

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)

Edgar Filing: KROGER CO - Form 10-K

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.

Edgar Filing: KROGER CO - Form 10-K

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.

6

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.”

8

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.

Edgar Filing: KROGER CO - Form 10-K

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”).

Edgar Filing: KROGER CO - Form 10-K

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.

Edgar Filing: KROGER CO - Form 10-K

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

Edgar Filing: KROGER CO - Form 10-K

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

15

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”).

Edgar Filing: KROGER CO - Form 10-K

- 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.

Edgar Filing: KROGER CO - Form 10-K

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.

Edgar Filing: KROGER CO - Form 10-K

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

- 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.

Edgar Filing: KROGER CO - Form 10-K

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.

30

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.

Edgar Filing: KROGER CO - Form 10-K

- 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.

Edgar Filing: KROGER CO - Form 10-K

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								Fair Value
	Expected Year of Maturity								
	2019	2020	2021	2022	2023	Thereafter	Total		
	(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								Fair Value
	Expected Year of Maturity								
	2018	2019	2020	2021	2022	Thereafter	Total		
	(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

Edgar Filing: KROGER CO - Form 10-K

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.

38

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

	Common Stock		Additional	Treasury Stock		Accumulated	Accumulated	Noncontro
(except per share amounts)	Shares	Amount	Paid-In	Shares	Amount	Other	Earnings	Interest
			Capital			Comprehens		
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	—	—	—	—	—	(35)	—	—
of \$(28)	—	—	66	—	(68)	—	—	52
Dividends declared (\$0.465 per	—	—	—	—	—	—	(443)	—
share)	—	—	—	—	—	—	—	—
(loss) including	—	—	—	—	—	—	1,975	(18)
controlling interests	—	—	—	—	—	—	—	—
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	—	—	—	—	—	244	—	—
of \$87	—	—	59	—	(69)	—	—	(20)
Dividends declared (\$0.495 per	—	—	—	—	—	—	(443)	—
share)	—	—	—	—	—	—	—	—
(loss) including	—	—	—	—	—	—	1,907	(18)
controlling interests	—	—	—	—	—	—	—	—
February 3, 2018	1,918	\$ 1,918	\$ 3,161	1,048	\$ (14,684)	\$ (471)	\$ 17,007	\$ (26)
Common stock:								

Edgar Filing: KROGER CO - Form 10-K

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.

46

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

Edgar Filing: KROGER CO - Form 10-K

	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 period of the change.

The merger was accounted for under the purchase method of accounting and was financed through the issuance of commercial paper. In a business combination, the purchase price is allocated to assets acquired and liabilities

assumed based on their fair values, with any excess of purchase price over fair value recognized as goodwill. In addition to recognizing assets and liabilities on the acquired company's balance sheet, the Company reviews supply contracts, leases, financial instruments, employment agreements and other significant agreements to identify potential assets or liabilities that require recognition in connection with the application of acquisition accounting under Accounting Standards Codification ("ASC") 805. Intangible assets are recognized apart from goodwill when the asset arises from contractual or other legal rights, or are separable from the acquired entity such that they may be sold, transferred, licensed, rented or exchanged either on a standalone basis or in combination with a related contract, asset or liability.

The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at the acquisition date.

	June 22, 2018
ASSETS	
Total current assets	\$ 36
Property, plant and equipment	6
Other assets	1
Intangibles	143
Total Assets, excluding Goodwill	186
LIABILITIES	
Total current liabilities	(28)
Other long-term liabilities	(94)
Total Liabilities	(122)
Total Identifiable Net Assets	64
Goodwill	163
Total Purchase Price	\$ 227

The preliminary purchase price allocation for the Home Chef acquisition is based upon a preliminary valuation which is subject to change as the Company obtains additional information with respect to income taxes during the measurement period. The allocation will be completed by the second quarter of 2019.

Of the \$143 allocated to intangible assets, the Company recorded \$99 and \$44 related to customer relationships and the trade name, respectively. The Company will amortize the customer relationships, using the cash flow trended method over seven years. The goodwill recorded as part of the merger was attributable to the assembled workforce of Home Chef and operational synergies expected from the merger. The merger was treated as a 30% stock purchase and 70% partnership interest purchase for income tax purposes. The tax basis of the assets acquired and liabilities assumed for the portion of the transaction treated as a partnership interest purchase was stepped up, and the related goodwill is deductible for tax purposes. The assets acquired and liabilities assumed for the portion treated as a stock purchase did not result in a step up of tax basis, and goodwill is not expected to be deductible for tax purposes. The Company determined the Home Chef results of operations are not material. Therefore the pro forma information is not required for fiscal year 2018 and 2017.

On September 2, 2016, the Company closed its merger with Modern HC Holdings, Inc. (“ModernHEALTH”) by purchasing 100% of the outstanding shares of ModernHEALTH for \$407. This merger allows the Company to expand its specialty pharmacy services by significantly increasing geographic reach and patient therapies. The merger was

accounted for under the purchase method of accounting and was financed through the issuance of commercial paper.

The Company's purchase price allocation was finalized in the third quarter of 2017. The changes in the fair values assumed from the preliminary amounts determined as of September 2, 2016 were a decrease in goodwill of \$2, a decrease in current liabilities of \$2. The table below summarizes the final fair value of the assets acquired and liabilities assumed:

50

	September 2, 2016
ASSETS	
Total current assets	\$ 82
Property, plant and equipment	8
Intangibles	136
Total Assets, excluding Goodwill	226
LIABILITIES	
Total current liabilities	(68)
Fair-value of long-term debt including obligations under capital leases and financing obligations	(1)
Deferred income taxes	(33)
Total Liabilities	(102)
Total Identifiable Net Assets	124
Goodwill	283
Total Purchase Price	\$ 407

Of the \$136 allocated to intangible assets, the Company recorded \$131 and \$5 related to pharmacy prescription files and distribution agreements, respectively. The Company will amortize the pharmacy prescription files and distribution agreements, using the straight line method, over 10 years. The goodwill recorded as part of the merger was attributable to the assembled workforce of ModernHEALTH and operational synergies expected from the merger, as well as any intangible assets that did not qualify for separate recognition. The merger was treated as a stock purchase for income tax purposes. The assets acquired and liabilities assumed as part of the merger did not result in a step up of tax basis and goodwill is not expected to be deductible for tax purposes.

Partnership Agreement

On May 17, 2018, the Company entered into a Partnership Framework Agreement with Ocado International Holdings Limited and Ocado Group plc (“Ocado”). Under this agreement, Ocado will partner exclusively with the Company in the U.S., enhancing the Company’s digital and robotics capabilities in its distribution networks. As part of the agreement, the Company provided a letter of credit for \$180, which supports its commitment to contract with Ocado to build a number of fulfillment centers. The balance of the letter of credit will reduce over time with the construction of each fulfillment center.

In addition, on May 17, 2018, the Company entered into a Share Subscription Agreement with Ocado, pursuant to which the Company agreed to purchase 33.1 million ordinary shares of Ocado for an aggregate purchase price of \$243. The Company completed the purchase of these 33.1 million shares on May 29, 2018. This is in addition to 8.1 million Ocado shares purchased earlier in the first quarter of 2018, and 6.5 million additional shares purchased in the second quarter of 2018. The equity investment in Ocado is measured at fair value through earnings. The fair value of all shares owned, which is measured using Level 1 inputs, was \$620 at February 2, 2019 and is included in “Other assets” in the Company’s Consolidated Balance Sheets. The Company recorded an unrealized gain of \$228 in 2018, none of which was realized during the period as the Company did not sell any Ocado securities.

3.GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the changes in the Company's net goodwill balance through February 2, 2019.

	2018	2017
Balance beginning of year		
Goodwill	\$ 5,567	\$ 5,563
Accumulated impairment losses	(2,642)	(2,532)
Subtotal	2,925	3,031
Activity during the year		
Mergers	163	18
Impairment losses	—	(110)
Held for sale adjustment	(1)	(14)
Balance end of year		
Goodwill	5,729	5,567
Accumulated impairment losses	(2,642)	(2,642)
Total Goodwill	\$ 3,087	\$ 2,925

In 2018, the Company acquired all of the outstanding shares of Home Chef (see Note 2) resulting in additional goodwill totaling \$163. Certain assets and liabilities including goodwill totaling \$1 and \$14, respectively for 2018 and 2017 were classified as held for sale in the Consolidated Balance Sheet (see Note 17).

Testing for impairment must be performed annually, or on an interim basis upon the occurrence of a triggering event or a change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The annual evaluation of goodwill and indefinite-lived intangible assets was performed during the fourth quarter of 2018 and 2016 and did not result in impairment.

Based on the results of the Company's impairment assessment in the fourth quarter of 2017, the Kroger Specialty Pharmacy reporting unit was the only reporting unit for which there was a potential impairment. In the fourth quarter of 2017, the operating performance of the Kroger Specialty Pharmacy reporting unit began to be affected by reduced margins as a result of compression in reimbursement by third party payers and a reduction of certain types of revenue. As a result of this decline, particularly in future expected cash flows, along with comparable fair value information, management concluded that the carrying value of goodwill for Kroger Specialty Pharmacy reporting unit exceeded its fair value, resulting in a pre-tax impairment charge of \$110 (\$74 after-tax). The pre-impairment goodwill balance for

Kroger Specialty Pharmacy was \$353, as of the fourth quarter 2017.

The following table summarizes the Company's intangible assets balance through February 2, 2019.

	2018		2017	
	Gross carrying amount	Accumulated amortization(1)	Gross carrying amount	Accumulated amortization(1)
Definite-lived favorable leasehold interests	\$ 160	\$ (47)	\$ 174	\$ (53)
Definite-lived pharmacy prescription files	316	(92)	238	(70)
Definite-lived customer relationships	186	(88)	93	(67)
Definite-lived other	103	(55)	99	(44)
Indefinite-lived trade name	685	—	641	—
Indefinite-lived liquor licenses	90	—	89	—
Total	\$ 1,540	\$ (282)	\$ 1,334	\$ (234)

(1) Favorable leasehold interests are amortized to rent expense, pharmacy prescription files are amortized to merchandise costs, customer relationships are amortized to depreciation and amortization expense and other intangibles are amortized to OG&A expense and depreciation and amortization expense.

In 2018, the Company acquired definite and indefinite lived intangible assets totaling approximately \$143, excluding goodwill, as a result of the merger with Home Chef (see Note 2). Additionally, the majority of the Company's pharmacy prescription file purchases for 2018 were completed in a single transaction for \$75.

Amortization expense associated with intangible assets totaled approximately \$80, \$59 and \$63, during fiscal years 2018, 2017 and 2016, respectively. Future amortization expense associated with the net carrying amount of definite-lived intangible assets for the years subsequent to 2018 is estimated to be approximately:

2019	\$ 87
2020	83
2021	67
2022	59
2023	47
Thereafter	140
Total future estimated amortization associated with definite-lived intangible assets	\$ 483

4.PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consists of:

	2018	2017
Land	\$ 3,254	\$ 3,201
Buildings and land improvements	12,245	12,072
Equipment	14,277	13,635
Leasehold improvements	10,306	9,773
Construction-in-progress	2,716	2,050
Leased property under capital leases and financing obligations	1,066	1,000
Total property, plant and equipment	43,864	41,731
Accumulated depreciation and amortization	(22,229)	(20,660)
Property, plant and equipment, net	\$ 21,635	\$ 21,071

Accumulated depreciation and amortization for leased property under capital leases was \$345 at February 2, 2019 and \$354 at February 3, 2018.

Approximately \$169 and \$177, net book value, of property, plant and equipment collateralized certain mortgages at February 2, 2019 and February 3, 2018, respectively.

5.TAXES BASED ON INCOME

The provision for taxes based on income consists of:

	2018	2017	2016
Federal			
Current	\$ 775	\$ 309	\$ 721
Deferred	(3)	(747)	158
Subtotal federal	772	(438)	879
State and local			
Current	108	15	51
Deferred	20	18	27
Subtotal state and local	128	33	78
Total	\$ 900	\$ (405)	\$ 957

A reconciliation of the statutory federal rate and the effective rate follows:

	2018	2017	2016
Statutory rate	21.0 %	33.7 %	35.0 %
State income taxes, net of federal tax benefit	2.6	1.7	1.6
Credits	(1.3)	(2.5)	(1.1)
Resolution of issues	0.5	—	(0.5)
Domestic manufacturing deduction	—	(1.1)	(0.7)
Excess tax benefits from share-based payments	(0.3)	(0.4)	(1.6)
Effect of Tax Cuts and Jobs Act	—	(60.8)	—
Impairment of goodwill	—	2.3	—
Other changes, net	0.1	(0.2)	0.1
	22.6 %	(27.3) %	32.8 %

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. In accordance with SAB

118, the Company has completed accounting for the Tax Act resulting in no measurement period adjustments.

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.

The tax effects of significant temporary differences that comprise tax balances were as follows:

	2018	2017
Deferred tax assets:		
Compensation related costs	\$ 350	\$ 348
Lease accounting	81	78
Closed store reserves	41	45
Net operating loss and credit carryforwards	110	146
Other	55	54
Subtotal	637	671
Valuation allowance	(54)	(62)
Total deferred tax assets	583	609
Deferred tax liabilities:		
Depreciation and amortization	(1,850)	(1,892)
Insurance related costs	(38)	(32)
Inventory related costs	(257)	(253)
Total deferred tax liabilities	(2,145)	(2,177)
Deferred taxes	\$ (1,562)	\$ (1,568)

At February 2, 2019, the Company had net operating loss carryforwards for state income tax purposes of \$1,208. These net operating loss carryforwards expire from 2019 through 2038. The utilization of certain of the Company's state net operating loss carryforwards may be limited in a given year. Further, based on the analysis described below, the Company has recorded a valuation allowance against some of the deferred tax assets resulting from its state net operating losses.

At February 2, 2019, the Company had state credit carryforwards of \$47, most of which expire from 2019 through 2027. The utilization of certain of the Company's credits may be limited in a given year. Further, based on the analysis described below, the Company has recorded a valuation allowance against some of the deferred tax assets resulting from its state credits.

At February 2, 2019, the Company had federal net operating loss carryforwards of \$2. These net operating loss carryforwards expire from 2036 through 2037. The utilization of certain of the Company's federal net operating loss carryforwards may be limited in a given year. Further, based on the analysis described below, the Company has not recorded a valuation allowance against the deferred tax assets resulting from its federal net operating losses.

The Company regularly reviews all deferred tax assets on a tax filer and jurisdictional basis to estimate whether these assets are more likely than not to be realized based on all available evidence. This evidence includes historical taxable income, projected future taxable income, the expected timing of the reversal of existing temporary differences and the implementation of tax planning strategies. Projected future taxable income is based on expected results and assumptions as to the jurisdiction in which the income will be earned. The expected timing of the reversals of existing temporary differences is based on current tax law and the Company's tax methods of accounting. Unless deferred tax assets are more likely than not to be realized, a valuation allowance is established to reduce the carrying value of the deferred tax asset until such time that realization becomes more likely than not. Increases and decreases in these valuation allowances are included in "Income tax expense" in the Consolidated Statements of Operations. As of February 2, 2019, February 3, 2018 and January 28, 2017, the total valuation allowance was \$54, \$62 and \$50, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, including positions impacting only the timing of tax benefits, is as follows:

	2018	2017	2016
Beginning balance	\$ 180	\$ 177	\$ 204
Additions based on tax positions related to the current year	7	11	10
Reductions based on tax positions related to the current year	(1)	(1)	(1)
Additions for tax positions of prior years	23	6	3
Reductions for tax positions of prior years	(22)	(8)	(30)
Settlements	(10)	—	(2)
Lapse of statute	(3)	(5)	(7)
Ending balance	\$ 174	\$ 180	\$ 177

The Company does not anticipate that changes in the amount of unrecognized tax benefits over the next twelve months will have a significant impact on its results of operations or financial position.

As of February 2, 2019, February 3, 2018 and January 28, 2017, the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$72, \$88 and \$73 respectively.

To the extent interest and penalties would be assessed by taxing authorities on any underpayment of income tax, such amounts have been accrued and classified as a component of income tax expense. During the years ended February 2, 2019, February 3, 2018 and January 28, 2017, the Company recognized approximately \$2, \$8 and \$(1), respectively, in interest and penalties (recoveries). The Company had accrued approximately \$30, \$28 and \$20 for the payment of interest and penalties as of February 2, 2019, February 3, 2018 and January 28, 2017, respectively.

As of February 2, 2019, the Internal Revenue Service had concluded its examination of our 2012 and 2013 federal tax returns.

6. DEBT OBLIGATIONS

Long-term debt consists of:

	February 2, 2019	February 3, 2018
1.50% to 8.00% Senior Notes due through 2048	\$ 12,097	\$ 12,201
5.63% to 12.75% Mortgages due in varying amounts through 2027	14	22
1.68% to 2.63% Commercial paper borrowings due through February 2019	800	2,121
3.37% Term Loan due 2019	1,000	—
Other	440	443
Total debt, excluding capital leases and financing obligations	14,351	14,787
Less current portion	(3,103)	(3,509)
Total long-term debt, excluding capital leases and financing obligations	\$ 11,248	\$ 11,278

In 2018, the Company issued \$600 of senior notes due in fiscal year 2029 bearing an interest rate of 4.50% and \$600 of senior notes due in fiscal year 2049 bearing an interest rate of 5.40%. In connection with the senior note issuances, the Company also terminated forward-starting interest rate swap agreements with an aggregate notional amount of \$750. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the fourth quarter of 2018. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized gain of \$39, \$30 net of tax, has been deferred in Accumulated Other Comprehensive Loss and will continue to amortize to earnings as the interest payments are made. The Company also repaid, upon maturity, \$300 of senior notes bearing an interest rate of 6.80%, \$300 of senior notes bearing an interest rate of 2.00%, \$200 of senior notes bearing an interest rate of 7.00% and \$500 of senior notes bearing an interest rate of 2.30%, with proceeds from the senior notes issuances.

In 2017, the Company issued \$400 of senior notes due in fiscal year 2022 bearing an interest rate of 2.80%, \$600 of senior notes due in fiscal year 2027 bearing an interest rate of 3.70% and \$500 of senior notes due in fiscal year 2048 bearing an interest rate of 4.65%. In connection with the senior note issuances, the Company also terminated forward-starting interest rate swap agreements with an aggregate notional amount of \$600. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the second quarter of 2017. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$20, \$12 net of tax, has been deferred in Accumulated Other Comprehensive Loss and will continue to amortize to earnings as the interest payments are made. The Company also repaid, upon maturity, \$600 of senior notes bearing an interest rate of 6.40%, with proceeds from the senior notes issuances.

In 2018, the Company obtained a \$1,000 term loan with a maturity date of March 16, 2019. The funds were drawn on March 26, 2018 and were used to reduce outstanding commercial paper borrowings. Under the terms of the agreement, interest rates are adjusted monthly based on the Company's Public Debt Rating and prevailing LIBOR rates. On March 15, 2019, the Company paid the \$1,000 term loan through increased commercial paper borrowings.

On August 29, 2017, the Company entered into an amended, extended and restated \$2,750 unsecured revolving credit facility (the "Credit Agreement"), with a termination date of August 29, 2022, unless extended as permitted under the Credit Agreement. This Credit Agreement amended the Company's \$2,750 credit facility that would otherwise have terminated on June 30, 2019. The Company has the ability to increase the size of the Credit Agreement by up to an additional \$1,000, subject to certain conditions.

Borrowings under the Credit Agreement bear interest, at the Company's option, at either (i) LIBOR plus a market spread, based on the Company's Public Debt Rating or (ii) the base rate, defined as the highest of (a) the Federal Funds Rate plus 0.5%, (b) the Bank of America prime rate, and (c) one-month LIBOR plus 1.0%, plus a market rate spread based on the Company's Public Debt Rating. The Company will also pay a Commitment Fee based on its Public Debt Rating and Letter of Credit fees equal to a market rate spread based on the Company's 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.

The Credit Agreement contains covenants, which, among other things, require the maintenance of a Leverage Ratio of not greater than 3.50:1.00 and a Fixed Charge Coverage Ratio of not less than 1.70:1.00. The Company may repay the Credit Agreement in whole or in part at any time without premium or penalty. The Credit Agreement is not guaranteed by the Company's subsidiaries.

As of February 2, 2019, the Company had \$800 of commercial paper borrowings, with a weighted average interest rate of 2.63% and no borrowings under the Credit Agreement. As of February 3, 2018, the Company had \$2,121 of commercial paper borrowings, with a weighted average interest rate of 1.68%, and no borrowings under the Credit Agreement.

As of February 2, 2019, the Company had outstanding letters of credit in the amount of \$363, of which \$3 reduces funds available under the Credit Agreement. The letters of credit are maintained primarily to support performance, payment, deposit or surety obligations of the Company.

Most of the Company's outstanding public debt is subject to early redemption at varying times and premiums, at the option of the Company. In addition, subject to certain conditions, some of the Company's publicly issued debt will be subject to redemption, in whole or in part, at the option of the holder upon the occurrence of a redemption event, upon not less than five days' notice prior to the date of redemption, at a redemption price equal to the default amount, plus a specified premium. "Redemption Event" is defined in the indentures as the occurrence of (i) any person or group, together with any affiliate thereof, beneficially owning 50% or more of the voting power of the Company, (ii) any one person or group, or affiliate thereof, succeeding in having a majority of its nominees elected to the Company's Board of Directors, in each case, without the consent of a majority of the continuing directors of the Company or (iii) both a change of control and a below investment grade rating.

The aggregate annual maturities and scheduled payments of long-term debt, as of year-end 2018, and for the years subsequent to 2018 are:

2019	\$ 3,103
2020	720
2021	793
2022	896
2023	595
Thereafter	8,244
Total debt	\$ 14,351

7.DERIVATIVE FINANCIAL INSTRUMENTS

GAAP requires that derivatives be carried at fair value on the balance sheet, and provides for hedge accounting when certain conditions are met. The Company's derivative financial instruments are recognized on the balance sheet at fair value. Changes in the fair value of derivative instruments designated as "cash flow" hedges, to the extent the hedges are highly effective, are recorded in other comprehensive income, net of tax effects. Ineffective portions of cash flow hedges, if any, are recognized in current period earnings. Other comprehensive income or loss is reclassified into current period earnings when the hedged transaction affects earnings. Changes in the fair value of derivative instruments designated as "fair value" hedges, along with corresponding changes in the fair values of the hedged assets or liabilities, are recorded in current period earnings. Ineffective portions of fair value hedges, if any, are recognized in current period earnings.

The Company assesses, both at the inception of the hedge and on an ongoing basis, whether derivatives used as hedging instruments are highly effective in offsetting the changes in the fair value or cash flow of the hedged items. If it is determined that a derivative is not highly effective as a hedge or ceases to be highly effective, the Company discontinues hedge accounting prospectively.

Interest Rate Risk Management

The Company is exposed to market risk from fluctuations in interest rates. The Company manages its exposure to interest rate fluctuations through the use of a commercial paper program, interest rate swaps (fair value hedges) and forward-starting interest rate swaps (cash flow hedges). The Company's 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, the Company uses 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 the Company's 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.

The Company reviews compliance with these guidelines annually with the Financial Policy Committee of the Board of Directors. These guidelines may change as the Company's needs dictate.

Fair Value Interest Rate Swaps

The table below summarizes the outstanding interest rate swaps designated as fair value hedges as of February 3, 2018. We have no outstanding interest rate derivatives classified as fair value hedges as of February 2, 2019.

	2017		
	Pay		Pay
	Floating		Fixed
Notional amount	\$ 100		\$ —
Number of contracts	2		—
Duration in years	0.88		—
Average variable rate	7.23	%	—
Average fixed rate	6.80	%	—
Maturity	December 2018		

The gain or loss on these derivative instruments as well as the offsetting gain or loss on the hedged items attributable to the hedged risk is recognized in current earnings as “Interest expense.” These gains and losses for 2018 and 2017 were as follows:

Consolidated Statements of Operations Classification	Year-To-Date		February 3, 2018	
	February 2, 2019		Gain/(Loss) on	
	Swaps	Borrowings	Swaps	Borrowings
Interest Expense	\$ 1	\$ —	\$ —	\$ —

The following table summarizes the location and fair value of derivative instruments designated as fair value hedges on the Company’s Consolidated Balance Sheets:

Derivatives Designated as Fair Value Hedging Instruments	Asset Derivatives		Balance Sheet Location
	Fair Value		
	February 2, 2019	February 3, 2018	
Interest Rate Hedges	\$ —	\$ (1)	Other long-term liabilities

Cash Flow Forward-Starting Interest Rate Swaps

As of February 2, 2019, the Company had five forward-starting interest rate swap agreements with a maturity date of January 2020 with an aggregate notional amount totaling \$250. 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. The Company entered into these forward-starting interest rate swaps in order to lock in fixed interest rates on its forecasted issuance of debt in January 2020. 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 and accumulated other comprehensive income for \$20 net of tax.

As of February 3, 2018, the Company had nine forward-starting interest rate swap agreements with a maturity date of January 2019 with an aggregate notional amount totaling \$750 and five forward-starting interest rate swap agreements with maturity dates of January 2020 with an aggregate notional amount totaling \$250. The Company entered into these forward-starting interest rate swaps in order to lock in fixed interest rates on its forecasted issuance of debt in January 2019 and January 2020. Accordingly, the forward-starting interest rate swaps were designated as cash-flow hedges as defined by GAAP. As of February 3, 2018, the fair value of the interest rate swaps was recorded in other assets for \$103 and accumulated other comprehensive income for \$73 net of tax.

During 2018, the Company terminated nine forward-starting interest rate swaps with maturity dates of January 2019 with an aggregate notional amount totaling \$750. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the fourth quarter of 2018. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized gain of \$39, \$30 net of tax, has been deferred in AOCI and will be amortized to earnings as the interest payments are made.

During 2017, the Company terminated eleven forward-starting interest rate swaps with maturity dates of August 2017, with an aggregate notional amount totaling \$600. These forward-starting interest rate swap agreements were hedging the variability in future benchmark interest payments attributable to changing interest rates on the forecasted issuance of fixed-rate debt issued during the third quarter of 2017. Since these forward-starting interest rate swap agreements were classified as cash flow hedges, the unamortized loss of \$20, \$12 net of tax, has been deferred in AOCI and will be amortized to earnings as the interest payments are made.

The following table summarizes the effect of the Company's derivative instruments designated as cash flow hedges for 2018 and 2017:

	Year-To-Date		Year-To-Date		Location of Gain/(Loss)
	2018	2017	2018	2017	
Derivatives in Cash Flow Hedging Relationships					
Forward-Starting Interest Rate Swaps, net of tax*	\$ 6	\$ 24	\$ (5)	\$ (3)	Interest expense

*The amounts of Gain/(Loss) in AOCI on derivatives include unamortized proceeds and payments from forward-starting interest rate swaps once classified as cash flow hedges that were terminated prior to end of 2018 and 2017, respectively.

For the above fair value and cash flow interest rate swaps, the Company has entered into International Swaps and Derivatives Association master netting agreements that permit the net settlement of amounts owed under their respective derivative contracts. Under these master netting agreements, net settlement generally permits the Company or the counterparty to determine the net amount payable for contracts due on the same date and in the same currency for similar types of derivative transactions. These master netting agreements generally also provide for net settlement of all outstanding contracts with a counterparty in the case of an event of default or a termination event.

Collateral is generally not required of the counterparties or of the Company under these master netting agreements. As of February 2, 2019 and February 3, 2018, no cash collateral was received or pledged under the master netting agreements.

Edgar Filing: KROGER CO - Form 10-K

The effect of the net settlement provisions of these master netting agreements on the Company's derivative balances upon an event of default or termination event is as follows as of February 2, 2019 and February 3, 2018:

	Gross Amounts Recognized	Gross Amounts Offset in the Balance Sheet	Net Amount Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet Instruments	Cash Collateral	Net Amount
February 2, 2019						
Assets						
Cash Flow Forward-Starting Interest Rate Swaps	\$ 33	\$ —	\$ 33	\$ —	\$ —	\$ 33
February 3, 2018						
Assets						
Cash Flow Forward-Starting Interest Rate Swaps	\$ 103	\$ —	\$ 103	\$ —	\$ —	\$ 103
Liabilities						
Fair Value Interest Rate Swaps	\$ 1	\$ —	\$ 1	\$ —	\$ —	\$ 1

8. FAIR VALUE MEASUREMENTS

GAAP establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy defined in the standards are as follows:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities;

Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable;

Level 3 - Unobservable pricing inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing an asset or liability.

For items carried at (or adjusted to) fair value in the consolidated financial statements, the following tables summarize the fair value of these instruments at February 2, 2019 and February 3, 2018:

February 2, 2019 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	\$ 671	\$ —	\$ —	\$ 671
Other Investment	—	—	22	22
Interest Rate Hedges	—	33	—	33
Total	\$ 671	\$ 33	\$ 22	\$ 726

February 3, 2018 Fair Value Measurements Using

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Trading Securities	\$ 64	\$ —	\$ —	\$ 64
Available-For-Sale Securities	25	—	—	25
Interest Rate Hedges	—	102	—	102
Total	\$ 89	\$ 102	\$ —	\$ 191

In 2018, realized gains on Level 1, available-for-sale securities totaled \$5.

The Company values interest rate hedges using observable forward yield curves. These forward yield curves are classified as Level 2 inputs.

Fair value measurements of non-financial assets and non-financial liabilities are primarily used in the impairment analysis of goodwill, other intangible assets, long-lived assets and in the valuation of store lease exit costs. The Company reviews goodwill and indefinite-lived intangible assets for impairment annually, during the fourth quarter of each fiscal year, and as circumstances indicate the possibility of impairment. See Note 3 for further discussion related to the Company's carrying value of goodwill. Long-lived assets and store lease exit costs were measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. See Note 1 for further discussion of the Company's policies and recorded amounts for impairments of long-lived assets and valuation of store lease exit costs. In 2018, long-lived assets with a carrying amount of \$85 were written down to their fair value of \$29, resulting in an impairment charge of \$56. In 2017, long-lived assets with a carrying amount of \$98 were written down to their fair value of \$27, resulting in an impairment charge of \$71. In 2018, the Company entered into an agreement with a third party. As part of the consideration for entering the agreement, the Company received a financial instrument of \$22.

Mergers are accounted for using the acquisition method of accounting, which requires that the purchase price paid for a merger be allocated to the assets and liabilities acquired based on their estimated fair values as of the effective date of the merger, with the excess of the purchase price over the net assets being recorded as goodwill. See Note 2 for further discussion related to accounting for mergers.

Fair Value of Other Financial Instruments

Current and Long-term Debt

The fair value of the Company's long-term debt, including current maturities, was estimated based on the quoted market prices for the same or similar issues adjusted for illiquidity based on available market evidence. If quoted market prices were not available, the fair value was based upon the net present value of the future cash flow using the forward interest rate yield curve in effect at respective year-ends. At February 2, 2019, the fair value of total debt was \$14,190 compared to a carrying value of \$14,351. At February 3, 2018, the fair value of total debt was \$15,167 compared to a carrying value of \$14,787.

Contingent Consideration

As a result of the Home Chef merger, the Company recognized a contingent liability of \$91 on the acquisition date. The contingent consideration was measured using unobservable (Level 3) inputs and is included in "Other long-term liabilities" within the Consolidated Balance Sheet. The liability is remeasured to fair value at each reporting period, and the change in fair value, including accretion for the passage of time, is recognized in net 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.

Cash and Temporary Cash Investments, Store Deposits In-Transit, Receivables, Prepaid and Other Current Assets, Trade Accounts Payable, Accrued Salaries and Wages and Other Current Liabilities

The carrying amounts of these items approximated fair value.

Other Assets

In 2016, the Company entered into agreements with a third party. As part of the consideration for entering these agreements, the Company received a financial instrument that derives its value from the third party's business operations. The Company used the Monte-Carlo simulation method to determine the fair value of this financial instrument. 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 this financial instrument. The assumptions used in the Monte-Carlo simulation are classified as Level 3 inputs. The financial instrument was valued at \$335 and recorded in "Other assets" within the Consolidated Balance Sheets. As the financial instrument was obtained in exchange for certain obligations, the Company also recognized offsetting deferred revenue liabilities in "Other current liabilities" and "Other long-term liabilities" within the Consolidated Balance Sheets. The deferred revenue will be amortized to "Sales" within the Consolidated Statements of Operations over the term of the agreements. Post inception, the Company received a distribution of \$58, which was recorded as a reduction of the cost method investment. In the fourth quarter of 2018, a transaction occurred that resulted in the settlement of the financial instrument. As a result of the settlement, the Company received cash proceeds of \$235. The Company recognized an impairment of financial instrument of \$42 in OG&A in the fourth quarter of 2018.

The fair values of certain investments recorded in "other assets" within the Consolidated Balance Sheets were estimated based on quoted market prices for those or similar investments, or estimated cash flows, if appropriate. At February 2, 2019 and February 3, 2018, the carrying and fair value of long-term investments for which fair value is determinable was \$155 and \$176, respectively. At February 2, 2019 and February 3, 2018, the carrying value of notes receivable for which fair value is determinable was \$146 and \$170, respectively.

9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table represents the changes in AOCI by component for the years ended February 2, 2019 and February 3, 2018:

	Cash Flow Hedging Activities(1)	Available for sale Securities(1)	Pension and Postretirement Defined Benefit Plans(1)	Total(1)
Balance at January 28, 2017	\$ (2)	\$ —	\$ (713)	\$ (715)
OCI before reclassifications(2)	23	4	165	192
Amounts reclassified out of AOCI(3)	3	—	49	52
Net current-period OCI	26	4	214	244
Balance at February 3, 2018	\$ 24	\$ 4	\$ (499)	\$ (471)

Edgar Filing: KROGER CO - Form 10-K

Balance at February 3, 2018	\$ 24	\$ 4	\$ (499)	\$ (471)
OCI before reclassifications(2)	(23)	(4)	104	77
Amounts reclassified out of AOCI(3)	5	—	43	48
Net current-period OCI	(18)	(4)	147	125
Balance at February 2, 2019	\$ 6	\$ —	\$ (352)	\$ (346)

(1) All amounts are net of tax.

(2) Net of tax of \$0, \$1 and \$63 for cash flow hedging activities, available for sale securities and pension and postretirement defined benefit plans, respectively, as of February 3, 2018. Net of tax of \$(8), \$(1) and \$32 for cash flow hedging activities, available for sale securities and pension and postretirement defined benefit plans, respectively, as of February 2, 2019.

(3) Net of tax of \$20 and \$3 for pension and postretirement defined benefit plans and cash flow hedging activities, respectively, as of February 3, 2018. Net of tax of \$13 and \$3 for pension and postretirement defined benefit plans and cash flow hedging activities, respectively, as of February 2, 2019.

The following table represents the items reclassified out of AOCI and the related tax effects for the years ended February 2, 2019, February 3, 2018 and January 28, 2017:

	For the year ended February 2, 2019	For the year ended February 3, 2018	For the year ended January 28, 2017
Cash flow hedging activity items			
Amortization of gains and losses on cash flow hedging activities (1)	\$ 8	\$ 6	\$ 2
Tax expense	(3)	(3)	—
Net of tax	5	3	2
Available for sale security items			
Realized gains on available for sale securities (2)	—	—	(27)
Tax expense	—	—	13
Net of tax	—	—	(14)
Pension and postretirement defined benefit plan items			
Amortization of amounts included in net periodic pension expense (3)	56	69	53
Tax expense	(13)	(20)	(20)
Net of tax	43	49	33
Total reclassifications, net of tax	\$ 48	\$ 52	\$ 21

- (1) Reclassified from AOCI into interest expense.
(2) Reclassified from AOCI into operating, general and administrative expense.
(3) Reclassified from AOCI into non-service component of company-sponsored pension plan costs. These components are included in the computation of net periodic pension expense.

10.LEASES AND LEASE-FINANCED TRANSACTIONS

While the Company's current strategy emphasizes ownership of store real estate, the Company operates primarily in leased facilities. Lease terms generally range from 10 to 20 years with options to renew for varying terms. Terms of certain leases include escalation clauses, percentage rent based on sales or payment of executory costs such as property taxes, utilities or insurance and maintenance. Rent expense for leases with escalation clauses or other lease concessions are accounted for on a straight-line basis beginning with the earlier of the lease commencement date or the date the Company takes possession. Portions of certain properties are subleased to others for periods generally ranging from one to 20 years.

Rent expense (under operating leases) consists of:

	2018	2017	2016
Minimum rentals	\$ 967	\$ 1,005	\$ 973
Contingent payments	19	19	16
Tenant income	(102)	(113)	(108)
Total rent expense	\$ 884	\$ 911	\$ 881

Minimum annual rentals and payments under capital leases and lease-financed transactions for the five years subsequent to 2019 and in the aggregate are listed below. Amounts in the table only include payments through the noncancelable lease term.

	Capital Leases	Operating Leases	Lease- Financed Transactions
2019	\$ 103	\$ 948	\$ 5
2020	89	880	6
2021	86	773	5
2022	82	649	5
2023	81	556	5
Thereafter	766	3,197	17
Total	\$ 1,207	\$ 7,003	\$ 43
Less estimated executory costs included in capital leases	—		
Net minimum lease payments under capital leases	1,207		
Less amount representing interest	372		
Present value of net minimum lease payments under capital leases	\$ 835		

Total future minimum rentals under noncancellable subleases at February 2, 2019 were \$183.

11.EARNINGS PER COMMON SHARE

Net earnings attributable to The Kroger Co. per basic common share equals net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted average number of common shares outstanding. Net earnings attributable to The Kroger Co. per diluted common share equals net earnings attributable to The Kroger Co. less income allocated to participating securities divided by the weighted average number of common shares outstanding, after giving effect to dilutive stock options. The following table provides a reconciliation of net earnings attributable to The Kroger Co. and shares used in calculating net earnings attributable to The Kroger Co. per basic common share to those used in calculating net earnings attributable to The Kroger Co. per diluted common share:

For the year ended
February 2, 2019

For the year ended
February 3, 2018

For the year ended
January 28, 2017

Edgar Filing: KROGER CO - Form 10-K

	Earnings	Shares	Per	Earnings	Shares	Per	Earnings	Shares
(Amounts, except per share amounts)	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)
Earnings attributable to The Kroger basic common share	\$ 3,076	810	\$ 3.80	\$ 1,890	895	\$ 2.11	\$ 1,959	942
Effect of stock options		8			9			16
Earnings attributable to The Kroger diluted common share	\$ 3,076	818	\$ 3.76	\$ 1,890	904	\$ 2.09	\$ 1,959	958

The Company had combined undistributed and distributed earnings to participating securities totaling \$34, \$17 and \$16 in 2019, 2018 and 2017, respectively.

The Company had stock options outstanding for approximately 10.1 million, 15.6 million and 7.1 million shares, respectively, for the years ended February 2, 2019, February 3, 2018, and January 28, 2017, which were excluded from the computations of net earnings per diluted common share because their inclusion would have had an anti-dilutive effect on net earnings per diluted share.

12. STOCK OPTION PLANS

The Company grants options for common shares (“stock options”) to employees under various plans at an option price equal to the fair market value of the stock option at the date of grant. The Company accounts for stock options under the 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.

Stock options typically expire 10 years from the date of grant. Stock options vest between one and five years from the date of grant. At February 2, 2019, approximately 22 million common shares were available for future option grants under the 2011 and 2014 Long-Term Incentive Plans (the “Plans”).

In addition to the stock options described above, the Company awards restricted stock to employees and non-employee directors under various plans. The restrictions on these awards generally lapse between one and five years from the date of the awards. The Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying shares on the grant date of the award, over the period the awards lapse. As of February 2, 2019, approximately 6 million common shares were available under the Plans for future restricted stock awards or shares issued to the extent performance criteria are achieved. The Company has the ability to convert shares available for stock options under the Plans to shares available for restricted stock awards. Under the Plans, four shares available for option awards can be converted into one share available for restricted stock awards.

Equity awards granted are based on the aggregate value of the award on grant date. This can affect the number of shares granted in a given year as equity awards. Excess tax benefits related to equity awards are recognized in the provision for income taxes. Equity awards may be approved at one of four meetings of its Board of Directors occurring shortly after the Company’s release of quarterly earnings. The 2018 primary grant was made in conjunction with the June meeting of the Company’s Board of Directors.

All awards become immediately exercisable upon certain changes of control of the Company.

Stock Options

Changes in options outstanding under the stock option plans are summarized below:

	Shares subject to option (in millions)	Weighted- average exercise price
Outstanding, year-end 2015	34.9	\$ 18.26
Granted	4.8	\$ 37.10
Exercised	(4.9)	\$ 14.20
Canceled or Expired	(0.5)	\$ 28.35
Outstanding, year-end 2016	34.3	\$ 21.32
Granted	7.0	\$ 23.00
Exercised	(3.8)	\$ 14.08
Canceled or Expired	(0.8)	\$ 28.29
Outstanding, year-end 2017	36.7	\$ 22.23
Granted	2.7	\$ 27.88
Exercised	(4.4)	\$ 15.34
Canceled or Expired	(0.9)	\$ 28.05
Outstanding, year-end 2018	34.1	\$ 23.42

A summary of options outstanding, exercisable and expected to vest at February 2, 2019 follows:

	Number of shares (in millions)	Weighted-average remaining contractual life (in years)	Weighted-average exercise price	Aggregate intrinsic value (in millions)
Options Outstanding	34.1	5.73	\$ 23.42	229
Options Exercisable	22.7	4.50	\$ 20.95	201
Options Expected to Vest	11.2	8.14	\$ 28.33	27

Restricted stock

Changes in restricted stock outstanding under the restricted stock plans are summarized below:

	Restricted shares outstanding (in millions)	Weighted-average grant-date fair value
Outstanding, year-end 2015	7.6	\$ 28.01
Granted	3.6	\$ 37.03
Lapsed	(3.5)	\$ 28.52
Canceled or Expired	(0.3)	\$ 30.70
Outstanding, year-end 2016	7.4	\$ 32.09
Granted	5.8	\$ 23.04
Lapsed	(3.6)	\$ 31.05
Canceled or Expired	(0.4)	\$ 29.26
Outstanding, year-end 2017	9.2	\$ 26.78
Granted	4.6	\$ 27.99
Lapsed	(4.4)	\$ 25.93
Canceled or Expired	(0.6)	\$ 26.57
Outstanding, year-end 2018	8.8	\$ 27.86

The weighted-average grant date fair value of stock options granted during 2018, 2017 and 2016 was \$6.78, \$4.71 and \$7.48, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option-pricing model, based on the assumptions shown in the table below. The Black-Scholes model utilizes accounting judgment and financial estimates, including the term option holders are expected to retain their

stock options before exercising them, the volatility of the Company's share price over that expected term, the dividend yield over the term and the number of awards expected to be forfeited before they vest. Using alternative assumptions in the calculation of fair value would produce fair values for stock option grants that could be different than those used to record stock-based compensation expense in the Consolidated Statements of Operations. The increase in the fair value of the stock options granted during 2018, compared to 2017, resulted primarily from an increase in the Company's share price, which decreased the expected dividend yield, an increase in the weighted average expected volatility and the weighted average risk-free interest rate also contributed to the increase in fair value. The decrease in the fair value of the stock options granted during 2017, compared to 2016, resulted primarily from a decrease in the Company's share price, which increased the expected dividend yield, partially offset by an increase in the weighted average expected volatility and the weighted average risk-free interest rate.

The following table reflects the weighted-average assumptions used for grants awarded to option holders:

	2018		2017		2016	
Weighted average expected volatility	24.50	%	22.78	%	21.40	%
Weighted average risk-free interest rate	2.82	%	2.21	%	1.29	%
Expected dividend yield	2.00	%	2.20	%	1.40	%
Expected term (based on historical results)	7.2	years	7.2	years	7.2	years

The weighted-average risk-free interest rate was based on the yield of a treasury note as of the grant date, continuously compounded, which matures at a date that approximates the expected term of the options. The dividend yield was based on our history and expectation of dividend payouts. Expected volatility was determined based upon historical stock volatilities; however, implied volatility was also considered. Expected term was determined based upon historical exercise and cancellation experience.

Total stock compensation recognized in 2018, 2017 and 2016 was \$154, \$151 and \$141, respectively. Stock option compensation recognized in 2018, 2017 and 2016 was \$25, \$32 and \$28, respectively. Restricted shares compensation recognized in 2018, 2017 and 2016 was \$129, \$119 and \$113, respectively.

The total intrinsic value of stock options exercised was \$58, \$55 and \$105 in 2018, 2017 and 2016, respectively. The total amount of cash received in 2018 by the Company from the exercise of stock options granted under share-based payment arrangements was \$65. As of February 2, 2019, there was \$214 of total unrecognized compensation expense remaining related to non-vested share-based compensation arrangements granted under Plans. This cost is expected to be recognized over a weighted-average period of approximately two years. The total fair value of options that vested was \$30, \$29 and \$28 in 2018, 2017 and 2016, respectively.

Shares issued as a result of stock option exercises may be newly issued shares or reissued treasury shares. Proceeds received from the exercise of options, and the related tax benefit, may be utilized to repurchase the Company's common shares under a stock repurchase program adopted by the Company's Board of Directors. During 2018, the Company repurchased approximately three million common shares in such a manner.

13.COMMITMENTS AND CONTINGENCIES

The Company continuously evaluates contingencies based upon the best available evidence.

The Company believes that allowances for loss have been provided to the extent necessary and that its assessment of contingencies is reasonable. To the extent that resolution of contingencies results in amounts that vary from the Company's estimates, future earnings will be charged or credited.

The principal contingencies are described below:

Insurance — The Company's workers' compensation risks are self-insured in most states. In addition, other workers' compensation risks and certain levels of insured general liability risks are based on retrospective premium plans, deductible plans, and self-insured retention plans. The liability for workers' compensation risks is accounted for on a present value basis. Actual claim settlements and expenses incident thereto may differ from the provisions for loss. Property risks have been underwritten by a subsidiary and are all reinsured with unrelated insurance companies. Operating divisions and subsidiaries have paid premiums, and the insurance subsidiary has provided loss allowances, based upon actuarially determined estimates.

Litigation — 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, the Company is of the belief that any resulting liability will not have a material effect on the Company's financial position, results of operations, or cash flows.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made provisions where it is reasonably possible to estimate and when an adverse outcome is probable. Nonetheless, assessing and predicting the outcomes of these matters involves substantial uncertainties. Management currently believes that the aggregate range of loss for the Company's exposure is not material to the Company. It remains possible that despite management's current belief, material differences in actual outcomes or changes in management's evaluation or predictions could arise that could have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

Assignments — The Company is contingently liable for leases that have been assigned to various third parties in connection with facility closings and dispositions. The Company could be required to satisfy the obligations under the leases if any of the assignees is unable to fulfill its lease obligations. Due to the wide distribution of the Company's assignments among third parties, and various other remedies available, the Company believes the likelihood that it will be required to assume a material amount of these obligations is remote.

14.STOCK

Preferred Shares

The Company has authorized five million shares of voting cumulative preferred shares; two million shares were available for issuance at February 2, 2019. The shares have a par value of \$100 per share and are issuable in series.

Common Shares

The Company has authorized two billion common shares, \$1 par value per share.

Common Stock Repurchase Program

The Company maintains stock repurchase programs that comply with Rule 10b5-1 of the Securities Exchange Act of 1934 to allow for the orderly repurchase of The Kroger Co. common shares, from time to time. The Company made open market purchases totaling \$727, \$1,567 and \$1,661 under these repurchase programs in 2018, 2017 and 2016, respectively. On April 20, 2018 the Company entered and funded a \$1,200 accelerated stock repurchase ("ASR") program to reacquire shares in privately negotiated transactions. The final delivery under the ASR program occurred during the second quarter of 2018, which included the settlement of the remaining 2.3 million Kroger Common shares. In total, the Company invested \$1,200 to repurchase 46.3 million Kroger common shares at an average price of \$25.91 per share.

In addition to these repurchase programs, in December 1999, the Company began a program to repurchase common shares to reduce dilution resulting from its employee stock option plans. This program is solely funded by proceeds from stock option exercises and the related tax benefit. The Company repurchased approximately \$83, \$66 and \$105 under the stock option program during 2018, 2017 and 2016, respectively.

15. COMPANY- SPONSORED BENEFIT PLANS

The Company administers non-contributory defined benefit retirement plans for some non-union employees and union-represented employees as determined by the terms and conditions of collective bargaining agreements. These include several qualified pension plans (the “Qualified Plans”) and non-qualified pension plans (the “Non-Qualified Plans”). The Non-Qualified Plans pay benefits to any employee that earns in excess of the maximum allowed for the Qualified Plans by Section 415 of the Internal Revenue Code. The Company only funds obligations under the Qualified Plans. Funding for the company-sponsored pension plans is based on a review of the specific requirements and on evaluation of the assets and liabilities of each plan.

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees. The majority of the Company’s employees may become eligible for these benefits if they reach normal retirement age while employed by the Company. Funding of retiree health care benefits occurs as claims or premiums are paid.

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 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.

Edgar Filing: KROGER CO - Form 10-K

Amounts recognized in AOCI as of February 2, 2019 and February 3, 2018 consists of the following (pre-tax):

	Pension Benefits		Other Benefits		Total	
	2018	2017	2018	2017	2018	2017
Net actuarial loss (gain)	\$ 837	\$ 1,040	\$ (130)	\$ (130)	\$ 707	\$ 910
Prior service credit	—	—	(66)	(77)	(66)	(77)
Total	\$ 837	\$ 1,040	\$ (196)	\$ (207)	\$ 641	\$ 833

Amounts in AOCI expected to be recognized as components of net periodic pension or postretirement benefit costs in the next fiscal year are as follows (pre-tax):

	Pension Benefits		Other Benefits		Total	
	2019	2019	2019	2019	2019	2019
Net actuarial loss (gain)	\$ 53	\$ (10)	\$ 43			
Prior service credit	—	(11)	(11)			
Total	\$ 53	\$ (21)	\$ 32			

Other changes recognized in other comprehensive income (loss) in 2018, 2017 and 2016 were as follows (pre-tax):

	Pension Benefits			Other Benefits			Total		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
Incurred net actuarial loss (gain)	\$ (126)	\$ 322	\$ 165	\$ (10)	\$ (20)	\$ (9)	\$ (136)	\$ 302	\$ 156
Amortization of prior service credit	—	—	—	11	8	8	11	8	8
Amortization of net actuarial gain (loss)	(77)	(88)	(71)	10	11	10	(67)	(77)	(61)
Settlement recognition of net actuarial loss	—	(502)	—	—	—	—	—	(502)	—
Other	(203)	(268)	94	11	(29)	9	(192)	(297)	103

Total
 recognized in
 other
 comprehensive
 income (loss)

Total
 recognized in
 net periodic
 benefit cost and
 other
 comprehensive
 income (loss)

\$ (127)	\$ 323	\$ 188	\$ 5	\$ (30)	\$ 10	\$ (122)	\$ 293	\$ 198
----------	--------	--------	------	---------	-------	----------	--------	--------

70

Information with respect to change in benefit obligation, change in plan assets, the funded status of the plans recorded in the Consolidated Balance Sheets, net amounts recognized at the end of fiscal years, weighted average assumptions and components of net periodic benefit cost follow:

	Pension Benefits					
	Qualified Plans		Non-Qualified Plans		Other Benefits	
	2018	2017	2018	2017	2018	2017
Change in benefit obligation:						
Benefit obligation at beginning of fiscal year	\$ 3,235	\$ 4,140	\$ 328	\$ 316	\$ 202	\$ 243
Service cost	35	53	2	2	7	8
Interest cost	124	163	12	13	8	9
Plan participants' contributions	—	—	—	—	13	12
Actuarial (gain) loss	(134)	126	(13)	15	(9)	(20)
Plan curtailments	(92)	—	(6)	—	—	—
Plan settlements	—	(1,040)	—	—	—	—
Benefits paid	(174)	(202)	(24)	(21)	(21)	(23)
Other	—	(5)	(1)	3	—	(27)
Benefit obligation at end of fiscal year	\$ 2,994	\$ 3,235	\$ 298	\$ 328	\$ 200	\$ 202
Change in plan assets:						
Fair value of plan assets at beginning of fiscal year	\$ 2,943	\$ 3,138	\$ —	\$ —	\$ —	\$ —
Actual return on plan assets	46	210	—	—	—	—
Employer contributions	185	1,000	25	21	8	11
Plan participants' contributions	—	—	—	—	13	12
Plan settlements	—	(1,198)	—	—	—	—
Benefits paid	(174)	(202)	(24)	(21)	(21)	(23)
Other	10	(5)	(1)	—	—	—
Fair value of plan assets at end of fiscal year	\$ 3,010	\$ 2,943	\$ —	\$ —	\$ —	\$ —
Funded status and net asset and liability recognized at end of fiscal year	\$ 16	\$ (292)	\$ (298)	\$ (328)	\$ (200)	\$ (202)

As of February 2, 2019, other assets and other current liabilities include \$47 and \$35, respectively, of the net asset and liability recognized for the above benefit plans. As of February 3, 2018, other current liabilities include \$30 of net liability recognized for the above benefit plans.

In 2018, the Company contributed \$185, \$117 net of tax, to the company-sponsored pension plan. This contribution was designated to the 2017 tax year in order to deduct the contributions at the previous year tax rate. The Company

announced changes to certain non-union company-sponsored pension plans. The Company will freeze the compensation and service periods used to calculate pension benefits for active employees who participate in the affected pension plans as of December 31, 2019. Beginning January 1, 2020, the affected active employees will no longer accrue additional benefits for future service and eligible compensation received under these plans. The financial effects of these changes are not material to the financial statements for the year ended February 2, 2019.

In 2017, the Company settled certain company-sponsored pension plan obligations using existing assets of the plan and a \$1,000 contribution made to the plan in the third quarter of 2017. The Company recognized a settlement charge of approximately \$502, \$335 net of tax, associated with the settlement of the Company's obligations for the eligible participants' pension balances that were distributed out of the plan via a transfer to other qualified retirement plan options, a lump sum payout, or the purchase of an annuity contract, based on each participant's election.

As of February 2, 2019 and February 3, 2018, pension plan assets do not include common shares of The Kroger Co.

	Pension Benefits			Other Benefits		
	2018	2017	2016	2018	2017	2016
Weighted average assumptions						
Discount rate — Benefit obligation	4.23 %	4.00 %	4.25 %	4.19 %	3.93 %	4.18 %
Discount rate — Net periodic benefit cost	4.00 %	4.25 %	4.62 %	3.93 %	4.18 %	4.44 %
Expected long-term rate of return on plan assets	5.90 %	7.50 %	7.40 %			
Rate of compensation increase — Net periodic benefit cost	3.03 %	3.07 %	2.71 %			
Rate of compensation increase — Benefit obligation	3.04 %	3.03 %	3.07 %			

The Company's discount rate assumptions were intended to reflect the rates at which the pension benefits could be effectively settled. They take into account the timing and amount of benefits that would be available under the plans. The Company's policy is to match the plan's cash flows to that of a hypothetical bond portfolio whose cash flow from coupons and maturities match the plan's projected benefit cash flows. The discount rates are the single rates that produce the same present value of cash flows. The selection of the 4.23% and 4.19% discount rates as of year-end 2018 for pension and other benefits, respectively, represents the hypothetical bond portfolio using bonds with an AA or better rating constructed with the assistance of an outside consultant. A 100 basis point increase in the discount rate would decrease the projected pension benefit obligation as of February 2, 2019, by approximately \$362.

The Company's 2018 assumed pension plan investment return rate was 5.90% compared to 7.50% in 2017 and 7.40% in 2016. The value of all investments in the company-sponsored defined benefit pension plans during the calendar year ended December 31, 2018, net of investment management fees and expenses, decreased 2.4% and for fiscal year 2018 investments increased 1.9%. Historically, the Company's pension plans' average rate of return was 8.1% for the 10 calendar years ended December 31, 2018, net of all investment management fees and expenses. For the past 20 years, the Company's pension plans' average annual rate of return has been 6.10%. At the beginning of 2018, to determine the expected rate of return on pension plan assets held by the Company for 2018, the Company considered current and forecasted plan asset allocations as well as historical and forecasted rates of return on various asset categories.

The Company calculates its expected return on plan assets by using the market-related value of plan assets. The market-related value of plan assets is determined by adjusting the actual fair value of plan assets for gains or losses on plan assets. Gains or losses represent the difference between actual and expected returns on plan investments for each plan year. Gains or losses on plan assets are recognized evenly over a five-year period. Using a different method to calculate the market-related value of plan assets would provide a different expected return on plan assets.

On February 2, 2019, the Company adopted an updated assumption for generational mortality improvement, based on additional years of published mortality experience.

The funded status increased in 2018, compared to 2017, due to the \$185 contribution made in 2018 to the qualified plans, the increase in discount rate from 2017 to 2018 and the announced plan freeze to certain non-union company-sponsored pension plans as of December 31, 2019.

72

The following table provides the components of the Company's net periodic benefit costs for 2018, 2017 and 2016:

Components of net periodic benefit cost:	Pension Benefits Qualified Plans			Non-Qualified Plans			Other Benefits		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
Service cost	\$ 35	\$ 53	\$ 68	\$ 2	\$ 2	\$ 2	\$ 7	\$ 8	\$ 9
Interest cost	124	163	177	12	13	14	8	9	10
Expected return on plan assets	(174)	(233)	(238)	—	—	—	—	—	—
Amortization of:									
Prior service credit	—	—	—	—	—	—	(11)	(8)	(8)
Actuarial (gain) loss	69	79	60	8	9	8	(10)	(11)	(10)
Settlement loss recognized	—	502	—	—	—	—	—	—	—
Other	—	—	3	—	3	—	—	1	—
Net periodic benefit cost	\$ 54	\$ 564	\$ 70	\$ 22	\$ 27	\$ 24	\$ (6)	\$ (1)	\$ 1

The following table provides the projected benefit obligation (“PBO”), accumulated benefit obligation (“ABO”) and the fair value of plan assets for those company-sponsored pension plans with accumulated benefit obligations in excess of plan assets.

3	Qualified Plans		Non-Qualified Plans	
	2018	2017	2018	2017
PBO at end of fiscal year	\$ 295	\$ 3,051	\$ 298	\$ 328
ABO at end of fiscal year	\$ 293	\$ 2,916	\$ 291	\$ 313
Fair value of plan assets at end of year	\$ 263	\$ 2,755	\$ —	\$ —

The following table provides information about the Company's estimated future benefit payments.

	Pension Benefits	Other Benefits
2019	\$ 193	\$ 13

Edgar Filing: KROGER CO - Form 10-K

2020	\$ 199	\$ 14
2021	\$ 204	\$ 15
2022	\$ 212	\$ 15
2023	\$ 205	\$ 16
2024 —2028	\$ 1,074	\$ 82

The following table provides information about the target and actual pension plan asset allocations as of February 2, 2019.

Pension plan asset allocation	Target allocations		Actual Allocations			
	2018		2018	2017		
Global equity securities	2.0	%	4.2	%	2.2	%
Emerging market equity securities	1.0		2.3		1.7	
Investment grade debt securities	80.0		73.2		53.3	
High yield debt securities	4.0		3.5		3.7	
Private equity	10.0		9.5		9.6	
Hedge funds	—		4.5		17.4	
Real estate	3.0		2.8		3.2	
Other	—		—		8.9	
Total	100.0	%	100.0	%	100.0	%

Investment objectives, policies and strategies are set by the Pension Investment Committee (the “Committee”). The primary objectives include holding and investing the assets and distributing benefits to participants and beneficiaries of the pension plans. Investment objectives have been established based on a comprehensive review of the capital markets and each underlying plan’s current and projected financial requirements. The time horizon of the investment objectives is long-term in nature and plan assets are managed on a going-concern basis.

Investment objectives and guidelines specifically applicable to each manager of assets are established and reviewed annually. Derivative instruments may be used for specified purposes, including rebalancing exposures to certain asset classes. Any use of derivative instruments for a purpose or in a manner not specifically authorized is prohibited, unless approved in advance by the Committee.

The target allocations shown for 2018 were established in 2018 in conjunction with the continuation of the Company’s transition to a LDI strategy, which began in 2017. A LDI strategy focuses on maintaining a close to fully-funded status over the long-term with minimal funded status risk. This is achieved by investing more of the plan assets in fixed income instruments to more closely match the duration of the plan liability. This LDI strategy will be phased in over time as the Company is able to transition out of illiquid investments. During this transition, the Company’s target allocation will change by increasing the Company’s fixed income instruments. Cash flow from employer contributions and redemption of plan assets to fund participant benefit payments can be used to fund underweight asset classes and divest overweight asset classes, as appropriate. The Company expects that cash flow will be sufficient to meet most rebalancing needs.

In 2018, the Company contributed \$185, \$117 net of tax, to the company-sponsored defined benefit plans and the Company is not required to make any contributions to these plans in 2019. If the Company does make any contributions in 2019, the Company expects these contributions will decrease its required contributions in future years. Among other things, investment performance of plan assets, the interest rates required to be used to calculate the pension obligations, and future changes in legislation, will determine the amounts of any contributions. The Company expects 2019 expense for company-sponsored pension plans to be approximately \$41.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The Company used a 5.80% initial health care cost trend rate, which is assumed to decrease on a linear basis to a 4.50% ultimate health care cost trend rate in 2037, to determine its expense. A one-percentage-point change in the assumed health care cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Effect on total of service and interest cost components	\$ 2	\$ (2)
Effect on postretirement benefit obligation	\$ 19	\$ (17)

Edgar Filing: KROGER CO - Form 10-K

The following tables, set forth by level, within the fair value hierarchy, the Qualified Plans' assets at fair value as of February 2, 2019 and February 3, 2018:

Assets at Fair Value as of February 2, 2019

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets Measured at NAV	Total
Cash and cash equivalents	\$ 126	\$ —	\$ —	\$ —	\$ 126
Corporate Stocks	66	—	—	—	66
Corporate Bonds	—	896	—	—	896
U.S. Government Securities	—	240	—	—	240
Mutual Funds/Collective Trusts	257	—	—	805	1,062
Hedge Funds	—	—	49	85	134
Private Equity	—	—	—	285	285
Real Estate	—	—	67	19	86
Other	—	115	—	—	115
Total	\$ 449	\$ 1,251	\$ 116	\$ 1,194	\$ 3,010

Assets at Fair Value as of February 3, 2018

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets Measured at NAV	Total
Cash and cash equivalents	\$ 414	\$ —	\$ —	\$ —	\$ 414
Corporate Stocks	61	—	—	—	61
Corporate Bonds	—	900	—	—	900
U.S. Government Securities	—	222	—	—	222
Mutual Funds/Collective Trusts	1	—	—	—	1
Partnerships/Joint Ventures	—	—	—	271	271
Hedge Funds	—	—	56	545	601
Private Equity	—	—	—	278	278
Real Estate	—	—	68	22	90
Other	—	—	—	105	105
Total	\$ 476	\$ 1,122	\$ 124	\$ 1,221	\$ 2,943

The fair value of asset groupings changed significantly beginning in 2017 and continuing into 2018 due to the LDI transition that began in 2017 as described above.

For measurements using significant unobservable inputs (Level 3) during 2018 and 2017, a reconciliation of the beginning and ending balances is as follows:

	Hedge Funds	Real Estate
Ending balance, January 28, 2017	\$ 67	65
Contributions into Fund	13	11
Realized gains	1	3
Unrealized losses	5	8
Distributions	(30)	(19)
Ending balance, February 3, 2018	56	68
Contributions into Fund	—	9
Realized gains	1	12
Unrealized gains	4	(5)
Distributions	(16)	(15)
Other	4	(2)
Ending balance, February 2, 2019	\$ 49	\$ 67

See Note 8 for a discussion of the levels of the fair value hierarchy. The assets' fair value measurement level above is based on the lowest level of any input that is significant to the fair value measurement.

The following is a description of the valuation methods used for the Qualified Plans' assets measured at fair value in the above tables:

- Cash and cash equivalents: The carrying value approximates fair value.
- Corporate Stocks: The fair values of these securities are based on observable market quotations for identical assets and are valued at the closing price reported on the active market on which the individual securities are traded.
- Corporate Bonds: The fair values of these securities are primarily based on observable market quotations for similar bonds, valued at the closing price reported on the active market on which the individual securities are traded. When such quoted prices are not available, the bonds are valued using a discounted cash flow approach using current yields on similar instruments of issuers with similar credit ratings, including adjustments for certain risks that may not be observable, such as credit and liquidity risks.

- U.S. Government Securities: Certain U.S. Government securities are valued at the closing price reported in the active market in which the security is traded. Other U.S. government securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for similar securities, the security is valued under a discounted cash flow approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.
- Mutual Funds/Collective Trusts: The mutual funds/collective trust funds are public investment vehicles valued using a Net Asset Value (NAV) provided by the manager of each fund. The NAV is based on the underlying net assets owned by the fund, divided by the number of shares outstanding. The NAV's unit price is quoted on a private market that is not active. However, the NAV is based on the fair value of the underlying securities within the fund, which are traded on an active market, and valued at the closing price reported on the active market on which those individual securities are traded.
- Partnerships/Joint Ventures: These funds consist primarily of U.S. government securities, Corporate Bonds, Corporate Stocks, and derivatives, which are valued in a manner consistent with these types of investments, noted above.
- Hedge Funds: Hedge funds are private investment vehicles valued using a Net Asset Value (NAV) provided by the manager of each fund. The NAV is based on the underlying net assets owned by the fund, divided by the number of shares outstanding. The NAV's unit price is quoted on a private market that is not active. The NAV is based on the fair value of the underlying securities within the funds, which may be traded on an active market, and valued at the closing price reported on the active market on which those individual securities are traded. For investments not traded on an active market, or for which a quoted price is not publicly available, a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches, are employed by the fund manager to value investments. Fair values of all investments are adjusted annually, if necessary, based on audits of the Hedge Fund financial statements; such adjustments are reflected in the fair value of the plan's assets.
- Private Equity: Private Equity investments are valued based on the fair value of the underlying securities within the fund, which include investments both traded on an active market and not traded on an active market. For those investments that are traded on an active market, the values are based on the closing price reported on the active market on which those individual securities are traded. For investments not traded on an active market, or for which a quoted price is not publicly available, a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches, are employed by the fund manager to value investments. Fair values of all investments are adjusted annually, if necessary, based on audits of the private equity fund financial statements; such adjustments are reflected in the fair value of the plan's assets.
- Real Estate: Real estate investments include investments in real estate funds managed by a fund manager. These investments are valued using a variety of unobservable valuation methodologies, including discounted cash flow, market multiple and cost valuation approaches.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and

consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement.

The Company contributed and expensed \$263, \$219 and \$215 to employee 401(k) retirement savings accounts in 2018, 2017 and 2016, respectively. The 401(k) retirement savings account plans provide to eligible employees both matching contributions and automatic contributions from the Company based on participant contributions, compensation as defined by the plan and length of service.

16. MULTI-EMPLOYER PENSION PLANS

The Company contributes 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.

The Company recognizes expense in connection with these plans as contributions are funded or when commitments are probable and reasonably estimable, in accordance with GAAP. The Company made cash contributions to these plans of \$358 in 2018, \$954 in 2017 and \$289 in 2016. The increase in 2017, compared to 2018 and 2016, is primarily due to the \$467 pre-tax payment to satisfy withdrawal obligations of certain local unions of the Central States Pension Fund and the 2017 United Food and Commercial Workers (“UFCW”) Contribution.

The Company continues to evaluate and address potential exposure to under-funded multi-employer pension plans as it relates to the Company’s associates who are beneficiaries of these plans. These under-fundings are not a liability of the Company. When an opportunity arises that is economically feasible and beneficial to the Company and its associates, the Company 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 the Company’s debt profile as it relates to its credit rating since these off balance sheet commitments are typically considered in the Company’s investment grade debt rating.

The Company is currently designated as the named fiduciary of the UFCW Consolidated Pension Plan and the International Brotherhood of Teamsters (“IBT”) Consolidated Pension Fund and has sole investment authority over these assets. The Company 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 certain local unions of the Company to withdraw from the Central States Pension Fund. Significant effects of these restructuring agreements recorded in our Consolidated Financial Statements are:

- In 2018, the Company incurred a \$155 charge, \$121 net of tax, for obligations related to withdrawal liabilities for certain local unions of the Central States multi-employer pension plan fund.
- In 2017, the Company incurred a \$550 charge, \$360 net of tax, for obligations related to withdrawals from and settlements of withdrawal liabilities for certain multi-employer pension plan funds, of which \$467 was contributed to the Central States Pension Plan in 2017.

- In 2017, the Company contributed \$111, \$71 net of tax, to the UFCW Consolidated Pension Plan.

- In 2016, the Company incurred a charge of \$111, \$71 net of tax, due to commitments and withdrawal liabilities arising from the restructuring of certain multi-employer pension plan obligations, of which \$28 was contributed to the UFCW Consolidated Pension Plan in 2016.

The risks of participating in multi-employer pension plans are different from the risks of participating in single-employer pension plans in the following respects:

- a. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.

- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan allocable to such withdrawing employer may be borne by the remaining participating employers.

- c. If the Company stops participating in some of its multi-employer pension plans, the Company may be required to pay those plans an amount based on its allocable share of the unfunded vested benefits of the plan, referred to as a withdrawal liability.

The Company's participation in multi-employer plans is outlined in the following tables. The EIN / Pension Plan Number column provides the Employer Identification Number ("EIN") and the three-digit pension plan number. The most recent Pension Protection Act Zone Status available in 2018 and 2017 is for the plan's year-end at December 31, 2017 and December 31, 2016, respectively. Among other factors, generally, plans in the red zone are less than 65 percent funded, plans in the yellow zone are less than 80 percent funded and plans in the green zone are at least 80 percent funded. The FIP/RP Status Pending / Implemented Column indicates plans for which a funding improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented. Unless otherwise noted, the information for these tables was obtained from the Forms 5500 filed for each plan's year-end at December 31, 2017 and December 31, 2016. The multi-employer contributions listed in the table below are the Company's multi-employer contributions made in fiscal years 2018, 2017 and 2016.

The following table contains information about the Company's multi-employer pension plans:

	EIN / Pension Plan Number	Pension Protection Act Zone Status		FIP/RP Status Pending/ Implemented	Multi-Employer Contributions			Surcharge Imposed (5)
		2018	2017		2018	2017	2016	
Pension Fund SO CA UFCW Unions & Food Employers Joint Pension Trust Fund(1) (2) Desert States Employers & UFCW Unions Pension Plan(1) Sound Retirement Trust (formerly Retail Clerks Pension Plan)(1) (3) Rocky Mountain UFCW Unions and Employers Pension Plan(1) Oregon Retail Employees Pension Plan(1) Bakery and Confectionary	95-1939092 - 001	Yellow	Yellow	Implemented	\$ 71	\$ 66	\$ 60	No
	84-6277982 - 001	Green	Green	No	19	18	18	No
	91-6069306 - 001	Green	Green	Implemented	23	20	18	No
	84-6045986 - 001	Green	Green	No	20	19	16	No
	93-6074377 - 001	Green	Green	No	9	9	8	No
	52-6118572 - 001	Red	Red	Implemented	11	11	10	No

Union & Industry International Pension Fund(1) Retail Food Employers & UFCW Local 711 Pension(1) Denver Area Meat Cutters and Employers Pension Plan (9) United Food & Commercial Workers Intl Union — Industry Pension Fund(1)(4) Western Conference of Teamsters Pension Plan Central States, Southeast & Southwest Areas Pension Plan (7) UFCW Consolidated Pension Plan(1) IBT Consolidated Pension Plan(1) (6) (7) Other (8) Total Contributions	51-6031512 - 001	Yellow	Yellow	Implemented	10	10	9	No
	84-6097461 - 001	Green	Green	No	—	—	3	No
	51-6055922 - 001	Green	Green	No	32	33	37	No
	91-6145047 - 001	Green	Green	No	34	34	33	No
	36-6044243 - 001	Red	Red	Implemented	18	492	23	No
	58-6101602 - 001	Green	Green	No	55	201	34	No
	82-2153627 - 001	N/A	N/A	No	37 19	— 41	— 20	No
					\$ 358	\$ 954	\$ 289	

- (1) The Company's multi-employer contributions to these respective funds represent more than 5% of the total contributions received by the pension funds.
- (2) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at March 31, 2018 and March 31, 2017.
- (3) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at September 30, 2017 and September 30, 2016.
- (4) The information for this fund was obtained from the Form 5500 filed for the plan's year-end at June 30, 2017 and June 30, 2016.
- (5) Under the Pension Protection Act, a surcharge may be imposed when employers make contributions under a collective bargaining agreement that is not in compliance with a rehabilitation plan. As of February 2, 2019, the

collective bargaining agreements under which the Company was making contributions were in compliance with rehabilitation plans adopted by the applicable pension fund.

- (6) The information for this fund was obtained from the Form 5500 filed for the plan's first year beginning February 20, 2017 and year-end December 31, 2017.
- (7) In 2017, the Company ratified a new contract with the IBT that provided certain local unions to withdraw from this pension fund and form the IBT consolidated pension fund.
- (8) The increase in 2017, compared to 2018 and 2016, in the "Other" funds is due primarily to withdrawal settlement payments for certain multi-employer funds in 2017.
- (9) As of June 30, 2016, the Denver Area Meat Cutters and Employers Pension Plan merged with the Rocky Mountain UFCW Unions and Employers Pension Plan. The final Form 5500 for this plan was for the period of January 1, 2016 through June 30, 2016 (the date of the Merger). Prior to the merger, the Company's multi-employer contributions to this fund represented more than 5% of the total contributions received by the pension fund.

The following table describes (a) the expiration date of the Company's collective bargaining agreements and (b) the expiration date of the Company's most significant collective bargaining agreements for each of the material multi-employer funds in which the Company participates.

Pension Fund	Expiration Date of Collective Bargaining Agreements	Most Significant Collective Bargaining Agreements(1) (not in millions) Count	Expiration
SO CA UFCW Unions & Food Employers Joint Pension Trust Fund	March 2019 to June 2020	2	March 2019 to June 2020
UFCW Consolidated Pension Plan	January 2019 (2) to August 2022	8	February 2019 to August 2021
Desert States Employers & UFCW Unions Pension Plan	October 2020 to February 2022	1	October 2020 to May 2019 to August 2019
Sound Retirement Trust (formerly Retail Clerks Pension Plan)	April 2019 to April 2020	3	January 2019 (2) to August 2018 (2)
Rocky Mountain UFCW Unions and Employers Pension Plan	January 2019 (2) to February 2019	1	to June 2019
Oregon Retail Employees Pension Plan	August 2018 (2) to April 2022	3	August 2019 to June 2021
Bakery and Confectionary Union & Industry International Pension Fund	July 2018 (2) to July 2022	4	March 2019
Retail Food Employers & UFCW Local 711 Pension	June 2017 (2) to April 2020	1	January 2019 (2)
Denver Area Meat Cutters and Employers Pension Plan	January 2019 (2) to February 2019	1	April 2019 to March 2021
United Food & Commercial Workers Intl Union — Industry Pension Fund	February 2019 to August 2022	2	April 2019 to July 2021
Western Conference of Teamsters Pension Plan	April 2019 to July 2021	5	September 2019 to
International Brotherhood of Teamsters Consolidated Pension Fund	September 2019 to September 2022	3	2019 to

-
- (1) This column represents the number of significant collective bargaining agreements and their expiration date for each of the Company's pension funds listed above. For purposes of this table, the "significant collective bargaining agreements" are the largest based on covered employees that, when aggregated, cover the majority of the employees for which we make multi-employer contributions for the referenced pension fund.
 - (2) Certain collective bargaining agreements for each of these pension funds are operating under an extension.

Based on the most recent information available to it, the Company believes the present value of actuarial accrued liabilities in most of these multi-employer plans substantially exceeds the value of the assets held in trust to pay benefits. Moreover, if the Company were to exit certain markets or otherwise cease making contributions to these funds, the Company 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.

The Company also contributes to various other multi-employer benefit plans that provide health and welfare benefits to active and retired participants. Total contributions made by the Company to these other multi-employer health and welfare plans were approximately \$1,282 in 2018, \$1,247 in 2017 and \$1,143 in 2016.

17. HELD FOR SALE AND DISPOSAL OF BUSINESS

During the second quarter of 2018, the Company announced that as a result of a review of its assets, the Company has decided to explore strategic alternatives for its Turkey Hill Dairy business, including a potential sale. Additionally during the fourth quarter of 2018, the Company announced that it had entered into a definitive agreement to sell its You Technology business.

The following table presents information related to the major classes of assets and liabilities of all business that were classified as assets and liabilities held for sale in the Consolidated Balance Sheet as of February 2, 2019 and February 3, 2018:

(In millions)	February 2, 2019	February 3, 2018
Assets held for sale:		
Cash and temporary cash investments	\$ 1	\$ 1
Store deposits in transit	-	15
Receivables	64	49
FIFO inventory	21	95
LIFO reserve	(1)	(36)
Prepaid and other current assets	3	13
Property, plant and equipment, net	77	441
Intangibles, net	-	11
Goodwill	1	14
Other assets	-	1
Total assets held for sale	\$ 166	\$ 604
Liabilities held for sale:		
Trade accounts payable	\$ 26	\$ 119
Accrued salaries and wages	8	14
Other current liabilities	17	85
Other long-term liabilities	-	41
Total liabilities held for sale	\$ 51	\$ 259

Subsequent to February 2, 2019, the Company completed the sale of its You Technology business unit and announced a definitive agreement for its Turkey Hill Dairy business unit. The businesses classified as held for sale will not be reported as discontinued operations as the dispositions do not represent a strategic shift that will have a major effect on the Company's operations and financial results.

As of February 3, 2018, certain assets and liabilities, primarily those related to the Company's convenience store business, were classified as held for sale in the Consolidated Balance Sheet. On April 20, 2018, the Company completed the sale of its convenience store business unit for \$2,169. The Company recognized a net gain on this sale for \$1,782, \$1,360 net of tax, in 2018.

18. VOLUNTARY RETIREMENT OFFERING

In 2016, the Company announced a Voluntary Retirement Offering (“VRO”) for certain non-store associates. Approximately 1,300 associates irrevocably accepted the VRO in the first quarter of 2017. Due to the employee acceptances, the Company recognized a VRO charge of \$184, \$117 net of tax, in the first quarter of 2017, which was comprised of \$165 for severance and other benefits, as well as \$19 of other non-cash charges. This charge was recorded in the OG&A caption within the Consolidated Statements of Operations for 2017. The Company paid \$162 of the severance and other benefits in 2017.

19. RECENTLY ADOPTED ACCOUNTING STANDARDS

During the fourth quarter of 2017, the Company 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. The Company performed its annual evaluation of goodwill in accordance with this standard, which resulted in a goodwill impairment charge in 2017 of \$110, \$74 net of tax, related to the Kroger Specialty Pharmacy reporting unit.

On February 4, 2018, the Company 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. The Company adopted the standard using a modified retrospective approach with the adoption primarily involving the evaluation of whether the Company acts as principal or agent in certain vendor arrangements where the purchase and sale of inventory are virtually simultaneous. The Company 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 the Company's 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. The Company 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 the Company's operating profit subtotal as reported in the Company's Consolidated Statements of Operations, but remain included in net earnings before income tax expense. Due to the adoption, the Company reclassified \$527 for 2017 and \$16 for 2016, of non-service company-sponsored pension plan costs from operating profit to other income (expense) on its 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 the Company's 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). The Company adopted this ASU on February 4, 2018. As a result of the adoption, the Company recorded a mark to market gain on Ocado securities, for those securities the Company owned as of the end of 2018, within the Consolidated Statements

of Operations as opposed to a component of Other Comprehensive Income on the Company's Consolidated Statements of Comprehensive Income.

81

20.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 the Company in the first quarter of its fiscal year ending February 1, 2020. The Company will apply the transition package of practical expedients permitted within the standard, which allows the Company to carryforward its 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. The Company estimates adoption of the standard will result in right of use assets and lease liabilities of approximately \$6,700 as of February 3, 2019. When combined with the Company’s existing capital leases, the Company’s total lease assets and liabilities will be approximately \$7,400 and \$7,600, respectively, as of February 3, 2019. The Company does not expect adoption to have a material impact on the Company’s consolidated net earnings or cash flows.

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, the Company 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. The Company is currently evaluating the effect of this standard on the Company’s Consolidated Financial Statements.

21. QUARTERLY DATA (UNAUDITED)

The two tables that follow reflect the unaudited results of operations for 2018 and 2017.

	Quarter First (16 Weeks)	Second (12 Weeks)	Third (12 Weeks)	Fourth (12 Weeks)	Total Year (52 Weeks)
2018					
Sales	\$ 37,530	\$ 27,869	\$ 27,672	\$ 28,091	\$ 121,162
Operating Expenses					
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	29,362	21,930	21,699	21,902	94,894
Operating, general and administrative	6,122	4,612	4,556	5,013	20,305
Rent	276	204	200	204	884
Depreciation and amortization	741	574	570	581	2,465
Operating profit	1,029	549	647	391	2,614
Other income (expense)					
Interest expense	(192)	(144)	(142)	(142)	(620)
Non-service component of company sponsored pension plan costs	(10)	(4)	(6)	(7)	(26)
Mark to market gain (loss) on Ocado securities	36	216	(100)	75	228
Gain on sale of business	1,771	11	—	—	1,782
Net earnings before income tax expense	2,634	628	399	317	3,978
Income tax expense	616	127	91	66	900
Net earnings including noncontrolling interests	2,018	501	308	251	3,078
Net loss attributable to noncontrolling interests	(8)	(7)	(9)	(8)	(32)
	\$ 2,026	\$ 508	\$ 317	\$ 259	\$ 3,110

Net earnings attributable to
The Kroger Co.

Net earnings attributable to
The Kroger Co. per basic
common share

\$ 2.39	\$ 0.63	\$ 0.39	\$ 0.32	\$ 3.80
---------	---------	---------	---------	---------

Average number of shares
used in basic calculation

839	797	797	798	810
-----	-----	-----	-----	-----

Net earnings attributable to
The Kroger Co. per diluted
common share

\$ 2.37	\$ 0.62	\$ 0.39	\$ 0.32	\$ 3.76
---------	---------	---------	---------	---------

Average number of shares
used in diluted calculation

846	805	807	806	818
-----	-----	-----	-----	-----

Dividends declared per
common share

\$ 0.125	\$ 0.140	\$ 0.140	\$ 0.140	\$ 0.545
----------	----------	----------	----------	----------

Annual amounts may not sum due to rounding.

Net earnings for the first quarter of 2018 include a reduction to OG&A expenses of \$13, \$10 net of tax, for adjustments to obligations related to certain local unions withdrawing from the Central States multi-employer pension fund, a reduction to depreciation and amortization expenses of \$14, \$11 net of tax, related to held for sale assets, gains in other income (expense) of \$1,771, \$1,352 net of tax, related to the sale of the convenience store business unit and \$36, \$27 net of tax, for the mark to market gain on Ocado securities.

Net earnings for the second quarter of 2018 include gains in other income (expense) of \$11, \$8 net of tax, related to the sale of the convenience store business unit and \$216, \$164 net of tax, for the mark to market gain on Ocado securities.

Net earnings for the third quarter of 2018 include a loss in other income (expense) of \$100, \$77 net of tax, for the mark to market loss on Ocado securities.

Net earnings for the fourth quarter of 2018 include charges to OG&A expenses of \$168, \$131 net of tax, for obligations related to certain local unions withdrawing from the Central States multi-employer pension fund, \$33, \$26 net of tax, for the revaluation of contingent consideration and \$42, \$33 net of tax, for an impairment of financial instrument, a gain in other income (expense) of \$75, \$59 net of tax, for the mark to market gain on Ocado securities.

	Quarter				
	First (16 Weeks)	Second (12 Weeks)	Third (12 Weeks)	Fourth (13 Weeks)	Total Year (53 Weeks)
2017					
Sales	\$ 36,285	\$ 27,597	\$ 27,749	\$ 31,031	\$ 122,662
Operating Expenses					
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	28,281	21,609	21,532	24,240	95,662
Operating, general and administrative	6,367	4,517	4,701	5,456	21,041
Rent	270	225	196	220	911
Depreciation and amortization	736	562	573	565	2,436
Operating profit	631	684	747	550	2,612
Other income (expense)					
Interest expense	(177)	(138)	(136)	(148)	(601)
Non-service component of company sponsored pension plan costs	(9)	(6)	(7)	(506)	(527)
Net earnings (loss) before income tax (benefit) expense	445	540	604	(104)	1,484
Income tax expense (benefit)	148	189	215	(957)	(405)
Net earnings including noncontrolling interests	297	351	389	853	1,889
Net loss attributable to noncontrolling interests	(6)	(2)	(8)	(1)	(18)

Edgar Filing: KROGER CO - Form 10-K

Net earnings attributable to The Kroger Co.	\$ 303	\$ 353	\$ 397	\$ 854	\$ 1,907
Net earnings attributable to The Kroger Co. per basic common share	\$ 0.33	\$ 0.39	\$ 0.44	\$ 0.97	\$ 2.11
Average number of shares used in basic calculation	914	897	887	875	895
Net earnings attributable to The Kroger Co. per diluted common share	\$ 0.32	\$ 0.39	\$ 0.44	\$ 0.96	\$ 2.09
Average number of shares used in diluted calculation	925	905	893	884	904
Dividends declared per common share	\$ 0.120	\$ 0.125	\$ 0.125	\$ 0.125	\$ 0.495

Annual amounts may not sum due to rounding.

Net earnings for the first quarter of 2017 include \$199, \$126 net of tax, related to the withdrawal liability for certain multi-employer pension funds and \$184, \$117 net of tax, related to the voluntary retirement offering.

Net earnings for the fourth quarter of 2017 include charges to OG&A expenses of \$351, \$234 net of tax, related to obligations from withdrawing from and settlements of withdrawal liabilities for certain multi-employer pension funds, \$110, \$74 net of tax, related to the Kroger Specialty Pharmacy goodwill impairment and \$502, \$335 net of tax, related to a company-sponsored pension plan termination.

Net earnings for the fourth quarter of 2017 include a reduction to depreciation and amortization expenses of \$19, \$13 net of tax, related to held for sale assets, a reduction to income tax expense of \$922 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. In addition, net earnings include \$119, \$79 net of tax, due to a 53rd week in fiscal year 2017.

22.SUBSEQUENT EVENTS

On March 13, 2019, the Company completed the sale of its You Technology business to Inmar for total consideration of \$565, including \$400 received upon closing. The transaction includes a long-term service agreement for Inmar to provide the Company digital coupon services. The sale resulted in a gain and will be included in “Gain on sale of business” in the Consolidated Statements of Operations in the first quarter of 2019.

On March 22, 2019, the Company announced a definitive agreement for the sale of its Turkey Hill Dairy business to an affiliate of Peak Rock Capital, subject to customary closing conditions and any regulatory reviews. The transaction will result in a gain and it is expected to close in the first quarter of 2019.

ITEM 9.CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A.CONTROLS AND PROCEDURES.

As of February 2, 2019, our Chief Executive Officer and Chief Financial Officer, together with a disclosure review committee appointed by the Chief Executive Officer, evaluated the Company's disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of February 2, 2019.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There was no change in our internal control over financial reporting during the fiscal quarter ended February 2, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. With the participation of the Chief Executive Officer and the Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in Internal Control — Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, management has concluded that the Company's internal control over financial reporting was effective as of February 2, 2019.

The effectiveness of the Company's internal control over financial reporting as of February 2, 2019, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which can be found in Item 8 of this Form 10-K.

ITEM 9B.OTHER INFORMATION.

As previously disclosed, Mr. Christopher Hjelm is retiring from the Company, effective August 1, 2019. On April 1, 2019, the Company and Mr. Hjelm entered into agreements under the terms of which he will receive the following, subject to the conditions contained in the agreement: (i) twelve months salary continuation at the base salary in effect at the time of the separation of his employment, (ii) restricted Kroger stock and stock options previously granted that are scheduled to become vested in 2020 or 2021 will continue to vest on the vesting schedule set forth in the award agreements for 2020 and 2021 only, (iii) a lump sum payment equal to the cost of twelve months of COBRA medical and/or dental plan(s) continuation coverage, less applicable withholdings, (iv) pro-rated annual bonus for 2019, and (v) pro-rated long term incentive payments for previously awarded long-term incentives under outstanding plans.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information required by this Item not otherwise set forth below is set forth under the headings Election of Directors, Information Concerning the Board of Directors — Committees of the Board, Information Concerning the Board of Directors — Audit Committee, Information Concerning the Board of Directors — Code of Ethics and Section 16(a) Beneficial Ownership Reporting Compliance in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission before within 120 days after the end of the fiscal year 2018 (the “2019 proxy statement”) and is hereby incorporated by reference into this Form 10-K.

EXECUTIVE OFFICERS OF THE COMPANY

The following is a list of the names and ages of the executive officers and the positions held by each such person. Except as otherwise noted, each person has held office for at least five years. Each officer will hold office at the discretion of the Board for the ensuing year until removed or replaced.

Name	Age	Recent Employment History
Mary E. Adcock	43	Ms. Adcock was elected Group Vice President of Retail Operations, effective June 2016. Prior to that, she served as Vice President of Operations for Kroger’s Columbus Division from November 2015 to May 2016 and as Vice President of Merchandising for the Columbus Division from March 2014 to November 2015. From February 2012 to March 2014, Ms. Adcock served as Vice President of Natural Foods Merchandising and from October 2009 to February 2012, she served as Vice President of Deli/Bakery Manufacturing. Prior to that, Ms. Adcock held several leadership positions in the manufacturing department, including human resources manager, general manager and division operations manager. Ms. Adcock joined Kroger in 1999 as human resources assistant manager at the Country Oven Bakery in Bowling Green, Kentucky.
Jessica C. Adelman	43	Ms. Adelman joined Kroger in November 2015 as Group Vice President of Corporate Affairs. Prior to joining Kroger, she served as senior vice president of corporate affairs for Syngenta North America, a leading agriculture company, since 2008. Prior to that, Ms. Adelman held several strategic leadership roles with other companies, including director of Cargill Government Solutions. Ms. Adelman has 20 years of experience as a public affairs executive in the food industry.

Stuart W.
Aitken

Mr. Aitken was elected Senior Vice President in February 2019 and served as Group Vice President from June 2015 to February 2019. He is responsible for leading Kroger's alternative profit businesses, including Kroger's data analytics subsidiary, 84.51° LLC and Kroger Personal Finance. Prior to joining Kroger, he served as the chief executive officer of dunnhumby USA, LLC from July 2010 to June 2015. Mr. Aitken has over 15 years of marketing, academic and technical experience across a variety of industries, and held various leadership roles with other companies, including Michaels Stores and Safeway, Inc.

- Robert W. Clark 53 Mr. Clark was elected Senior Vice President of Merchandising in March 2016 and is also responsible for manufacturing and supply chain. From March 2013 to March 2016, he served as Group Vice President of Non-Perishables. Prior to that, he served as Vice President of Merchandising for Kroger's Fred Meyer division from October 2011 to March 2013. From August 2010 to October 2011 he served as Vice President of Operations for Kroger's Columbus division. Prior to that, from May 2002 to August 2010, he served as Vice President of Merchandising for Kroger's Fry's division. From 1985 to 2002, Mr. Clark held various leadership positions in store and district management, as well as grocery merchandising. Mr. Clark began his career with Kroger in 1985 as a courtesy clerk at Fry's.
- Yael Cosset 45 Mr. Cosset was elected Group Vice President and Chief Digital Officer in January 2017 and is responsible for leading Kroger's digital strategy, focused on building Kroger's presence in the marketplace in digital channels, personalization and e-commerce. Before that, he served as Chief Commercial Officer and Chief Information Officer of 84.51° LLC from April 2015 to December 2016. Prior to joining Kroger, Mr. Cosset served in several leadership roles at dunnhumby USA, LLC from 2009 to 2015, including Executive Vice President of Consumer Markets and Global Chief Information Officer.
- Michael J. Donnelly 60 Mr. Donnelly was elected Executive Vice President and Chief Operating Officer in December 2017. Prior to that, he was Executive Vice President of Merchandising from September 2015 to December 2017, and Senior Vice President of Merchandising from July 2011 to September 2015. Before that, Mr. Donnelly held a variety of key management positions with Kroger, including President of Ralphs Grocery Company, President of Fry's Food Stores, and Senior Vice President, Drug/GM Merchandising and Procurement. Mr. Donnelly joined Kroger in 1978 as a clerk.
- Carin L. Fike 50 Ms. Fike was elected Vice President and Treasurer effective April 2017. Prior to that, she served as Assistant Treasurer from March 2011 to April 2017. Before that, Ms. Fike served as Director of Investor Relations from December 2003 to March 2011. Ms. Fike began her career with Kroger in 1999 as a manager in the Financial Reporting department after working with PricewaterhouseCoopers from 1995 to 1999, where most recently she was an audit manager.
- Todd A. Foley 49 Mr. Foley was elected Vice President and Corporate Controller effective April 2017. Before that, he served as Vice President and Treasurer from June 2013 to April 2017. Prior to that, Mr. Foley served as Assistant Corporate Controller from March 2006 to June 2013, and Controller of Kroger's Cincinnati/Dayton division from October 2003 to March 2006. Mr. Foley began his career with Kroger in 2001 as an audit manager in the Internal Audit Department after working for PricewaterhouseCoopers from 1991 to 2001, where most recently he was a senior audit manager.

- Christopher T. Hjelm 57 Mr. Hjelm was elected Executive Vice President and Chief Information Officer in September 2015. Prior to that, he served as Senior Vice President and Chief Information Officer from August 2005 to September 2015. From February 2005 to July 2005, he was Chief Information Officer of Travel Distribution Services for Cendant Corporation. From July 2003 to November 2004, Mr. Hjelm served as Chief Technology Officer for Orbitz LLC, which was acquired by Cendant Corporation in November 2004. Mr. Hjelm served as Senior Vice President for Technology at eBay Inc. from March 2002 to June 2003, and served as Executive Vice President for Broadband Network Services for Excite@Home from June 2001 to February 2002. From January 2000 to June 2001, Mr. Hjelm served as Chairman, President and Chief Executive Officer of ZOHO Corporation. Prior to that, he held various key roles for 14 years with Federal Express Corporation, including that of Senior Vice President and Chief Information Officer.
- Calvin J. Kaufman 56 Mr. Kaufman was elected Senior Vice President in June 2017, and is responsible for the oversight of several Kroger retail divisions. From July 2013 to June 2017, he served as President of the Louisville division. Prior to that, he served as President of Kroger Manufacturing and Our Brands from June 2008 to June 2013, and Group Vice President of Fred Meyer Logistics from September 2005 to May 2008. Mr. Kaufman held various positions in Logistics after joining Kroger in the Fred Meyer division in September 1994.
- Timothy A. Massa 52 Mr. Massa was elected Senior Vice President of Human Resources and Labor Relations in June 2018. Prior to that, he served as Group Vice President of Human Resources and Labor Relations from June 2014 to June 2018. Mr. Massa joined Kroger in October 2010 as Vice President, Corporate Human Resources and Talent Development. Prior to joining Kroger, he served in various Human Resources leadership roles for 21 years at Procter & Gamble, most recently serving as Global Human Resources Director of Customer Business Development.
- Stephen M. McKinney 62 Mr. McKinney was elected Senior Vice President in March 2018, and is responsible for the oversight of several Kroger retail divisions. From October 2013 to March 2018, he served as President of Kroger's Fry's Food Stores division. Prior to that, he served as Vice President of Operations for the Ralphs division from October 2007 to September 2013, and Vice President of Operations for the Southwest division from October 2006 to September 2007. From 1988 to 1998, Mr. McKinney served in various leadership positions in the Fry's Food Stores division, including store manager, deli director, and executive director of operations. From 1981 to 1998, Mr. McKinney held several roles with Florida Choice Supermarkets, a former Kroger banner, including store manager, buyer, and field representative. He started his career with Kroger in 1981 as a clerk with Florida Choice.

- W. Rodney McMullen 58 Mr. McMullen was elected Chairman of the Board effective January 1, 2015, and Chief Executive Officer effective January 1, 2014. Prior to that, he served as President and Chief Operating Officer from August 2009 to December 2013. Prior to that he was elected Vice Chairman in June 2003, Executive Vice President, Strategy, Planning and Finance in January 2000, Executive Vice President and Chief Financial Officer in May 1999, Senior Vice President in October 1997, and Group Vice President and Chief Financial Officer in June 1995. Before that he was appointed Vice President, Control and Financial Services in March 1993, and Vice President, Planning and Capital Management in December 1989. Mr. McMullen joined Kroger in 1978 as a part-time stock clerk.
- J. Michael Schlotman 61 Mr. Schlotman was elected Executive Vice President and Chief Financial Officer in September 2015. Before that, he was elected Senior Vice President and Chief Financial Officer in June 2003, and Group Vice President and Chief Financial Officer in January 2000. Prior to that he was elected Vice President and Corporate Controller in 1995, and served in various positions in corporate accounting since joining Kroger in 1985.
- Erin S. Sharp 61 Ms. Sharp has served as Group Vice President of Manufacturing since June 2013. She joined Kroger in 2011 as Vice President of Operations for Kroger's Manufacturing division. Before joining Kroger, Ms. Sharp served as Vice President of Manufacturing for the Sara Lee Corporation. In that role, she led the manufacturing and logistics operations for the central region of their U.S. Fresh Bakery Division. Ms. Sharp has over 30 years of experience supporting food manufacturing operations.
- Alessandro Tosolini 52 Mr. Tosolini was elected Senior Vice President of New Business Development in December 2014. Before joining Kroger, he held numerous leadership positions with Procter & Gamble for 24 years, in the U.S. and internationally, most recently serving as senior vice president of Global e Business and vice president of Global eCommerce.
- Mark C. Tuffin 59 Mr. Tuffin has served as Senior Vice President since January 2014, and is responsible for the oversight of several of Kroger's retail divisions. Prior to that, he served as President of Kroger's Smith's division from July 2011 to January 2014. From September 2009 to July 2011, Mr. Tuffin served as Vice President of Transition, where he was responsible for implementing an organizational restructuring initiative for Kroger's retail divisions. He joined Kroger's Smith's division in 1996 and served in a series of leadership roles, including Vice President of Merchandising from September 1999 to September 2009. Mr. Tuffin held various positions with other supermarket retailers before joining Smith's in 1996.
- Christine S. Wheatley 48 Ms. Wheatley was elected Group Vice President, Secretary and General Counsel in May 2014. She joined Kroger in February 2008 as Corporate Counsel, and became Senior Attorney in 2010, Senior Counsel in 2011, and Vice President in 2012. Before joining Kroger, Ms. Wheatley was engaged in the private practice of law for 11 years, most recently as a partner at Porter Wright Morris & Arthur in Cincinnati.

ITEM 11.EXECUTIVE COMPENSATION.

The information required by this Item is set forth in the sections entitled Compensation Discussion and Analysis, Compensation Committee Report, and Compensation Tables in the 2019 proxy statement and is hereby incorporated by reference into this Form 10-K.

ITEM 12.SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The following table provides information regarding shares outstanding and available for issuance under our existing equity compensation plans.

Equity Compensation Plan Information

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)	(b) Weighted-average exercise price of outstanding options, warrants and rights (1)	(c) Number of securities remaining for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	36,526,924	\$ 23.42	28,386,544
Equity compensation plans not approved by security holders	—	\$ —	—
Total	36,526,924	\$ 23.42	28,386,544

(1) The total number of securities reported includes the maximum number of common shares, 2,378,494, that may be issued under performance units granted under our long-term incentive plans. The nature of the awards is more particularly described in the Compensation Discussion and Analysis section of the definitive 2019 proxy statement and is hereby incorporated by reference into this Form 10-K. The weighted-average exercise price in column (b) does not take these performance unit awards into account. Based on historical data, or in the case of the awards made in 2016 through 2018 and earned in 2018 the actual payout percentage, our best estimate of the number of common shares that will be issued under the performance unit grants is approximately 2,379,302.

The remainder of the information required by this Item is set forth in the section entitled Beneficial Ownership of Common Stock in the 2019 proxy statement and is hereby incorporated by reference into this Form 10-K.

ITEM 13.CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

This information required by this Item is set forth in the sections entitled Related Person Transactions and Information Concerning the Board of Directors-Independence in the 2019 proxy statement and is hereby incorporated by reference into this Form 10-K.

ITEM 14.PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information required by this Item is set forth in the section entitled Ratification of the Appointment of Kroger's Independent Auditor in the 2019 proxy statement and is hereby incorporated by reference into this Form 10-K.

PART IV

ITEM 15.EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

- (a)1. Financial Statements:
Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of February 2, 2019 and February 3, 2018
Consolidated Statements of Operations for the years ended February 2, 2019, February 3, 2018 and January 28, 2017
Consolidated Statements of Comprehensive Income for the years ended February 2, 2019, February 3, 2018 and January 28, 2017

Consolidated Statements of Cash Flows for the years ended February 2, 2019, February 3, 2018 and January 28, 2017
Consolidated Statement of Changes in Shareholders' Equity for the years ended February 2, 2019, February 3, 2018 and January 28, 2017
Notes to Consolidated Financial Statements
- (a)2. Financial Statement Schedules:
There are no Financial Statement Schedules included with this filing for the reason that they are not applicable or are not required or the information is included in the financial statements or notes thereto.
- (a)3.(b) Exhibits
- 3.1 Amended Articles of Incorporation are hereby incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 22, 2010, as amended by the Amendment to Amended Articles of Incorporation, which is hereby incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 23, 2015.
- 3.2 The Company's Regulations are hereby incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed with the SEC on June 29, 2018.
- 4.1 Instruments defining the rights of holders of long-term debt of the Company and its subsidiaries are not filed as Exhibits because the amount of debt under each instrument is less than 10% of the consolidated assets of the Company. The Company undertakes to file these instruments with the SEC upon request.
- 10.1* The Kroger Co. Deferred Compensation Plan for Independent Directors. Incorporated by reference to Exhibit 10.2 of the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2016.
- 10.2* The Kroger Co. Executive Deferred Compensation Plan. Incorporated by reference to Exhibit 10.4 of the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2005.
- 10.3* The Kroger Co. 401(k) Retirement Savings Account Restoration Plan. Incorporated by reference to Exhibit 10.4 of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2007.

- 10.4* The Kroger Co. Supplemental Retirement Plans for Certain Retirement Benefit Plan Participants. Incorporated by reference to Exhibit 10.6 of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2007.
- 10.5* The Kroger Co. Employee Protection Plan dated January 13, 2017. Incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2017.
- 10.6 Amended and Restated Credit Agreement dated August 29, 2017, among The Kroger Co., the initial lenders named therein, and Bank of America, N.A. and Wells Fargo Bank National Association, as co-administrative agents, Citibank, N.A., as syndication agent, and Mizuho Bank, Ltd. and U.S. Bank National Association, as co-documentation agents, incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on August 29, 2017.
- 10.7* The Kroger Co. 2008 Long-Term Incentive and Cash Bonus Plan. Incorporated by reference to Exhibit 4.2 of the Company's Form S-8 filed with the SEC on June 26, 2008.

- 10.8* The Kroger Co. 2011 Long-Term Incentive and Cash Bonus Plan. Incorporated by reference to Exhibit 4.2 of the Company's Form S-8 filed with the SEC on June 23, 2011.
- 10.9* The Kroger Co. 2014 Long-Term Incentive and Cash Bonus Plan. Incorporated by reference to Exhibit 4.2 of the Company's Form S-8 filed with the SEC on July 29, 2014.
- 10.10* Form of Restricted Stock Grant Agreement under Long-Term Incentive and Cash Bonus Plans. Incorporated by reference to Exhibit 10.9 of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2007.
- 10.11* Form of Non-Qualified Stock Option Grant Agreement under Long-Term Incentive and Cash Bonus Plans. Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 24, 2008.
- 10.12* Form of Performance Unit Award Agreement under Long-Term Incentive and Cash Bonus Plans. Incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q for the quarter ended August 12, 2017.
- 10.13* Form of Performance Unit Award Under Long-Term Incentive Plans. Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended August 18, 2018.
- 10.14* The Kroger Co. 2015 Long-Term Cash Bonus Plan. Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 23, 2015.
- 10.15* The Kroger Co. 2016 Long-Term Cash Bonus Plan. Incorporated by reference to Exhibit 10.18 of the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2016.
- 10.16* The Kroger Co. 2017 Long-Term Cash Bonus Plan. Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 20, 2017.
- 10.17 Retirement Agreement between the Company and Christopher T. Hjelm, dated as of April 1, 2019.
- 10.18 Amendment to Stock Option Agreements and Restricted Stock Agreements between the Company and Christopher T. Hjelm, dated as of April 1, 2019.
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 24.1 Powers of Attorney.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification.
- 32.1 Section 1350 Certifications.
- 101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema Document.
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB XBRL Taxonomy Extension Label Linkbase Document.
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

*Management contract or compensatory plan or arrangement.

93

ITEM 16.FORM 10-K SUMMARY

Not Applicable.

94

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE KROGER CO.

Dated: April 2, 2019 /s/ W. Rodney McMullen
W. Rodney McMullen
Chairman of the Board and Chief Executive Officer
(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities indicated on the 2nd April 2019.

/s/ J. Michael Schlotman J. Michael Schlotman	Executive Vice President and Chief Financial Officer (principal financial officer)
/s/ Todd A. Foley Todd A Foley	Vice President & Corporate Controller (principal accounting officer)
* Nora A. Aufreiter	Director
* Robert D. Beyer	Director
* Anne Gates	Director
* Susan J. Kropf	Chairman of the Board and Chief Executive Officer
* W. Rodney McMullen	Director
* Jorge P. Montoya	Director
* Clyde R. Moore	Director
* James A. Runde	Director

Ronald L. Sargent

*

Director

Bobby S. Shackouls

*

Director

Mark S. Sutton

*

Director

Ashok Vemuri

* By: /s/ Christine S. Wheatley

Christine S. Wheatley

Attorney-in-fact