock Exchange under the symbol “KR.” As of March 28, 2019, there were 27,037 shareholders of record.

During 2018, we paid two quarterly cash dividends of \$0.125 per share and two quarterly cash dividends of \$0.14 per share. During 2017, we paid two quarterly cash dividends of \$0.12 per share and two quarterly cash dividends of \$0.125 per share. On March 1, 2019, we paid a quarterly cash dividend of \$0.14 per share. On March 14, 2019, we announced that our Board of Directors declared a quarterly cash dividend of \$0.14 per share, payable on June 1, 2019, to shareholders of record at the close of business on May 15, 2019. We currently expect to continue to pay comparable cash dividends on a quarterly basis, that will increase over time, depending on our earnings and other factors, including approval by our Board.

For information on securities authorized for issuance under our existing equity compensation plans, see Item 12 under the heading “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.”

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PERFORMANCE GRAPH

Set forth below is a line graph comparing the five-year cumulative total shareholder return on our common shares, based on the market price of the common shares and assuming reinvestment of dividends, with the cumulative total return of companies in the Standard & Poor's 500 Stock Index and a peer group composed of food and drug companies.

Company Name/Index	Base	INDEXED RETURNS				
	Period	Years Ending				
	2013	2014	2015	2016	2017	2018
The Kroger Co.	100	194.06	220.52	192.09	172.11	167.77
S&P 500 Index	100	114.22	113.46	137.14	168.46	168.36
Peer Group	100	125.06	116.69	114.76	148.26	143.99

Kroger's fiscal year ends on the Saturday closest to January 31.

Data supplied by Standard & Poor's.

The foregoing Performance Graph will not be deemed incorporated by reference into any other filing, absent an express reference thereto.

* Total assumes \$100 invested on February 1, 2014, in The Kroger Co., S&P 500 Index, and the Peer Group, with reinvestment of dividends.

** The Peer Group consists of Costco Wholesale Corp., CVS Caremark Corp, Etablissements Delhaize Freres Et Cie Le Lion ("Groupe Delhaize", which is included through July 22, 2016 when it merged with Koninklijke Ahold), Koninklijke Ahold Delhaize NV (changed name from Koninklijke Ahold after merger with Groupe Delhaize), Safeway, Inc. (included through January 29, 2015 when it was acquired by AB Acquisition LLC), Supervalu Inc. (included through October 19, 2018 when it was acquired by United Natural Foods), Target Corp., Wal-Mart Stores Inc., Walgreens Boots Alliance Inc. (formerly, Walgreen Co.), Whole Foods Market Inc. (included through August 28, 2017 when it was acquired by Amazon.com, Inc.).

The following table presents information on our purchases of our common shares during the fourth quarter of 2018.

ISSUER PURCHASES OF EQUITY SECURITIES

Period (1)	Total Number of Shares Purchased (2)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (4) (in millions)
First period - four weeks November 11, 2018 to December 8, 2018	211,696	\$ 30.41	192,716	\$ 546
Second period - four weeks December 9, 2018 to January 5, 2019	147,050	\$ 28.84	128,189	\$ 546
Third period — four weeks January 6, 2019 to February 2, 2019	196,646	\$ 28.54	165,094	\$ 546
Total	555,392	\$ 29.33	485,999	\$ 546

- (1) The reported periods conform to our fiscal calendar composed of thirteen 28-day periods. The fourth quarter of 2018 contained three 28-day periods.
- (2) Includes (i) shares repurchased under a program announced on December 6, 1999 to repurchase common shares to reduce dilution resulting from our employee stock option and long-term incentive plans, under which repurchases are limited to proceeds received from exercises of stock options and the tax benefits associated therewith (“1999 Repurchase Program”) and (ii) 69,393 shares that were surrendered to the Company by participants under our long term incentive plans to pay for taxes on restricted stock awards.
- (3) Represents shares repurchased under the 1999 Repurchase Program.
- (4) The amounts shown in this column reflect the amount remaining under the March 2018 Repurchase Program as of the specified period end dates. Amounts available under the 1999 Repurchase Program are dependent upon option exercise activity. The March 2018 Repurchase Program and the 1999 Repurchase Program do not have an expiration date but may be suspended or terminated by our Board of Directors at any time.

ITEM 6. SELECTED FINANCIAL DATA.

The following table presents our selected consolidated financial data for each of the last five fiscal years.

	Fiscal Years Ended				
	February 2, 2019 (52 weeks)	February 3, 2018 (53 weeks)	January 28, 2017 (52 weeks)	January 30, 2016 (52 weeks)	February 1, 2015 (52 weeks)
	(In millions, except per share amounts)				
Sales	\$ 121,162	\$ 122,662	\$ 115,337	\$ 109,830	\$ 108,465
Net earnings including noncontrolling interests	3,078	1,889	1,957	2,049	1,747
Net earnings attributable to The Kroger Co.	3,110	1,907	1,975	2,039	1,728
Net earnings attributable to The Kroger Co. per diluted common share	3.76	2.09	2.05	2.06	1.72
Total assets	38,118	37,197	36,505	33,897	30,497
Long-term liabilities, including obligations under capital leases and financing obligations	16,009	16,095	16,935	14,128	13,663
Total shareholders' equity — The Kroger Co.	7,886	6,931	6,698	6,820	5,412
Cash dividends per common share	0.530	0.490	0.450	0.395	0.340

Note: This information should be read in conjunction with MD&A and the Consolidated Financial Statements.

Fiscal year ended February 2, 2019 includes the gain on sale of our convenience store business unit.

Refer to Note 2 of the Consolidated Financial Statements for disclosure of business combinations and their effect on the Consolidated Statements of Operations and the Consolidated Balance Sheets.

All share and per share amounts presented are reflective of the two-for-one stock split that began trading at the split adjusted price on July 14, 2015.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis of financial condition and results of operations of The Kroger Co. should be read in conjunction with the "Forward-looking Statements" section set forth in Part I, the "Risk Factors" section set forth in Item 1A of Part I and the "Outlook" section below.

OUR BUSINESS

The Kroger Co. was founded in 1883 and incorporated in 1902. As of February 2, 2019, Kroger is one of the world's largest retailers, as measured by revenue, operating 2,764 supermarkets under a variety of local banner names in 35 states and the District of Columbia. Of these stores, 2,270 have pharmacies and 1,537 have fuel centers. We offer Pickup (also referred to as ClickList®) and Harris Teeter ExpressLane™ — personalized, order online, pick up at the store services — at 1,581 of our supermarkets and provide home delivery service to 91% of Kroger households. We also operate an online retailer.

We operate 37 food production plants, primarily bakeries and dairies, which supply approximately 32% of Our Brands units and 43% of the grocery category Our Brands units sold in our supermarkets; the remaining Our Brands items are produced to our strict specifications by outside manufacturers.

Our revenues are predominately earned and cash is generated as consumer products are sold to customers in our stores, fuel centers and via our online platforms. We earn income predominately by selling products at price levels that produce revenues in excess of the costs we incur to make these products available to our customers. Such costs include procurement and distribution costs, facility occupancy and operational costs, and overhead expenses. Our retail operations, which represent 97% of our consolidated sales, is our only reportable segment.

On June 22, 2018, we closed our merger with Home Chef by purchasing 100% of the ownership interest in Home Chef, for \$197 million net of cash and cash equivalents of \$30 million, in addition to future earnout payments of up to \$500 million over five years that are contingent on achieving certain milestones. Home Chef is included in our ending Consolidated Balance Sheet for 2018 and in our Consolidated Statements of Operations from June 22, 2018 through February 2, 2019.

On April 20, 2018, we completed the sale of our convenience store business unit for \$2.2 billion. The convenience store business is included in our ending Consolidated Balance Sheet for 2017 and in our Consolidated Statements of Operations in all periods in 2016 and 2017 and through April 19, 2018.

On September 2, 2016, we closed our merger with Modern HC Holdings, Inc. (“ModernHEALTH”) by purchasing 100% of the outstanding shares of ModernHEALTH for \$407 million. ModernHEALTH is included in our ending Consolidated Balance Sheet for 2016, 2017 and 2018 and in our Consolidated Statements of Operations from September 2, 2016 through January 28, 2017 and all periods in 2017 and 2018.

See Note 2 to the Consolidated Financial Statements for more information related to our mergers with Home Chef and ModernHEALTH.

USE OF NON-GAAP FINANCIAL MEASURES

The accompanying Consolidated Financial Statements, including the related notes, are presented in accordance with generally accepted accounting principles (“GAAP”). We provide non-GAAP measures, including First-In, First-Out (“FIFO”) gross margin, FIFO operating profit, adjusted operating net earnings, adjusted operating net earnings per diluted share and Restock cash flow because management believes these metrics are useful to investors and analysts. These non-GAAP financial measures should not be considered as an alternative to gross margin, operating profit, net earnings, net earnings per diluted share and net cash provided or used by operating or investing activities or any other GAAP measure of performance. These measures should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP.

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We calculate FIFO gross margin as FIFO gross profit divided by sales. FIFO gross profit is calculated as sales less merchandise costs, including advertising, warehousing, and transportation expenses, but excluding the Last-In, First-Out (“LIFO”) charge. Merchandise costs exclude depreciation and rent expenses. FIFO gross margin is an important measure used by management as management believes FIFO gross margin is a useful metric to investors and analysts because it measures our day-to-day merchandising and operational effectiveness.

We calculate FIFO operating profit as operating profit excluding the LIFO charge. FIFO operating profit is an important measure used by management as management believes FIFO operating profit is a useful metric to investors and analysts because it measures our day-to-day operational effectiveness.

The adjusted operating net earnings and adjusted operating net earnings per diluted share metrics are important measures used by management to compare the performance of core operating results between periods. We believe adjusted operating net earnings and adjusted operating net earnings per diluted share are useful metrics to investors and analysts because they present more accurate year-over-year comparisons for our net earnings and net earnings per diluted share because adjusted items are not the result of our normal operations. Net earnings for 2018 include the following, which we define as the “2018 Adjusted Items:”

- Charges to operating, general and administrative expenses (“OG&A”) of \$155 million, \$121 million net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension fund; \$33 million, \$26 million net of tax, for the revaluation of contingent consideration; and \$42 million, \$33 million net of tax, for an impairment of financial instrument (the “2018 OG&A Adjusted Items”). We had initially received the financial instrument in 2016 with no cash outlay as part of the consideration for entering into agreements with a third party.
- A reduction to depreciation and amortization expenses of \$14 million, \$11 million net of tax, related to held for sale assets (the “2018 Depreciation Adjusted Item”).
- Gains in other income (expense) of \$1.8 billion, \$1.4 billion net of tax, related to the sale of our convenience store business unit and \$228 million, \$174 million net of tax, for the mark to market gain on Ocado Group plc (“Ocado”) securities.

Net earnings for 2017 include the following, which we define as the “2017 Adjusted Items:”

- Charges to OG&A of \$550 million, \$360 million net of tax, for obligations related to withdrawing from and settlements of withdrawal liabilities for certain multi-employer pension funds; \$184 million, \$117 million net of tax, related to the voluntary retirement offering (“VRO”); and \$110 million, \$74 million net of tax, related to the Kroger Specialty Pharmacy goodwill impairment (the “2017 OG&A Adjusted Items”).

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A reduction to depreciation and amortization expenses of \$19 million, \$13 million net of tax, related to held for sale assets (the "2017 Depreciation Adjusted Item").

- A reduction to income tax expense of \$922 million primarily due to the re-measurement of deferred tax liabilities and the reduction of the statutory rate for the last five weeks of the fiscal year from the Tax Cuts and Jobs Act ("Tax Act") (the "2017 Tax Expense Adjusted Item").
- A charge in other income (expense) of \$502 million, \$335 million net of tax, related to a company-sponsored pension plan termination.

In addition, net earnings for 2017 include \$119 million, \$79 million net of tax, due to a 53rd week in fiscal year 2017 (the "Extra Week").

Net earnings for 2016 include \$111 million, \$71 million net of tax, of charges to OG&A related to the restructuring of certain pension obligations to help stabilize associates' future benefits (the "2016 Adjusted Items").

OVERVIEW

Notable items for 2018 are:

- Net earnings per diluted share of \$3.76.
- Adjusted operating net earnings per diluted share of \$2.11.
- Identical sales, excluding fuel, increased 1.8% in 2018.
- Digital revenue grew over 58% in 2018, driven by Pickup. Digital revenue primarily includes revenue from all curbside pickup locations and online sales delivered to customer locations.
- Alternative profit increased in 2018, including third party media and our Kroger Personal Finance business, which had combined operating profit growth of approximately 20% in 2018.
- Sold our convenience store business unit for \$2.2 billion.
- Announced Ocado partnership and completed our merger with Home Chef.
- Announced we had entered into a definitive agreement to sell our You Technology business to Inmar. On March 13, 2019, we completed the sale of our You Technology business for \$565 million, which includes a long-term service agreement for Inmar to provide us digital coupon services.
- During 2018, we announced we had decided to explore strategic alternatives for our Turkey Hill Dairy business, including a potential sale. On March 19, 2019, we announced a definitive agreement for the sale of our Turkey Hill Dairy business to an affiliate of Peak Rock Capital.
- During 2018, we returned \$2.4 billion to shareholders from share repurchases and dividend payments, which includes \$1.2 billion repurchased under a \$1.2 billion accelerated stock repurchase (“ASR”) program using after tax proceeds from the sale of our convenience store business unit.
- Net cash provided by operating activities was \$4.2 billion in 2018 compared to \$3.4 billion in 2017.
- Restock cash flow was \$1.9 billion in 2018 and \$735 million in 2017.

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The following table provides a reconciliation of net earnings attributable to The Kroger Co. to adjusted operating net earnings attributable to The Kroger Co. and a reconciliation of net earnings attributable to The Kroger Co. per diluted common share to adjusted operating net earnings attributable to The Kroger Co. per diluted common share, excluding the 2018, 2017 and 2016 Adjusted Items.

Net Earnings per Diluted Share excluding the Adjusted Items

(\$ in millions, except per share amounts)

	2018	2017	2016
Net earnings attributable to The Kroger Co.	\$ 3,110	\$ 1,907	\$ 1,975
Adjustments for pension plan agreements (1)(2)	121	360	71
Adjustment for voluntary retirement offering (1)(3)	—	117	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment (1)(4)	—	74	—
Adjustment for company-sponsored pension plan termination (1)(5)	—	335	—
Adjustment for gain on sale of convenience store business (1)(6)	(1,360)	—	—
Adjustment for mark to market gain on Ocado securities (1)(7)	(174)	—	—
Adjustment for depreciation related to held for sale assets (1)(8)	(11)	(13)	—
Adjustment for contingent consideration (1)(9)	26	—	—
Adjustment for impairment of financial instrument (1)(10)	33	—	—
Adjustment for Tax Act (1)(11)	—	(922)	—
Total Adjusted Items	(1,365)	(49)	71
Net earnings attributable to The Kroger Co. excluding the Adjusted Items	\$ 1,745	\$ 1,858	\$ 2,046
Extra Week adjustment (1)(12)	—	(79)	—
Net earnings attributable to The Kroger Co. excluding the Adjusted Items and the Extra Week adjustment	\$ 1,745	\$ 1,779	\$ 2,046
Net earnings attributable to The Kroger Co. per diluted common share	\$ 3.76	\$ 2.09	\$ 2.05
Adjustments for pension plan agreements (13)	0.15	0.40	0.07
Adjustment for voluntary retirement offering (13)	—	0.13	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment (13)	—	0.08	—
Adjustment for company-sponsored pension plan termination (13)	—	0.37	—
Adjustment for gain on sale of convenience store business (13)	(1.65)	—	—
Adjustment for mark to market gain on Ocado securities (13)	(0.21)	—	—
Adjustment for depreciation related to held for sale assets (13)	(0.01)	(0.01)	—
Adjustment for contingent consideration (13)	0.03	—	—
Adjustment for impairment of financial instrument (13)	0.04	—	—
Adjustment for Tax Act (13)	—	(1.02)	—
Total Adjusted Items	(1.65)	(0.05)	0.07
Net earnings attributable to The Kroger Co. per diluted common share excluding the Adjusted Items	\$ 2.11	\$ 2.04	\$ 2.12

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Extra Week adjustment(13)	—	(0.09)	—
Net earnings attributable to The Kroger Co. per diluted common share excluding the Adjusted Items and the Extra Week adjustment	\$ 2.11	\$ 1.95	\$ 2.12
Average numbers of common shares used in diluted calculation	818	904	958

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Net Earnings per Diluted Share excluding the Adjusted Items (continued)

(\$ in millions, except per share amounts)

- (1) The amounts presented represent the after-tax effect of each adjustment.
- (2) The pre-tax adjustments for the pension plan agreements were \$155 in 2018, \$550 in 2017, and \$111 in 2016.
- (3) The pre-tax adjustment for the voluntary retirement offering was \$184.
- (4) The pre-tax adjustment for Kroger Specialty Pharmacy goodwill impairment was \$110.
- (5) The pre-tax adjustment for the company-sponsored pension plan termination was \$502.
- (6) The pre-tax adjustment for gain on sale of convenience store business was (\$1,782).
- (7) The pre-tax adjustment for mark to market gain on Ocado securities was (\$228).
- (8) The pre-tax adjustment for depreciation related to held for sale assets was (\$14) in 2018 and (\$19) in 2017.
- (9) The pre-tax adjustment for contingent consideration was \$33.
- (10) The pre-tax adjustment for impairment of financial instrument was \$42.
- (11) Due to the re-measurement of deferred tax liabilities and the reduction of the statutory income tax rate for the last few weeks of the fiscal year.
- (12) The pre-tax Extra Week adjustment was (\$119).
- (13) The amount presented represents the net earnings per diluted common share effect of each adjustment.

RESULTS OF OPERATIONS

Sales

Total Sales

(\$ in millions)

	2018	Percentage Change (1)	2017	2017 Adjusted (2)	Percentage Change (3)	2016
Total sales to retail customers without fuel (4)	\$ 104,486	2.1 %	\$ 104,207	\$ 102,290	3.1 %	\$ 99,243
Supermarket fuel sales	14,903	15.5 %	13,177	12,906	14.4 %	11,286
Convenience stores (5)	944	(78.7) %	4,515	4,434	8.3 %	4,096
Other sales (6)	829	10.1 %	763	753	5.8 %	712
Total sales	\$ 121,162	0.6 %	\$ 122,662	\$ 120,383	4.4 %	\$ 115,337

- (1) This column represents the percentage change in 2018 compared to 2017 adjusted sales, which removes the Extra Week.
- (2) The 2017 Adjusted column represents the items presented in the 2017 column adjusted to remove the Extra Week.

- (3) This column represents the percentage change in 2017 adjusted sales compared to 2016.
- (4) Digital sales, primarily including Pickup, Delivery and pharmacy e-commerce sales, grew approximately 58% in 2018, 90% in 2017 and 49% in 2016, adjusted to remove the Extra Week. These sales are included in the “total sales to retail customers without fuel” line above.
- (5) We completed the sale of our convenience store business during the first quarter of 2018.
- (6) Other sales primarily relate to external sales at food production plants, data analytic services, third party media revenue and digital coupon services.

Total sales decreased in 2018, compared to 2017, by 1.2%. The decrease in total sales in 2018, compared to 2017, is due to the Extra Week in 2017, partially offset by the increase in 2018 sales, compared to 2017 adjusted sales. Total sales increased in 2018, compared to 2017 adjusted sales, by 0.6%. This increase was primarily due to our increases in total sales to retail customers without fuel and supermarket fuel sales, partially offset by a reduction in convenience store sales due to the sale of our convenience store business unit. The increase in total sales to retail customers without fuel for 2018, compared to 2017 adjusted sales to retail customers without fuel, was primarily due to our merger with Home Chef and our identical sales increase, excluding fuel, of 1.8%. Identical sales, excluding fuel, for 2018, compared to 2017, increased primarily due to changes in product mix, including higher quality products at a higher price point, and Kroger Specialty Pharmacy sales growth, partially offset by our continued investments in lower prices for our customers. Total supermarket fuel sales increased 15.5% in 2018, compared to 2017 adjusted supermarket fuel sales, primarily due to an increase in the average retail fuel price of 13.6% and an increase in fuel gallons sold of 1.5%. The increase in the average retail fuel price was caused by an increase in the product cost of fuel.

Total sales increased in 2017, compared to 2016, by 6.4%. The increase in total sales in 2017, compared to 2016, is due to the increase in adjusted sales and the Extra Week. Total adjusted sales increased in 2017, compared to 2016, by 4.4%. This increase was primarily due to our increases in total sales to retail customers without fuel and supermarket fuel sales. The increase in total sales to retail customers without fuel for 2017, adjusted for the Extra Week, compared to 2016, was primarily due to our merger with ModernHEALTH, identical sales increase, excluding fuel, of 0.9%, and an increase in supermarket square footage. Identical sales, excluding fuel, for 2017, compared to 2016, increased primarily due to an increase in the number of households shopping with us, changes in product mix, Kroger Specialty Pharmacy sales growth and product cost inflation of 0.7%, partially offset by our continued investments in lower prices for our customers. Excluding mergers, acquisitions and operational closings, total supermarket square footage at the end of 2017 increased 1.9% over the end of 2016. Total adjusted supermarket fuel sales increased 14.4% in 2017, compared to 2016, primarily due to an increase in the average retail fuel price of 12.3% and an increase in fuel gallons sold of 1.9%. The increase in the average retail fuel price was caused by an increase in the product cost of fuel.

We calculate identical sales, excluding fuel, as sales to retail customers, including sales from all departments at identical supermarket locations, Kroger Specialty Pharmacy businesses and ship-to-home solutions. We define a supermarket as identical when it has been in operation without expansion or relocation for five full quarters. Additionally, sales from all acquired businesses are treated as identical as if they were part of the Company in the prior year. Although identical sales is a relatively standard term, numerous methods exist for calculating identical sales growth. As a result, the method used by our management to calculate identical sales may differ from methods other companies use to calculate identical sales. We urge you to understand the methods used by other companies to calculate identical sales before comparing our identical sales to those of other such companies. Certain pharmacy fees recorded as a reduction of sales have been comparatively reflected in the identical sales calculation. Our identical sales results are summarized in the following table. We used the identical sales dollar figures presented below to calculate percentage changes for 2018.

Identical Sales

(\$ in millions)

	2018 (1)	2017 (2)
Excluding fuel	\$ 101,928	\$ 100,153
Excluding fuel	1.8 %	0.9 %

-
- (1) Identical sales for 2018 were calculated on a 52 week basis by excluding week 1 of fiscal 2017 in our 2017 identical sales base.
- (2) Identical sales for 2017 were calculated on a 53 week basis by including week 1 of fiscal 2017 in our 2016 identical sales base.

Gross Margin, LIFO and FIFO Gross Margin

We define gross margin as sales minus merchandise costs, including advertising, warehousing, and transportation. Rent expense, depreciation and amortization expense, and interest expense are not included in gross margin.

Our gross margin rates, as a percentage of sales, were 21.68% in 2018, 22.01% in 2017 and 22.40% in 2016. The decrease in 2018, compared to 2017, resulted primarily from continued investments in lower prices for our customers, a higher LIFO charge, a change in product sales mix and increased transportation and advertising costs, as a percentage of sales, partially offset by growth in Our Brands products which have a higher gross margin compared to national brand products, improved merchandise costs, decreased shrink, as a percentage of sales, and a higher gross margin rate on fuel sales.

The decrease in 2017, compared to 2016, resulted primarily from continued investments in lower prices for our customers and our merger with ModernHEALTH due to its lower gross margin rate, and increased warehousing, transportation and shrink costs, as a percentage of sales, partially offset by improved merchandise costs, a lower LIFO charge, a change in our product sales mix, including higher gross margin perishable departments growing their percentage share of sales to total sales, growth in Our Brands products which have a higher gross margin compared to national brand products, decreased advertising costs, as a percentage of sales, and a higher gross margin rate on fuel sales.

Our LIFO charge for 2018 was \$29 million, compared to a LIFO credit of \$8 million in 2017 and a LIFO charge of \$19 million in 2016. In 2018, our LIFO charge primarily resulted from annualized product cost inflation, primarily related to pharmacy. Our LIFO credit in 2017 was primarily due to a reduction of pharmacy inventory in 2017 compared to 2016. In 2016, our LIFO charge primarily resulted from annualized product cost inflation related to pharmacy, and was partially offset by annualized product cost deflation in other departments.

Our FIFO gross margin rates, which exclude the LIFO charges and credit, were 21.70% in 2018, 22.01% in 2017 and 22.42% in 2016. Our fuel sales lower our FIFO gross margin rate due to the very low FIFO gross margin rate, as a percentage of sales, of fuel sales compared to non-fuel sales. Excluding the effect of fuel and the Extra Week, our FIFO gross margin rate decreased 55 basis points in 2018, compared to 2017. This decrease resulted primarily from our lower gross margin rate, excluding the effect of the LIFO charge and fuel, which has been described above.

Excluding the effect of fuel, the Extra Week and ModernHEALTH, our FIFO gross margin rate decreased 19 basis points in 2017, compared to 2016. This decrease resulted primarily from our lower gross margin rate, excluding the effect of the LIFO credit and charge, fuel and ModernHEALTH which has been described above.

Operating, General and Administrative Expenses

OG&A expenses consist primarily of employee-related costs such as wages, healthcare benefit costs and retirement plan costs; and utility and credit card fees. Certain other income items are classified as a reduction of OG&A expenses. These items include gift card and lottery commissions, coupon processing and vending machine fees, check cashing, money order and wire transfer fees, and baled salvage credits. Rent expense, depreciation and amortization expense, and interest expense are not included in OG&A.

OG&A expenses, as a percentage of sales, were 16.76% in 2018, 17.15% in 2017 and 16.61% in 2016. The decrease in 2018, compared to 2017 resulted primarily from effective cost controls due to process changes, decreased utilities, the 2017 OG&A Adjusted Items, and our incremental contribution of \$111 million, \$69 million net of tax, to the United Food and Commercial Workers (“UFCW”) Consolidated Pension Plan in 2017 (“2017 UFCW Contribution”), partially offset by the 2018 OG&A Adjusted Items, investments in our digital strategy and increased incentive plan costs. Our fuel sales lower our OG&A rate, as a percentage of sales, due to the very low OG&A rate, as a percentage of sales, of fuel sales compared to non-fuel sales. Excluding the effect of fuel, the Extra Week, the 2018 OG&A Adjusted Items, the 2017 OG&A Adjusted Items, and the 2017 UFCW Contribution, our OG&A rate increased 14 basis points in 2018, compared to 2017. This increase resulted primarily from investments in our digital strategy and increased incentive plan costs, partially offset by effective cost controls due to process changes and decreased utilities.

The increase in 2017, compared to 2016, resulted primarily from the 2017 OG&A Adjusted Items, investing in our digital strategy, increases in store wages attributed to investing in incremental labor hours and higher wages to improve retention, employee engagement and customer experience, the 2017 UFCW Contribution, increases in incentive plan and healthcare costs, partially offset by savings from the VRO, effective cost controls, higher fuel sales,

the 2016 Adjusted Items and our merger with ModernHEALTH due to its lower OG&A rate, as a percentage of sales. Excluding the effect of fuel, the Extra Week, the 2017 UFCW Contribution, the 2017 OG&A and 2016 Adjusted Items and ModernHEALTH, our OG&A rate increased 21 basis points in 2017, compared to 2016. This increase resulted primarily from investing in our digital strategy, increases in store wages attributed to investing in incremental labor hours and higher wages to improve retention, employee engagement and customer experience, increases in incentive plan and healthcare costs, partially offset by savings from the VRO and effective cost controls.

Rent Expense

Rent expense decreased, as a percentage of sales, in 2018 compared to 2017, due to decreased closed store liabilities. Rent expense decreased as a percentage of sales in 2017, compared to 2016, due to our continued emphasis on owning rather than leasing, whenever possible, and higher fuel sales, which decreases our rent expense, as a percentage of sales, partially offset by increased closed store liabilities.

Depreciation and Amortization Expense

Depreciation and amortization expense increased as a percentage of sales in 2018, compared to 2017, due to the Extra Week and additional depreciation on capital investments, excluding mergers and lease buyouts, of \$3.0 billion, during 2018, partially offset by higher fuel sales, which decreases our depreciation expense as a percentage of sales.

Depreciation and amortization expense decreased as a percentage of sales in 2017, compared to 2016, due to higher fuel sales, which decreases our depreciation expense as a percentage of sales, the Extra Week and the 2017 Depreciation Adjusted Item, partially offset by additional depreciation on capital investments, excluding mergers and lease buyouts, of \$3.0 billion, during 2017.

Operating Profit and FIFO Operating Profit

Operating profit was \$2.6 billion in 2018, \$2.6 billion in 2017 and \$3.5 billion in 2016. Operating profit, as a percentage of sales, was 2.16% in 2018, 2.13% in 2017 and 2.99% in 2016. Operating profit, as a percentage of sales, increased 3 basis points in 2018, compared to 2017, due to decreased OG&A and rent expenses, as a percentage of sales, partially offset by a lower gross margin rate, increased depreciation and amortization expenses and a higher LIFO charge, as a percentage of sales.

Operating profit, as a percentage of sales, decreased 86 basis points in 2017, compared to 2016, due to a lower gross margin and increased OG&A expense, as a percentage of sales, partially offset by lower depreciation and amortization and rent expenses and a lower LIFO charge, as a percentage of sales.

FIFO operating profit was \$2.6 billion in 2018, \$2.6 billion in 2017 and \$3.5 billion in 2016. FIFO operating profit, as a percentage of sales, was 2.18% in 2018, 2.12% in 2017 and 3.01% in 2016. Fuel sales lower our operating profit rate due to the very low operating profit rate, as a percentage of sales, of fuel sales compared to non-fuel sales. FIFO operating profit, as a percentage of sales excluding fuel, the Extra Week, the 2017 UFCW Contribution and the 2018 and 2017 Adjusted Items, decreased 68 basis points in 2018, compared to 2017, due to a lower gross margin and increased OG&A and depreciation and amortization expenses, as a percentage of sales, partially offset by lower rent expense, as a percentage of sales.

FIFO operating profit, as a percentage of sales excluding fuel, the Extra Week, the 2017 UFCW Contribution, the 2017 and 2016 Adjusted Items and ModernHEALTH, decreased 45 basis points in 2017, compared to 2016, due to a lower gross margin and increased OG&A and depreciation and amortization expenses, as a percentage of sales.

Specific factors of the above operating trends under operating profit and FIFO operating profit are discussed earlier in this section.

Interest Expense

Interest expense totaled \$620 million in 2018, \$601 million in 2017 and \$522 million in 2016. The increase in interest expense in 2018, compared to 2017, resulted primarily from a higher weighted average interest rate. The increase in interest expense in 2017, compared to 2016, resulted primarily from additional borrowings used for share repurchases, the Extra Week, the \$1.2 billion we contributed to company-sponsored and company-managed pension plans in 2017, a \$467 million pre-tax payment to satisfy withdrawal obligations for certain local unions of the Central States Pension Fund, partially offset by a lower weighted average interest rate.

Income Taxes

Our effective income tax rate was 22.6% in 2018, (27.3)% in 2017 and 32.8% in 2016. The 2018 tax rate differed from the federal statutory rate primarily due to the effect of state income taxes and an IRS audit that resulted in a reduction of prior year tax deductions at pre-Tax Act rates and an increase in future tax deductions at post-Tax Act rates. These 2018 items were partially offset by the utilization of tax credits and deductions, the remeasurement of uncertain tax positions and adjustments to provisional amounts that increased prior year deductions at pre-Tax Act rates and decreased future deductions at post-Tax Act rates. The 2017 tax rate differed from the federal statutory rate primarily as a result of remeasuring deferred taxes due to the Tax Act, the Domestic Manufacturing Deduction and other changes, partially offset by non-deductible goodwill impairment charges and the effect of state income taxes. The 2016 tax rate differed from the federal statutory rate primarily as a result of the recognition of excess tax benefits related to share-based payments after the adoption of Accounting Standards Update (“ASU”) 2016-09, the utilization of tax credits, the Domestic Manufacturing Deduction and other changes, partially offset by the effect of state income taxes.

Net Earnings and Net Earnings Per Diluted Share

Our net earnings are based on the factors discussed in the Results of Operations section.

Net earnings of \$3.76 per diluted share in 2018 represented an increase of 79.9% from net earnings of \$2.09 per diluted share in 2017. Adjusted operating net earnings of \$2.11 per diluted share in 2018 represented an increase of 8.2% from adjusted operating net earnings of \$1.95 per diluted share in 2017. The 8.2% increase in adjusted operating net earnings per diluted share resulted primarily from lower income tax expense, higher fuel earnings and lower weighted average common shares outstanding due to common share repurchases, partially offset by lower non-fuel FIFO operating profit, a higher LIFO charge and increased interest expense.

Net earnings of \$2.09 per diluted share in 2017 represented an increase of 2.0% from net earnings of \$2.05 per diluted share in 2016. Adjusted operating net earnings of \$1.95 per diluted share in 2017 represented a decrease of 8.0% from adjusted operating net earnings of \$2.12 per diluted share in 2016. The 8.0% decrease in adjusted operating net earnings per diluted share resulted primarily from lower non-fuel FIFO operating profit and increased interest expense, partially offset by higher fuel earnings, a lower LIFO charge, decreased income tax expense and lower weighted average common shares outstanding due to common share repurchases.

COMMON SHARE REPURCHASE PROGRAMS

We maintain share repurchase programs that comply with Rule 10b5-1 of the Securities Exchange Act of 1934 and allow for the orderly repurchase of our common shares, from time to time. The share repurchase programs do not

have an expiration date but may be suspended or terminated by our Board of Directors at any time. We made open market purchases of our common shares totaling \$727 million in 2018, \$1.6 billion in 2017 and \$1.7 billion in 2016. On April 20, 2018, we entered and funded a \$1.2 billion ASR program to reacquire shares in privately negotiated transactions.

In addition to these repurchase programs, we also repurchase common shares to reduce dilution resulting from our employee stock option plans. This program is solely funded by proceeds from stock option exercises, and the tax benefit from these exercises. We repurchased approximately \$83 million in 2018, \$66 million in 2017 and \$105 million in 2016 of our common shares under the stock option program.

The shares repurchased in 2018 were reacquired under two separate share repurchase programs. The first is a series of Board of Director authorizations:

- On June 22, 2017, our Board of Directors approved a \$1.0 billion share repurchase program (the “June 2017 Repurchase Program”). This program was exhausted during the first quarter of 2018.
- On March 15, 2018, our Board of Directors approved a \$1.0 billion share repurchase program, to supplement the June 2017 Repurchase Program, to reacquire shares via open market purchase or privately negotiated transactions, including accelerated stock repurchase transactions, block trades, or pursuant to trades intending to comply with rule 10b5-1 of the Securities Exchange Act of 1934 (the “March 2018 Repurchase Program”).

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- On April 19, 2018, our Board of Directors approved a \$1.2 billion ASR program to reacquire shares in privately negotiated transactions. This program was exhausted during the second quarter of 2018.

As of February 2, 2019, there was \$546 million remaining under the March 2018 Repurchase Program.

The second share repurchase program is a program that uses the cash proceeds from the exercises of stock options by participants in Kroger's stock option, long-term incentive plans and the associated tax benefits.

During the first quarter through March 28, 2019, we repurchased an additional \$9 million of our common shares under the stock option program and no additional shares under the March 2018 Repurchase Program. As of March 28, 2019, we have \$546 million remaining under the March 2018 Repurchase Program.

CAPITAL INVESTMENTS

Capital investments, including changes in construction-in-progress payables and excluding mergers and the purchase of leased facilities, totaled \$3.0 billion in 2018, \$3.0 billion in 2017 and \$3.7 billion in 2016. Capital investments for mergers totaled \$197 million in 2018, \$16 million in 2017 and \$401 million in 2016. We merged with Home Chef in 2018 and ModernHEALTH in 2016. Refer to Note 2 to the Consolidated Financial Statements for more information on these mergers. Capital investments for the purchase of leased facilities totaled \$5 million in 2018, \$13 million in 2017 and \$5 million in 2016. The table below shows our supermarket storing activity and our total supermarket square footage:

Supermarket Storing Activity

	2018	2017	2016
Beginning of year	2,782	2,796	2,778
Opened	10	24	50
Opened (relocation)	4	15	21
Acquired	10	3	—
Closed (operational)	(38)	(41)	(32)
Closed (relocation)	(4)	(15)	(21)
End of year	2,764	2,782	2,796
Total supermarket square footage (in millions)	179	179	178

RETURN ON INVESTED CAPITAL

We calculate return on invested capital (“ROIC”) by dividing adjusted operating profit for the prior four quarters by the average invested capital. Adjusted operating profit is calculated by excluding certain items included in operating profit, and adding back our LIFO charge, depreciation and amortization and rent to our U.S. GAAP operating profit of the prior four quarters. Average invested capital is calculated as the sum of (i) the average of our total assets, (ii) the average LIFO reserve, (iii) the average accumulated depreciation and amortization and (iv) a rent factor equal to total rent for the last four quarters multiplied by a factor of eight; minus (i) the average taxes receivable, (ii) the average trade accounts payable, (iii) the average accrued salaries and wages, (iv) the average other current liabilities, excluding accrued income taxes and (v) the average liabilities held for sale. Averages are calculated for ROIC by adding the beginning balance of the first quarter and the ending balance of the fourth quarter, of the last four quarters, and dividing by two. We use a factor of eight for our total rent as we believe this is a common factor used by our investors, analysts and rating agencies. ROIC is a non-GAAP financial measure of performance. ROIC should not be reviewed in isolation or considered as a substitute for our financial results as reported in accordance with GAAP. ROIC is an important measure used by management to evaluate our investment returns on capital. Management believes ROIC is a useful metric to investors and analysts because it measures how effectively we are deploying our assets.

Although ROIC is a relatively standard financial term, numerous methods exist for calculating a company’s ROIC. As a result, the method used by our management to calculate ROIC may differ from methods other companies use to calculate their ROIC. We urge you to understand the methods used by other companies to calculate their ROIC before comparing our ROIC to that of such other companies.

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The following table provides a calculation of ROIC for 2018 and 2017 on a 52 week basis (\$ in millions). The 2018 calculation of ROIC excludes the financial position and results of operations of Home Chef, due to the merger in 2018, and the convenience store business, due to the sale in 2018.

	Fiscal Year Ended	
	February 2, 2019	February 3, 2018
Return on Invested Capital		
Numerator		
Operating profit (53 week basis in fiscal year 2017)	\$ 2,614	\$ 2,612
Extra Week operating profit adjustment	—	(131)
LIFO charge (credit)	29	(8)
Depreciation and amortization	2,465	2,436
Rent (53 week basis in fiscal year 2017)	884	911
Extra Week rent adjustment	—	(17)
Adjustment for merger with Home Chef	28	—
Adjustment for disposal of convenience store business	(21)	—
Adjustment for contingent consideration	33	—
Adjustment for impairment of financial instrument	42	—
Adjustment for Kroger Specialty Pharmacy goodwill impairment	—	110
Adjustments for pension plan agreements	155	550
Adjustment for depreciation related to held for sale assets	(14)	(19)
Adjustments for voluntary retirement offering	—	184
Adjusted operating profit on a 52 week basis	\$ 6,215	\$ 6,628
Denominator		
Average total assets	\$ 37,658	\$ 36,851
Average taxes receivable (1)	(115)	(181)
Average LIFO reserve	1,263	1,270
Average accumulated depreciation and amortization	21,703	20,287
Average trade accounts payable	(5,959)	(5,838)
Average accrued salaries and wages	(1,163)	(1,167)
Average other current liabilities (2)	(3,571)	(3,363)
Average liabilities held for sale	(155)	(130)
Adjustment for merger with Home Chef	(145)	—
Adjustment for disposal of convenience store business	(198)	—
Rent x 8	7,072	7,152
Average invested capital	\$ 56,390	\$ 54,881
Return on Invested Capital	11.02 %	12.08 %

(1) Taxes receivable were \$229 as of February 3, 2018 and \$132 as of January 28, 2017. We did not have any taxes receivable as of February 2, 2019.

(2) Other current liabilities included accrued income taxes of \$60 as of February 2, 2019 and \$1 as of January 28, 2017. We did not have any accrued income taxes as of February 3, 2018. Accrued income taxes are removed from other current liabilities in the calculation of average invested capital.

RESTOCK CASH FLOW

Restock cash flow is an adjusted free cash flow measure calculated as net cash provided by operating activities minus net cash used by investing activities plus or minus adjustments for certain items. We updated our definition of Restock cash flow during 2018 to more closely align with the performance metrics under our Restock Kroger plan. Restock cash flow is an important measure used by management to evaluate available funding for dividends, managing debt levels, share repurchases and other strategic investments. Management believes Restock cash flow is a useful metric to investors and analysts to demonstrate our available funding for dividends, managing debt levels, share repurchases and other strategic investments.

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The following table provides a calculation of Restock cash flow for 2018 and 2017 (\$ in millions).

	Fiscal Year Ended	
	February 2, 2019	February 3, 2018
Net cash provided by operating activities	\$ 4,164	\$ 3,413
Net cash used by investing activities	(1,186)	(2,707)
Difference	2,978	706
Adjustment for payments for lease buyouts	5	13
Adjustment for purchases of Ocado securities	392	—
Adjustment for purchases of stores	44	—
Adjustment for net proceeds from sale of business, net of tax	(1,709)	—
Adjustment for payments for acquisitions, net of cash acquired	197	16
Restock cash flow	\$ 1,907	\$ 735

CRITICAL ACCOUNTING POLICIES

We have chosen accounting policies that we believe are appropriate to report accurately and fairly our operating results and financial position, and we apply those accounting policies in a consistent manner. Our significant accounting policies are summarized in Note 1 to the Consolidated Financial Statements.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and other factors we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

We believe the following accounting policies are the most critical in the preparation of our financial statements because they involve the most difficult, subjective or complex judgments about the effect of matters that are inherently uncertain.

Impairments of Long-Lived Assets

We monitor the carrying value of long-lived assets for potential impairment each quarter based on whether certain triggering events have occurred. These events include current period losses combined with a history of losses or a projection of continuing losses or a significant decrease in the market value of an asset. When a triggering event occurs, we perform an impairment calculation, comparing projected undiscounted cash flows, utilizing current cash flow information and expected growth rates related to specific stores, to the carrying value for those stores. If we identify impairment for long-lived assets to be held and used, we compare the assets' current carrying value to the assets' fair value. Fair value is determined based on market values or discounted future cash flows. We record impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for disposal, we adjust the value of the property and equipment to reflect recoverable values based on our previous efforts to dispose of similar assets and current economic conditions. We recognize impairment for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. We recorded asset impairments in the normal course of business totaling \$56 million in 2018, \$71 million in 2017 and \$26 million in 2016. We record costs to reduce the carrying value of long-lived assets in the Consolidated Statements of Operations as "Operating, general and administrative" expense.

The factors that most significantly affect the impairment calculation are our estimates of future cash flows. Our cash flow projections look several years into the future and include assumptions on variables such as inflation, the economy and market competition. Application of alternative assumptions and definitions, such as reviewing long-lived assets for impairment at a different level, could produce significantly different results.

Business Combinations

We account for business combinations using the acquisition method of accounting. All the assets acquired, liabilities assumed and amounts attributable to noncontrolling interests are recorded at their respective fair values at the date of acquisition once we obtain control of an entity. The determination of fair values of identifiable assets and liabilities involves estimates and the use of valuation techniques when market value is not readily available. We use various techniques to determine fair value in such instances, primarily including the income approach. Significant estimates used in determining fair value include, but are not limited to, the amount and timing of future cash flows, growth rates, discount rates and useful lives. The excess of the purchase price over fair values of identifiable assets and liabilities is recorded as goodwill. See Note 3 for further information about goodwill.

Goodwill

Our goodwill totaled \$3.1 billion as of February 2, 2019. We review goodwill for impairment in the fourth quarter of each year, and also upon the occurrence of triggering events. We perform reviews of each of our operating divisions and other consolidated entities (collectively, “reporting units”) that have goodwill balances. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and we compare fair value to the carrying value of a reporting unit for purposes of identifying potential impairment. We base projected future cash flows on management’s knowledge of the current operating environment and expectations for the future. We recognize goodwill impairment for any excess of a reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit.

Our annual evaluation of goodwill is performed for our reporting units during the fourth quarter. In 2017, we recorded goodwill impairment for our Kroger Specialty Pharmacy (“KSP”) reporting unit totaling \$110 million, \$74 million net of tax, resulting in a remaining goodwill balance of \$243 million. The 2018 fair value of our KSP reporting unit was estimated primarily based on a discounted cash flow model resulting in a percentage of excess fair value over carrying value of approximately 3%. The annual evaluation of goodwill performed in 2018 and 2016 did not result in impairment for any of our reporting units. Based on current and future expected cash flows, we believe additional goodwill impairments are not reasonably likely. A 10% reduction in fair value of our reporting units would not indicate a potential for impairment of our goodwill balance except for our KSP reporting unit.

For additional information relating to our results of the goodwill impairment reviews performed during 2018, 2017 and 2016, see Note 3 to the Consolidated Financial Statements.

The impairment review requires the extensive use of management judgment and financial estimates. Application of alternative estimates and assumptions could produce significantly different results. The cash flow projections embedded in our goodwill impairment reviews can be affected by several factors such as inflation, business valuations in the market, the economy, market competition and our ability to successfully integrate recently acquired businesses.

Multi-Employer Pension Plans

We contribute to various multi-employer pension plans based on obligations arising from collective bargaining agreements. These multi-employer pension plans provide retirement benefits to participants based on their service to contributing employers. The benefits are paid from assets held in trust for that purpose. Trustees are appointed in equal number by employers and unions. The trustees typically are responsible for determining the level of benefits to be provided to participants as well as for such matters as the investment of the assets and the administration of the plans.

We recognize expense in connection with these plans as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. We made cash contributions to these plans of \$358 million in 2018, \$954 million in 2017 and \$289 million in 2016. The increase in 2017, compared to 2018 and 2016 is due to the \$467 million pre-tax payment we made in 2017 to satisfy withdrawal obligations for certain local unions of the Central States Pension Fund and the 2017 UFCW Contribution.

We continue to evaluate and address our potential exposure to under-funded multi-employer pension plans as it relates to our associates who are beneficiaries of these plans. These under-fundings are not our liability. When an opportunity arises that is economically feasible and beneficial to us and our associates, we may negotiate the restructuring of under-funded multi-employer pension plan obligations to help stabilize associates' future benefits and become the fiduciary of the restructured multi-employer pension plan. The commitments from these restructurings do not change our debt profile as it relates to our credit rating since these off-balance sheet commitments are typically considered in our investment grade debt rating. We are currently designated as the named fiduciary of the UFCW Consolidated Pension Plan and the International Brotherhood of Teamsters ("IBT") Consolidated Pension Fund and have sole investment authority over these assets. We became the fiduciary of the IBT Consolidated Pension Fund in 2017 due to the ratification of a new labor contract with the IBT that provided for the withdrawal of certain local unions from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2018, we incurred a \$155 million charge, \$121 million net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension fund.
- In 2017, we incurred a \$550 million charge, \$360 million net of tax, for obligations related to withdrawing from and settlements for withdrawal liabilities for certain multi-employer pension plan obligations, of which \$467 million was contributed to the Central States Pension Fund in 2017.
- In 2017, we contributed an incremental \$111 million, \$71 million net of tax, to the UFCW Consolidated Pension Plan.
- In 2016, we incurred a charge of \$111 million, \$71 million net of tax, due to commitments and withdrawal liabilities arising from the restructuring of certain multi-employer pension plan obligations, of which \$28 million was contributed to the UFCW Consolidated Pension Plan in 2016.

As we continue to work to find solutions to under-funded multi-employer pension plans, it is possible we could incur withdrawal liabilities for certain funds.

Based on the most recent information available to us, we believe that the present value of actuarially accrued liabilities in most of the multi-employer plans to which we contribute substantially exceeds the value of the assets held in trust to pay benefits. We have attempted to estimate the amount by which these liabilities exceed the assets, (i.e., the amount of underfunding), as of December 31, 2018. Because we are only one of a number of employers contributing to these plans, we also have attempted to estimate the ratio of our contributions to the total of all contributions to these plans in a year as a way of assessing our "share" of the underfunding. Nonetheless, the underfunding is not a direct obligation or liability of ours or of any employer.

As of December 31, 2018, we estimate our share of the underfunding of multi-employer pension plans to which we contribute, or as it relates to certain funds, an estimated withdrawal liability, was approximately \$3.1 billion, \$2.4 billion net of tax. This represents an increase in the estimated amount of underfunding of approximately \$800 million,

\$600 million net of tax, as of December 31, 2018, compared to December 31, 2017. The increase in the amount of underfunding is primarily attributable to lower expected returns on assets in the funds. Our estimate is based on the most current information available to us including actuarial evaluations and other data (that include the estimates of others), and such information may be outdated or otherwise unreliable.

We have made and disclosed this estimate not because, except as noted above, this underfunding is a direct liability of ours. Rather, we believe the underfunding is likely to have important consequences. In the event we were to exit certain markets or otherwise cease making contributions to these plans, we could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated, in accordance with GAAP.

The amount of underfunding described above is an estimate and could change based on contract negotiations, returns on the assets held in the multi-employer pension plans, benefit payments or future restructuring agreements. The amount could decline, and our future expense would be favorably affected, if the values of the assets held in the trust significantly increase or if further changes occur through collective bargaining, trustee action or favorable legislation. On the other hand, our share of the underfunding could increase and our future expense could be adversely affected if the asset values decline, if employers currently contributing to these funds cease participation or if changes occur through collective bargaining, trustee action or adverse legislation. We continue to evaluate our potential exposure to under-funded multi-employer pension plans. Although these liabilities are not a direct obligation or liability of ours, any commitments to fund certain multi-employer pension plans will be expensed when our commitment is probable and an estimate can be made.

See Note 16 to the Consolidated Financial Statements for more information relating to our participation in these multi-employer pension plans.

RECENTLY ADOPTED ACCOUNTING STANDARDS

During the fourth quarter of 2017, we adopted ASU 2017-04 "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating the second step from the goodwill impairment test. ASU 2017-04 requires applying a one-step quantitative test and recording the amount of goodwill impairment as the excess of the reporting unit's carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 does not amend the optional qualitative assessment of goodwill impairment. We performed our annual evaluation of goodwill in accordance with this standard, which resulted in a goodwill impairment charge in 2017 of \$110 million, \$74 million net of tax, related to our Kroger Specialty Pharmacy reporting unit.

On February 4, 2018, we adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" which superseded previous revenue recognition guidance. Topic 606 is a comprehensive new revenue recognition model that requires a company to recognize revenue when goods and services are transferred to the customer in an amount that is proportionate to what has been delivered at that point and that reflects the consideration to which the company expects to be entitled for those goods or services. We adopted the standard using a modified retrospective approach with the adoption primarily involving the evaluation of whether we act as principal or agent in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. We will continue to record revenue and related costs on a gross basis for the arrangements. The adoption of the standard did not have a material effect on our Consolidated Statements of Operations, Consolidated Balance Sheets or Consolidated Statements of Cash Flows.

In March 2017, the Financial Accounting Standard's Board ("FASB") issued ASU "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07)." ASU 2017-07 requires an employer to report the service cost component of retiree benefits in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented separately from the service cost component and outside a subtotal of income from operations. We adopted ASU 2017-07 on February 4, 2018 and

retrospectively applied it to all periods presented. As a result, retiree benefit plan interest expense, investment returns, settlements and other non-service cost components of retiree benefit expenses are excluded from our operating profit subtotal as reported in our Consolidated Statements of Operations, but remain included in net earnings before income tax expense. Due to the adoption, we reclassified \$527 million for 2017 and \$16 million for 2016, of non-service company-sponsored pension plan costs from operating profit to other income (expense) on our Consolidated Statements of Operations. Information about retiree benefit plans' interest expense, investment returns and other components of retiree benefit expenses can be found in Note 15 to our Consolidated Financial Statements.

In January 2016, the FASB issued “Financial Instruments—Overall (Topic 825),” which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments (ASU 2016-01). We adopted this ASU on February 4, 2018. As a result of the adoption, we recorded a mark to market gain on Ocado securities, for those securities we owned as of the end of 2018, within the Consolidated Statements of Operations as opposed to a component of Other Comprehensive Income on our Consolidated Statements of Comprehensive Income.

RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2016, the FASB issued ASU 2016-02, "Leases," which provides guidance for the recognition of lease agreements. The standard's core principle is that a company will now recognize most leases on its balance sheet as lease liabilities with corresponding right-of-use assets. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance will be effective for us in the first quarter of our fiscal year ending February 1, 2020. We will apply the transition package of practical expedients permitted within the standard, which allows us to carryforward our historical lease classification, and will apply the transition option which does not require application of the guidance to comparative periods in the year of adoption. We estimate adoption of the standard will result in recognition of right of use assets and lease liabilities of approximately \$6.7 billion as of February 3, 2019. When combined with our existing capital leases, our total lease assets will be approximately \$7.4 billion and our total lease liabilities will be approximately \$7.6 billion as of February 3, 2019. We do not expect adoption to have a material impact on our consolidated net earnings or cash flows. We believe our current off-balance sheet leasing commitments are reflected in our investment grade debt rating.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income." ASU 2018-02 amends ASC 220, "Income Statement - Reporting Comprehensive Income," to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. In addition, under ASU 2018-02, we may be required to provide certain disclosures regarding stranded tax effects. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the effect of this standard on our Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Information

Net cash provided by operating activities

We generated \$4.2 billion of cash from operations in 2018, compared to \$3.4 billion in 2017 and \$4.3 billion in 2016. The increase in net cash provided by operating activities in 2018, compared to 2017, resulted primarily from an increase in net earnings including noncontrolling interests, a decrease in the non-cash adjustment for deferred income taxes, positive changes in working capital and reduced contributions to the company sponsored pension plans, partially offset by non-cash adjustments for the expense for company-sponsored pension plans, the gain on sale of our convenience store business unit and the mark to market gain on Ocado securities.

The decrease in net cash provided by operating activities in 2017, compared to 2016, resulted primarily from a decrease in net earnings including noncontrolling interests, the \$1.0 billion contribution to the company-sponsored defined benefit plans and deferred taxes, partially offset by an increase in non-cash expenses and changes in working capital. Deferred taxes changed in 2017, compared to 2016, as a result of remeasuring deferred taxes due to the Tax Act.

Cash provided (used) by operating activities for changes in working capital was \$580 million in 2018, (\$164) million in 2017 and (\$492) million in 2016. The increase in cash provided by operating activities for changes in working capital in 2018, compared to 2017, was primarily due to the following:

- A lower increase, over the prior year, of store deposits in-transit in 2018, compared to 2017;
- A decrease in prepaid medical benefit costs at the end of 2018, compared to 2017;
- Increases in accrued incentive plan costs; and
- Positive working capital related to income taxes receivable and payable as a result of an overpayment of our fourth quarter 2017 estimated taxes and our estimated taxes on the gain on sale of our convenience store business unit; partially offset by
- Higher third-party payor receivables due to increasing pharmacy sales and the timing of third-party payments; and

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- Increased inventory purchases due to change in inventory mix and new distribution centers.

The decrease in cash used by operating activities for changes in working capital in 2017, compared to 2016, was primarily due to the following:

- A lower amount of cash used for inventory purchases due to decreased capital investments related to store growth,
 - Increased cash collections due to our emphasis on better receivables management, and
- A lower increase, over the prior year, of prepaid benefit costs in 2017, compared to 2016; partially offset by
- An overpayment of our fourth quarter 2017 estimated income taxes, and
- An increase in store deposits in-transit due to increased sales in the last few days of 2017.

Cash paid for taxes increased in 2018, compared to 2017, primarily due to the payment of estimated taxes on the gain on sale of our convenience store business unit and lower estimated tax payments in 2017 due to the \$1 billion, \$650 million net of tax, pension contribution made in 2017.

Net cash used by investing activities

Cash used by investing activities was \$1.2 billion in 2018, \$2.7 billion in 2017 and \$3.9 billion in 2016. The amount of cash used by investing activities decreased in 2018 compared to 2017 primarily due to the net proceeds from the sale of our convenience store business unit, partially offset by the payment for our merger with Home Chef and the purchases of Ocado securities. The amount of cash used by investing activities decreased in 2017 compared to 2016 primarily due to reduced cash payments for capital investments and lower payments for mergers.

Net cash used by financing activities

Cash used by financing activities was \$2.9 billion in 2018, \$681 million in 2017 and \$352 million in 2016. The increase in the amount of cash used for financing activities in 2018 compared to 2017 was primarily due to increased payments on long-term debt and commercial paper and increased share repurchases, partially offset by an increase in proceeds from issuance of long-term debt. We used a portion of the proceeds from the sale of our convenience store

business unit to pay down outstanding commercial paper borrowings and fund a \$1.2 billion ASR program, which was completed in the second quarter of 2018. The increase in the amount of cash used for financing activities in 2017 compared to 2016 was primarily due to lower net long-term borrowings, partially offset by lower treasury stock purchases and higher net commercial paper borrowings.

Debt Management

Total debt, including both the current and long-term portions of capital leases and lease-financing obligations, decreased \$360 million to \$15.2 billion as of year-end 2018 compared to 2017. The decrease in 2018, compared to 2017, resulted primarily from net payments on commercial paper borrowings of \$1.3 billion and payments of \$1.3 billion on maturing long-term debt obligations, partially offset by the issuance of (i) \$600 million of senior notes bearing an interest rate of 4.50%, (ii) \$600 million of senior notes bearing an interest rate of 5.40% and (iii) our \$1.0 billion term loan that has a variable interest rate. The variable interest rate on the term loan was 3.37% as of February 2, 2019. The combined \$1.2 billion senior notes issuance has a higher weighted average interest rate than the \$1.3 billion maturing long-term debt obligations it replaced. As a result, we expect a higher weighted average interest rate in 2019 which may contribute to increased interest expense. The sale of our convenience store business unit allowed us to pay down debt and fund our ASR program.

Total debt, including both the current and long-term portions of capital lease and lease-financing obligations, increased \$1.5 billion to \$15.6 billion as of year-end 2017 compared to 2016. The increase in 2017, compared to 2016, resulted from the issuance of (i) \$400 million of senior notes bearing an interest rate of 2.80%, (ii) \$600 million of senior notes bearing an interest rate of 3.70%, (iii) \$500 million of senior notes bearing an interest rate of 4.65% and (iv) increases in commercial paper borrowings, partially offset by payments of \$700 million on maturing long-term debt obligations.

Liquidity Needs

We estimate our liquidity needs over the next twelve-month period to approximate \$6.4 billion, which includes anticipated requirements for working capital, capital investments, interest payments and scheduled principal payments of debt and commercial paper, offset by cash and temporary cash investments on hand at the end of 2018. We generally operate with a working capital deficit due to our efficient use of cash in funding operations and because we have consistent access to the capital markets. Based on current operating trends, we believe that cash flows from operating activities and other sources of liquidity, including borrowings under our commercial paper program and bank credit facility, will be adequate to meet our liquidity needs for the next twelve months and for the foreseeable future beyond the next twelve months. We have approximately \$1.3 billion of senior notes, \$800 million of commercial paper and the \$1.0 billion term loan maturing in the next twelve months, which are included in the \$6.4 billion of estimated liquidity needs. We expect to satisfy these obligations using cash generated from operations, proceeds from the sale of our You Technology and Turkey Hill Dairy businesses and through issuing additional senior notes, a term loan or commercial paper. On March 15, 2019, we repaid our \$1.0 billion term loan through increased commercial paper borrowings, which have a lower interest rate. We believe we have adequate coverage of our debt covenants to continue to maintain our current investment grade debt ratings and to respond effectively to competitive conditions.

Factors Affecting Liquidity

We can currently borrow on a daily basis approximately \$2.75 billion under our commercial paper program. At February 2, 2019, we had \$800 million of commercial paper borrowings outstanding. Commercial paper borrowings are backed by our credit facility, and reduce the amount we can borrow under the credit facility. If our short-term credit ratings fall, the ability to borrow under our current commercial paper program could be adversely affected for a period of time and increase our interest cost on daily borrowings under our commercial paper program. This could require us to borrow additional funds under the credit facility, under which we believe we have sufficient capacity. However, in the event of a ratings decline, we do not anticipate that our borrowing capacity under our commercial paper program would be any lower than \$500 million on a daily basis. Although our ability to borrow under the credit facility is not affected by our credit rating, the interest cost and applicable margin on borrowings under the credit facility could be affected by a downgrade in our Public Debt Rating. "Public Debt Rating" means, as of any date, the rating that has been most recently announced by either S&P or Moody's, as the case may be, for any class of non-credit enhanced long-term senior unsecured debt issued by the Company. As of March 28, 2019, we had \$810 million of commercial paper borrowings outstanding.

Our credit facility requires the maintenance of a Leverage Ratio and a Fixed Charge Coverage Ratio (our “financial covenants”). A failure to maintain our financial covenants would impair our ability to borrow under the credit facility. These financial covenants are described below:

- Our Leverage Ratio (the ratio of Net Debt to Adjusted EBITDA, as defined in the credit facility) was 2.64 to 1 as of February 2, 2019. If this ratio were to exceed 3.50 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.
- Our Fixed Charge Coverage Ratio (the ratio of Adjusted EBITDA plus Consolidated Rental Expense to Consolidated Cash Interest Expense plus Consolidated Rental Expense, as defined in the credit facility) was 4.17 to 1 as of February 2, 2019. If this ratio fell below 1.70 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.

Our credit facility is more fully described in Note 6 to the Consolidated Financial Statements. We were in compliance with our financial covenants at year-end 2018.

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The tables below illustrate our significant contractual obligations and other commercial commitments, based on year of maturity or settlement, as of February 2, 2019 (in millions of dollars):

	2019	2020	2021	2022	2023	Thereafter	Total
Contractual Obligations (1)(2)							
Long-term debt (3)	\$ 3,103	\$ 720	\$ 793	\$ 896	\$ 595	\$ 8,244	\$ 14,351
Interest on long-term debt (4)	529	475	441	412	392	4,952	7,201
Capital lease obligations	103	89	86	82	81	766	1,207
Operating lease obligations	948	880	773	649	556	3,197	7,003
Financed lease obligations	5	6	5	5	5	17	43
Self-insurance liability (5)	228	142	98	64	42	122	696
Construction commitments (6)	672	—	—	—	—	—	672
Purchase obligations (7)	566	277	149	55	42	12	1,101
Total	\$ 6,154	\$ 2,589	\$ 2,345	\$ 2,163	\$ 1,713	\$ 17,310	\$ 32,274
Other Commercial							
Commitments							
Standby letters of credit	\$ 349	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 349
Surety bonds	406	—	—	—	—	—	406
Total	\$ 755	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 755

- (1) The contractual obligations table excludes funding of pension and other postretirement benefit obligations, which totaled approximately \$218 million in 2018. This table also excludes contributions under various multi-employer pension plans, which totaled \$358 million in 2018.
- (2) The liability related to unrecognized tax benefits has been excluded from the contractual obligations table because a reasonable estimate of the timing of future tax settlements cannot be determined.
- (3) As of February 2, 2019, we had \$800 million of commercial paper and no borrowings under our credit facility.
- (4) Amounts include contractual interest payments using the interest rate as of February 2, 2019, and stated fixed and swapped interest rates, if applicable, for all other debt instruments.
- (5) The amounts included in the contractual obligations table for self-insurance liability related to workers' compensation claims have been stated on a present value basis.
- (6) Amounts include funds owed to third parties for projects currently under construction. These amounts are reflected in other current liabilities in our Consolidated Balance Sheets.
- (7) Amounts include commitments, many of which are short-term in nature, to be utilized in the normal course of business, such as several contracts to purchase raw materials utilized in our food production plants and several contracts to purchase energy to be used in our stores and food production plants. Our obligations also include management fees for facilities operated by third parties and outside service contracts. Any upfront vendor allowances or incentives associated with outstanding purchase commitments are recorded as either current or long-term liabilities in our Consolidated Balance Sheets.

As of February 2, 2019, we maintained a \$2.75 billion (with the ability to increase by \$1 billion), unsecured revolving credit facility that, unless extended, terminates on August 29, 2022. Outstanding borrowings under the credit facility, the commercial paper borrowings, and some outstanding letters of credit, reduce funds available under the credit facility. As of February 2, 2019, we had \$800 million of outstanding commercial paper and no borrowings under our revolving credit facility. The outstanding letters of credit that reduce funds available under our credit facility totaled \$3 million as of February 2, 2019.

In addition to the available credit mentioned above, as of February 2, 2019, we had authorized for issuance \$1.3 billion of securities remaining under a shelf registration statement filed with the SEC and effective on December 14, 2016.

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We also maintain surety bonds related primarily to our self-insured workers' compensation claims. These bonds are required by most states in which we are self-insured for workers' compensation and are placed with predominately third-party insurance providers to insure payment of our obligations in the event we are unable to meet our claim payment obligations up to our self-insured retention levels. These bonds do not represent liabilities of ours, as we already have reserves on our books for the claims costs. Market changes may make the surety bonds more costly and, in some instances, availability of these bonds may become more limited, which could affect our costs of, or access to, such bonds. Although we do not believe increased costs or decreased availability would significantly affect our ability to access these surety bonds, if this does become an issue, we would issue letters of credit, in states where allowed, against our credit facility to meet the state bonding requirements. This could increase our cost and decrease the funds available under our credit facility.

We also are contingently liable for leases that have been assigned to various third parties in connection with facility closings and dispositions. We could be required to satisfy obligations under the leases if any of the assignees are unable to fulfill their lease obligations. Due to the wide distribution of our assignments among third parties, and various other remedies available to us, we believe the likelihood that we will be required to assume a material amount of these obligations is remote. We have agreed to indemnify certain third-party logistics operators for certain expenses, including multi-employer pension plan obligations and withdrawal liabilities.

In addition to the above, we enter into various indemnification agreements and take on indemnification obligations in the ordinary course of business. Such arrangements include indemnities against third party claims arising out of agreements to provide services to us; indemnities related to the sale of our securities; indemnities of directors, officers and employees in connection with the performance of their work; and indemnities of individuals serving as fiduciaries on benefit plans. While our aggregate indemnification obligation could result in a material liability, we are not aware of any current matter that could result in a material liability.

OUTLOOK

This discussion and analysis contains certain forward-looking statements about our future performance. These statements are based on management's assumptions and beliefs in light of the information currently available to it. Such statements are indicated by words such as "achieve," "affect," "believe," "committed," "continue," "could," "effect," "estimate," "expects," "future," "growth," "intends," "likely," "may," "plan," "range," "result," "strategy," "strong," "trend," "would," and similar words or phrases. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially.

Statements elsewhere in this report and below regarding our expectations, projections, beliefs, intentions or strategies are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. While we believe that the statements are accurate, uncertainties about the general economy, our labor relations, our ability to execute our plans on a timely basis and other uncertainties described below could cause actual results to differ materially.

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- We are targeting identical sales growth, excluding fuel, to range from 2.0% to 2.25% in 2019.
- We expect net earnings to range from \$2.15 to \$2.25 per diluted share for 2019.
- We expect FIFO operating profit to range from \$2.9 billion to \$3.0 billion for 2019.
- We expect capital investments, excluding mergers, acquisitions, and purchases of leased facilities, to range between \$3.0 and \$3.2 billion in 2019.
- We expect our 2019 tax rate to be approximately 22%.
- We expect a higher weighted average interest rate in 2019 which may contribute to increased interest expense.

Various uncertainties and other factors could cause actual results to differ materially from those contained in the forward-looking statements. These include:

- The extent to which our sources of liquidity are sufficient to meet our requirements may be affected by the state of the financial markets and the effect that such condition has on our ability to issue commercial paper at acceptable rates. Our ability to borrow under our committed lines of credit, including our bank credit facilities, could be impaired if one or more of our lenders under those lines is unwilling or unable to honor its contractual obligation to lend to us, or in the event that natural disasters or weather conditions interfere with the ability of our lenders to lend to us. Our ability to refinance maturing debt may be affected by the state of the financial markets.
- Our ability to achieve sales, earnings, incremental FIFO operating profit, and free cash flow goals may be affected by: labor negotiations or disputes; changes in the types and numbers of businesses that compete with us; pricing and promotional activities of existing and new competitors, including non-traditional competitors, and the aggressiveness of that competition; Our response to these actions; the state of the economy, including interest rates, the inflationary and deflationary trends in certain commodities, changes in tariffs, and the unemployment rate; the effect that fuel costs have on consumer spending; volatility of fuel margins; changes in government-funded benefit programs; manufacturing commodity costs; diesel fuel costs related to our logistics operations; trends in consumer spending; the extent to which our customers exercise caution in their purchasing in response to economic conditions; the uncertain pace of economic growth; changes in inflation or deflation in product and operating costs; stock repurchases; our ability to retain pharmacy sales from third party payors; consolidation in the healthcare industry, including pharmacy benefit managers; our ability to negotiate modifications to multi-employer pension plans; natural disasters or adverse weather conditions; the potential costs and risks associated with potential cyber-attacks or data security breaches; the success of our future growth plans; the ability to execute on Restock Kroger; and the successful integration of merged companies and new partnerships.
- Our ability to achieve these goals may also be affected by our ability to manage the factors identified above. Our ability to execute our financial strategy may be affected by our ability to generate cash flow.
- Our effective tax rate may differ from the expected rate due to changes in laws, the status of pending items with various taxing authorities, and the deductibility of certain expenses.

We cannot fully foresee the effects of changes in economic conditions on our business. We have assumed economic and competitive situations will not change significantly in 2019.

Other factors and assumptions not identified above, including those discussed in Item 1A of this Report, could also cause actual results to differ materially from those set forth in the forward-looking information. Accordingly, actual events and results may vary significantly from those included in, contemplated or implied by forward-looking statements made by us or our representatives. We undertake no obligation to update the forward-looking information contained in this filing.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Financial Risk Management

We use derivative financial instruments primarily to manage our exposure to fluctuations in interest rates. We do not enter into derivative financial instruments for trading purposes. As a matter of policy, all of our derivative positions are intended to reduce risk by hedging an underlying economic exposure. Because of the high correlation between the hedging instrument and the underlying exposure, fluctuations in the value of the instruments generally are offset by reciprocal changes in the value of the underlying exposure. The interest rate derivatives we use are straightforward instruments with liquid markets.

We manage our exposure to interest rates and changes in the fair value of our debt instruments primarily through the strategic use of our commercial paper program, variable and fixed rate debt, and interest rate swaps. Our current program relative to interest rate protection contemplates hedging the exposure to changes in the fair value of fixed-rate debt attributable to changes in interest rates. To do this, we use the following guidelines: (i) use average daily outstanding borrowings to determine annual debt amounts subject to interest rate exposure, (ii) limit the average annual amount subject to interest rate reset and the amount of floating rate debt to a combined total amount that represents 25% of the carrying value of our debt portfolio or less, (iii) include no leveraged products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status.

As of February 2, 2019, we maintained five forward-starting interest rate swap agreements with a maturity date of January 15, 2020 with an aggregate notional amount totaling \$250 million. A forward-starting interest rate swap is an agreement that effectively hedges the variability in future benchmark interest payments attributable to changes in interest rates on the forecasted issuance of fixed-rate debt. We entered into these forward-starting interest rate swaps in order to lock in fixed interest rates on our forecasted issuances of debt in fiscal year 2019. The fixed interest rates for these forward-starting interest rate swaps range from 2.15% to 2.17%. The variable rate component on the forward-starting interest rate swaps is 3 month LIBOR. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of February 2, 2019, the fair value of the interest rate swaps was recorded in other assets for \$33 million and accumulated other comprehensive income for \$20 million, net of tax.

Annually, we review with the Financial Policy Committee of our Board of Directors compliance with the guidelines described above. The guidelines may change as our business needs dictate.

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The tables below provide information about our interest rate derivatives classified as fair value hedges and underlying debt portfolio as of February 2, 2019 and February 3, 2018. The amounts shown for each year represent the contractual maturities of long-term debt, excluding capital leases, and the average outstanding notional amounts of interest rate derivatives classified as fair value hedges as of February 2, 2019 and February 3, 2018. Interest rates reflect the weighted average rate for the outstanding instruments. The variable component of each interest rate derivative and the variable rate debt is based on U.S. dollar LIBOR using the forward yield curve as of February 2, 2019 and February 3, 2018. The Fair Value column includes the fair value of our debt instruments and interest rate derivatives classified as fair value hedges as of February 2, 2019 and February 3, 2018. We have no outstanding interest rate derivatives classified as fair value hedges as of February 2, 2019. See Notes 6, 7 and 8 to the Consolidated Financial Statements.

	February 2, 2019							Total	Fair Value
	Expected Year of Maturity								
	2019	2020	2021	2022	2023	Thereafter			
	(in millions)								
Debt									
Fixed rate	\$ (1,251)	\$ (695)	\$ (793)	\$ (896)	\$ (595)	\$ (8,163)	\$ (12,393)	\$ (12,232)	
Average interest rate	4.51 %	4.47 %	4.47 %	4.56 %	4.74 %	4.70 %			
Variable rate	\$ (1,852)	\$ (25)	\$ —	\$ —	\$ —	\$ (81)	\$ (1,958)	\$ (1,958)	
Average interest rate	3.09 %	4.26	—	—	—	1.75 %			

	February 3, 2018						Total	Fair Value
	Expected Year of Maturity							
	2018	2019	2020	2021	2022	Thereafter		
	(in millions)							
Debt								
Fixed rate	\$ (1,332)	\$ (1,243)	\$ (696)	\$ (795)	\$ (897)	\$ (7,494)	\$ (12,457)	\$ (12,837)
Average interest rate	4.48 %	4.65 %	4.58 %	4.57 %	4.65 %	4.60 %		
Variable rate	\$ (2,177)	\$ —	\$ (25)	\$ —	\$ —	\$ (128)	\$ (2,330)	\$ (2,330)
Average interest rate	1.73 %	—	3.15 %	—	—	2.07 %		

February 3, 2018

	Average Notional Amounts Outstanding						February 3, 2018	February 3, 2018 Fair Value
	2018 (in millions)	2019	2020	2021	2022	Thereafter	Total	
Interest Rate Derivatives Classified as Fair Value Hedges								
Fixed to variable	\$ 88	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 88	\$ (1)
Average pay rate	7.63 %	—	—	—	—	—		
Average receive rate	6.80 %	—	—	—	—	—		

Based on our year-end 2018 variable rate debt levels, a 10 percent change in interest rates would be immaterial. See Note 7 to the Consolidated Financial Statements for further discussion of derivatives and hedging policies.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of

The Kroger Co.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of The Kroger Co. and its subsidiaries (the “Company”) as of February 2, 2019 and February 3, 2018, and the related consolidated statements of operations, comprehensive income, changes in shareholders’ equity and cash flows for each of the three years in the period ended February 2, 2019, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of February 2, 2019 and February 3, 2018, and the results of its operations and its cash flows for each of the three years in the period ended February 2, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Change in Accounting Principle

As discussed in Note 19 to the consolidated financial statements, the Company changed the manner in which it accounts for revenues from contracts with customers in 2018.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the

Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Cincinnati, Ohio

April 2, 2019

We have served as the Company's auditor since 1929.

THE KROGER CO.

CONSOLIDATED BALANCE SHEETS

(In millions, except par amounts)	February 2, 2019	February 3, 2018
ASSETS		
Current assets		
Cash and temporary cash investments	\$ 429	\$ 347
Store deposits in-transit	1,181	1,161
Receivables	1,589	1,637
FIFO inventory	8,123	7,781
LIFO reserve	(1,277)	(1,248)
Assets held for sale	166	604
Prepaid and other current assets	592	835
Total current assets	10,803	11,117
Property, plant and equipment, net	21,635	21,071
Intangibles, net	1,258	1,100
Goodwill	3,087	2,925
Other assets	1,335	984
Total Assets	\$ 38,118	\$ 37,197
LIABILITIES		
Current liabilities		
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 3,157	\$ 3,560
Trade accounts payable	6,059	5,858
Accrued salaries and wages	1,227	1,099
Liabilities held for sale	51	259
Other current liabilities	3,780	3,421
Total current liabilities	14,274	14,197
Long-term debt including obligations under capital leases and financing obligations	12,072	12,029
Deferred income taxes	1,562	1,568
Pension and postretirement benefit obligations	494	792
Other long-term liabilities	1,881	1,706
Total Liabilities	30,283	30,292
Commitments and contingencies see Note 13		
SHAREHOLDERS' EQUITY		
Preferred shares, \$100 par per share, 5 shares authorized and unissued	—	—
Common shares, \$1 par per share, 2,000 shares authorized; 1,918 shares issued in 2018 and 2017	1,918	1,918

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Additional paid-in capital	3,245	3,161
Accumulated other comprehensive loss	(346)	(471)
Accumulated earnings	19,681	17,007
Common shares in treasury, at cost, 1,120 shares in 2018 and 1,048 shares in 2017	(16,612)	(14,684)
Total Shareholders' Equity - The Kroger Co.	7,886	6,931
Noncontrolling interests	(51)	(26)
Total Equity	7,835	6,905
Total Liabilities and Equity	\$ 38,118	\$ 37,197

The accompanying notes are an integral part of the consolidated financial statements.

THE KROGER CO.

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(In millions, except per share amounts)	2018 (52 weeks)	2017 (53 weeks)	2016 (52 weeks)
Sales	\$ 121,162	\$ 122,662	\$ 115,337
Operating expenses			
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	94,894	95,662	89,502
Operating, general and administrative	20,305	21,041	19,162
Rent	884	911	881
Depreciation and amortization	2,465	2,436	2,340
Operating profit	2,614	2,612	3,452
Other income (expense)			
Interest expense	(620)	(601)	(522)
Non-service component of company-sponsored pension plan costs	(26)	(527)	(16)
Mark to market gain on Ocado securities	228	—	—
Gain on sale of business	1,782	—	—
Net earnings before income tax (benefit) expense	3,978	1,484	2,914
Income tax (benefit) expense	900	(405)	957
Net earnings including noncontrolling interests	3,078	1,889	1,957
Net loss attributable to noncontrolling interests	(32)	(18)	(18)
Net earnings attributable to The Kroger Co.	\$ 3,110	\$ 1,907	\$ 1,975
Net earnings attributable to The Kroger Co. per basic common share	\$ 3.80	\$ 2.11	\$ 2.08
Average number of common shares used in basic calculation	810	895	942
Net earnings attributable to The Kroger Co. per diluted common share	\$ 3.76	\$ 2.09	\$ 2.05
Average number of common shares used in diluted calculation	818	904	958

The accompanying notes are an integral part of the consolidated financial statements.

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THE KROGER CO.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(In millions)	2018 (52 weeks)	2017 (53 weeks)	2016 (52 weeks)
Net earnings including noncontrolling interests	\$ 3,078	\$ 1,889	\$ 1,957
Other comprehensive income (loss)			
Realized gains and losses on available for sale securities, net of income tax (1)	(4)	4	(20)
Change in pension and other postretirement defined benefit plans, net of income tax(2)	147	214	(64)
Unrealized gains and losses on cash flow hedging activities, net of income tax(3)	(23)	23	47
Amortization of unrealized gains and losses on cash flow hedging activities, net of income tax (4)	5	3	2
Total other comprehensive income (loss)	125	244	(35)
Comprehensive income	3,203	2,133	1,922
Comprehensive loss attributable to noncontrolling interests	(32)	(18)	(18)
Comprehensive income attributable to The Kroger Co.	\$ 3,235	\$ 2,151	\$ 1,940

(1) Amount is net of tax expense (benefit) of \$(1) in 2018, \$1 in 2017 and \$(16) in 2016.

(2) Amount is net of tax expense (benefit) of \$45 in 2018, \$83 in 2017 and \$(39) in 2016.

(3) Amount is net of tax expense (benefit) of \$(8) in 2018, \$0 in 2017 and \$27 in 2016.

(4) Amount is net of tax expense of \$3 in 2018 and \$3 in 2017 and \$0 in 2016.

The accompanying notes are an integral part of the consolidated financial statements.

THE KROGER CO.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(In millions)	2018 (52 weeks)	2017 (53 weeks)	2016 (52 weeks)
Cash Flows from Operating Activities:			
Net earnings including noncontrolling interests	\$ 3,078	\$ 1,889	\$ 1,957
Adjustments to reconcile net earnings including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	2,465	2,436	2,340
LIFO (credit) charge	29	(8)	19
Stock-based employee compensation	154	151	141
Expense for company-sponsored pension plans	76	591	94
Goodwill impairment charge	—	110	—
Deferred income taxes	(45)	(694)	201
Gain on sale of business	(1,782)	—	—
Mark to market gain on Ocado securities	(228)	—	—
Other	116	79	(2)
Changes in operating assets and liabilities net of effects from mergers and disposals of businesses:			
Store deposits in-transit	(20)	(265)	13
Receivables	(208)	61	(110)
Inventories	(354)	(23)	(382)
Prepaid and other current assets	244	41	(172)
Trade accounts payable	213	158	16
Accrued expenses	416	(40)	(118)
Income taxes receivable and payable	289	(96)	261
Contribution to company-sponsored pension plans	(185)	(1,000)	—
Other	(94)	23	14
Net cash provided by operating activities	4,164	3,413	4,272
Cash Flows from Investing Activities:			
Payments for property and equipment, including payments for lease buyouts	(2,967)	(2,809)	(3,699)
Proceeds from sale of assets	85	138	132
Proceeds on settlement of financial instrument	235	—	—
Payments for acquisitions, net of cash acquired	(197)	(16)	(401)
Purchases of stores	(44)	—	—
Net proceeds from sale of business	2,169	—	—
Purchases of Ocado securities	(392)	—	—
Other	(75)	(20)	93
Net cash used by investing activities	(1,186)	(2,707)	(3,875)

Cash Flows from Financing Activities:			
Proceeds from issuance of long-term debt	2,236	1,523	2,781
Payments on long-term debt	(1,372)	(788)	(1,355)
Net (payments) borrowings on commercial paper	(1,321)	696	435
Dividends paid	(437)	(443)	(429)
Proceeds from issuance of capital stock	65	51	68
Treasury stock purchases	(2,010)	(1,633)	(1,766)
Other	(57)	(87)	(86)
Net cash used by financing activities	(2,896)	(681)	(352)
Net increase in cash and temporary cash investments	82	25	45
Cash and temporary cash investments:			
Beginning of year	347	322	277
End of year	\$ 429	\$ 347	\$ 322
Reconciliation of capital investments:			
Payments for property and equipment, including payments for lease buyouts	\$ (2,967)	\$ (2,809)	\$ (3,699)
Payments for lease buyouts	5	13	5
Changes in construction-in-progress payables	(56)	(188)	72
Total capital investments, excluding lease buyouts	\$ (3,018)	\$ (2,984)	\$ (3,622)
Disclosure of cash flow information:			
Cash paid during the year for interest	\$ 614	\$ 656	\$ 505
Cash paid during the year for income taxes	\$ 600	\$ 348	\$ 557

The accompanying notes are an integral part of the consolidated financial statements

THE KROGER CO.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended February 2, 2019, February 3, 2018 and January 28, 2017

(except per share amounts)	Common Stock		Additional	Treasury Stock		Accumulated	Accumulated	Noncontro
	Shares	Amount	Paid-In Capital	Shares	Amount	Other Comprehensive Gain (Loss)	Earnings	Interest
January 30, 2016	1,918	\$ 1,918	\$ 2,980	951	\$ (11,409)	\$ (680)	\$ 14,011	\$ (22)
Common stock:								
Shares exercised	—	—	(1)	(5)	68	—	—	—
Stock issued	—	—	(116)	(3)	57	—	—	—
Stock activity:								
Stock purchases, at cost	—	—	—	47	(1,661)	—	—	—
Shares exchanged	—	—	—	4	(105)	—	—	—
Employee compensation	—	—	141	—	—	—	—	—
Comprehensive loss net of of \$(28)	—	—	—	—	—	(35)	—	—
Dividends declared (\$0.465 per share)	—	—	66	—	(68)	—	—	52
(loss) including of interests	—	—	—	—	—	—	(443)	—
January 28, 2017	1,918	\$ 1,918	\$ 3,070	994	\$ (13,118)	\$ (715)	\$ 15,543	\$ 12
Common stock:								
Shares exercised	—	—	—	(4)	51	—	—	—
Stock issued	—	—	(119)	(2)	85	—	—	—
Stock activity:								
Stock purchases, at cost	—	—	—	58	(1,567)	—	—	—
Shares exchanged	—	—	—	2	(66)	—	—	—
Employee compensation	—	—	151	—	—	—	—	—
Comprehensive gain net of of \$87	—	—	—	—	—	244	—	—
Dividends declared (\$0.495 per share)	—	—	59	—	(69)	—	—	(20)
(loss) including of interests	—	—	—	—	—	—	(443)	—
February 3, 2018	1,918	\$ 1,918	\$ 3,161	1,048	\$ (14,684)	\$ (471)	\$ 17,007	\$ (26)
Common stock:								

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s exercised	—	—	—	(4)	65	—	—	—
ock issued	—	—	(119)	(3)	74	—	—	—
ck activity:								
ck purchases, at cost	—	—	—	76	(1,927)	—	—	—
s exchanged	—	—	—	3	(83)	—	—	—
mployee compensation	—	—	154	—	—	—	—	—
ehensive gain net of	—	—	—	—	—	125	—	—
f \$39	—	—	49	—	(57)	—	—	7
ds declared (\$0.545 per	—	—	—	—	—	—	(436)	—
re)	—	—	—	—	—	—	—	—
(loss) including	—	—	—	—	—	—	3,110	(32)
ng interests	—	—	—	—	—	—	—	—
February 2, 2019	1,918	\$ 1,918	\$ 3,245	1,120	\$ (16,612)	\$ (346)	\$ 19,681	\$ (51)

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in the Notes to Consolidated Financial Statements are in millions except per share amounts.

1.ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in preparing these financial statements.

Description of Business, Basis of Presentation and Principles of Consolidation

The Kroger Co. (the “Company”) was founded in 1883 and incorporated in 1902. As of February 2, 2019, the Company was one of the largest retailers in the world based on annual sales. The Company also manufactures and processes food for sale by its supermarkets. The accompanying financial statements include the consolidated accounts of the Company, its wholly-owned subsidiaries and other consolidated entities. Intercompany transactions and balances have been eliminated.

Refer to Note 19 for a description of changes to the Consolidated Statements of Operations for a recently adopted accounting standard regarding the presentation of the non-service component of company-sponsored pension plan costs.

Fiscal Year

The Company’s fiscal year ends on the Saturday nearest January 31. The last three fiscal years consist of the 52-week period ended February 2, 2019, 53-week period ended February 3, 2018 and 52-week period ended January 28, 2017.

Pervasiveness of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Disclosure

of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of consolidated revenues and expenses during the reporting period is also required. Actual results could differ from those estimates.

Cash, Temporary Cash Investments and Book Overdrafts

Cash and temporary cash investments represent store cash and short-term investments with original maturities of less than three months. Book overdrafts are included in "Trade accounts payable" and "Accrued salaries and wages" in the Consolidated Balance Sheets.

Deposits In-Transit

Deposits in-transit generally represent funds deposited to the Company's bank accounts at the end of the year related to sales, a majority of which were paid for with debit cards, credit cards and checks, to which the Company does not have immediate access but settle within a few days of the sales transaction.

Inventories

Inventories are stated at the lower of cost (principally on a last-in, first-out “LIFO” basis) or market. In total, approximately 90% of inventories in 2018 and 93% of inventories in 2017 were valued using the LIFO method. The remaining inventories, including substantially all fuel inventories, are stated at the lower of cost (on a FIFO basis) or net realizable value. Replacement cost was higher than the carrying amount by \$1,277 at February 2, 2019 and \$1,248 at February 3, 2018. The Company follows the Link-Chain, Dollar-Value LIFO method for purposes of calculating its LIFO charge or credit.

The item-cost method of accounting to determine inventory cost before the LIFO adjustment is followed for substantially all store inventories at the Company’s supermarket divisions. This method involves counting each item in inventory, assigning costs to each of these items based on the actual purchase costs (net of vendor allowances and cash discounts) of each item and recording the cost of items sold. The item-cost method of accounting allows for more accurate reporting of periodic inventory balances and enables management to more precisely manage inventory. In addition, substantially all of the Company’s inventory consists of finished goods and is recorded at actual purchase costs (net of vendor allowances and cash discounts).

The Company evaluates inventory shortages throughout the year based on actual physical counts in its facilities. Allowances for inventory shortages are recorded based on the results of these counts to provide for estimated shortages as of the financial statement date.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost or, in the case of assets acquired in a business combination, at fair value. Depreciation and amortization expense, which includes the depreciation of assets recorded under capital leases, is computed principally using the straight-line method over the estimated useful lives of individual assets. Buildings and land improvements are depreciated based on lives varying from 10 to 40 years. All new purchases of store equipment are assigned lives varying from three to nine years. Leasehold improvements are amortized over the shorter of the lease term to which they relate, which generally varies from four to 25 years, or the useful life of the asset. Food production plant and distribution center equipment is depreciated over lives varying from three to 15 years. Information technology assets are generally depreciated over five years. Depreciation and amortization expense was \$2,465 in 2018, \$2,436 in 2017 and \$2,340 in 2016.

Interest costs on significant projects constructed for the Company’s own use are capitalized as part of the costs of the newly constructed facilities. Upon retirement or disposal of assets, the cost and related accumulated depreciation and amortization are removed from the balance sheet and any gain or loss is reflected in net earnings. Refer to Note 4 for further information regarding the Company’s property, plant and equipment.

Deferred Rent

The Company recognizes rent holidays, including the time period during which the Company has access to the property for construction of buildings or improvements and escalating rent provisions on a straight-line basis over the term of the lease. The deferred amount is included in “Other current liabilities” and “Other long-term liabilities” on the Company’s Consolidated Balance Sheets.

Goodwill

The Company reviews goodwill for impairment during the fourth quarter of each year, and also upon the occurrence of a triggering event. The Company performs reviews of each of its operating divisions and other consolidated entities (collectively, “reporting units”) that have goodwill balances. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and is compared to the carrying value of a reporting unit for purposes of identifying potential impairment. Projected future cash flows are based on management’s knowledge of the current operating environment and expectations for the future. Goodwill impairment is recognized for any excess of the reporting unit’s carrying value over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. Results of the goodwill impairment reviews performed during 2018, 2017 and 2016 are summarized in Note 3.

Impairment of Long-Lived Assets

The Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether certain triggering events have occurred. These events include current period losses combined with a history of losses or a projection of continuing losses or a significant decrease in the market value of an asset. When a triggering event occurs, an impairment calculation is performed, comparing projected undiscounted future cash flows, utilizing current cash flow information and expected growth rates related to specific stores, to the carrying value for those stores. If the Company identifies impairment for long-lived assets to be held and used, the Company compares the assets' current carrying value to the assets' fair value. Fair value is based on current market values or discounted future cash flows. The Company records impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for disposal, the value of the property and equipment is adjusted to reflect recoverable values based on previous efforts to dispose of similar assets and current economic conditions. Impairment is recognized for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. The Company recorded asset impairments in the normal course of business totaling \$56, \$71 and \$26 in 2018, 2017 and 2016, respectively. Costs to reduce the carrying value of long-lived assets for each of the years presented have been included in the Consolidated Statements of Operations as Operating, general and administrative ("OG&A") expense.

Accounts Payable

The Company has an agreement with a third party to provide an accounts payable tracking system which facilitates participating suppliers' ability to finance payment obligations from the Company with designated third-party financial institutions. Participating suppliers may, at their sole discretion, make offers to finance one or more payment obligations of the Company prior to their scheduled due dates at a discounted price to participating financial institutions. The Company's obligations to its suppliers, including amounts due and scheduled payment dates, are not affected by suppliers' decisions to finance amounts under this arrangement.

Contingent Consideration

Certain Company business combinations involve potential payment of future consideration that is contingent upon the achievement of certain performance milestones. The Company records contingent consideration at fair value at the date of acquisition based on the consideration expected to be transferred, estimated as the probability-weighted future cash flows, discounted back to present value using a discount rate determined in accordance with accepted valuation methods. The liability for contingent consideration is remeasured to fair value at each reporting period using Level 3 inputs, and the change in fair value, including accretion for the passage of time, is recognized in earnings until the contingency is resolved. In 2018, an adjustment to increase the contingent consideration liability as of year-end 2018 was recorded for \$33 in OG&A expense.

Store Closing Costs

The Company provides for closed store liabilities relating to the present value of the estimated remaining non-cancellable lease payments after the closing date, net of estimated subtenant income. The Company estimates the net lease liabilities using a discount rate to calculate the present value of the remaining net rent payments on closed stores. The closed store lease liabilities usually are paid over the lease terms associated with the closed stores, which generally have remaining terms ranging from one to 20 years. Adjustments to closed store liabilities primarily relate to changes in subtenant income and actual exit costs differing from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known. Store closing liabilities are reviewed quarterly to ensure that any accrued amount that is not a sufficient estimate of future costs is adjusted to income in the proper period.

Owned stores held for disposal are reduced to their estimated net realizable value. Costs to reduce the carrying values of property, equipment and leasehold improvements are accounted for in accordance with the Company's policy on impairment of long-lived assets. Inventory write-downs, if any, in connection with store closings, are classified in the Consolidated Statements of Operations as "Merchandise costs." Costs to transfer inventory and equipment from closed stores are expensed as incurred.

The current portion of the future lease obligations of stores is included in "Other current liabilities," and the long-term portion is included in "Other long-term liabilities" in the Consolidated Balance Sheets.

Interest Rate Risk Management

The Company uses derivative instruments primarily to manage its exposure to changes in interest rates. The Company's current program relative to interest rate protection and the methods by which the Company accounts for its derivative instruments are described in Note 7.

Benefit Plans and Multi-Employer Pension Plans

The Company recognizes the funded status of its retirement plans on the Consolidated Balance Sheets. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized as part of net periodic benefit cost are required to be recorded as a component of Accumulated Other Comprehensive Income ("AOCI"). The Company has elected to measure defined benefit plan assets and obligations as of January 31, which is the month-end that is closest to its fiscal year-ends, which were February 2, 2019 for fiscal 2018 and February 3, 2018 for fiscal 2017.

The determination of the obligation and expense for company-sponsored pension plans and other post-retirement benefits is dependent on the selection of assumptions used by actuaries and the Company in calculating those amounts. Those assumptions are described in Note 15 and include, among others, the discount rate, the expected long-term rate of return on plan assets, mortality and the rates of increase in compensation and health care costs. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in future periods. While the Company believes that the assumptions are appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the pension and other post-retirement obligations and future expense.

The Company also participates in various multi-employer plans for substantially all union employees. Pension expense for these plans is recognized as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. Refer to Note 16 for additional information regarding the Company's participation in these various multi-employer pension plans.

The Company administers and makes contributions to the employee 401(k) retirement savings accounts. Contributions to the employee 401(k) retirement savings accounts are expensed when contributed or over the service period in the case of automatic contributions. Refer to Note 15 for additional information regarding the Company's benefit plans.

Share Based Compensation

The Company accounts for stock options under fair value recognition provisions. Under this method, the Company recognizes compensation expense for all share-based payments granted. The Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award. In addition, the Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying stock on the grant date of the award, over the period the awards lapse. Excess tax benefits related to share-based payments are recognized in the provision for income taxes. Refer to Note 12 for additional information regarding the Company's stock based compensation.

Deferred Income Taxes

Deferred income taxes are recorded to reflect the tax consequences of differences between the tax basis of assets and liabilities and their financial reporting basis. Refer to Note 5 for the types of differences that give rise to significant portions of deferred income tax assets and liabilities.

Uncertain Tax Positions

The Company reviews the tax positions taken or expected to be taken on tax returns to determine whether and to what extent a benefit can be recognized in its consolidated financial statements. Refer to Note 5 for the amount of unrecognized tax benefits and other related disclosures related to uncertain tax positions.

Various taxing authorities periodically audit the Company's income tax returns. These audits include questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income to various tax jurisdictions. In evaluating the exposures connected with these various tax filing positions, including state and local taxes, the Company records allowances for probable exposures. A number of years may elapse before a particular matter, for which an allowance has been established, is audited and fully resolved. As of February 2, 2019, the Internal Revenue Service had concluded its examination of our 2012 and 2013 federal tax returns.

The assessment of the Company's tax position relies on the judgment of management to estimate the exposures associated with the Company's various filing positions.

Self-Insurance Costs

The Company is primarily self-insured for costs related to workers' compensation and general liability claims. Liabilities are actuarially determined and are recognized based on claims filed and an estimate of claims incurred but not reported. The liabilities for workers' compensation claims are accounted for on a present value basis. The Company has purchased stop-loss coverage to limit its exposure to any significant exposure on a per claim basis. The Company is insured for covered costs in excess of these per claim limits.

The following table summarizes the changes in the Company's self-insurance liability through February 2, 2019.

	2018	2017	2016
Beginning balance	\$ 695	\$ 682	\$ 639
Expense	229	247	263
Claim payments	(228)	(234)	(220)
Ending balance	696	695	682
Less: Current portion	(228)	(234)	(229)
Long-term portion	\$ 468	\$ 461	\$ 453

The current portion of the self-insured liability is included in "Other current liabilities," and the long-term portion is included in "Other long-term liabilities" in the Consolidated Balance Sheets.

The Company maintains surety bonds related to self-insured workers' compensation claims. These bonds are required by most states in which the Company is self-insured for workers' compensation and are placed with third-party insurance providers to insure payment of the Company's obligations in the event the Company is unable to meet its

claim payment obligations up to its self-insured retention levels. These bonds do not represent liabilities of the Company, as the Company has recorded reserves for the claim costs.

The Company is similarly self-insured for property-related losses. The Company maintains stop loss coverage to limit its property loss exposures including coverage for earthquake, wind, flood and other catastrophic events.

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Revenue Recognition

Sales

The Company recognizes revenues from the retail sale of products, net of sales taxes, at the point of sale. Pharmacy sales are recorded when the product is provided to the customer. Digital channel originated sales are recognized either upon pickup in store or upon delivery to the customer and may include shipping revenue. Discounts provided to customers by the Company at the time of sale, including those provided in connection with loyalty cards, are recognized as a reduction in sales as the products are sold. Discounts provided by vendors, usually in the form of paper coupons, are not recognized as a reduction in sales provided the coupons are redeemable at any retailer that accepts coupons. The Company records a receivable from the vendor for the difference in sales price and cash received. For merchandise sold in one of the Company's stores or online, tender is accepted at the point of sale. The Company acts as principal in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. The Company records revenue and related costs on a gross basis for these arrangements. Effective February 4, 2018, the Company prospectively reclassified certain pharmacy fees of \$250 for 2018 from merchandise costs to be recorded as a reduction to sales on the Company's Consolidated Statements of Operations. For pharmacy sales, collection of third party receivables is typically expected within three months or less from the time of purchase. The third-party receivables from pharmacy sales are recorded in Receivables in the Company's Consolidated Balance Sheets and were \$645 as of February 2, 2019 and \$571 as of February 3, 2018.

Gift Cards and Gift Certificates

The Company does not recognize a sale when it sells its own gift cards and gift certificates (collectively "gift cards"). Rather, it records a deferred revenue liability equal to the amount received. A sale is then recognized when the gift cards are redeemed to purchase the Company's products. The Company's gift cards do not expire. While gift cards are generally redeemed within 12 months, some are never fully redeemed. The Company recognizes gift card breakage under the proportional method, where recognition of breakage income is based upon the historical run-off rate of unredeemed gift cards. The Company's gift card deferred revenue liability was \$100 as of February 2, 2019 and \$90 as of February 3, 2018.

Disaggregated Revenues

The following table presents sales revenue by type of product for the year-ended February 2, 2019, February 3, 2018, and January 28, 2017:

2018

2017

2016

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	Amount	% of total		Amount	% of total		Amount	% of total	
Non Perishable (1)(5)	\$ 60,649	50.1	%	\$ 60,872	49.6	%	\$ 58,828	51.0	%
Fresh (2)(5)	29,089	24.0	%	29,141	23.8	%	27,666	24.0	%
Supermarket Fuel	14,903	12.3	%	13,177	10.7	%	11,286	9.8	%
Pharmacy (5)	10,617	8.8	%	10,724	8.7	%	10,421	9.0	%
Convenience Stores									
(3)	944	0.8	%	4,515	3.7	%	4,096	3.6	%
Other (4)(5)	4,959	4.0	%	4,233	3.5	%	3,040	2.6	%
Total Sales	\$ 121,162	100	%	\$ 122,662	100	%	\$ 115,337	100	%

(1) Consists primarily of grocery, general merchandise, health and beauty care and natural foods.

(2) Consists primarily of produce, floral, meat, seafood, deli, bakery and fresh prepared.

(3) The Company completed the sale of its convenience store business unit during the first quarter of 2018.

(4) Consists primarily of sales related to food production plants to outside parties, data analytic services, third party media revenue, other consolidated entities, specialty pharmacy, in-store health clinics, digital coupon services and other online sales not included in the categories above.

(5) Digital sales, primarily including Pickup, Deliver and pharmacy e-commerce sales, grew approximately 58%, 90% and 49% in 2018, 2017 and 2016, respectively, adjusted to remove the impact of the 53rd week in 2017. These sales are included in the non perishable, fresh, pharmacy, and other line items above.

Merchandise Costs

The “Merchandise costs” line item of the Consolidated Statements of Operations includes product costs, net of discounts and allowances; advertising costs (see separate discussion below); inbound freight charges; warehousing costs, including receiving and inspection costs; transportation costs; and food production and operational costs.

Warehousing, transportation and manufacturing management salaries are also included in the “Merchandise costs” line item; however, purchasing management salaries and administration costs are included in the OG&A line item along with most of the Company’s other managerial and administrative costs. Rent expense and depreciation and amortization expense are shown separately in the Consolidated Statements of Operations.

Warehousing and transportation costs include distribution center direct wages, transportation direct wages, repairs and maintenance, utilities, inbound freight and, where applicable, third party warehouse management fees. These costs are recognized in the periods the related expenses are incurred.

The Company believes the classification of costs included in merchandise costs could vary widely throughout the industry. The Company’s approach is to include in the “Merchandise costs” line item the direct, net costs of acquiring products and making them available to customers in its stores. The Company believes this approach most accurately presents the actual costs of products sold.

The Company recognizes all vendor allowances as a reduction in merchandise costs when the related product is sold. When possible, vendor allowances are applied to the related product cost by item and, therefore, reduce the carrying value of inventory by item. When the items are sold, the vendor allowance is recognized. When it is not possible, due to systems constraints, to allocate vendor allowances to the product by item, vendor allowances are recognized as a reduction in merchandise costs based on inventory turns and, therefore, recognized as the product is sold.

Advertising Costs

The Company’s advertising costs are recognized in the periods the related expenses are incurred and are included in the “Merchandise costs” line item of the Consolidated Statements of Operations. The Company’s advertising costs totaled \$752 in 2018, \$707 in 2017 and \$717 in 2016. The Company does not record vendor allowances for co-operative advertising as a reduction of advertising expense.

Operating, General and Administrative Expenses

OG&A expenses include all operating costs of the Company, except merchandise costs, as described above, and rent and depreciation and amortization. Certain other income items are classified as a reduction of OG&A costs. These include items such as gift card and lottery commissions, coupon processing and vending machine fees, check cashing, money order and wire transfer fees, and baled salvage credits.

Consolidated Statements of Cash Flows

For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be temporary cash investments.

Segments

The Company operates supermarkets, multi-department stores throughout the United States. The Company's retail operations, which represent 97% of the Company's consolidated sales, are its only reportable segment. The Company's operating divisions have been aggregated into one reportable segment due to the operating divisions having similar economic characteristics with similar long-term financial performance. In addition, the Company's operating divisions offer customers similar products, have similar distribution methods, operate in similar regulatory environments, purchase the majority of the merchandise for retail sale from similar (and in many cases identical) vendors on a coordinated basis from a centralized location, serve similar types of customers, and are allocated capital from a centralized location. Operating divisions are organized primarily on a geographical basis so that the operating division management team can be responsive to local needs of the operating division and can execute company strategic plans and initiatives throughout the locations in the operating division. This geographical separation is the primary differentiation between these retail operating divisions. The geographical basis of organization reflects how the business is managed and how the Company's Chief Executive Officer, who acts as the Company's chief operating decision maker, assesses performance internally. All of the Company's operations are domestic.

2.MERGERS AND PARTNERSHIP AGREEMENTS

Merger Agreement

On June 22, 2018, the Company finalized the merger with Home Chef, a meal kit delivery company. The merger will allow the Company to increase the availability of meal kits and expand its offerings to customers. The Company completed the merger by purchasing 100% of the ownership interest in Home Chef, for \$197 net of cash and cash equivalents of \$30, in addition to future earnout payments of up to \$500 over five years that are contingent on achieving certain milestones. The contingent consideration is based on future performance of both the online and offline business and the related customer engagement. The fair value of the earnout liability in the amount of \$91 recognized on the acquisition date was measured using unobservable (Level 3) inputs and is included in "Other long-term liabilities" within the Consolidated Balance Sheet. The Company estimated the fair value of the earnout liability by applying a Monte-Carlo simulation method using the Company's projection of future operating results for both the online and offline businesses related to the Home Chef merger and the estimated probability of achievement of the earnout target metrics. The Monte-Carlo simulation is a generally accepted statistical technique used to generate a defined number of valuation paths in order to develop a reasonable estimate of the fair value of the earnout liability. Changes in the fair value of the earnout liability in future periods will be recorded in the Company's results in the