

KROGER CO  
Form 10-Q  
September 23, 2009

## **UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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## FORM 10-Q

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

**For the quarterly period ended August 15, 2009**

**OR**

**o**

**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**

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## THE KROGER CO.

(Exact name of registrant as specified in its charter)

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**Ohio**

(State or other jurisdiction of  
incorporation or organization)

**31-0345740**

(I.R.S. Employer  
Identification No.)

**1014 Vine Street, Cincinnati, OH 45202**

(Address of principal executive offices)

(Zip Code)

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(513) 762-4000

(Registrant's telephone number, including area code)

Unchanged

(Former name, former address and former fiscal year, if changed since last report)

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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 the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒.

There were 650,820,180 shares of Common Stock (\$1 par value) outstanding as of September 18, 2009.

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****THE KROGER CO.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in millions, except per share amounts)

(unaudited)

	Second Quarter Ended		Two Quarters Ended	
	August 15, 2009	August 16, 2008	August 15, 2009	August 16, 2008
Sales	\$ 17,735	\$ 18,094	\$ 40,534	\$ 41,238
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	13,650	14,066	30,917	31,911
Operating, general and administrative	3,088	3,004	7,123	6,894
Rent	150	151	350	358
Depreciation and amortization	348	327	801	760
Operating profit	499	546	1,343	1,315
Interest expense	115	111	278	263
Earnings before income tax expense	384	435	1,065	1,052
Income tax expense	133	159	383	386
Net earnings including noncontrolling interests	251	276	682	666
Net earnings (loss) attributable to noncontrolling interests	(4)	(1)	(8)	3
Net earnings attributable to The Kroger Co.	\$ 255	\$ 277	\$ 690	\$ 663
Net earnings attributable to The Kroger Co. per basic common share	\$ 0.39	\$ 0.42	\$ 1.06	\$ 1.01
Average number of common shares used in basic calculation	648	651	648	655
Net earnings attributable to The Kroger Co. per diluted common share	\$ 0.39	\$ 0.42	\$ 1.05	\$ 1.00
Average number of common shares used in diluted calculation	651	658	651	661
Dividends declared per common share	\$ .09	\$ .09	\$ .18	\$ .18

The accompanying notes are an integral part of the Consolidated Financial Statements.



## THE KROGER CO.

## CONSOLIDATED BALANCE SHEETS

(in millions, except per share amounts)

(unaudited)

	August 15, 2009	January 31, 2009
<b>ASSETS</b>		
Current assets		
Cash and temporary cash investments	\$ 369	\$ 263
Deposits in-transit	628	631
Receivables	774	944
FIFO inventory	5,473	5,659
LIFO credit	(838)	(800)
Prefunded employee benefits		300
Prepaid and other current assets	300	209
Total current assets	6,706	7,206
Property, plant and equipment, net	13,606	13,161
Goodwill	2,271	2,271
Other assets	562	573
Total Assets	\$ 23,145	\$ 23,211
<b>LIABILITIES</b>		
Current liabilities		
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 582	\$ 558
Trade accounts payable	3,857	3,822
Accrued salaries and wages	792	828
Deferred income taxes	344	344
Other current liabilities	2,132	2,077
Total current liabilities	7,707	7,629
Long-term debt including obligations under capital leases and financing obligations		
Face-value long-term debt including obligations under capital leases and financing obligations	6,913	7,460
Adjustment to reflect fair-value interest rate hedges	44	45
Long-term debt including obligations under capital leases and financing obligations	6,957	7,505
Deferred income taxes	475	384
Pension and postretirement benefit obligations	978	1,174
Other long-term liabilities	1,231	1,248
Total Liabilities	17,348	17,940
Commitments and contingencies (see Note 11)		
<b>SHAREOWNERS EQUITY</b>		
Preferred stock, \$100 par per share, 5 shares authorized and unissued		
Common stock, \$1 par per share, 1,000 shares authorized; 955 shares issued in 2009 and 955 shares issued in 2008	955	955
Additional paid-in capital	3,298	3,266

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Accumulated other comprehensive loss	(496)	(495)
Accumulated earnings	8,060	7,489
Common stock in treasury, at cost, 309 shares in 2009 and 306 shares in 2008	(6,096)	(6,039)
Total Shareowners' Equity - The Kroger Co.	5,721	5,176
Noncontrolling interests	76	95
Total Equity	5,797	5,271
Total Liabilities and Equity	\$ 23,145	\$ 23,211

The accompanying notes are an integral part of the Consolidated Financial Statements.



## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions and unaudited)

	Two Quarters Ended	
	August 15, 2009	August 16, 2008
Cash Flows from Operating Activities:		
Net earnings including noncontrolling interests	\$ 682	\$ 666
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	801	760
LIFO charge	38	86
Stock-based employee compensation	45	48
Expense for Company-sponsored pension plans	19	16
Deferred income taxes	90	106
Other	27	17
Changes in operating assets and liabilities net of effects from acquisitions of businesses:		
Deposits in-transit	3	14
Receivables	39	16
Inventories	186	40
Prepaid expenses	209	283
Trade accounts payable	151	33
Accrued expenses	(78)	(16)
Income taxes receivable and payable	186	50
Contribution to Company-sponsored pension plans	(200)	
Other	(32)	7
Net cash provided by operating activities	2,166	2,126
Cash Flows from Investing Activities:		
Payments for capital expenditures	(1,210)	(1,053)
Proceeds from sale of assets	6	49
Payments for acquisitions	(13)	(80)
Other	(5)	
Net cash used by investing activities	(1,222)	(1,084)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	3	775
Dividends paid	(117)	(109)
Payments on long-term debt	(413)	(987)
Payments on credit facility	(129)	(288)
Excess tax benefits on stock-based awards	1	9
Proceeds from issuance of capital stock	8	157
Treasury stock purchases	(80)	(539)
Decrease in book overdrafts	(116)	(92)
Other	5	(5)
Net cash used by financing activities	(838)	(1,079)
Net increase (decrease) in cash and temporary cash investments	106	(37)
Cash from Consolidated Variable Interest Entity		65

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## Cash and temporary cash investments:

Beginning of year		263		242
End of quarter	\$	369	\$	270

## Reconciliation of capital expenditures:

Payments for capital expenditures	\$	(1,210)	\$	(1,053)
Changes in construction-in-progress payables		(45)		(62)
Total capital expenditures	\$	(1,255)	\$	(1,115)

## Disclosure of cash flow information:

Cash paid during the year for interest	\$	303	\$	294
Cash paid during the year for income taxes	\$	115	\$	283

The accompanying notes are an integral part of the Consolidated Financial Statements.

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

(in millions, except per share amounts)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive Gain (Loss)	Accumulated Earnings	Noncontrolling Interest	Total
Balances at February 2, 2008	947	\$ 947	\$ 3,031	284	\$ (5,422)	\$ (122)	\$ 6,480	\$ 7	\$ 4,921
Issuance of common stock:									
Stock options exercised	7	7	146		2				155
Restricted stock issued			(42)	(1)	27				(15)
Treasury stock activity:									
Treasury stock purchases, at cost				15	(400)				(400)
Stock options exchanged				5	(139)				(139)
Tax benefits from exercise of stock options			32						32
Share-based employee compensation			48						48
Other comprehensive gain net of income tax of \$5						6			6
Purchase of non-wholly owned entity								97	97
Other			12		(12)			(7)	(7)
Cash dividends declared (\$0.18 per common share)							(119)		(119)
Net earnings including noncontrolling interests							663	3	666
Balances at August 16, 2008	954	\$ 954	\$ 3,227	303	\$ (5,944)	\$ (116)	\$ 7,024	\$ 100	\$ 5,245
Balances at January 31, 2009	955	\$ 955	\$ 3,266	306	\$ (6,039)	\$ (495)	\$ 7,489	\$ 95	\$ 5,271
Issuance of common stock:									
Stock options exercised			7						7
Restricted stock issued			(55)	(1)	39				(16)
Treasury stock activity:									
Treasury stock purchases, at cost				3	(68)				(68)
Stock options exchanged				1	(12)				(12)
Tax benefits from exercise of stock options			17						17

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Share-based employee compensation						45						45				
Other comprehensive gain net of income tax of (\$1)							(1)					(1)				
Other						18	(16)				(11)	(9)				
Cash dividends declared (\$0.18 per common share)										(119)		(119)				
Net earnings including noncontrolling interests										690	(8)	682				
Balances at August 15, 2009	955	\$	955	\$	3,298	309	\$	(6,096)	\$	(496)	\$	8,060	\$	76	\$	5,797

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.

Certain prior-year amounts have been reclassified to conform to current-year presentation.

**1. ACCOUNTING POLICIES**

*Basis of Presentation and Principles of Consolidation*



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The accompanying financial statements include the consolidated accounts of The Kroger Co., its wholly-owned subsidiaries, and the Variable Interest Entities ( VIE ) in which the Company is the primary beneficiary. The January 31, 2009 balance sheet was derived from audited financial statements, adjusted for the adoption of Statement of Financial Accounting Standards ( SFAS ) No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51* (SFAS 160) and, due to its summary nature, does not include all disclosures required by generally accepted accounting principles ( GAAP ). Significant intercompany transactions and balances have been eliminated. References to the Company in these Consolidated Financial Statements mean the consolidated company.

In the opinion of management, the accompanying unaudited Consolidated Financial Statements include all normal, recurring adjustments that are necessary for a fair presentation of results of operations for such periods but should not be considered as indicative of results for a full year. The financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted, pursuant to SEC regulations. Accordingly, the accompanying Consolidated Financial Statements should be read in conjunction with the 2008 Annual Report on Form 10-K of The Kroger Co. for the fiscal year ended January 31, 2009.

The unaudited information in the Consolidated Financial Statements for the second quarter and two quarters ended August 15, 2009 and August 16, 2008 includes the results of operations of the Company for the 28-week periods then ended.

In the first quarter of 2009, the Company adopted SFAS No. 160, and applied it retrospectively. As a result, the Company reclassified noncontrolling interests in amounts of \$95 from the mezzanine section to equity in the January 31, 2009 Consolidated Balance Sheet. Certain reclassifications to the Consolidated Statement of Operations have been made to prior period amounts to conform to the presentation of the current period under SFAS 160. Recorded amounts for prior periods previously presented as Net Earnings, which are now presented as Net Earnings Attributable to The Kroger Co., have not changed as a result of the adoption of SFAS 160.

### *Impairment of Long-Lived Assets*

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company monitors the carrying value of long-lived assets for potential impairment each quarter based on whether certain trigger 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 trigger 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 determined in accordance with SFAS No. 157, *Fair Value Measurements* (SFAS 157), and 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 sale, 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 \$4 in the second quarter of 2009 and \$2 in the second quarter of 2008. During the first two quarters of 2009 and 2008, the Company recorded asset impairments in the normal course of business totaling \$15 and \$17, 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 expense.

*Store Closing and Other Expense Allowances*





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All closed store liabilities related to exit or disposal activities initiated after December 31, 2002, are accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The Company provides for closed store liabilities relating to the present value of the estimated remaining noncancelable 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, or that no longer is needed for its originally intended purpose, 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 Merchandise costs. Costs to transfer inventory and equipment from closed stores are expensed as incurred.

The following table summarizes accrual activity for future lease obligations of stores that were closed in the normal course of business and locations closed in California prior to the Fred Meyer merger in 1999.

	<b>Future Lease Obligations</b>	
	<b>August 15, 2009</b>	<b>August 16, 2008</b>
Balance at beginning of year	\$ 65	\$ 74
Additions	1	2
Payments	(6)	(7)
Adjustments	(1)	5
Balance at end of second quarter	\$ 59	\$ 74

## 2. STOCK OPTION PLANS

The Company recognized total stock-based compensation of \$20 and \$23 in the second quarter ended August 15, 2009 and August 16, 2008, respectively. The Company recorded \$45 and \$48 of stock-based compensation for the first two quarters ended August 15, 2009 and August 16, 2008, respectively. These costs were recognized as operating, general and administrative costs in the Company's Consolidated Statements of Operations.

The Company grants options for common stock ( stock options ) to employees, as well as to its non-employee directors, under various plans at an option price equal to the fair market value of the stock at the date of grant. In addition to stock options, the Company awards restricted stock to employees and its non-employee directors under various plans. Equity awards may be made once each quarter on a predetermined date. It has been the Company's practice to make a general annual grant to employees, which occurred in the second quarter of 2009. Special grants may be made in the other three quarters. It has been the Company's practice to make a grant to non-employee directors in December of each year.

Stock options granted in the first two quarters of 2009 expire 10 years from the date of grant and vest from one year to five years from the date of grant. Restricted stock awards granted in the first two quarters of 2009 have restrictions that lapse in one year to five years from the date of the awards. All grants and awards become immediately exercisable, in the case of options, and restrictions lapse, in the case of restricted stock, upon certain changes of control of the Company.



Changes in equity awards outstanding under the plans are summarized below.

*Stock Options*

	Shares subject to option		Weighted-average exercise price
Outstanding, January 31, 2009	39.7	\$	21.58
Granted	3.5	\$	22.34
Exercised	(.5)	\$	16.54
Canceled or Expired	(5.1)	\$	27.17
Outstanding, August 15, 2009	37.6	\$	20.94

*Restricted Stock*

	Restricted shares outstanding		Weighted-average grant-date fair value
Outstanding, January 31, 2009	4.1	\$	27.22
Granted	2.4	\$	22.33
Lapsed	(2.0)	\$	27.52
Canceled or Expired	(0.1)	\$	26.59
Outstanding, August 15, 2009	4.4	\$	24.39

The weighted-average fair value of stock options granted during the first two quarters ended August 15, 2009 and August 16, 2008, was \$6.30 and \$8.67, 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 extensive accounting judgment and financial estimates, including the term employees are expected to retain their stock options before exercising them, the volatility of the Company's stock 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 following table reflects the weighted average assumptions used for grants awarded to option holders:

	2009	2008
Risk-free interest rate	3.17%	3.64%
Expected dividend yield	1.80%	1.50%
Expected volatility	28.05%	27.89%
Expected term	6.8 Years	6.8 Years

**3. DEBT OBLIGATIONS**

Long-term debt consists of:

	August 15, 2009	January 31, 2009
Commercial Paper and Money Market Borrowings	\$	\$ 129
4.95% to 9.20% Senior Notes and Debentures due through 2038	6,824	7,186
5.00% to 9.95% Mortgages due in varying amounts through 2034	94	119
Other	156	163
Total debt, excluding capital leases and financing obligations	7,074	7,597
Less current portion	(552)	(528)
Total long-term debt, excluding capital leases and financing obligations	\$ 6,522	\$ 7,069

On June 1, 2009, the Company repaid \$350 of senior notes bearing an interest rate of 7.25%. In the first quarter of 2010, \$500 of senior notes bearing an interest rate of 8.05% will mature.

**4. COMPREHENSIVE INCOME**

Comprehensive income is as follows:

	Second Quarter Ended		Year-To-Date	
	August 15, 2009	August 16, 2008	August 15, 2009	August 16, 2008
Net earnings including noncontrolling interests	\$ 251	\$ 276	\$ 682	\$ 666
Unrealized gain on hedging activities, net of tax(1)				3
Amortization of unrealized gains and losses on hedging activities, net of tax(2)		1	1	1
Amortization of amounts included in net periodic pension expense(3)	(2)	1	(2)	2
Other		(1)		
Comprehensive income	249	277	681	672
Comprehensive income (loss) attributable to noncontrolling interests	(4)	(1)	(8)	3
Comprehensive income attributable to The Kroger Co.	\$ 253	\$ 278	\$ 689	\$ 669

(1) Amount is net of tax of \$2 for the first two quarters of 2008.

(2) Amount is net of tax of \$1 for the second quarter of 2008 and \$1 for the first two quarters of 2008.

(3)

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Amount is net of tax of \$(1) for the second quarter of 2009 and \$1 for the second quarter of 2008. Amount is net of tax of \$(1) for the first two quarters of 2009 and \$2 for the first two quarters of 2008.

During 2009 and 2008, unrealized gains and losses on hedging activities included in comprehensive income consisted of reclassifications of unrealized gains and losses on cash flow hedges into net earnings.

## 5. BENEFIT PLANS

The following table provides the components of net periodic benefit costs for the Company-sponsored pension plans and other post-retirement benefit plans for the second quarter of 2009 and 2008.

	Second Quarter			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Components of net periodic benefit cost:				
Service cost	\$ 8	\$ 9	\$ 2	\$ 2
Interest cost	40	36	5	5
Expected return on plan assets	(40)	(41)		
Amortization of:				
Prior service cost		1	(1)	(1)
Actuarial loss	1	2	(1)	
Net periodic benefit cost	\$ 9	\$ 7	\$ 5	\$ 6

The following table provides the components of net periodic benefit costs for the Company-sponsored pension plans and other post-retirement benefit plans for the first two quarters of 2009 and 2008.

	Year-To-Date			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Components of net periodic benefit cost:				
Service cost	\$ 16	\$ 21	\$ 5	\$ 5
Interest cost	94	84	10	11
Expected return on plan assets	(94)	(96)		
Amortization of:				
Prior service cost	1	2	(3)	(3)
Actuarial loss	2	5	(2)	
Net periodic benefit cost	\$ 19	\$ 16	\$ 10	\$ 13

The Company contributed \$200 to Company-sponsored pension plans in the first two quarters of 2009.

The Company contributed \$62 and \$51 to employee 401(k) retirement savings accounts in the first two quarters of 2009 and 2008, respectively.

The Company also contributes to various multi-employer pension plans based on obligations arising from most of its collective bargaining agreements. These plans provide retirement benefits to participants based on their service to contributing employers. The Company recognizes expense in connection with these plans as contributions are funded, in accordance with SFAS No. 87, *Employers' Accounting for Pensions*.



**6. INCOME TAXES**

The effective income tax rate was 36.0% and 36.7% for the first two quarters of 2009 and 2008, respectively. The 2009 and 2008 effective income tax rate differed from the federal statutory rate primarily due to the effect of state income taxes and the benefit from the favorable resolution of certain tax issues. There were no material changes in unrecognized tax benefits during the first two quarters of 2009.

**7. 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:

	Second Quarter Ended August 15, 2009			Second Quarter Ended August 16, 2008		
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Net earnings attributable to The Kroger Co. per basic common share	\$ 253	648	\$ 0.39	\$ 275	651	\$ 0.42
Dilutive effect of stock options		3			7	
Net earnings attributable to The Kroger Co. per diluted common share	\$ 253	651	\$ 0.39	\$ 275	658	\$ 0.42
	Year-To-Date August 15, 2009			Year-To-Date August 16, 2008		
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Net earnings attributable to The Kroger Co. per basic common share	\$ 685	648	\$ 1.06	\$ 659	655	\$ 1.01
Dilutive effect of stock options		3			6	
Net earnings attributable to The Kroger Co. per diluted common share	\$ 685	651	\$ 1.05	\$ 659	661	\$ 1.00

The Company had undistributed and distributed earnings to participating securities totaling \$2 in both the second quarter of 2009 and 2008, respectively. For the first two quarters of 2009 and 2008, the Company had undistributed and distributed earnings to participating securities totaling \$5 and \$4, respectively.

The Company had options outstanding for approximately 20 shares and 5 shares during the second quarter of 2009 and 2008, respectively, that were excluded from the computations of net earnings attributable to The Kroger Co. per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share. For the first two quarters of 2009 and 2008, the Company had options outstanding for approximately 21 and 12 shares, respectively, that were excluded from the computations of net earnings attributable to The Kroger Co. per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share.

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The share amounts above for the second quarter and first two quarters of 2008 differ from those previously reported due to the adoption of Financial Accounting Standards Board Staff Position ( FSP ) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities*. It clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities and included in the calculation of basic EPS. The Company adopted this FSP effective February 1, 2009.

## 8. RECENTLY ADOPTED ACCOUNTING STANDARDS

In December 2007, the FASB issued SFAS 160, which establishes accounting and reporting standards for a parent's noncontrolling interest in a subsidiary and the accounting for future ownership changes with respect to the subsidiary. This standard defines a noncontrolling interest, previously called a minority interest, as the portion of equity in a subsidiary that is not attributable, directly or indirectly, to a parent. SFAS 160 requires, among other things, that a noncontrolling interest be clearly identified, labeled and presented in the consolidated balance sheet as equity, but separate from the parent's equity; that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and that if a subsidiary is deconsolidated, the parent measure at fair value any noncontrolling equity investment that the parent retains in the former subsidiary and recognize a gain or loss in net income based on the fair value of the non-controlling equity investment. The Company adopted SFAS 160 effective February 1, 2009, and applied it retrospectively. As a result, the Company reclassified noncontrolling interests in amounts of \$95 from the mezzanine section to equity in the January 31, 2009 Consolidated Balance Sheet. Certain reclassifications to the Consolidated Statement of Operations have been made to prior period amounts to conform to the presentation of the current period under SFAS 160. Recorded amounts for prior periods previously presented as Net Earnings, which are now presented as Net Earnings Attributable to The Kroger Co., have not changed as a result of the adoption of SFAS 160.

Effective February 1, 2009, the Company adopted FSP No. FAS 157-2, *Effective Date of Statement No. 157* (FSP 157-2). FSP 157-2 deferred the effective date of SFAS No. 157, *Fair Value Measurements*, for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. See Note 13 to the Consolidated Financial Statements for further discussion of the adoption of FSP 157-2.

Effective February 1, 2009, the Company adopted SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R), which replaces SFAS No. 141. SFAS 141R further expands the definitions of a business and the fair value measurement and reporting in a business combination. All business combinations completed after February 1, 2009, will be accounted for under SFAS 141R. The Company did not complete any business combinations during the first two quarters of fiscal 2009.

Effective February 1, 2009, the Company adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosures on an entity's derivative and hedging activities. The new disclosures required by this standard are included in Note 12 to the Consolidated Financial Statements.

Effective February 1, 2009, the Company adopted FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities and included in the computation of EPS pursuant to the two-class method. See Note 7 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, the Company adopted SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. See Note 14 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, the Company adopted three new FASB Staff Positions (FSP) all of which impact the accounting and disclosure related to certain financial instruments. FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability*

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*Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about the fair value of financial instruments on an interim basis in addition to the annual disclosure requirements. The new disclosures required by this FSP are included in Note 13. The adoption of these FSP s did not have a material effect on the Company s Consolidated Financial Statements.

## 9. RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2008, the FASB issued FSP No. FAS 132(R)-1, *Employers' Disclosure about Postretirement Benefit Plan Assets* (FSP 132(R)-1). FSP 132(R)-1 provides additional guidance on employers' disclosures about the plan assets of defined benefit pension or other postretirement plans. FSP 132(R)-1 requires disclosures about how investment allocation decisions are made, the fair value of each major category of plan assets, valuation techniques used to develop fair value measurements of plan assets, the impact of measurements on changes in plan assets when using significant unobservable inputs and significant concentrations of risk in the plan assets. FSP 132(R)-1 becomes effective for fiscal years ending after December 15, 2009. The Company is currently evaluating the effect the adoption of FSP 132(R)-1 will have on its Consolidated Financial Statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. SFAS 167 will become effective for the Company's fiscal year beginning January 31, 2010. The Company is currently evaluating the effect the adoption of SFAS 167 will have on its Consolidated Financial Statements.

In July 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162* (SFAS 168), which is effective for interim and annual fiscal periods ending after September 15, 2009. This standard replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and the codification from this standard will supersede all then-existing non-SEC accounting and reporting standards to become the sole source of authoritative U.S. GAAP. The adoption of this standard will have no financial effect on the Company's Consolidated Financial Statements.

## 10. GUARANTOR SUBSIDIARIES

The Company's outstanding public debt (the "Guaranteed Notes") is jointly and severally, fully and unconditionally guaranteed by The Kroger Co. and certain of its subsidiaries (the "Guarantor Subsidiaries"). At August 15, 2009, a total of approximately \$6,824 of Guaranteed Notes were outstanding. The Guarantor Subsidiaries and non-guarantor subsidiaries are direct or indirect subsidiaries of The Kroger Co. Separate financial statements of The Kroger Co. and each of the Guarantor Subsidiaries are not presented because the guarantees are full and unconditional and the Guarantor Subsidiaries are jointly and severally liable. The Company believes that separate financial statements and other disclosures concerning the Guarantor Subsidiaries would not be material to investors.

The non-guaranteeing subsidiaries, including non-wholly owned entities, represent less than 3% on an individual and aggregate basis of consolidated assets, pre-tax earnings, cash flow, and equity. Therefore, the non-guarantor subsidiaries' information, including non-wholly owned entities, is not separately presented and recorded amounts are included within the Guarantor Subsidiaries totals in the tables below.

There are no current restrictions on the ability of the Guarantor Subsidiaries to make payments under the guarantees referred to above. The obligations of each guarantor under its guarantee are limited to the maximum amount permitted under Bankruptcy Law, the Uniform Fraudulent Conveyance Act, the Uniform Fraudulent Transfer Act, or any similar Federal or state law (e.g. laws requiring adequate capital to pay dividends) respecting fraudulent conveyance or fraudulent transfer.



The following tables present summarized financial information as of August 15, 2009 and January 31, 2009 and for the second quarter, and two quarters ended August 15, 2009 and August 16, 2008:

# Condensed Consolidating

## Balance Sheets

As of August 15, 2009

	The Kroger Co.	Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>				
Cash and temporary cash investments	\$ 24	\$ 345	\$	\$ 369
Deposits in-transit	66	562		628
Receivables	2,142	603	(1,971)	774
Net inventories	455	4,180		4,635
Prepaid and other current assets	86	214		300
<b>Total current assets</b>	<b>2,773</b>	<b>5,904</b>	<b>(1,971)</b>	<b>6,706</b>
Property, plant and equipment, net	1,799	11,807		13,606
Goodwill	5	2,266		2,271
Other assets	790	1,686	(1,914)	562
Investment in and advances to subsidiaries	10,653		(10,653)	
<b>Total assets</b>	<b>\$ 16,020</b>	<b>\$ 21,663</b>	<b>\$ (14,538)</b>	<b>\$ 23,145</b>
<b>Current liabilities</b>				
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 582	\$	\$	\$ 582
Trade accounts payable	357	3,500		3,857
Other current liabilities	952	6,201	(3,885)	3,268
<b>Total current liabilities</b>	<b>1,891</b>	<b>9,701</b>	<b>(3,885)</b>	<b>7,707</b>
Long-term debt including obligations under capital leases and financing obligations				
Face value long-term debt including obligations under capital leases and financing obligations	6,913			6,913
Adjustment to reflect fair-value interest rate hedges	44			44
Long-term debt including obligations under capital leases and financing obligations	6,957			6,957
Other long-term liabilities	1,375	1,309		2,684
<b>Total liabilities</b>	<b>10,223</b>	<b>11,010</b>	<b>(3,885)</b>	<b>17,348</b>
Shareowners Equity	5,797	10,653	(10,653)	5,797
<b>Total liabilities and shareowners equity</b>	<b>\$ 16,020</b>	<b>\$ 21,663</b>	<b>\$ (14,538)</b>	<b>\$ 23,145</b>





## Condensed Consolidating

## Balance Sheets

As of January 31, 2009

	The Kroger Co.	Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>				
Cash and temporary cash investments	\$ 27	\$ 236	\$	\$ 263
Deposits in-transit	71	560		631
Receivables	2,150	765	(1,971)	944
Net inventories	384	4,475		4,859
Prepaid and other current assets	366	143		509
Total current assets	2,998	6,179	(1,971)	7,206
Property, plant and equipment, net	1,747	11,414		13,161
Goodwill	5	2,266		2,271
Other assets	797	1,562	(1,786)	573
Investment in and advances to subsidiaries	10,393		(10,393)	
Total assets	\$ 15,940	\$ 21,421	\$ (14,150)	\$ 23,211
<b>Current liabilities</b>				
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 558	\$	\$	\$ 558
Trade accounts payable	386	3,436		3,822
Other current liabilities	879	6,127	(3,757)	3,249
Total current liabilities	1,823	9,563	(3,757)	7,629
<b>Long-term debt including obligations under capital leases and financing obligations</b>				
Face value long-term debt including obligations under capital leases and financing obligations	7,460			7,460
Adjustment to reflect fair-value interest rate hedges	45			45
Long-term debt including obligations under capital leases and financing obligations	7,505			7,505
Other long-term liabilities	1,341	1,465		2,806
Total liabilities	10,669	11,028	(3,757)	17,940
Shareowners Equity	5,271	10,393	(10,393)	5,271
Total liabilities and shareowners equity	\$ 15,940	\$ 21,421	\$ (14,150)	\$ 23,211

**Condensed Consolidating****Statements of Operations****For the Quarter Ended August 15, 2009**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Sales	\$ 2,234	\$ 15,827	\$ (326)	\$ 17,735
Merchandise costs, including advertising, warehousing and transportation	1,865	12,111	(326)	13,650
Operating, general and administrative	398	2,690		3,088
Rent	23	127		150
Depreciation and amortization	36	312		348
Operating profit (loss)	(88)	587		499
Interest expense	(110)	(5)		(115)
Equity in earnings of subsidiaries	564		(564)	
Earnings before income tax expense	366	582	(564)	384
Income tax expense	111	22		133
Net earnings including noncontrolling interests	255	560	(564)	251
Net loss attributable to noncontrolling interests		(4)		(4)
Net earnings attributable to The Kroger Co.	\$ 255	\$ 564	\$ (564)	\$ 255

**Condensed Consolidating****Statements of Operations****For the Quarter Ended August 16, 2008**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Sales	\$ 2,346	\$ 16,048	\$ (300)	\$ 18,094
Merchandise costs, including advertising, warehousing and transportation	1,967	12,399	(300)	14,066
Operating, general and administrative	427	2,577		3,004
Rent	31	120		151
Depreciation and amortization	34	293		327
Operating profit (loss)	(113)	659		546
Interest expense	(110)	(1)		(111)
Equity in earnings of subsidiaries	549		(549)	
Earnings before income tax expense	326	658	(549)	435
Income tax expense	49	110		159
Net earnings including noncontrolling interests	277	548	(549)	276

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Net loss attributable to noncontrolling interests				(1)			(1)		
Net earnings attributable to The Kroger Co.		\$	277	\$	549	\$	(549)	\$	277

**Condensed Consolidating****Statements of Operations****For the Two Quarters Ended August 15, 2009**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Sales	\$ 5,117	\$ 36,056	\$ (639)	\$ 40,534
Merchandise costs, including advertising, warehousing and transportation	4,190	27,366	(639)	30,917
Operating, general and administrative	911	6,212		7,123
Rent	62	288		350
Depreciation and amortization	91	710		801
Operating profit (loss)	(137)	1,480		1,343
Interest expense	(272)	(6)		(278)
Equity in earnings of subsidiaries	1,187		(1,187)	
Earnings before income tax expense	778	1,474	(1,187)	1,065
Income tax expense	88	295		383
Net earnings including noncontrolling interests	690	1,179	(1,187)	682
Net loss attributable to noncontrolling interests		(8)		(8)
Net earnings attributable to The Kroger Co.	\$ 690	\$ 1,187	\$ (1,187)	\$ 690

**Condensed Consolidating****Statements of Operations****For the Two Quarters Ended August 16, 2008**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Sales	\$ 5,418	\$ 36,407	\$ (587)	\$ 41,238
Merchandise costs, including advertising, warehousing and transportation	4,478	28,020	(587)	31,911
Operating, general and administrative	940	5,954		6,894
Rent	73	285		358
Depreciation and amortization	86	674		760
Operating profit (loss)	(159)	1,474		1,315
Interest expense	(260)	(3)		(263)
Equity in earnings of subsidiaries	1,103		(1,103)	
Earnings before income tax expense	684	1,471	(1,103)	1,052
Income tax expense	21	365		386
Net earnings including noncontrolling interests	663	1,106	(1,103)	666

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Net earnings attributable to noncontrolling  
interests

3

3

Net earnings attributable to The Kroger Co.

\$

663

\$

1,103

\$

(1,103)

\$

663

17

**Condensed Consolidating****Statements of Cash Flows****For the Two Quarters Ended August 15, 2009**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Consolidated</b>
Net cash (used) provided by operating activities	\$ (120)	\$ 2,286	\$ 2,166
Cash flows from investing activities:			
Payments for capital expenditures, excluding acquisitions	(72)	(1,138)	(1,210)
Other		(12)	(12)
Net cash used by investing activities	(72)	(1,150)	(1,222)
Cash flows from financing activities:			
Dividends paid	(117)		(117)
Proceeds from issuance of long-term debt	3		3
Payments on long-term debt	(413)		(413)
Proceeds from issuance of capital stock	9		9
Treasury stock purchases	(80)		(80)
Other	(140)	(100)	(240)
Net change in advances to subsidiaries	927	(927)	
Net cash (used) provided by financing activities	189	(1,027)	(838)
Net increase (decrease) in cash and temporary cash investments	(3)	109	106
Cash and temporary cash investments:			
Beginning of year	27	236	263
End of quarter	\$ 24	\$ 345	\$ 369

**Condensed Consolidating****Statements of Cash Flows****For the Two Quarters Ended August 16, 2008**

	<b>The Kroger Co.</b>	<b>Guarantor Subsidiaries</b>	<b>Consolidated</b>
Net cash provided by operating activities	\$ 88	\$ 2,038	\$ 2,126
Cash flows from investing activities:			
Payments for capital expenditures, excluding acquisitions	(87)	(966)	(1,053)
Other	(18)	(13)	(31)
Net cash used by investing activities	(105)	(979)	(1,084)
Cash flows from financing activities:			
Dividends paid	(109)		(109)
Proceeds from issuance of long-term debt	775		775
Payments on long-term debt	(987)		(987)
Proceeds from issuance of capital stock	166		166
Treasury stock purchases	(539)		(539)
Other	(249)	(136)	(385)
Net change in advances to subsidiaries	893	(893)	
Net cash used by financing activities	(50)	(1,029)	(1,079)
Net increase (decrease) in cash and temporary cash investments	(67)	30	(37)
Cash from consolidated Variable Interest Entity	65		65
Cash and temporary cash investments:			
Beginning of year	26	216	242
End of quarter	\$ 24	\$ 246	\$ 270



## 11. COMMITMENTS AND CONTINGENCIES

The Company continually 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 certain 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 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** On October 6, 2006, the Company petitioned the Tax Court (*In Re: Ralphs Grocery Company and Subsidiaries, formerly known as Ralphs Supermarkets, Inc., Docket No. 20364-06*) for a redetermination of deficiencies set by the Commissioner of Internal Revenue. The dispute at issue involves a 1992 transaction in which Ralphs Holding Company acquired the stock of Ralphs Grocery Company and made an election under Section 338(h)(10) of the Internal Revenue Code. The Commissioner has determined that the acquisition of the stock was not a purchase as defined by Section 338(h)(3) of the Internal Revenue Code and that the acquisition does not qualify as a purchase. The Company believes that it has strong arguments in favor of its position and believes it is more likely than not that its position will be sustained. However, due to the inherent uncertainty involved in the litigation process, there can be no assurances that the Tax Court will rule in favor of the Company. As of August 15, 2009, an adverse decision would require a cash payment up to approximately \$451. In conjunction with SFAS 141R, any accounting implications of an adverse decision in this case would be charged through the income statement.

On February 2, 2004, the Attorney General for the State of California filed an action in Los Angeles federal court (*California, ex rel Lockyer v. Safeway, Inc. dba Vons, a Safeway Company; Albertson's, Inc. and Ralphs Grocery Company, a division of The Kroger Co., United States District Court Central District of California, Case No. CV04-0687*) alleging that the Mutual Strike Assistance Agreement (the "Agreement") between the Company, Albertson's, Inc. and Safeway Inc. (collectively, the "Retailers"), which was designed to prevent the union from placing disproportionate pressure on one or more of the Retailers by picketing such Retailer(s) but not the other Retailer(s) during the labor dispute in southern California, violated Section 1 of the Sherman Act. The lawsuit seeks declarative and injunctive relief. On May 28, 2008, pursuant to a stipulation between the parties, the court entered a final judgment in favor of the defendants. As a result of the stipulation and final judgment, there are no further claims to be litigated at the trial court level. The Attorney General has appealed a trial court ruling to the Ninth Circuit Court of Appeals and the defendants are appealing a separate ruling. Although this lawsuit is subject to uncertainties inherent to the litigation process, based on the information presently available to the Company, management does not expect that the ultimate resolution of this action will have a material adverse effect on the Company's financial condition, results of operations or cash flows.

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, are pending against the Company. Some of these suits purport or have been determined to be class actions and/or seek

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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 adverse effect on the Company's financial position.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made adequate provisions therefor. Nonetheless, assessing and predicting the outcomes of these matters involve substantial uncertainties. 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 impact on the Company's financial condition or results of operation.

*Guarantees* The Company has guaranteed half of the indebtedness of two real estate entities in which Kroger has a 50% ownership interest. The Company's share of the responsibility for this indebtedness, should the entities be unable to meet their obligations, totals approximately \$7. Based on the covenants underlying this indebtedness as of August 15, 2009, it is unlikely that the Company will be responsible for repayment of these obligations. The Company also agreed to guarantee, up to \$25, the indebtedness of an entity in which Kroger has a 50% ownership interest. The Company's share of the responsibility, as of August 15, 2009, should the entity be unable to meet its obligations, totals approximately \$25 and is collateralized by approximately \$5 of inventory located in the Company's stores.

*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.

*Benefit Plans* The Company administers certain non-contributory defined benefit retirement plans and contributory defined contribution retirement plans for substantially all non-union employees and some union-represented employees as determined by the terms and conditions of collective bargaining agreements. Funding for the defined benefit pension plans is based on a review of the specific requirements, and an evaluation of the assets and liabilities, of each plan. Funding for the Company's matching and automatic contributions under the defined contribution plans is based on years of service, plan compensation, and amount of contributions by participants.

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees. Funding for the retiree health care benefits occurs as claims or premiums are paid.

The determination of the obligation and expense for the Company's defined benefit retirement pension plan and other post-retirement benefits is dependent on the Company's selection of assumptions used by actuaries in calculating those amounts. Those assumptions are described in the Company's 2008 Annual Report on Form 10-K and include, among other things, the discount rate, the expected long-term rate of return on plan assets, 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 such 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 contributed \$200 to its Company-sponsored defined benefit pension plans in the first two quarters of 2009. The Company expects these contributions will reduce its minimum required contributions in future years. Among other things, investment performance of plan assets, the interest rates required to be used to calculate pension obligations and future changes in legislation will determine the amounts of any additional contributions. In addition, the Company expects our cash contributions and expense to the 401(k) Retirement Savings Account Plan from automatic and matching contributions to participants to increase in 2009, compared to 2008.

The Company also contributes to various multi-employer pension plans based on obligations arising from most of its collective bargaining agreements. These 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.

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Based on the most recent information available to it, the Company believes that the present value of actuarial accrued liabilities in most or all of these multi-employer plans exceeds the value of the assets held in trust to pay benefits. Because the Company is one of a number of employers contributing to these plans, it is difficult to ascertain what the Company's share of the underfunding would be, although we anticipate the Company's contributions to these plans will increase each year. The Company believes that funding levels have not changed significantly since year end. As a result, the Company believes its contributions to multi-employer pension plans could as much as double over the next several years, after 2009, to reduce this underfunding. 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 determined, in accordance with SFAS No. 87, *Employers' Accounting for Pensions*.

## 12. DERIVATIVE FINANCIAL INSTRUMENTS

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), as amended, defines derivatives, requires that derivatives be carried at fair value on the balance sheet and provides for hedge accounting when certain conditions are met. In accordance with this standard, 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 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 of \$2,500 or less, (iii) include no leverage products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status.

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

### Fair Value Interest Rate Swaps

At the end of the second quarter of 2009, the Company maintained 18 interest rate swap agreements that are being accounted for as fair value hedges. 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 are recognized in current income as Interest expense. These gains and losses for the second quarter of 2009 and the first two quarters of 2009, were as follows:

Income Statement Classification	Second Quarter Ended August 15, 2009		Year-To-Date August 15, 2009	
	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings

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Interest Expense	\$	8	\$	(8)	\$	8	\$	(8)
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The following table summarizes the location and fair value of derivative instruments designated as fair value hedges on the Company's Consolidated Balance Sheet:

Derivatives Designated as Fair Value Hedging Instruments Under SFAS 133	Fair Value		Asset Derivatives	
	August 15, 2009		Balance Sheet Location	
Interest Rate Hedges	\$	8	Other Assets	

As of August 15, 2009, the Company has unamortized proceeds from twelve interest rate swaps once classified as fair value hedges totaling approximately \$36. The unamortized proceeds are recorded as adjustments to the carrying values of the underlying debt and are being amortized over the remaining term of the debt. As of August 15, 2009, the Company expects to reclassify an unrealized gain of \$14 from this adjustment to the carrying values of the underlying debt to earnings over the next twelve months.

Cash Flow Forward-Starting Interest Rate Swaps

As of August 15, 2009, the Company did not maintain any forward-starting interest rate swap derivatives.

The Company has unamortized net payments from three forward-starting interest rate swaps once classified as cash flow hedges totaling approximately \$12. The unamortized proceeds and payments from these terminated forward-starting interest rate swaps have been recorded net of tax in other comprehensive income and will be amortized to earnings as the payments of interest to which the hedges relate are made. As of August 15, 2009, the Company expects to reclassify an unrealized net loss of \$2 from Accumulated Other Comprehensive Loss ( AOCL ) to earnings over the next twelve months.

The following table summarizes the effect of the Company's derivative instruments designated as cash flow hedges for the second quarter of 2009:

Derivatives in SFAS 133 Cash Flow Hedging Relationships	Second Quarter Ended August 15, 2009		Location of Gain/(Loss) Reclassified into Income (Effective Portion)
	Amount of Gain/(Loss) in AOCL on Derivative (Effective Portion)	Amount of Gain/(Loss) Reclassified from AOCL into Income (Effective Portion)	
Forward-Starting Interest Rate Swaps, net of tax	\$ (8)	\$	Interest expense

The following table summarizes the effect of the Company's derivative instruments designated as cash flow hedges for the first two quarters of 2009:

Derivatives in SFAS 133 Cash Flow Hedging Relationships	Year-To-Date August 15, 2009		Location of Gain/(Loss) Reclassified into Income (Effective Portion)
	Amount of Gain/(Loss) in AOCL on Derivative (Effective Portion)	Amount of Gain/(Loss) Reclassified from AOCL into Income (Effective Portion)	
Forward-Starting Interest Rate Swaps, net of tax	\$ (8)	\$ (1)	Interest expense

*Commodity Price Protection*

The Company enters into purchase commitments for various resources, including raw materials utilized in its manufacturing facilities and energy to be used in its stores, warehouses, manufacturing facilities and administrative offices. The Company enters into commitments expecting to take delivery of and to utilize those resources in the conduct of normal business. Those commitments for which the Company expects to utilize or take delivery in a reasonable amount of time in the normal course of business qualify as normal purchases and normal sales.

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Some of the product the Company purchases is shipped in corrugated cardboard packaging. The corrugated cardboard is sold when it is economical for the Company to do so. As of August 15, 2009, the Company maintained a derivative instrument to manage exposure to changes in corrugated cardboard prices. This derivative has a three-year term. The instrument does not qualify for hedge accounting, in accordance with SFAS 133. Accordingly, the change in the fair value of this instrument is marked-to-market in the Company's Consolidated Statements of Operations as operating, general and administrative expense. For the second quarter of 2009 and the first two quarters of 2009, the change in the fair value of this instrument was insignificant. As of August 15, 2009, the fair value of this instrument was insignificant.



**13. FAIR VALUE MEASUREMENTS**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a market-based framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not expand or require any new fair value measurements. SFAS 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. FASB Staff Position (FSP) 157-2, *Effective Date of Statement No. 157* (FSP 157-2), deferred the effective date of SFAS No. 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. The Company adopted SFAS 157 for financial assets and financial liabilities effective February 3, 2008 and adopted the remaining provisions of SFAS 157 for nonfinancial assets and nonfinancial liabilities on February 1, 2009.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy defined by SFAS 157 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 those financial instruments carried at fair value in the consolidated financial statements, the following table summarizes the fair value of these instruments at August 15, 2009:

**Fair Value Measurements Using**

	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>		<b>Significant Other Observable Inputs (Level 2)</b>		<b>Significant Unobservable Inputs (Level 3)</b>		<b>Total</b>
Available-for-Sale Securities	\$	12	\$		\$		12
Interest Rate Hedges				8			8
Total	\$	12	\$	8	\$		20

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in the impairment analysis of goodwill, other intangible assets, and long-lived assets and in the valuation of store lease exit costs. The Company reviews goodwill and other intangible assets for impairment annually, during the fourth quarter of each fiscal year, or as circumstances indicate the possibility of impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. Long-lived assets and store lease exit costs were measured at fair value on a

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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.

### **Fair Value of Other Financial Instruments**

#### ***Current and Long-term Debt***



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The fair value of the Company's long-term debt, including current maturities, was estimated based on the quoted market price 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 August 15, 2009. At August 15, 2009, the fair value of total debt was \$7,804 compared to a carrying value of \$7,074.

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

The carrying amounts of these items approximated fair value.



*Long-term Investments*



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The fair values of these investments were estimated based on quoted market prices for those or similar investments, or estimated cash flows, if appropriate. At August 15, 2009, the carrying and fair value of practicable long-term investments was \$67.

### 14. SUBSEQUENT EVENTS

The Company contributed \$65 to Company-sponsored pension plans on September 14, 2009.

In preparing the Company's Consolidated Financial Statements, the Company evaluated subsequent events through the time of filing on September 23, 2009.



**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following analysis should be read in conjunction with the Consolidated Financial Statements.

**OVERVIEW**

Second quarter 2009 total sales were \$17.7 billion compared with \$18.1 billion for the same period of 2008. This decrease in total sales is attributable to the year-over-year decline in retail fuel prices. The average retail price for a gallon of fuel sold at Kroger fuel stations was 37% lower in the second quarter of 2009 compared to the second quarter of 2008. In the second quarter of 2009, our identical supermarket sales increased 2.6% without fuel compared to the second quarter of 2008. We are pleased with this increase, considering changes in customer behavior, significant deflation in produce and dairy and an overall slightly negative product cost inflation estimate. This increase also reflects meaningful increases in estimated unit sales volumes of 8.5%, excluding fuel and pharmacy. These increases in identical supermarket sales and unit volume demonstrate our customer-focused strategy which delivers value in a number of ways through our people, products, prices and the overall shopping experience.

For the second quarter of 2009, net earnings for the Company totaled \$255 million, or \$0.39 per diluted share, a decrease of \$.03 per diluted share over the second quarter of 2008. This decrease per diluted share was primarily due to lower gross margins partially offset by a lower LIFO charge compared to the second quarter of 2008. Our retail fuel operations accounted for approximately \$.01 of this decrease due to lower retail fuel margins in the second quarter of 2009 compared to the second quarter of 2008. In addition, gross margin, without fuel, declined due to sudden deflation, changes in customer behavior, planned investments and heightened competitive activity.

Based on Kroger's second quarter sales results, we confirmed our fiscal year 2009 identical supermarket sales growth guidance of 3.0% to 4.0%, excluding fuel. This guidance assumes product costs for the remainder of fiscal 2009 are consistent with or slightly lower than they were in the second half of fiscal 2008. In addition, we have revised our 2009 earnings per share guidance to reflect continued changes in customer behavior and an uncertain operating environment. We anticipate full-year fiscal 2009 earnings of \$1.90 to \$2.00 per diluted share. This is a wider range than our previous guidance of \$2.00 to \$2.05 per diluted share because of the uncertain economic environment and the caution on the part of customers caused by this environment.

**RESULTS OF OPERATIONS**

*Net Earnings*



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Net earnings totaled \$255 million for the second quarter of 2009, a decrease of 7.9% from net earnings of \$277 million for the second quarter of 2008. This decrease in our net earnings resulted from lower retail fuel margins and decreased operating profit, partially offset by a LIFO charge of \$15 million pre-tax, compared to a LIFO charge of \$46 million pre-tax in 2008. Net earnings totaled \$690 million for the first two quarters of 2009, an increase of 4.1% from net earnings of \$663 for the first two quarters of 2008. The increase in our net earnings for the first two quarters of 2009 resulted from an increase in operating profit, which benefited from a LIFO charge of \$38 million pre-tax, compared to a LIFO charge of \$86 million pre-tax in 2008.

Net earnings of \$0.39 per diluted share for the second quarter of 2009 represented a decrease of 7.1% over net earnings of \$0.42 per diluted share for the second quarter of 2008. Net earnings of \$1.05 per diluted share for the first two quarters of 2009 represented an increase of 5.0% over net earnings of \$1.00 for the first two quarters of 2008. The net earnings per share decline in the second quarter of 2009, compared to the second quarter of 2008, reflects the gross margin decline referred to above. Earnings per share growth for the first two quarters of 2009, compared to the first two quarters of 2008, resulted from increased net earnings.

*Sales***Total Sales**

(in millions)

	Second Quarter				Year-To-Date			
	2009	Percentage Increase	2008	Percentage Increase	2009	Percentage Increase	2008	Percentage Increase
Total supermarket sales without fuel	\$ 15,011	3.5%	\$ 14,499	5.6%	\$ 34,990	3.7%	\$ 33,730	6.7%
Total supermarket fuel sales	\$ 1,635	(26.6)%	\$ 2,228	63.8%	\$ 3,257	(29.9)%	\$ 4,645	57.7%
Total supermarket sales	\$ 16,646	(0.5)%	\$ 16,727	10.9%	\$ 38,247	(0.3)%	\$ 38,375	11.1%
Other sales(1)	1,089	(20.3)%	1,367	26.2%	2,287	(20.1)%	2,863	20.6%
Total sales	\$ 17,735	(2.0)%	\$ 18,094	11.9%	\$ 40,534	(1.7)%	\$ 41,238	11.7%

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- (1) Other sales primarily relate to sales at convenience stores, including fuel, jewelry stores, sales by our manufacturing plants to outside customers and non-wholly owned entities.

This decrease in total sales and other sales for the second quarter and first two quarters of 2009 is attributable to the year-over-year decline in retail fuel prices. The change in our total supermarket sales without fuel for the second quarter and first two quarters of 2009 was primarily the result of increases in identical supermarket sales and retail square footage. Identical supermarket sales for the second quarter and first two quarters of 2009, excluding fuel, increased due to increased transaction count offset partially by a lower average sale per shopping trip.

We define a supermarket as identical when it has been in operation without expansion or relocation for five full quarters. Fuel center discounts received at our fuel centers and earned based on in-store purchases are included in all of the supermarket identical sales results calculations illustrated below. Differences between total supermarket sales and identical supermarket sales primarily relate to changes in supermarket square footage. Identical supermarket sales include all sales at identical Fred Meyer multi-department stores. Our identical supermarket sales results are summarized in the table below. We used the identical supermarket dollar figures presented to calculate second quarter 2009 percent changes.

**Identical Supermarket Sales**

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(\$ in millions)

		Second Quarter	
	2009		2008
Including fuel centers	\$	15,867	\$ 16,121
Excluding fuel centers	\$	14,341	\$ 13,976
Including fuel centers		(1.6)%	9.7%
Excluding fuel centers		2.6%	4.7%

We define a supermarket as comparable when it has been in operation for five full quarters, including expansions and relocations. As is the case for identical supermarket sales, fuel center discounts received at our fuel centers and earned based on in-store purchases are included in all of the supermarket comparable sales results calculations illustrated below. Comparable supermarket sales include all sales at comparable Fred Meyer multi-department stores. Our comparable supermarket sales results are summarized in the table below. We used the comparable supermarket dollar figures presented to calculate second quarter 2009 percent changes.

**Comparable Supermarket Sales**

(\$ in millions)

	<b>Second Quarter</b>	
	<b>2009</b>	<b>2008</b>
Including fuel centers	\$ 16,408	\$ 16,617
Excluding fuel centers	\$ 14,816	\$ 14,391
Including fuel centers	(1.3)%	10.1%
Excluding fuel centers	3.0%	4.9%

*FIFO Gross Margin*



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We calculate First-In, First-Out ( FIFO ) Gross Margin as sales minus merchandise costs, including advertising, warehousing and transportation, but excluding the Last-In, First-Out ( LIFO ) charge. Merchandise costs exclude depreciation and rent expense. FIFO gross margin is an important measure used by management to evaluate merchandising and operational effectiveness.

Our FIFO gross margin rate increased 59 basis points to 23.11% for the second quarter of 2009 from 22.52% for the second quarter of 2008. Retail fuel sales lower our FIFO gross margin rate due to the very low FIFO gross margin on retail fuel sales as compared to non-fuel sales. Excluding the effect of retail fuel operations, our FIFO gross margin rate decreased 60 basis points for the second quarter of 2009 compared to the second quarter of 2008. Our FIFO gross margin, excluding the effect of retail fuel operations, declined during the second quarter of 2009 due to planned investments into our Customer 1st strategy, sales mix changes, heightened competitive activity and produce and dairy deflation, slightly offset by improvements in shrink, advertising, warehousing and transportation expenses, as a percent of sales.

Our FIFO gross margin rate increased 99 basis points to 23.82% for the first two quarters of 2009 from 22.83% for the first two quarters of 2008. Excluding the effect of retail fuel operations, our FIFO gross margin rate decreased 23 basis points for the first two quarters of 2009 compared to the first two quarters of 2008, due to planned investments into our Customer 1st strategy, partially offset by improvements in shrink, advertising, warehousing and transportation expenses, as a percent of sales.

### *LIFO Charge*





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The LIFO charge in the second quarter of 2009 was \$15 million compared to \$46 million in the second quarter of 2008. The LIFO charge for the first two quarters of 2009 was \$38 million compared to \$86 million in the first two quarters of 2008. The LIFO charge decreased in both the second quarter and the first two quarters of 2009, compared to the same periods of 2008, primarily due to an expected decrease in annualized product cost inflation for those categories of inventory on the LIFO method of valuation for 2009 compared to 2008.

*Operating, General and Administrative Expenses*



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Operating, general and administrative ( OG&A ) expenses consist primarily of employee-related costs such as wages, health care benefit costs and retirement plan costs, utilities and credit card fees. Rent expense, depreciation and amortization expense, and interest expense are not included in OG&A.

OG&A expenses, as a percent of sales, increased 81 basis points to 17.41% for the second quarter of 2009 from 16.60% for the second quarter of 2008. Retail fuel sales lower our OG&A rate due to the very low OG&A rate on retail fuel sales as compared to non-fuel sales. OG&A expenses, as a percent of sales excluding fuel, decreased 7 basis points in the second quarter of 2009 compared to the second quarter of 2008. The decrease in our OG&A rate in the second quarter of 2009, excluding the effect of retail fuel sales, resulted primarily from increased supermarket identical sales growth, strong cost controls, and lower incentive compensation and utility costs. These benefits were partially offset by increases in health care, pension expenses and credit card fees.

OG&A expenses, as a percent of sales, increased 85 basis points to 17.57% for the first two quarters of 2009 from 16.72% for the first two quarters of 2008. OG&A expenses, as a percent of sales excluding fuel, decreased 3 basis points in the first two quarters of 2009 compared to the first two quarters of 2008. The decrease in our OG&A rate in 2009, excluding the effect of retail fuel operations, resulted primarily from increased identical supermarket sales growth, strong cost controls and lower utility costs. These benefits were partially offset by increases in health care costs, pension expenses and credit card fees.



*Rent Expense*



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Rent expense was \$150 million, or 0.85% of sales, for the second quarter of 2009, compared to \$151 million, or 0.83% of sales, for the second quarter of 2008. For the year-to-date period, rent expense was \$350 million, or 0.86% of total sales in 2009, compared to \$358 million, or 0.87% of sales, in 2008. Rent expense, as a percent of sales excluding fuel, decreased 4 basis points in the second quarter of 2009 compared to the second quarter of 2008. Rent expense, as a percent of sales excluding fuel, decreased 6 basis points in the first two quarters of 2009 compared to the first two quarters of 2008. The decrease in rent expense in the second quarter of 2009 and the first two quarters of 2009, as a percent of sales excluding fuel, compared to the same periods in 2008, resulted from decreased rent expense and our continued strategy to own rather than lease whenever possible. The decrease in rent expense in the first two quarters of 2009, in total dollars, compared to the first two quarters of 2008, was primarily due to lower lease liabilities for closed stores.

### *Depreciation Expense*





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Depreciation expense was \$348 million, or 1.96% of total sales, for the second quarter of 2009 compared to \$327 million, or 1.81% of total sales, for the second quarter of 2008. Depreciation expense was \$801 million, or 1.98% of total sales, for the first two quarters of 2009 compared to \$760 million, or 1.84% of total sales, for the first two quarters of 2008. The increase in depreciation expense, in total dollars, was the result of higher capital expenditures over the last four quarters ending with the second quarter of 2009 compared to the comparable period ending in 2008.

### *Interest Expense*



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Net interest expense was \$115 million, or 0.65% of total sales, in the second quarter of 2009 and \$111 million, or 0.62% of total sales, in the second quarter of 2008. For the year-to-date period, interest expense was \$278 million, or 0.69% of total sales, in 2009 and \$263 million, or 0.64% of total sales, in 2008. The increase in net interest expense for both the quarter and year-to-date periods of 2009, when compared to the same periods of 2008, resulted primarily from a higher weighted average interest rate and a reduction in interest income.

### *Income Taxes*



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Our effective income tax rate was 34.6% for the second quarter of 2009 and 36.6% for the second quarter of 2008. For the year-to-date period, our effective income tax rate was 36.0% in 2009 and 36.7% in 2008. The 2009 and 2008 effective income tax rates differed from the federal statutory rate primarily due to the effect of state income taxes and the benefit from the favorable resolution of certain tax issues.

### LIQUIDITY AND CAPITAL RESOURCES

#### *Cash Flow Information*

##### Net cash provided by operating activities

We generated \$2.2 billion of cash from operating activities during the first two quarters of 2009, compared to \$2.1 billion in the first two quarters of 2008. The cash provided by operating activities came from net earnings adjusted for non-cash expenses and changes in our operating assets and liabilities. We realized increases in cash from changes in operating assets and liabilities of \$664 million in the first two quarters of 2009 and \$427 million in the first two quarters of 2008. The increase in the change in operating assets and liabilities in the first two quarters of 2009, compared to the same period in 2008, resulted primarily from a decrease in income tax receivables and inventories and an increase in trade accounts payable, offset partially by decreased accrued expenses and prepaid expenses. Prepaid expenses decreased significantly since year-end, reflecting prepayments of certain employee benefits at year-end. In the first two quarters of 2009, we contributed \$200 million to Kroger sponsored pension plans. During the first two quarters of 2008, we did not make a voluntary cash contribution to Kroger sponsored pension plans.

The amount of cash paid for income taxes decreased in the first two quarters of 2009 compared to the first two quarters of 2008 because we applied our fiscal 2008 overpayment of income taxes to current year taxes.

Net cash used by investing activities

We used \$1.2 billion of cash for investing activities during the first two quarters of 2009 compared to \$1.1 billion during the first two quarters of 2008. The amount of cash used for investing activities increased in the first two quarters of 2009 versus 2008 due to increased payments for capital expenditures, partially offset by decreased payments for acquisitions and proceeds from sale of assets. During the first two quarters of 2009, we paid \$115 million for purchases of leased facilities related to several retail stores and one distribution center. These purchases of leased facilities have been classified as payments for capital expenditures.

Net cash used by financing activities

We used \$838 million of cash for financing activities in the first two quarters of 2009 compared to \$1.1 billion in the first two quarters of 2008. The decrease in the amount of cash used for financing activities in the first two quarters of 2009, compared to the same period of 2008, was primarily related to the decrease in the amount of treasury stock we purchased, payments on long-term debt and the credit facility offset by decreased proceeds from the issuance of long-term debt and capital stock. Proceeds from the issuance of common stock resulted from exercises of employee stock options. To preserve liquidity and financial flexibility, we reduced the amount of stock repurchased during the first two quarters of 2009 compared to the same period in 2008.

*Debt Management*





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As of August 15, 2009, we maintained a committed \$2.5 billion, five-year revolving credit facility that, unless extended, terminates in 2011. Outstanding borrowings under the credit agreement and commercial paper borrowings, and some outstanding letters of credit, reduce funds available under the credit agreement. In addition to the credit agreement, we maintained three uncommitted money market lines totaling \$100 million in the aggregate. The money market lines allow us to borrow from banks at mutually agreed upon rates, usually at rates below the rates offered under the credit agreement. As of August 15, 2009, we did not have any borrowings under the credit facility, money market lines or outstanding commercial paper. The outstanding letters of credit that reduced the funds available under our credit agreement totaled \$321 million as of August 15, 2009.

Our bank credit facility and the indentures underlying our publicly issued debt contain various restrictive covenants. As of August 15, 2009, we were in compliance with these financial covenants. Furthermore, management believes it is not reasonably likely that Kroger will fail to comply with these financial covenants in the foreseeable future.

Total debt, including both the current and long-term portions of capital leases and lease-financing obligations, decreased \$87 million to \$7.5 billion as of the end of the second quarter of 2009, from \$7.6 billion as of the end of the second quarter of 2008. Total debt decreased \$523 million as of the end of the second quarter of 2009 from \$8.1 billion as of year-end 2008. The decrease as of the end of the second quarter of 2009, compared to the end of the second quarter of 2008, resulted from the issuance of \$600 million of senior notes bearing an interest rate of 7.50% in the fourth quarter of 2008, offset by payment at maturity of our \$350 million of senior notes bearing an interest rate of 7.25% in the second quarter of 2009, decreased outstanding commercial paper and payments on our money market lines. As of August 15, 2009, our cash and temporary cash investments were \$369 million compared to \$263 million as of January 31, 2009.

### *Common Stock Repurchase Program*

During the second quarter of 2009, we invested \$60 million to repurchase 2.8 million shares of Kroger stock at an average price of \$21.58 per share. For the first two quarters of 2009, we invested \$80 million to repurchase 3.7 million shares of Kroger stock at an average price of \$21.39 per share. These shares were reacquired under two separate stock repurchase programs. The first is a \$1 billion repurchase program that was authorized by Kroger's Board of Directors on January 18, 2008. The second is a program that uses the cash proceeds from the exercises of stock options by participants in Kroger's stock option and long-term incentive plans as well as the associated tax benefits. As of August 15, 2009, we had approximately \$425 million remaining under the January 2008 repurchase program. In the second quarter of 2009, to preserve liquidity and financial flexibility, we reduced the amount of stock repurchased during the quarter, decreasing the uses of cash for treasury stock purchases during the quarter and in the first two quarters of 2009, compared to the same periods in 2008.

## **CAPITAL EXPENDITURES**

Capital expenditures, excluding acquisitions and the purchase of leased facilities, totaled \$518 million for the second quarter of 2009 compared to \$461 million for the second quarter of 2008. Year-to-date, capital expenditures, excluding acquisitions and the purchase of leased facilities, totaled \$1.1 billion in 2009 and 2008. During the second quarter of 2009, capital expenditures for the purchase of leased facilities totaled \$84 million compared to \$17 million for the second quarter of 2008. During the first two quarters of 2009, capital expenditures for purchases of leased facilities totaled \$115 million compared to \$17 million for the first two quarters of 2008. This increase was due to the Company purchasing several retail stores and one distribution center at very attractive rates during the first two quarters of 2009. During the second quarter of 2009, we opened, acquired, expanded or relocated 12 food stores and also completed 46 within-the-wall remodels. During the first two quarters of 2009, we opened, acquired, expanded or relocated 23 food stores and also completed 83 within-the-wall remodels. Total food store square footage increased 1.2% from the second quarter of 2008. Excluding acquisitions and operational closings, total food store square footage increased 1.8% over the second quarter of 2008.

## **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. Except as noted below, our critical accounting policies are summarized in our 2008 Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

The preparation of financial statements in conformity with generally accepted accounting principles 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 vary from those estimates.

## **RECENTLY ADOPTED ACCOUNTING STANDARDS**

In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 160 (SFAS 160), which establishes accounting and reporting standards for a parent's noncontrolling interest in a subsidiary and the accounting for future ownership changes with respect to the subsidiary. This standard defines a noncontrolling interest, previously called a minority interest, as the portion of equity in a subsidiary that is not attributable, directly or indirectly, to a parent. SFAS 160 requires, among other things, that a noncontrolling interest be clearly identified, labeled and presented in the consolidated balance sheet as equity, but separate from the parent's equity; that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and that if a subsidiary is deconsolidated, the parent measure at fair value any noncontrolling equity investment that the parent retains in the former subsidiary and recognize a gain or loss in net income based on the fair value of the non-controlling equity investment. We adopted SFAS 160 effective February 1, 2009, and applied it retrospectively. As a result, we reclassified noncontrolling interests in amounts of \$95 million from the mezzanine section to equity in the January 31, 2009 Consolidated Balance Sheet. Certain reclassifications to the Consolidated Statement of Operations have been made to prior period amounts to conform to the presentation of the current period under SFAS 160. Recorded amounts for prior periods previously presented as Net Earnings, which are now presented as Net Earnings Attributable to The Kroger Co., have not changed as a result of the adoption of SFAS 160.

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Effective February 1, 2009, we adopted FASB Staff Position ( FSP ) No. FAS 157-2, *Effective Date of Statement No. 157* (FSP 157-2). FSP 157-2 deferred the effective date of SFAS No. 157, *Fair Value Measurements*, for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. See Note 13 to the Consolidated Financial Statements for further discussion of the adoption of FSP 157-2.

Effective February 1, 2009, we adopted SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R), which replaces SFAS No. 141. SFAS 141R further expands the definitions of a business and the fair value measurement and reporting in a business combination. All business combinations completed after February 1, 2009, will be accounted for under SFAS 141R. We did not complete any business combinations during the first two quarters of fiscal 2009.

Effective February 1, 2009, we adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosures on an entity's derivative and hedging activities. The new disclosures required by this standard are included in Note 12 to the Consolidated Financial Statements.

Effective February 1, 2009, we adopted FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities and included in the computation of EPS pursuant to the two-class method. See Note 7 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, we adopted SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. See Note 14 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, we adopted three new FASB Staff Positions (FSP) all of which impact the accounting and disclosure related to certain financial instruments. FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements* (SFAS 157), when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about the fair value of financial instruments on an interim basis in addition to the annual disclosure requirements. The new disclosures required by this FSP are included in Note 13. The adoption of these FSPs did not have a material effect on our Consolidated Financial Statements.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2008, the FASB issued FSP No. FAS 132(R)-1, *Employers' Disclosure about Postretirement Benefit Plan Assets* (FSP 132(R)-1). FSP 132(R)-1 provides additional guidance on employers' disclosures about the plan assets of defined benefit pension or other postretirement plans. FSP 132(R)-1 requires disclosures about how investment allocation decisions are made, the fair value of each major category of plan assets, valuation techniques used to develop fair value measurements of plan assets, the impact of measurements on changes in plan assets when using significant unobservable inputs and significant concentrations of risk in the plan assets. FSP 132(R)-1 becomes effective for fiscal years ending after December 15, 2009. We are currently evaluating the effect the adoption of FSP 132(R)-1 will have on our Consolidated Financial Statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. SFAS 167 will become effective for our fiscal year beginning January 31, 2010. We are currently evaluating the effect the adoption of SFAS 167 will have on our Consolidated Financial Statements.

In July 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162* (SFAS 168), which is effective for interim and annual fiscal periods ending after September 15, 2009. This standard replaces SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and the codification from this standard will supersede all then-existing non-SEC accounting and reporting standards to become the sole source of authoritative U.S. GAAP. The adoption of this standard will have no effect on our Consolidated Financial Statements.



## OUTLOOK

This discussion and analysis contains certain forward-looking statements about Kroger's future performance. These statements are based on management's assumptions and beliefs in light of the information currently available. Such statements relate to, among other things: projected change in net earnings; identical supermarket sales growth; expected product cost; expected pension plan contributions; our ability to generate operating cash flow; projected capital expenditures; square footage growth; opportunities to reduce costs; cash flow requirements; and our operating plan for the future; and are indicated by words such as comfortable, committed, will, expect, goal, should, intend, target, anticipate, plan, 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 21 E of the Securities Exchange Act of 1934. 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.

- We expect earnings per diluted share in the range of \$1.90-\$2.00 for 2009. In addition, our shareholder return is enhanced by our dividend by over 1.5%.
- We expect identical supermarket sales growth, excluding fuel sales, of 3%-4% in 2009, assuming product costs for the remainder of fiscal year 2009 are consistent with or slightly lower than they were in the second half of fiscal year 2008.
- For fiscal year 2009, we will continue to focus on driving sales growth and balancing investments in gross margin and improved customer service to provide a better shopping experience for our customers. We expect to finance these investments primarily with operating cost reductions. We expect non-fuel operating margins to slightly decline in 2009, excluding the benefit of an expected lower LIFO charge.
- For fiscal year 2009, we expect fuel margins, which can be highly volatile, to be approximately \$0.11 per gallon, as well as continued strong growth in gallons sold.
- For fiscal year 2009, we expect our annualized LIFO charge to be \$70 million, assuming product cost inflation of 1%-2%.
- For fiscal year 2009, we expect interest expense to be approximately \$495 million.
- We plan to use cash flow primarily for capital investments, debt reduction and to pay cash dividends. As market conditions change, we plan to re-evaluate the above uses of cash flow and our stock repurchase activity.
- We expect to obtain sales growth from new square footage, as well as from increased productivity from existing locations.
- Capital expenditures reflect our strategy of growth through expansion, as well as focusing on productivity increases from our existing store base through remodels. In addition, we will continue our emphasis on self-development and ownership of real estate, logistics and technology improvements. The continued capital spending in technology is focused on improving store operations, logistics, manufacturing procurement, category management, merchandising and buying practices, and should reduce merchandising costs. We intend to continue using cash flow from operations to finance capital expenditure requirements. We expect capital investments for 2009 to be in the range of \$1.9-\$2.1 billion, excluding acquisitions and purchases of leased facilities. We expect total food store square footage to grow approximately 1.5%-2.0% before acquisitions and operational closings.
- Based on current operating trends, we believe that cash flow from operations and other sources of liquidity, including borrowings under our commercial paper program and bank credit facility, will be adequate to meet anticipated requirements for working capital, capital expenditures, interest payments and scheduled principal payments for the foreseeable future. We also believe we have adequate coverage of our debt covenants to continue to respond effectively to competitive conditions.



- We believe we have adequate sources of cash if needed under our credit agreement.
- We expect that our OG&A results will be affected by increased costs, such as higher pension costs and credit card fees, as well as any potential future labor disputes, offset by improved productivity from process changes and leverage gained through sales increases.
- We expect that our effective tax rate for 2009 will be approximately 36.5%.
- We expect rent expense, as a percent of total sales and excluding closed-store activity, will decrease due to the emphasis our current strategy places on ownership of real estate.
- We believe that in 2009 there will be opportunities to reduce our operating costs in such areas as administration, productivity improvements, shrink, warehousing and transportation. These savings will be invested in our core business to drive profitable sales growth and offer improved value and shopping experiences for our customers.
- Although we were not required to make cash contributions to Company-sponsored defined benefit pension plans during 2009, we contributed \$200 million to these plans in the first two quarters of 2009. On September 14, 2009, we contributed an additional \$65 million to Company-sponsored pension plans. We expect any elective contributions made during 2009 will decrease our 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 additional contributions. We also expect 2009 expense for Company-sponsored defined benefit pension plans to be comparable to 2008. In addition, we expect our cash contributions and expense to the 401(k) Retirement Savings Account Plan from automatic and matching contributions to participants to slightly increase in 2009, compared to 2008.
- We do not expect a significant increase in our contributions to multi-employer pension plans in 2009 compared to 2008, subject to collective bargaining. In addition, we believe our contributions to multi-employer pension plans could as much as double over the next several years after 2009, subject to collective bargaining and capital market conditions.
- We expect bad debt expense from the credit extended to our customers through our company branded credit card in 2009 to be approximately \$18 million.

Various uncertainties and other factors could cause us to fail to achieve our goals. 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 impact 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.
- The labor agreement covering associates in Colorado has expired. We expect our associates to vote soon on a contract offer. A failure to ratify a contract could lead to a work stoppage. The labor agreements covering associates in Atlanta, Arizona and Portland, that expired in 2008 or 2009, have all been extended. In addition, we have a labor agreement expiring later in 2009, covering associates in Dallas. In all of these store contracts, rising health care and pension costs will continue to be an important issue in negotiations. A prolonged work stoppage affecting a substantial number of locations could have a material adverse effect on our results.
- If market conditions change, it could affect our uses of cash flow.
- Our ability to achieve sales and earnings goals may be affected by: labor disputes; industry consolidation; pricing and promotional activities of existing and new competitors, including non-traditional competitors; our response to these actions; the state of the economy, including the inflationary and deflationary trends in certain commodities; manufacturing commodity costs; diesel fuel costs related to our logistics operations; trends in consumer spending; stock repurchases; and the success of our future growth plans.
- Our estimate of product cost inflation could be affected by general economic conditions, weather, availability of raw materials and ingredients in the products that we sell and their packaging, and other factors beyond our control.





- The timing of our recognition of LIFO expense will be affected primarily by expected food inflation during the year.
- If actual results differ significantly from anticipated future results for certain reporting units including variable interest entities, an impairment loss for any excess of the carrying value of the reporting units goodwill over the implied fair value would have to be recognized.
- In addition to the factors identified above, our identical store sales growth could be affected by increases in Kroger private label sales, the effect of our sister stores (new stores opened in close proximity to an existing store) and reductions in retail pricing.
- Our operating margins, without fuel, could decline more than expected if we are unable to pass on any cost increases, fail to deliver the cost savings contemplated or if changes in the cost of our inventory and the timing of those changes differ from our expectations.
- Our expected operating margin per gallon of fuel and fuel gallons sold could be affected by changes in the price of fuel or a change in our operating costs.
- We have estimated our exposure to the claims and litigation arising in the normal course of business, as well as to the material litigation facing Kroger, and believe we have made adequate provisions for them where it is reasonably possible to estimate and where we believe an adverse outcome is probable. Unexpected outcomes in these matters, however, could result in an adverse effect on our earnings.
- Consolidation in the food industry is likely to continue and the effects on our business, either favorable or unfavorable, cannot be foreseen.
- Rent expense, which includes subtenant rental income, could be adversely affected by the state of the economy, increased store closure activity and future consolidation.
- Depreciation expense, which includes the amortization of assets recorded under capital leases, is computed principally using the straight-line method over the estimated useful lives of individual assets, or the remaining terms of leases. Use of the straight-line method of depreciation creates a risk that future asset write-offs or potential impairment charges related to store closings would be larger than if an accelerated method of depreciation were followed.
- 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.
- The actual amount of automatic and matching cash contributions to our 401(k) Retirement Savings Account Plan will depend on the number of participants, savings rate, plan compensation, and length of service of participants.
- Our contributions and recorded expense related to multi-employer pension funds could increase more than anticipated. Should asset values in these funds further deteriorate, if employers withdraw from these funds without providing for their share of the liability, or should our estimates prove to be understated, our contributions could increase more rapidly than we have anticipated, after 2009.
- If weakness in the financial markets continues or worsens, our contributions to Company-sponsored defined benefit pension plans could increase more than anticipated.
- Changes in laws or regulations, including changes in accounting standards, taxation requirements and environmental laws may have a material effect on our financial statements.
- Changes in the general business and economic conditions in our operating regions, including the rate of inflation, population growth and employment and job growth in the markets in which we operate, may affect our ability to hire and train qualified employees to operate our stores. This would negatively affect earnings and sales growth. General economic changes may also affect the shopping habits of our customers, which could affect sales and earnings.

- Changes in our product mix may negatively affect certain financial indicators. For example, we continue to add supermarket fuel centers to our store base. Since gasoline generates low profit margins, we expect to see our FIFO gross profit margins decline as gasoline sales increase. Although this negatively affects our FIFO gross margin, gasoline sales provide a positive effect on OG&A expense as a percent of sales.
- Our capital expenditures, expected square footage growth, and number of store projects completed during the year could differ from our estimate if we are unsuccessful in acquiring suitable sites for new stores, if development costs vary from those budgeted or if our logistics and technology projects are not completed in the time frame expected or on budget.
- Interest expense could be adversely affected by the interest rate environment, changes in the Company's credit ratings, fluctuations in the amount of outstanding debt, decisions to incur prepayment penalties on the early redemption of debt and any factor that adversely affects our operations and results in an increase in debt.
- Impairment losses could be affected by changes in our assumptions of future cash flows or market values. Our cash flow projections include several years of projected cash flows which would be affected by changes in the economic environment, real estate market values, competitive activity, inflation and customer behavior.
- Our estimated expense and obligation for Company-sponsored pension plans and other post-retirement benefits could be affected by changes in the assumptions used in calculating those amounts. These assumptions include, among others, the discount rate, the expected long-term rate of return on plan assets, average life expectancy and the rate of increases in compensation and health care costs.
- Adverse weather conditions could increase the cost our suppliers charge for their products, or may decrease the customer demand for certain products. Increases in demand for certain commodities could also increase the cost our suppliers charge for their products. Additionally, increases in the cost of inputs, such as utility costs or raw material costs, could negatively affect financial ratios and earnings.
- Although we presently operate only in the United States, civil unrest in foreign countries in which our suppliers do business may affect the prices we are charged for imported goods. If we are unable to pass on these increases to our customers, our FIFO gross margin and net earnings will suffer.

We cannot fully foresee the effects of changes in economic conditions on Kroger's business. We have assumed economic and competitive conditions will not change significantly for the remainder of 2009.

Other factors and assumptions not identified above 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.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There have been no material changes in our exposure to market risk from the information provided in Item 7A. Quantitative and Qualitative Disclosures About Market Risk on our Form 10-K filed with the SEC on March 31, 2009.

**Item 4. Controls and Procedures.**

The Chief Executive Officer and the Chief Financial Officer, together with a disclosure review committee appointed by the Chief Executive Officer, evaluated Kroger's disclosure controls and procedures as of the quarter ended August 15, 2009. Based on that evaluation, Kroger's Chief Executive Officer and Chief Financial Officer concluded that Kroger's disclosure controls and procedures were effective as of the end of the period covered by this report.

In connection with the evaluation described above, there was no change in Kroger's internal control over financial reporting during the quarter ended August 15, 2009, that has materially affected, or is reasonably likely to materially affect, Kroger's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. 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, 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 adverse effect on the Company's financial position.

The Company continually evaluates its exposure to loss contingencies arising from pending or threatened litigation and believes it has made adequate provisions therefor. Nonetheless, assessing and predicting the outcomes of these matters involve substantial uncertainties. It remains possible that despite management's current belief, material differences in actual outcomes or changes in management's evaluations or predictions could arise that could have a material adverse impact on the Company's financial condition or results of operation.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(c)

**ISSUER PURCHASES OF EQUITY SECURITIES**

<b>Period(1)</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)</b>	<b>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(3) (in millions)</b>
<b>First four weeks</b>				
May 24, 2009 to June 20, 2009	307	\$ 20.87	307	\$ 476
<b>Second four weeks</b>				
June 21, 2009 to July 18, 2009	1,723,146	\$ 21.99	1,723,146	\$ 459
<b>Third four weeks</b>				
July 19, 2009 to August 15, 2009	1,702,117	\$ 21.46	1,702,117	\$ 425
<b>Total</b>	<b>3,425,570</b>	<b>\$ 21.73</b>	<b>3,425,570</b>	<b>\$ 425</b>

- (1) The reported periods conform to the Company's fiscal calendar composed of thirteen 28-day periods. The second quarter of 2009 contained three 28-day periods.
- (2) Shares were repurchased under (i) a \$1 billion stock repurchase program, authorized by the Board of Directors on January 18, 2008, and (ii) a program announced on December 6, 1999, to repurchase common stock to reduce dilution resulting from our employee stock option and long-term incentive plans, which program is limited to proceeds received from exercises of stock options and the tax benefits associated therewith. The programs have no expiration date but may be terminated by the Board of Directors at any time. Total shares purchased include shares that were surrendered to the Company by participants in the Company's long-term incentive plans to pay for taxes on restricted stock awards.
- (3) Amounts shown in this column reflect amounts remaining under the \$1 billion stock repurchase program referenced in clause (i) of Note 2 above. Amounts to be repurchased under the program utilizing option exercise proceeds are dependent upon option exercise activity.

**Item 4. Submission of Matters to a Vote of Security Holders.**

(a) June 25, 2009 Annual Meeting

(c) The shareholders elected fifteen directors to serve until the annual meeting in 2010, or until their successors have been elected and qualified, and ratified the selection of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for 2009. The shareholders approved the shareholder proposal to recommend the amendment of the Company's articles of incorporation to provide that director nominees in an uncontested election shall be elected by the affirmative vote of the majority of votes cast at an annual meeting. The shareholders did not approve a shareholder proposal to recommend a schedule for increasing the percentage of eggs stocked from hens not confined in battery cages.

To serve until 2010	For	Withheld	Abstain
Reuben V. Anderson	553,584,965	12,424,396	1,427,562
Robert D. Beyer	557,616,114	8,011,824	1,808,985
David B. Dillon	552,274,911	13,897,424	1,264,588
Susan J. Kropf	561,311,977	5,387,554	737,392
John T. LaMacchia	552,820,351	13,213,059	1,403,513
David B. Lewis	561,904,852	4,640,748	891,323
Don W. McGeorge	558,472,342	8,139,741	804,840
W. Rodney McMullen	558,385,938	8,268,864	782,121
Jorge P. Montoya	561,403,799	5,214,284	818,840
Clyde R. Moore	514,844,817	51,111,823	1,480,283
Susan M. Phillips	560,363,350	5,540,781	1,532,792
Steven R. Rogel	545,163,568	20,496,289	1,777,066
James A. Runde	560,897,626	5,691,334	847,963
Ronald L. Sargent	536,949,987	28,969,568	1,517,368
Bobby S. Shackouls	560,392,002	5,457,066	1,587,855

There were no broker non-votes with respect to the election of directors.

	For	Against	Abstain	Broker Non-Votes
Approve PricewaterhouseCoopers LLP as auditors	558,435,684	7,978,492	1,002,747	
	For	Against	Abstain	Broker Non-Votes
Shareholder proposal (to recommend a schedule for increasing the percentage of eggs stocked from hens not confined in battery cages)	25,731,496	405,702,962	83,776,136	52,226,329
Shareholder proposal (to recommend the amendment of the Company's articles of incorporation to provide that director nominees shall be elected by the affirmative vote of the majority of votes cast at an annual meeting)	272,801,998	241,137,791	1,270,805	52,226,329





**Item 6. Exhibits.**

- EXHIBIT 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 20, 2006, filed with the SEC on June 29, 2006.
- EXHIBIT 3.2 - The Company's regulations are hereby incorporated by reference to Exhibit 3.2 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 26, 2007, filed with the SEC on July 3, 2007.
- EXHIBIT 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 Commission upon request.
- EXHIBIT 10.1 \* - Letter Agreement dated June 24, 2009, between the Company and Don W. McGeorge.
- EXHIBIT 31.1 - Rule 13a-14(a) / 15d-14(a) Certifications - Chief Executive Officer.
- EXHIBIT 31.2 - Rule 13a-14(a) / 15d-14(a) Certifications - Chief Financial Officer.
- EXHIBIT 32.1 - Section 1350 Certifications.
- EXHIBIT 99.1 - Additional Exhibits - Statement of Computation of Ratio of Earnings to Fixed Charges.
- EXHIBIT 101.INS - XBRL Instance Document.
- EXHIBIT 101.SCH - XBRL Taxonomy Extension Schema Document.
- EXHIBIT 101.CAL - XBRL Taxonomy Extension Calculation Linkbase Document.
- EXHIBIT 101.DEF - XBRL Taxonomy Extension Definition Linkbase Document.
- EXHIBIT 101.LAB - XBRL Taxonomy Extension Label Linkbase Document.
- EXHIBIT 101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document.

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\* Management contract or compensation plan or arrangement in which directors or executive officers are eligible to participate.

**SIGNATURES**

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### **THE KROGER CO.**

Dated: September 23, 2009

By: /s/ David B. Dillon  
David B. Dillon  
Chairman of the Board and Chief Executive Officer

Dated: September 23, 2009

By: /s/ J. Michael Schlotman  
J. Michael Schlotman  
Senior Vice President and Chief Financial Officer

**Exhibit Index**

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