

KROGER CO  
Form 10-K  
March 31, 2009

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended January 31, 2009.

OR

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

For the transition period from            to

Commission file number 1-303

**THE KROGER CO.**

(Exact name of registrant as specified in its charter)

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**Ohio**  
(State or Other Jurisdiction of Incorporation or Organization)

**31-0345740**  
(I.R.S. Employer Identification No.)

**1014 Vine Street, Cincinnati, OH**  
(Address of Principal Executive Offices)

**45202**  
(Zip Code)

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

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

| <b>Title of each class</b> | <b>Name of each exchange on which registered</b> |
|----------------------------|--|
| Common Stock \$1 par value | New York Stock Exchange                          |

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

**NONE**

(Title of class)

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

Yes  No

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

Yes  No

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

Yes  No

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

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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.

|   |                                     |                           |                          |
|---|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer   | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer (Do not check if a smaller reporting company) | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

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

Yes  No

The aggregate market value of the Common Stock of The Kroger Co. held by non-affiliates as of August 16, 2008: \$19.6 billion. There were 652,340,070 shares of Common Stock (\$1 par value) outstanding as of March 27, 2009.

### Documents Incorporated by Reference:

Portions of proxy statement to be filed pursuant to Regulation 14A of the Exchange Act on or before June 1, 2009, incorporated by reference into Part III of Form 10-K.

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**PART I**

**ITEM 1.**

**BUSINESS.**

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The Kroger Co. was founded in 1883 and incorporated in 1902. As of January 31, 2009, the Company was one of the largest retailers in the United States based on annual sales. The Company also manufactures and processes some of the food for sale in its supermarkets. The Company's principal executive offices are located at 1014 Vine Street, Cincinnati, Ohio 45202, and its telephone number is (513) 762-4000. The Company maintains a web site ([www.kroger.com](http://www.kroger.com)) that includes additional information about the Company. The Company makes available through its web site, free of charge, its annual reports on Form 10-K, its quarterly reports on Form 10-Q and its current reports on Form 8-K, including amendments thereto. These forms are available as soon as reasonably practicable after the Company has filed with, or furnished them electronically to, the SEC.

The Company's revenues are earned and cash is generated as consumer products are sold to customers in its stores. The Company earns income predominantly by selling products at price levels that produce revenues in excess of its costs to make these products available to its customers. Such costs include procurement and distribution costs, facility occupancy and operational costs, and overhead expenses.

### **EMPLOYEES**

As of January 31, 2009, the Company employed approximately 326,000 full and part-time employees. A majority of the Company's employees are covered by collective bargaining agreements negotiated with local unions affiliated with one of several different international unions. There are approximately 309 such agreements, usually with terms of three to five years.

During fiscal 2009, the Company has major labor contracts to be negotiated covering store employees in Albuquerque, Arizona, Atlanta, Dallas, Dayton, Denver and Portland. Negotiations in 2009 will be challenging as the Company must have competitive cost structures in each market while meeting our associates' needs for good wages, affordable health care and increases in Company pension contributions due to the recent downturns in the equity markets.

### **STORES**

As of January 31, 2009, the Company operated, either directly or through its subsidiaries, 2,481 supermarkets and multi-department stores, 781 of which had fuel centers. Approximately 43% of these supermarkets were operated in Company-owned facilities, including some Company-owned buildings on leased land. The Company's current strategy emphasizes self-development and ownership of store real estate. The Company's stores operate under several banners that have strong local ties and brand equity. Supermarkets are generally operated under one of the following formats: combination food and drug stores ( combo stores ); multi-department stores; marketplace stores; or price impact warehouses.

The combo stores are the primary food store format. They are typically able to earn a return above the Company's cost of capital by drawing customers from a 2 2½ mile radius. The Company believes this format is successful because the stores are large enough to offer the specialty departments that customers desire for one-stop shopping, including natural food and organic sections, pharmacies, general merchandise, pet centers and high-quality perishables such as fresh seafood and organic produce. Many combo stores include a fuel center.

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

Marketplace stores are smaller in size than multi-department stores. They offer full-service grocery and pharmacy departments as well as an expanded general merchandise area that includes outdoor living products, electronics, home goods and toys. Many marketplace stores include a fuel center.

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

In addition to the supermarkets, as of January 31, 2009, the Company operated through subsidiaries, 684 convenience stores and 385 fine jewelry stores. All of our fine jewelry stores located in malls are operated in leased locations. In addition, 87 convenience stores were operated through franchise agreements. Approximately 50% of the convenience stores operated by subsidiaries were operated in Company-owned facilities. The convenience stores offer a limited assortment of staple food items and general merchandise and, in most cases, sell gasoline.

## SEGMENTS

The Company operates retail food and drug stores, multi-department stores, jewelry stores, and convenience stores throughout the United States. The Company's retail operations, which represent substantially all of the Company's consolidated sales, earnings and total assets, are its only reportable segment. All of the Company's operations are domestic. Revenues, profit and losses, and total assets are shown in the Company's Consolidated Financial Statements set forth in Item 8 below.

## MERCHANDISING AND MANUFACTURING

Corporate brand products play an important role in the Company's merchandising strategy. Supermarket divisions typically stock approximately 14,000 private label items. The Company's corporate brand products are produced and sold in three tiers. Private Selection is the premium quality brand designed to be a unique item in a category or to meet or beat the gourmet or upscale brands. The banner brand (Kroger, Ralphs, King Soopers, etc.), which represents the majority of the Company's private label items, is designed to satisfy our customers' families with quality products. Before Kroger will carry a banner brand product, the product quality must meet our customers' expectations in taste and efficacy, and we guarantee it. Kroger Value is the value brand, designed to deliver good quality at a very affordable price.

Approximately 40% of the corporate brand units sold are produced in the Company's manufacturing plants; the remaining corporate brand items are produced to the Company's strict specifications by outside manufacturers. The Company performs a make or buy analysis on corporate brand products and decisions are based upon a comparison of market-based transfer prices versus open market purchases. As of January 31, 2009, the Company operated 40 manufacturing plants. These plants consisted of 18 dairies, 10 deli or bakery plants, five grocery product plants, three beverage plants, two meat plants and two cheese plants.

## EXECUTIVE OFFICERS OF THE REGISTRANT

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

**ITEM 1A. RISK FACTORS.**

There are risks and uncertainties that can affect our business. The significant risk factors are discussed below. Please also see the Outlook section in Item 7 of this Form 10-K for forward-looking statements and factors that could cause us not to realize our goals or meet our expectations.

**COMPETITIVE ENVIRONMENT**

The operating environment for the food retailing industry continues to be characterized by intense price competition, aggressive supercenter expansion, increasing fragmentation of retail formats, entry of non-traditional competitors and market consolidation. We have developed a strategic plan that we believe is a balanced approach that will enable Kroger to meet the wide-ranging needs and expectations of our customers in this challenging economic environment. However, the nature and extent to which our competitors implement various pricing and promotional activities in response to increasing competition - including our execution of our strategic plan - and our response to these competitive actions, can adversely affect our profitability. Our profitability and growth could also be adversely affected by changes in the overall economic environment that impact consumer spending, including discretionary spending.

**FOOD SAFETY**

Customers count on Kroger to provide them with wholesome food products. Concerns regarding the safety of food products could cause shoppers to avoid purchasing certain products from us, or to seek alternative sources of supply for all of their food needs, even if the basis for the concern is outside of our control. Any lost confidence on the part of our customers would be difficult and costly to reestablish. Any issue regarding the safety of any food items sold by Kroger, regardless of the cause, could have a substantial and adverse effect on our operations.

**LABOR RELATIONS**

A majority of our employees are covered by collective bargaining agreements with unions, and our relationship with those unions, including any work stoppages, could have an adverse impact on our financial results.

We are a party to approximately 309 collective bargaining agreements. We have major contracts to be negotiated in 2009 covering store employees in Albuquerque, Arizona, Atlanta, Dallas, Dayton, Denver and Portland. In negotiations, we expect that rising health care and pension costs, among other issues, will continue to be important topics for negotiation. Upon the expiration of our collective bargaining agreements, work stoppages by the affected workers could occur if we are unable to negotiate new contracts with labor unions. A strike could significantly disrupt our operations. Further, if we are unable to control health care, pension and wage costs, or gain operational flexibility under our collective bargaining agreements, we may experience increased operating costs and an adverse impact on future results of operations.

**STRATEGY EXECUTION**

**ITEM 1. BUSINESS.**



Our strategy focuses on improving our customers' shopping experience through improved service, product selection and price. Successful execution of this strategy requires a balance between sales growth and earnings growth. Maintaining this strategy requires the ability to identify and execute plans to generate cost savings and productivity improvements that can be invested in the merchandising and pricing initiatives necessary to support our customer-focused programs, as well as recognizing and implementing organizational changes as required. If we are unable to execute our plans, or if our plans fail to meet our customers' expectations, our sales and earnings growth expectations could be adversely affected.

#### **DATA AND TECHNOLOGY**

Our business is increasingly dependent on information technology systems that are complex and vital to continuing operations. If we were to experience difficulties maintaining existing systems or implementing new systems, we could incur significant losses due to disruptions in our operations. Additionally, these systems contain valuable proprietary data that, if breached, would have an adverse effect on Kroger.

## **INDEBTEDNESS**

As of year-end 2008, Kroger's outstanding indebtedness, including capital leases and financing obligations, totaled approximately \$8.1 billion. This indebtedness could reduce our ability to obtain additional financing for working capital, acquisitions or other purposes and could make us more vulnerable to economic downturns and competitive pressures. If debt markets do not permit us to refinance certain maturing debt, we may be required to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness. Changes in our credit ratings, or in the interest rate environment, could have an adverse effect on our financing costs and structure.

## **LEGAL PROCEEDINGS**

From time to time, we are a party to legal proceedings, including matters involving personnel and employment issues, personal injury, antitrust claims and other proceedings. Some of these proceedings, including product liability cases, could result in a substantial loss to Kroger in the event that other potentially responsible parties are unable (for financial reasons or otherwise) to satisfy a judgment entered against them. Others purport to be brought as class actions on behalf of similarly situated parties. We estimate our exposure to these legal proceedings and establish accruals for the estimated liabilities. Assessing and predicting the outcome of these matters involves substantial uncertainties. While we currently do not expect any outstanding legal proceedings to have a material effect on the financial condition of Kroger, unexpected outcomes in these legal proceedings, or changes in our evaluations or predictions about the proceedings, could have a material adverse effect on our financial results. Please also refer to the Legal Proceedings section in Item 3 below.

## **MULTI-EMPLOYER PENSION OBLIGATIONS**

As discussed in more detail below in Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies-*Post-Retirement Benefit Plans*, Kroger contributes to several multi-employer pension plans based on obligations arising under collective bargaining agreements with unions representing employees covered by those agreements. The funding status of most of those pension funds has deteriorated, and it is probable that the Company's contributions to those funds will increase significantly over the next several years. Despite the fact that the pension obligations of these funds are not the liability or responsibility of the Company, there is a risk that the agencies that rate Kroger's outstanding debt instruments could view the underfunded nature of these plans unfavorably when determining their ratings on our debt securities. Any downgrading of Kroger's debt ratings likely would increase Kroger's cost of borrowing.

## **INSURANCE**

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

## **CURRENT ECONOMIC CONDITIONS**

The global economy and financial markets have declined and experienced volatility due to uncertainties related to energy prices, availability of credit, difficulties in the banking and financial services sectors, the decline in the housing market, diminished market liquidity, falling consumer confidence and rising unemployment rates. As a result, consumers are more cautious. This could lead to reduced consumer spending, to consumers switching to a less expensive mix of products, or to consumers trading down to discounters for grocery items, all of which could affect our sales growth. We are unable to predict when the global economy and financial markets will improve. If the global economy and financial markets do not improve, our results of operations and financial condition could be adversely affected.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

**ITEM 2. PROPERTIES.**

As of January 31, 2009, the Company operated more than 3,600 owned or leased supermarkets, convenience stores, fine jewelry stores, distribution warehouses and food processing facilities through divisions, subsidiaries or affiliates. These facilities are located throughout the United States. A majority of the properties used to conduct the Company's business are leased.

The Company generally owns store equipment, fixtures and leasehold improvements, as well as processing and manufacturing equipment. The total cost of the Company's owned assets and capitalized leases at January 31, 2009, was \$23.9 billion while the accumulated depreciation was \$10.7 billion.

Leased premises generally have base terms ranging from ten-to-twenty years with renewal options for additional periods. Some options provide the right to purchase the property after conclusion of the lease term. Store rentals are normally payable monthly at a stated amount or at a guaranteed minimum amount plus a percentage of sales over a stated dollar volume. Rentals for the distribution, manufacturing and miscellaneous facilities generally are payable monthly at stated amounts. For additional information on lease obligations, see Note 8 to the Consolidated Financial Statements.

**ITEM 3. LEGAL PROCEEDINGS.**

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 January 31, 2009, an adverse decision would require a cash payment of up to approximately \$436 million, including interest.

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 in 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.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

None.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

(a)

**COMMON STOCK PRICE RANGE**

| Quarter | 2008     |          | 2007     |          |
|---------|----------|----------|----------|----------|
|         | High     | Low      | High     | Low      |
| 1st     | \$ 28.13 | \$ 23.39 | \$ 30.43 | \$ 24.74 |
| 2nd     | \$ 30.99 | \$ 25.86 | \$ 31.94 | \$ 23.95 |
| 3rd     | \$ 29.91 | \$ 22.30 | \$ 30.00 | \$ 25.30 |
| 4th     | \$ 29.03 | \$ 22.40 | \$ 29.35 | \$ 24.23 |

Main trading market: New York Stock Exchange (Symbol KR)

Number of shareholders of record at year-end 2008: 45,939

Number of shareholders of record at March 27, 2009: 45,712

During fiscal 2006, the Company's Board of Directors adopted a dividend policy and paid three quarterly dividends of \$0.065 per share. During fiscal 2007, the Company paid one quarterly dividend of \$0.065 and three quarterly dividends of \$0.075. During fiscal 2008, the Company paid one quarterly dividend of \$0.075 and three quarterly dividends of \$0.09. On March 1, 2009, the Company paid a quarterly dividend of \$0.09 per share. On March 12, 2009, the Company announced that its Board of Directors has declared a quarterly dividend of \$0.09 per share, payable on June 1, 2009, to shareholders of record at the close of business on May 15, 2009.

**PERFORMANCE GRAPH****ITEM 1. BUSINESS.**

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

Historically, our peer group has consisted of the major food store companies. In recent years there have been significant changes in the industry, including consolidation and increased competition from supercenters, drug chains, and discount stores. As a result, several years ago we changed our peer group (the Former Peer Group) to include companies operating supermarkets, supercenters and warehouse clubs in the United States as well as the major drug chains with which Kroger competes. This year, we changed our peer group (the Peer Group) once again to add Tesco plc, as it has become a significant competitor in the U.S. market.

| Company Name/Index | Base<br>Period | INDEXED RETURNS |        |                      |        |        |
|--------------------|----------------|-----------------|--------|----------------------|--------|--------|
|                    |                | 2004            | 2005   | Years Ending<br>2006 | 2007   | 2008   |
| The Kroger Co.     | 100            | 93.04           | 100.22 | 140.78               | 143.01 | 125.42 |
| S&P 500 Index      | 100            | 105.34          | 117.59 | 135.22               | 132.78 | 80.51  |
| Peer Group         | 100            | 108.99          | 107.87 | 122.24               | 125.95 | 102.29 |
| Former Peer Group  | 100            | 107.06          | 104.95 | 115.57               | 119.97 | 96.11  |

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

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\* Total assumes \$100 invested on February 1, 2004, in The Kroger Co., S&P 500 Index, the Peer Group and the Former Peer Group with reinvestment of dividends.

\*\* The Peer Group consists of Albertson's, Inc., Costco Wholesale Corp., CVS Corp, Delhaize Group SA (ADR), Great Atlantic & Pacific Tea Company, Inc., Koninklijke Ahold NV (ADR), Marsh Supermarkets Inc. (Class A), Safeway, Inc., Supervalu Inc., Target Corp., Tesco plc, Wal-Mart Stores Inc., Walgreen Co., Whole Foods Market Inc. and Winn-Dixie Stores, Inc. Albertson's, Inc., was substantially acquired by Supervalu in July 2006, and is included through 2005. Marsh Supermarkets was acquired by Marsh Supermarkets Holding Corp. in September 2006, and is included through 2005. Winn-Dixie emerged from bankruptcy in 2006 as a new issue and returns for the old and new issue were calculated then weighted to determine the 2006 return.



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\*\*\* The Former Peer Group consists of Albertson's, Inc., Costco Wholesale Corp., CVS Corp, Delhaize Group SA (ADR), Great Atlantic & Pacific Tea Company, Inc., Koninklijke Ahold NV (ADR), Marsh Supermarkets Inc. (Class A), Safeway, Inc., Supervalu Inc., Target Corp., Wal-Mart Stores Inc., Walgreen Co., Whole Foods Market Inc. and Winn-Dixie Stores, Inc. Albertson's, Inc., was substantially acquired by Supervalu in July 2006, and is included through 2005. Marsh Supermarkets was acquired by Marsh Supermarkets Holding Corp. in September 2006, and is included through 2005. Winn-Dixie emerged from bankruptcy in 2006 as a new issue and returns for the old and new issue were calculated then weighted to determine the 2006 return.

Data supplied by Standard & Poor's.

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

(c)

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period (1)                           | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (3)<br>(in millions) |
|--------------------------------------|----------------------------------|------------------------------|--|---|
| First period - four weeks            |                                  |                              |  |   |
| November 9, 2008 to December 6, 2008 | 13,315                           | \$ 28.63                     |  | \$ 493  |
| Second period - four weeks           |                                  |                              |  |   |
| December 7, 2008 to January 3, 2009  | 479,385                          | \$ 25.62                     | 450,500  | \$ 493  |
| Third period - four weeks            |                                  |                              |  |   |
| January 4, 2009 to January 31, 2009  | 164                              | \$ 24.77                     |  | \$ 493  |
| Total                                | 492,864                          | \$ 25.70                     | 450,500  | \$ 493  |

- (1) The reported periods conform to the Company's fiscal calendar composed of thirteen 28-day periods. The fourth quarter of 2008 contained three 28-day periods.
- (2) Shares were repurchased under a program announced on December 6, 1999, to repurchase common stock to reduce dilution resulting from our employee stock option plans. The program is limited to proceeds received from exercises of stock options and the tax benefits associated therewith. The program has 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, authorized by the Board of Directors on January 18, 2008. The program has no expiration date but may be terminated by the Board of Directors at any time. Amounts to be invested under the program utilizing option exercise proceeds are dependent upon option exercise activity.

## ITEM 6. SELECTED FINANCIAL DATA.

|   | January 31,<br>2009<br>(52 weeks)       | February 2,<br>2008<br>(52 weeks) | Fiscal Years Ended<br>February 3,<br>2007<br>(53 weeks) | January 28,<br>2006<br>(52 weeks) | January 29,<br>2005<br>(52 weeks) |
|---|---|-----------------------------------|---|-----------------------------------|-----------------------------------|
|   | (In millions, except per share amounts) |                                   |   |                                   |                                   |
| Sales   | \$ 76,000                               | \$ 70,235                         | \$ 66,111   | \$ 60,553                         | \$ 56,434                         |
| Net earnings (loss)   | 1,249                                   | 1,181                             | 1,115   | 958                               | (104)                             |
| Diluted earnings (loss) per share:  |   |                                   |   |                                   |                                   |
| Net earnings (loss)   | 1.90                                    | 1.69                              | 1.54  | 1.31                              | (0.14)                            |
| Total assets  | 23,211                                  | 22,293                            | 21,210  | 20,478                            | 20,491                            |
| Long-term liabilities, including<br>obligations under capital leases and<br>financing obligations | 10,311                                  | 8,696                             | 8,711   | 9,377                             | 10,537                            |
| Shareowners' equity   | 5,176                                   | 4,914                             | 4,923   | 4,390                             | 3,619                             |
| Cash dividends per common share   | 0.345                                   | 0.29                              | 0.195   |                                   |                                   |

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

**OUR BUSINESS**

The Kroger Co. was founded in 1883 and incorporated in 1902. It is one of the nation's largest retailers, as measured by revenue, operating 2,481 supermarket and multi-department stores under two dozen banners including Kroger, Ralphs, Fred Meyer, Food 4 Less, King Soopers, Smith's, Fry's, Fry's Marketplace, Dillons, QFC and City Market. Of these stores, 781 have fuel centers. We also operate 771 convenience stores and 385 fine jewelry stores.

Kroger operates 40 manufacturing plants, primarily bakeries and dairies, which supply approximately 40% of the corporate brand units sold in our retail outlets.

Our revenues are earned and cash is generated as consumer products are sold to customers in our stores. We earn income predominately by selling products at price levels that produce revenues in excess of the costs we incur to make these products available to our customers. Such costs include procurement and distribution costs, facility occupancy and operational costs, and overhead expenses. Our operations are reported as a single reportable segment: the retail sale of merchandise to individual customers.

**OUR 2008 PERFORMANCE**

By focusing on the customer through our Customer 1st strategy, we were able to report solid results for fiscal year 2008 in a particularly tough economy. At the beginning of the year, we expected to grow supermarket identical sales, excluding fuel, by 3% to 5%. For 2008, supermarket identical sales, excluding fuel, were 5.0%, meeting the upper end of our original guidance.

At the outset of fiscal year 2008, Kroger's earnings guidance was a range of \$1.83 to \$1.90 per diluted share. Our 2008 earnings was \$1.90 per diluted share or \$1.92 per diluted share, excluding the effect of a \$.02 per diluted share charge for damage and disruption caused by Hurricane Ike. Our 2008 earnings of \$1.92 per diluted share, excluding the charge for damage and disruption caused by Hurricane Ike, represents a growth rate of 13.6% over Kroger's 2007 full-year earnings of \$1.69 per diluted share. We believe that this growth plus Kroger's dividend yield of more than 1%, creates a strong return for shareholders.

Our market share also rose in 2008. Based on our internal data and analysis, we estimate that our market share increased approximately 61 basis points in 2008 across our 42 major markets. We define a major market as one in which we operate nine or more stores. This is the fourth consecutive year Kroger has achieved significant market share gain. Over the past four years combined, Kroger's market share in our major markets has increased approximately 225 basis points. Market share is critical to us because it allows us to leverage the fixed costs in our business over a wider revenue base. We hold the number one or number two market share position in 39 of our 42 major markets. Our fundamental operating philosophy is to maintain and increase market share.

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These market share results demonstrate to us that our long-term strategy is working. As population growth continues in the major markets where we operate, we intend to continue to grow Kroger's business by maintaining our existing strong market share and by building on additional opportunities for sales growth. We estimate that approximately 45% of the share in our major markets as much as \$100 billion is held by competitors who do not have Kroger's economies of scale. Our economies of scale allow us to deliver increasing value to customers, which is a competitive edge, particularly in today's economic climate.

Kroger's business model is structured to produce sustainable earnings per share growth in a variety of economic and competitive conditions, primarily through strong identical sales growth. We believe this is the right approach to produce sustainable earnings growth over a long period of time. We recognize that continual investment in our Customer 1st strategy is necessary to drive strong, sustainable identical sales growth. We believe that this Customer 1st strategy along with our financial strategies are delivering value to customers, shareholders, bondholders, and our associates, and so we remain committed to our plan.

## RESULTS OF OPERATIONS

The following discussion summarizes our operating results for 2008 compared to 2007 and for 2007 compared to 2006. Comparability is affected by certain income and expense items that fluctuated significantly between and among the periods.

### *Net Earnings*

Net earnings totaled \$1.2 billion for 2008, compared to net earnings totaling \$1.2 billion in 2007 and \$1.1 billion in 2006. The increase in our net earnings for 2008, compared to 2007 and 2006, resulted from strong non-fuel identical supermarket sales growth and strong fuel results. In addition, 2006 net earnings included a 53rd week.

Earnings per diluted share totaled \$1.90 or \$1.92, excluding the effect of a \$.02 per diluted share charge for damage and disruption caused by Hurricane Ike, in 2008, compared to \$1.69 per diluted share in 2007 and \$1.54 per diluted share in 2006. Earnings per diluted share increased 13.6% in 2008, excluding the effect of a \$.02 per diluted share charge for damage and disruption caused by Hurricane Ike, compared to 2007. Earnings per diluted share increased 15% in 2007, compared to 2006, after adjusting for the extra week in fiscal 2006. Net earnings in 2006 benefited from a 53rd week by an estimated \$.07 per share. Our earnings per share growth in 2008, 2007 and 2006 resulted from increased net earnings, strong identical sales growth and the repurchase of Kroger stock. During fiscal 2008, we repurchased 24 million shares of Kroger stock for a total investment of \$637 million. During fiscal 2007, we repurchased 53 million shares of our stock for a total investment of \$1.4 billion. During fiscal 2006, we repurchased 29 million shares of Kroger stock for a total investment of \$633 million.

### *Sales*



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**Total Sales**

(in millions)

|                                     | <b>2008</b>      | <b>Percentage<br/>Increase</b> |           | <b>2007</b>   | <b>Percentage<br/>Increase</b> |           | <b>2006</b>   |
|-------------------------------------|------------------|--------------------------------|-----------|---------------|--------------------------------|-----------|---------------|
| Total food store sales without fuel | \$ 63,795        | 6.1%                           | \$        | 60,142        | 4.2%                           | \$        | 57,712        |
| Total food store fuel sales         | 7,464            | 30.0%                          |           | 5,741         | 28.9%                          |           | 4,455         |
| Total food store sales              | \$ 71,259        | 8.2%                           | \$        | 65,883        | 6.0%                           | \$        | 62,167        |
| Other sales(1)                      | 4,741            | 8.9%                           |           | 4,352         | 10.3%                          |           | 3,944         |
| <b>Total Sales</b>                  | <b>\$ 76,000</b> | <b>8.2%</b>                    | <b>\$</b> | <b>70,235</b> | <b>6.2%</b>                    | <b>\$</b> | <b>66,111</b> |

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

The growth in our total sales in 2008 over fiscal 2007 was primarily the result of identical supermarket sales increases, increased fuel gallon sales, and inflation across most departments. Identical supermarket sales and total sales, excluding fuel, increased due to increased transaction count and average transaction size, and inflation across all departments. After adjusting for the extra week in fiscal 2006, total sales increased 8.2% in 2007 over fiscal 2006.

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. Annualized identical supermarket sales include all sales at the Fred Meyer multi-department stores. We calculate annualized identical supermarket sales by adding together four quarters of identical supermarket sales. Our identical supermarket sales results are summarized in the table below, based on the 52-week period of 2008, compared to the 52-week period of the previous year. The identical store count in the table below represents the total number of identical supermarkets as of January 31, 2009 and February 2, 2008.



**Identical Supermarket Sales**

(in millions)

|                                    | 2008      |    | 2007   |
|------------------------------------|-----------|----|--------|
| Including supermarket fuel centers | \$ 67,185 | \$ | 62,878 |
| Excluding supermarket fuel centers | \$ 60,300 | \$ | 57,416 |
| Including supermarket fuel centers | 6.9%      |    | 6.9%   |
| Excluding supermarket fuel centers | 5.0%      |    | 5.3%   |
| Identical 4th Quarter store count  | 2,369     |    | 2,280  |

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. Annualized comparable supermarket sales include all Fred Meyer multi-department stores. We calculate annualized comparable supermarket sales by adding together four quarters of comparable sales. Our annualized comparable supermarket sales results are summarized in the table below, based on the 52-week period of 2008, compared to the same 52-week period of the previous year. The comparable store count in the table below represents the total number of comparable supermarkets as of January 31, 2009 and February 2, 2008.

**Comparable Supermarket Sales**

(in millions)

|                                    | 2008      |    | 2007   |
|------------------------------------|-----------|----|--------|
| Including supermarket fuel centers | \$ 69,762 | \$ | 65,066 |
| Excluding supermarket fuel centers | \$ 62,492 | \$ | 59,372 |
| Including supermarket fuel centers | 7.2%      |    | 7.2%   |
| Excluding supermarket fuel centers | 5.3%      |    | 5.5%   |
| Comparable 4th Quarter store count | 2,444     |    | 2,352  |

*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 rates were 23.20% in 2008, 23.65% in 2007 and 24.27% in 2006. Our retail fuel sales reduce 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 rates decreased 15 basis points in 2008, 20 basis points in 2007 and 26 basis points in 2006. The decrease in our non-fuel FIFO gross margin rate reflects our continued reinvestment of operating cost savings into lower prices for our customers. In addition, FIFO gross margin in 2008, compared to 2007, decreased due to high inflation in product costs.

### *LIFO Charge*



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The LIFO charge was \$196 million in 2008, \$154 million in 2007 and \$50 million in 2006. Like many food retailers, we continued to experience product cost inflation in 2008 at levels that have not occurred for several years. This increase in product cost inflation caused the increase in the LIFO charge in 2008, compared to 2007 and 2006. In addition, product cost inflation in 2007, compared to 2006, caused the increase in the LIFO charge in 2007 compared to 2006.

*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, were 16.95% in 2008, 17.31% in 2007 and 17.91% in 2006. The growth in our retail fuel sales reduces 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 3 basis points in 2008, 33 basis points in 2007 and 9 basis points in 2006. The decrease in our OG&A rate in 2008, excluding the effect of retail fuel operations, was primarily the result of increased identical supermarkets sales growth and a settlement received from credit card processors, partially offset by the \$25 million charge related to Hurricane Ike and increases in credit card fees and health care costs. The decrease in our OG&A rate in 2007, excluding the effect of retail fuel operations, was primarily the result of strong identical sales growth, increased productivity, and progress that was made in 2007 in controlling our utility, health care and pension costs. These improvements were partially offset by increases in credit card fees. Excluding the effect of retail fuel operations and expenses recorded for one-time legal reserves, our OG&A rate declined 16 basis points in 2006.

*Rent Expense*





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Rent expense was \$659 million in 2008, as compared to \$644 million in 2007 and \$649 million in 2006. Rent expense, as a percent of sales, was 0.87% in 2008, as compared to 0.92% in 2007 and 0.98% in 2006. The decrease in rent expense, as a percent of sales, reflects our increasing sales and our continued emphasis on owning rather than leasing whenever possible.

### *Depreciation and Amortization Expense*



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Depreciation expense was \$1.4 billion in 2008, \$1.4 billion in 2007 and \$1.3 billion in 2006. The increases in depreciation and amortization expense were the result of capital expenditures totaling \$2.2 billion in 2008, \$2.1 billion in 2007 and \$1.8 billion in 2006. Depreciation and amortization expense, as a percent of sales, was 1.90% in 2008, 1.93% in 2007 and 1.92% in 2006. The decrease in depreciation and amortization expense in 2008, compared to 2007, as a percent of sales, is primarily the result of increasing sales. The increase in our depreciation and amortization expense in 2007, compared to 2006, as a percent of sales, is due to an annual depreciation charge in both years with 2006 containing 53 weeks of sales due to the structure of our fiscal calendar.

### *Interest Expense*



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Net interest expense totaled \$485 million in 2008, \$474 million in 2007 and \$488 million in 2006. The increase in interest expense in 2008, compared to 2007, was primarily the result of an increase in the average total debt balance for the year, partially offset by interest income related to the mark-to-market of ineffective fair value swaps. The decrease in interest expense in 2007, compared to 2006, was the result of replacing borrowings with new borrowings at a lower interest rate. The average total debt balance in 2007 was comparable to 2006.

### *Income Taxes*



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Our effective income tax rate was 36.5% in 2008, 35.4% in 2007 and 36.2% in 2006. The effective tax rates for those years differed from the federal statutory rate primarily due to the effect of state income taxes. In addition, the effective tax rate for 2007 differs from the expected federal statutory rate due to the resolution of some tax issues. The effective rate in 2006 includes an adjustment of some deferred tax balances.

During the third quarter of 2007, we resolved favorably some outstanding tax issues. This resulted in a 2007 tax benefit of approximately \$40 million and reduced our effective tax rate by 1.9%.

In 2006, during the reconciliation of our deferred tax balances, and after the filing of our annual federal and state tax returns, we identified adjustments to be made in prior years' deferred tax reconciliation. We corrected these deferred tax balances in our Consolidated Financial Statements for the year ended February 3, 2007, which resulted in a reduction of our fiscal 2006 provision for income tax expense of approximately \$21 million and reduced the rate by 1.2%. We do not believe these adjustments are material to our Consolidated Financial Statements for the year ended February 3, 2007, or to any prior years' Consolidated Financial Statements. As a result, we have not restated any prior year amounts.



## COMMON STOCK REPURCHASE PROGRAM

We maintain stock repurchase programs that comply with Securities Exchange Act Rule 10b5-1 and allow for the orderly repurchase of our common stock, from time to time. We made open market purchases totaling \$448 million in 2008, \$1.2 billion in 2007 and \$374 million in 2006 under these repurchase programs. In addition to these repurchase programs, in December 1999 we began a program to repurchase common stock to reduce dilution resulting from our employee stock option plans. This program is solely funded by proceeds from stock option exercises, and the tax benefit from these exercises. We repurchased approximately \$189 million in 2008, \$270 million in 2007 and \$259 million in 2006 under the stock option programs.

In 2008, to preserve liquidity and financial flexibility, we reduced the amount of stock repurchased during the year, decreasing the cash used for stock purchases in 2008, compared to 2007.

## CAPITAL EXPENDITURES

Capital expenditures, including changes in construction-in-progress payables and excluding acquisitions, totaled \$2.2 billion in 2008 compared to \$2.1 billion in 2007 and \$1.8 billion in 2006. The increase in capital spending in 2008 compared to 2007 and 2006 was the result of increasing our focus on remodels, merchandising and productivity projects. The table below shows our supermarket storing activity and our total food store square footage:

### Supermarket Storing Activity

|   | 2008  | 2007  | 2006  |
|---|-------|-------|-------|
| Beginning of year                             | 2,486 | 2,468 | 2,507 |
| Opened  | 21    | 23    | 20    |
| Opened (relocation)                           | 14    | 9     | 17    |
| Acquired                                      | 6     | 38    | 1     |
| Acquired (relocation)                         | 3     | 1     |       |
| Closed (operational)                          | (32)  | (43)  | (60)  |
| Closed (relocation)                           | (17)  | (10)  | (17)  |
| End of year                                   | 2,481 | 2,486 | 2,468 |
| Total food store square footage (in millions) | 147   | 145   | 142   |

## CRITICAL ACCOUNTING POLICIES

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

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

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

*Self-Insurance Costs*



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We primarily are self-insured for costs related to workers' compensation and general liability claims. The liabilities represent our best estimate, using generally accepted actuarial reserving methods, of the ultimate obligations for reported claims plus those incurred but not reported for all claims incurred through January 31, 2009. We establish case reserves for reported claims using case-basis evaluation of the underlying claim data and we update as information becomes known.

For both workers' compensation and general liability claims, we have purchased stop-loss coverage to limit our exposure to any significant exposure on a per claim basis. We are insured for covered costs in excess of these per claim limits. We account for the liabilities for workers' compensation claims on a present value basis utilizing a risk-adjusted discount rate. A 25 basis point decrease in our discount rate would increase our liability by approximately \$4 million. General liability claims are not discounted.

We are also similarly self-insured for property-related losses. We have purchased stop-loss coverage to limit our exposure to losses in excess of \$25 million on a per claim basis, except in the case of an earthquake, for which stop-loss coverage is in excess of \$50 million per claim, up to \$200 million per claim in California and \$300 million outside of California.

The assumptions underlying the ultimate costs of existing claim losses are subject to a high degree of unpredictability, which can affect the liability recorded for such claims. For example, variability in inflation rates of health care costs inherent in these claims can affect the amounts realized. Similarly, changes in legal trends and interpretations, as well as a change in the nature and method of how claims are settled can affect ultimate costs. Our estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, and any changes could have a considerable effect on future claim costs and currently recorded liabilities.

### *Impairments of Long-Lived Assets*



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In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we monitor 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, we perform an impairment calculation, comparing projected undiscounted cash flows, utilizing current cash flow information and expected growth rates related to specific stores, to the carrying value for those stores. If we identify impairment for long-lived assets to be held and used, we compare the assets' current carrying value to the assets' fair value. Fair value is determined based on market values or discounted future cash flows. We record impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for disposal, we adjust the value of the property and equipment to reflect recoverable values based on our previous efforts to dispose of similar assets and current economic conditions. We recognize impairment for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. We recorded asset impairments in the normal course of business totaling \$26 million in 2008, \$24 million in 2007 and \$61 million in 2006. We record costs to reduce the carrying value of long-lived assets in the Consolidated Statements of Operations as Operating, general and administrative expense.

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

*Goodwill*





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We review goodwill for impairment during the fourth quarter of each year, and also upon the occurrence of trigger events. We perform reviews at the operating division level. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and we compare fair value to the carrying value of a division for purposes of identifying potential impairment. We base projected future cash flows on management's knowledge of the current operating environment and expectations for the future. If we identify potential for impairment, we measure the fair value of a division against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the division's goodwill. We recognize goodwill impairment for any excess of the carrying value of the division's goodwill over the implied fair value. If actual results differ significantly from anticipated future results for certain reporting units, we would need to recognize an impairment loss for any excess of the carrying value of the division's goodwill over the implied fair value. Results of the goodwill impairment reviews performed during 2008, 2007 and 2006 are summarized in Note 2 to the Consolidated Financial Statements.

The annual impairment review requires the extensive use of accounting judgment and financial estimates. Application of alternative assumptions and definitions, such as reviewing goodwill for impairment at a different organizational level, could produce significantly different results. Similar to our policy on impairment of long-lived assets, the cash flow projections embedded in our goodwill impairment reviews can be affected by several items such as inflation, business valuations in the market, the economy and market competition.

*Store Closing Costs*



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We provide for closed store liabilities relating to the present value of the estimated remaining noncancellable lease payments after the closing date, net of estimated subtenant income. We estimate the net lease liabilities using a discount rate to calculate the present value of the remaining net rent payments on closed stores. We usually pay closed store lease liabilities 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. We make adjustments for changes in estimates in the period in which the change becomes known. We review store closing liabilities 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 earnings in the proper period.

We estimate subtenant income, future cash flows and asset recovery values based on our experience and knowledge of the market in which the closed store is located, our previous efforts to dispose of similar assets and current economic conditions. The ultimate cost of the disposition of the leases and the related assets is affected by current real estate markets, inflation rates and general economic conditions.

We reduce owned stores held for disposal to their estimated net realizable value. We account for costs to reduce the carrying values of property, equipment and leasehold improvements in accordance with our policy on impairment of long-lived assets. We classify inventory write-downs in connection with store closings, if any, in Merchandise costs. We expense costs to transfer inventory and equipment from closed stores as they are incurred.

### *Post-Retirement Benefit Plans*



(a) Company-sponsored defined benefit Pension Plans

We account for our defined benefit pension plans using the recognition and disclosure provisions of SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 99, 106 and 132(R)* (SFAS 158), which require the recognition of the funded status of retirement plans on the Consolidated Balance Sheet. We record, as a component of Accumulated Other Comprehensive Income ( AOCI ), actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized. We adopted the measurement date provisions of SFAS 158 effective February 3, 2008. The majority of our pension and postretirement plans previously used a December 31 measurement date. All plans are now measured as of our fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareowners' equity by approximately \$5 million (\$3 million after-tax) and increased long-term liabilities by approximately \$5 million. There was no effect on our results of operations.

The determination of our obligation and expense for Company-sponsored pension plans and other post-retirement benefits is dependent upon our selection of assumptions used by actuaries in calculating those amounts. Those assumptions are described in Note 13 to the Consolidated Financial Statements and 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. Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect our recognized expense and recorded obligation in future periods. While we believe that our assumptions are appropriate, significant differences in our actual experience or significant changes in our assumptions, including the discount rate used and the expected return on plan assets, may materially affect our pension and other post-retirement obligations and our future expense. Note 13 to the Consolidated Financial Statements discusses the effect of a 1% change in the assumed health care cost trend rate on other post-retirement benefit costs and the related liability.

The objective of our discount rate assumption is to reflect the rate at which the pension benefits could be effectively settled. In making this determination, we take into account the timing and amount of benefits that would be available under the plans. Our methodology for selecting the discount rate as of year-end 2008 was to match the plan's cash flows to that of a yield curve that provides the equivalent yields on zero-coupon corporate bonds for each maturity. Benefit cash flows due in a particular year can be settled theoretically by investing them in the zero-coupon bond that matures in the same year. The discount rate is the single rate that produces the same present value of cash flows. The selection of the 7.00% discount rate as of year-end 2008 represents the equivalent single rate under a broad-market AA yield curve constructed by an outside consultant. We utilized a discount rate of 6.50% for year-end 2007. The 50 basis point increase in the discount rate decreased the projected pension benefit obligation as of January 31, 2009, by approximately \$147 million.

To determine the expected return on pension plan assets, we consider current and forecasted plan asset allocations as well as historical and forecasted returns on various asset categories. For 2008 and 2007, we assumed a pension plan investment return rate of 8.5%. Our pension plan's average return was 4.1% for the 10 calendar years ended December 31, 2008, net of all investment management fees and expenses, primarily due to the poor performance of the financial markets in 2008. The value of all investments in our Company-sponsored defined benefit pension plans during the calendar year ending December 31, 2008, net of investment management fees and expenses declined 26.1%. We believe our 8.5% pension return assumption is appropriate because we expect that future returns will achieve the same level of performances as the very long-term historical average annual return (for example, the S&P 500 Index has returned 8.4% annually on a compound basis for the 20 years ending December 31, 2008) for the various markets in which the plan invests. We have been advised that during 2009, the trustees plan to increase the allocation of non-core assets, including high yield debt securities, commodities and real estate. Collectively, these changes should improve the diversification of pension plan assets. The trustees have advised us that they expect these changes will have little effect on the total portfolio risk but will increase the likelihood of achieving the 8.5% expected rate of return. See Note 13 to the Consolidated Financial Statements for more information on the asset allocations of pension plan assets.

Sensitivity to changes in the major assumptions used in the calculation of Kroger's pension plan liabilities for the qualified plans is illustrated below (in millions).

|                           | Percentage<br>Point Change | Projected Benefit<br>Obligation<br>Decrease/(Increase) | Expense<br>Decrease/(Increase) |
|---------------------------|----------------------------|--|--------------------------------|
| Discount Rate             | +/- 1.0%                   | \$ 257/\$(309)   | \$ 13/\$(28)                   |
| Expected Return on Assets | +/- 1.0%                   |  | \$ 21/\$(21)                   |

We contributed \$20 million in 2008, \$52 million in 2007 and \$150 million in 2006 to our Company-sponsored defined benefit pension plans. Although Kroger is not required to make cash contributions to its Company-sponsored defined benefit pension plans during fiscal 2009, we made a \$200 million cash contribution on February 2, 2009. Additional contributions may be made if required under the Pension Protection Act to avoid any benefit restrictions. We expect any voluntary contributions made during 2009 will reduce our minimum 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.

Net periodic benefit cost decreased in 2008 and 2007 compared to 2006 due to participants in the Cash Balance formula of the Consolidated Retirement Benefit Plan being moved to a defined contribution 401(k) retirement savings account plan effective January 1, 2007. Participants under that formula continue to earn interest on prior contributions but no additional pay credits will be earned. The 401(k) retirement savings plan provides to eligible employees both matching contributions and automatic contributions from Kroger based on participant contributions, plan compensation, and length of service. We contributed and expensed \$92 million in 2008 and \$90 million in 2007 to employee 401(k) retirement savings accounts.

(b) Multi-Employer Plans

We also contribute to various multi-employer pension plans based on obligations arising from most of our 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.



We recognize expense in connection with these plans as contributions are funded, in accordance with GAAP. We made contributions to these plans, and recognized expense, of \$219 million in 2008, \$207 million in 2007, and \$204 million in 2006.

Based on the most recent information available to us, we believe that the present value of actuarially accrued liabilities in most or all of these multi-employer plans substantially exceeds the value of the assets held in trust to pay benefits. We have attempted to estimate the amount by which these liabilities exceed the assets, (i.e., the amount of underfunding), as of December 31, 2008. Because Kroger is only one of a number of employers contributing to these plans, we also have attempted to estimate the ratio of Kroger's contributions to the total of all contributions to these plans in a year as a way of assessing Kroger's share of the underfunding. Nonetheless, the underfunding is not a direct obligation or liability of Kroger or of any employer. As of December 31, 2008, we estimate that Kroger's share of the underfunding of multi-employer plans to which Kroger contributes was \$3.0 billion, pre-tax, or \$1.9 billion, after-tax. This represents an increase in the amount of underfunding estimated as of December 31, 2008, compared to December 31, 2007. The increase in the amount of underfunding is attributable to the recent market downturn. Our estimate is based on the best information available to us including actuarial evaluations and other data (that include the estimates of others), and such information may be outdated or otherwise unreliable. Our estimate is imprecise and not necessarily reliable.

We have made and disclosed this estimate not because this underfunding is a direct liability of Kroger. Rather, we believe the underfunding is likely to have important consequences. In 2008, our contributions to these plans increased approximately 6% over the prior year and have grown at a compound annual rate of approximately 6% since 2004. We do not expect a significant increase in our contributions to multi-employer pension plans in 2009, compared to 2008, subject to collective bargaining and capital market conditions. We believe our contributions to multi-employer pension plans could as much as double over the next several years, after 2009, to reduce this underfunding. Finally, underfunding means that, in the event we were to exit certain markets or otherwise cease making contributions to these funds, we could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated, in accordance with SFAS No. 87, *Employers' Accounting for Pensions*.

The amount of underfunding described above is an estimate and could change based on contract negotiations, returns on the assets held in the multi-employer plans and benefit payments. The amount could decline, and Kroger's future expense would be favorably affected, if the values of the assets held in the trust significantly increase or if further changes occur through collective bargaining, trustee action or favorable legislation. On the other hand, Kroger's share of the underfunding could increase and Kroger's future expense could be adversely affected if the asset values decline, if employers currently contributing to these funds cease participation or if changes occur through collective bargaining, trustee action or adverse legislation.

#### *Deferred Rent*



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We recognize rent holidays, including the time period during which we have access to the property for construction of buildings or improvements, as well as construction allowances and escalating rent provisions on a straight-line basis over the term of the lease. The deferred amount is included in Other Current Liabilities and Other Long-Term Liabilities on the Consolidated Balance Sheets.

### *Fair Value of Financial Instruments*



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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 *Partial Deferral of the Effective Date of Statement No. 157* (FSP 157-2), deferred the effective date of SFAS 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. Effective February 3, 2008, we adopted SFAS 157, except for non-financial assets and non-financial liabilities which are deferred until February 1, 2009 by FSP 157-2.

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 January 31, 2009:

**Fair Value Measurements Using**

(in millions)

|                               | <b>Quoted Prices in<br/>Active Markets<br/>for Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b> |
|-------------------------------|---|--|--|--------------|
| Available-for-Sale Securities | \$ 11   | \$   | \$   | \$ 11        |

*Variable Interest Entities*



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In December 2008, the FASB issued FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FAS 140-4 and FIN 46(R)-8). FAS 140-4 and FIN 46(R)-8 require additional disclosures about an entity's involvement with variable interest entities and transfers of financial assets. Effective January 31, 2009, we adopted FAS 140-4 and FIN 46(R)-8.

In the first quarter of 2008, we made an investment in The Little Clinic LLC (TLC). TLC operates supermarket walk-in medical clinics in seven states, primarily in the Midwest and Southeast. At the date of investment, TLC was determined to be a variable-interest entity (VIE) under FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), with Kroger being the primary beneficiary. We were deemed the primary beneficiary due to our current ownership interest and half of our written put options being at a floor price. As a result, we consolidated TLC in accordance with FIN 46R. The minority interest was recorded at fair value on the acquisition date. The fair value of TLC was determined based on the amount of the investment made by Kroger and the percentage acquired. Our assessment of goodwill represents the excess of this amount over the fair value of TLC's net assets as of the investment date. Creditors of TLC have no recourse to the general credit of Kroger. Conversely, creditors of Kroger have no recourse to the assets of TLC. In addition, if requested by TLC's Board of Directors by January 1, 2010, we have agreed to make a pro rata portion of an additional capital contribution.



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The table below shows the unaudited amounts of assets and liabilities from TLC included in our consolidated results, after eliminating intercompany items, as of January 31, 2009 (in millions of dollars):

|                                    | <b>2008</b>   |
|------------------------------------|---------------|
| Current assets                     | \$ 31         |
| Property, plant and equipment, net | 7             |
| Goodwill                           | 102           |
| Other assets                       | 1             |
| <b>Total Assets</b>                | <b>\$ 141</b> |
| Current liabilities                | \$ 4          |
| Minority interests                 | \$ 82         |

In the fourth quarter of 2008, we became the primary beneficiary of i-wireless, LLC a VIE in which we have a 25% ownership interest. We were deemed the primary beneficiary due to our current ownership interest, \$25 million line of credit guarantee, and \$8 million loan to i-wireless, LLC. We became the primary beneficiary, in the fourth quarter of 2008, under FIN 46R after lending \$8 million to i-wireless, LLC. i-wireless, LLC sells prepaid phones primarily in our stores. The minority interest was recorded at fair value. The fair value of i-wireless, LLC was determined based on the amount of the investment made by Kroger in the fourth quarter of 2007 and the percentage acquired. Our assessment of goodwill represents the excess of this amount over the fair value of i-wireless, LLC net assets as of the date of the loan. We have guaranteed the indebtedness of i-wireless, LLC, up to \$25 million, which is collateralized by \$8 million of inventory located in our stores. The creditors of Kroger have no recourse to the assets of i-wireless, LLC.

The table below shows the preliminary and unaudited amounts of assets and liabilities from i-wireless, LLC included in our consolidated results, after eliminating intercompany items, as of January 31, 2009 (in millions of dollars):

|                                    | <b>2008</b>  |
|------------------------------------|--------------|
| Current assets                     | \$ 10        |
| Property, plant and equipment, net | 2            |
| Goodwill                           | 25           |
| Other assets                       | 5            |
| <b>Total Assets</b>                | <b>\$ 42</b> |
| Current liabilities                | \$ 5         |
| Long-term debt                     | \$ 30        |
| Minority interests                 | \$ 1         |

*Share-Based Compensation Expense*

We account for stock options under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)). Under this method, we recognize compensation expense for all share-based payments granted after January 29, 2006, as well as all share-based payments granted prior to, but not yet vested as of, January 29, 2006, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), we recognize share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award. In addition, we account for restricted stock awards under SFAS 123(R). We record expense for restricted stock awards in an amount equal to the fair market value of the underlying stock on the grant date of the award, over the period the awards lapse.

*Inventories*



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Inventories are stated at the lower of cost (principally on a LIFO basis) or market. In total, approximately 98% in 2008 and 97% in 2007 of inventories were valued using the LIFO method. Cost for the balance of the inventories was determined using the FIFO method. Replacement cost was higher than the carrying amount by \$800 million at January 31, 2009, and by \$604 million at February 2, 2008. We follow the Link-Chain, Dollar-Value LIFO method for purposes of calculating our LIFO charge or credit.

We follow the item-cost method of accounting to determine inventory cost before the LIFO adjustment for substantially all store inventories at our supermarket divisions. This method involves counting each item in inventory, assigning costs to each of these items based on the actual purchase costs (net of vendor allowances and cash discounts) of each item and recording the cost of items sold. The item-cost method of accounting allows for more accurate reporting of periodic inventory balances and enables management to more precisely manage inventory and purchasing levels when compared to the methodology followed under the retail method of accounting.

We evaluate inventory shortages throughout the year based on actual physical counts in our facilities. We record allowances for inventory shortages based on the results of recent physical counts to provide for estimated shortages from the last physical count to the financial statement date.

### *Vendor Allowances*



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We recognize all vendor allowances as a reduction in merchandise costs when the related product is sold. In most cases, vendor allowances are applied to the related product by item, and therefore reduce the carrying value of inventory by item. When it is not practicable to allocate vendor allowances to the product by item, we recognize vendor allowances as a reduction in merchandise costs based on inventory turns and as the product is sold. We recognized approximately \$3.5 billion in 2008, \$3.6 billion in 2007 and \$3.3 billion in 2006 of vendor allowances as a reduction in merchandise costs. We recognized more than 85% of all vendor allowances in the item cost with the remainder being based on inventory turns.

**LIQUIDITY AND CAPITAL RESOURCES**

*Cash Flow Information*





Net cash provided by operating activities

We generated \$2.9 billion of cash from operations in 2008 compared to \$2.6 billion in 2007 and \$2.4 billion in 2006. The increase in cash generated from operating activities was primarily due to strong operating results adjusted for non-cash expenses. In addition, changes in our operating assets and liabilities also affected the amount of cash provided by our operating activities. We realized decreases in cash from changes in operating assets and liabilities of \$411 million in 2008, \$164 million in 2007 and \$129 million in 2006. The increase in the change in operating assets and liabilities in 2008, compared to 2007, is primarily due to an increase in income taxes receivable. The increase in the change in operating assets and liabilities in 2007, compared to 2006, is primarily attributable to an increase in forward inventory buying activity. These amounts are also net of cash contributions to our Company-sponsored defined benefit pension plans totaling \$20 million in 2008, \$52 million in 2007, and \$150 in 2006.

Net cash used by investing activities

Cash used by investing activities was \$2.2 billion in 2008, compared to \$2.2 billion in 2007 and \$1.6 billion in 2006. Our use of cash for investing activities was consistent in 2008, compared to 2007. The amount of cash used by investing activities increased in 2007, compared to 2006, due primarily to higher capital spending and payments for two acquisitions. Capital expenditures, including changes in construction-in-progress payables and excluding acquisitions, were \$2.2 billion in 2008, \$2.1 billion in 2007 and \$1.8 billion in 2006. Refer to the Capital Expenditures section for an overview of our supermarket storing activity during the last three years.

Net cash used by financing activities

Financing activities used \$769 million of cash in 2008 compared to \$310 million in 2007 and \$785 million in 2006. The increase in the amount of cash used in 2008, compared to 2007, was primarily a result of payments on long term-debt and the bank revolver, offset by decreased stock repurchases. The decrease in the amount of cash used in 2007, compared to 2006, was primarily a result of proceeds received from the issuance of long term-debt, offset by greater stock repurchases and dividends paid. We repurchased \$637 million of Kroger stock in 2008 compared to \$1.4 billion in 2007 and \$633 million in 2006. We paid dividends totaling \$227 million in 2008, \$202 million in 2007 and \$140 million in 2006.

*Debt Management*



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Total debt, including both the current and long-term portions of capital leases and financing obligations, decreased \$59 million to \$8.1 billion as of year-end 2008 from \$8.1 billion as of year-end 2007. The slight decrease in 2008, compared to 2007, resulted from the issuance of \$400 million of senior notes bearing an interest rate of 5.00%, \$375 million of senior notes bearing an interest rate of 6.90% and \$600 million of senior notes bearing an interest rate of 7.50%, offset by decreased commercial paper, the payments on the bank revolver, the repayment of \$200 million of senior notes bearing an interest rate of 6.375% and \$750 million of senior notes bearing an interest rate of 7.45% that came due in 2008. Total debt increased to \$8.1 billion as of year-end 2007 from \$7.1 billion as of year-end 2006. The increases in 2007, compared to 2006, resulted from the issuance of \$600 million of senior notes bearing an interest rate of 6.4%, \$750 million of senior notes bearing an interest rate of 6.15% and borrowings under the bank credit facility in 2007, offset by the repayment of \$200 million of senior notes bearing an interest rate of 7.65% and \$300 million of senior notes bearing an interest rate of 7.80% that came due in 2007.

Our total debt balances were also affected by our prefunding of employee benefit costs and by the mark-to-market adjustments necessary to record fair value interest rate hedges of our fixed rate debt, pursuant to SFAS No. 133 *Accounting for Derivative Investments and Hedging Activities*, as amended. We had prefunded employee benefit costs of \$300 million in each of the three years ended 2008, 2007 and 2006. The mark-to-market adjustments increased the carrying value of our debt by \$45 million in 2008 and \$44 million in 2007.

*Factors Affecting Liquidity*



We currently borrow on a daily basis approximately \$250 million under our F2/P2/A3 rated commercial paper ( CP ) program. These borrowings are backed by our credit facility, and reduce the amount we can borrow under the credit facility. We have capacity available under our credit facility to backstop all CP amounts outstanding. If our credit rating declines below its current level of BBB/ Baa2/BBB-, the ability to borrow under our current CP program could be adversely affected for a period of time immediately following the reduction of our credit rating. This could require us to borrow additional funds under the credit facility, under which we believe we have sufficient capacity. However, in the event of a ratings decline, we do not anticipate that access to the CP markets currently available to us would be significantly limited for an extended period of time (i.e., in excess of 30 days). Although our ability to borrow under the credit facility is not affected by our credit rating, the interest cost on borrowings under the credit facility could be affected by a decrease in our credit rating or a decrease in our Applicable Percentage Ratio.

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

- Our Applicable Percentage Ratio (the ratio of Consolidated EBITDA to Consolidated Total Interest Expense, as defined in the credit facility) was 8.59 to 1 as of January 31, 2009. Our current borrowing rates are determined from the better of our Applicable Percentage Ratio or our credit ratings as defined by the credit facility.
- Our Leverage Ratio (the ratio of Net Debt to Consolidated EBITDA, as defined in the credit facility) was 2.02 to 1 as of January 31, 2009. If this ratio exceeded 3.50 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.
- Our Fixed Charge Coverage Ratio (the ratio of Consolidated EBITDA plus Consolidated Rental Expense to Consolidated Cash Interest Expense plus Consolidated Rental Expense, as defined in the credit facility) was 4.12 to 1 as of January 31, 2009. If this ratio fell below 1.70 to 1, we would be in default of our credit facility and our ability to borrow under the facility would be impaired.

Consolidated EBITDA, as defined in our credit facility, includes an adjustment for unusual gains and losses. Our credit agreement is more fully described in Note 5 to the Consolidated Financial Statements. We were in compliance with our financial covenants at year-end 2008.

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The tables below illustrate our significant contractual obligations and other commercial commitments, based on year of maturity or settlement, as of January 31, 2009 (in millions of dollars):

|                                       | 2009            | 2010            | 2011            | 2012            | 2013            | Thereafter      | Total            |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|
| <b>Contractual Obligations(1) (2)</b> |                 |                 |                 |                 |                 |                 |                  |
| Long-term debt (5)                    | \$ 528          | \$ 542          | \$ 544          | \$ 1,414        | \$ 1,019        | \$ 3,550        | \$ 7,597         |
| Interest on long-term debt (3)        | 479             | 426             | 398             | 350             | 286             | 2,442           | 4,381            |
| Capital lease obligations             | 53              | 51              | 57              | 48              | 45              | 219             | 473              |
| Operating lease obligations           | 778             | 738             | 674             | 624             | 575             | 3,274           | 6,663            |
| Low-income housing obligations        | 2               |                 |                 |                 |                 |                 | 2                |
| Financed lease obligations            | 13              | 13              | 13              | 13              | 13              | 172             | 237              |
| Self-insurance liability (4)          | 192             | 110             | 73              | 45              | 26              | 22              | 468              |
| Construction commitments              | 128             |                 |                 |                 |                 |                 | 128              |
| Purchase obligations                  | 394             | 87              | 63              | 51              | 28              | 19              | 642              |
| <b>Total</b>                          | <b>\$ 2,567</b> | <b>\$ 1,967</b> | <b>\$ 1,822</b> | <b>\$ 2,545</b> | <b>\$ 1,992</b> | <b>\$ 9,698</b> | <b>\$ 20,591</b> |
| <b>Other Commercial Commitments</b>   |                 |                 |                 |                 |                 |                 |                  |
| Credit facility(5)                    | \$ 129          | \$              | \$              | \$              | \$              | \$              | \$ 129           |
| Standby letters of credit             | 344             |                 |                 |                 |                 |                 | 344              |
| Surety bonds                          | 106             |                 |                 |                 |                 |                 | 106              |
| Guarantees                            | 27              |                 |                 |                 |                 |                 | 27               |
| <b>Total</b>                          | <b>\$ 606</b>   | <b>\$</b>       | <b>\$</b>       | <b>\$</b>       | <b>\$</b>       | <b>\$</b>       | <b>\$ 606</b>    |

- (1) The contractual obligations table excludes funding of pension and other postretirement benefit obligations, which totaled approximately \$45 million in 2008. This table also excludes contributions under various multi-employer pension plans, which totaled \$219 million in 2008.
- (2) We adopted FIN 48 on February 4, 2007. See Note 4 to our Consolidated Financial Statements for information regarding the adoption of FIN 48. The liability related to unrecognized tax benefits has been excluded from the contractual obligations table because a reasonable estimate of the timing of future tax settlements cannot be determined.
- (3) Amounts include contractual interest payments using the interest rate as of January 31, 2009 applicable to our variable interest debt instruments, excluding commercial paper borrowings due to the short-term nature of these borrowings, and stated fixed and swapped interest rates, if applicable, for all other debt instruments.
- (4) The amounts included in the contractual obligations table for self-insurance liability have been stated on a present value basis.
- (5) Long-term debt includes amounts under our credit facility which are also included in the Other Commercial Commitments table.

Our construction commitments include funds owed to third parties for projects currently under construction. These amounts are reflected in other current liabilities in our Consolidated Balance Sheets.

Our purchase obligations include commitments to be utilized in the normal course of business, such as several contracts to purchase raw materials utilized in our manufacturing plants and several contracts to purchase energy to be used in our stores and manufacturing facilities. Our obligations also include management fees for facilities operated by third parties. Any upfront vendor allowances or incentives associated with outstanding purchase commitments are recorded as either current or long-term liabilities in our Consolidated Balance Sheets.

As of January 31, 2009, we maintained a \$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 \$75 million in the



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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 January 31, 2009, we had no borrowings under our credit agreement and net outstanding commercial paper of \$90 million, that reduced amounts available under our credit agreement. In addition, as of January 31, 2009, we had borrowings under our money market lines totaling \$39 million. The outstanding letters of credit that reduce funds available under our credit agreement totaled \$337 million as of January 31, 2009.

In addition to the available credit mentioned above, as of January 31, 2009, we had authorized for issuance \$1.4 billion of securities under a shelf registration statement filed with the SEC and effective on December 20, 2007.

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

Most of our outstanding public debt is jointly and severally, fully and unconditionally guaranteed by The Kroger Co. and some of our subsidiaries. See Note 16 to the Consolidated Financial Statements for a more detailed discussion of those arrangements. In addition, we have guaranteed half of the indebtedness of two real estate entities in which we have 50% ownership interest. Our share of the responsibility for this indebtedness, should the entities be unable to meet their obligations, totals approximately \$7 million. Based on the covenants underlying this indebtedness as of January 31, 2009, it is unlikely that we will be responsible for repayment of these obligations. We have also agreed to guarantee, up to \$25 million, the indebtedness of an entity of which we have 25% ownership interest. Our share of the responsibility, as of January 31, 2009, should the entity be unable to meet its obligations, totals approximately \$25 million and is collateralized by approximately \$8 million of inventory located in our stores. In addition, we have guaranteed half of the lease payments of a location leased by an entity in which we have a 50% ownership interest. The net present value of the guaranteed rental payments is approximately \$6 million.

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

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

## **RECENTLY ADOPTED ACCOUNTING STANDARDS**

Effective January 31, 2009, we adopted FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FAS 140-4 and FIN 46(R)-8). FAS 140-4 and FIN 46(R)-8 require additional disclosures about an entity's involvement with variable interest entities and transfers of financial assets. See Note 2 to the Consolidated Financial Statements for further discussion of the adoption of FAS 140-4 and FIN 46(R)-8.

Effective February 3, 2008, we adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157), except for non-financial assets and non-financial liabilities as deferred until February 1, 2009 by FASB Staff Position (FSP) 157-2 *Partial Deferral of the Effective Date of Statement No. 157* (FSP 157-2). SFAS 157 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. FSP 157-2 deferred the effective date of SFAS 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. See Note 7 to the Consolidated Financial Statements for further discussion of the adoption of SFAS 157.

Effective February 4, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (FIN No. 48), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. See Note 4 to the Consolidated Financial Statements for further discussion of the adoption of FIN No. 48.

Effective February 3, 2007, we adopted the recognition and disclosure provisions (except for the measurement date change) of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statement No. 87, 99, 106 and 132(R)* (SFAS 158), which requires the recognition of the funded status of our retirement plans on the Consolidated Balance Sheet. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized are required to be recorded as a component of AOCI. We adopted the measurement date provisions of SFAS 158 effective February 3, 2008. The majority of our pension and postretirement plans previously used a December 31 measurement date. All plans are now measured as of our fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareowners' equity by approximately \$5 million (\$3 million after-tax) and increased long-term liabilities by approximately \$5 million. There was no effect on our results of operations. See Note 13 to the Consolidated Financial Statements for further discussion of the adoption of this standard.

## RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* (SFAS 160). SFAS 160 will require the consolidation of noncontrolling interests as a component of equity. SFAS 160 will become effective for our fiscal year beginning February 1, 2009. We are currently evaluating the effect the adoption of SFAS 160 will have on our Consolidated Financial Statements.

In December 2007, the FASB issued 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. SFAS 141R will become effective for our fiscal year beginning February 1, 2009. Because the standard will only impact transactions entered into after February 1, 2009, SFAS 141R will not effect our Consolidated Financial Statements upon adoption.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 requires enhanced disclosures of an entity's derivative and hedging activities. SFAS 161 will become effective for our fiscal year beginning February 1, 2009. We are currently evaluating the effect the adoption of SFAS 161 will have on our Consolidated Financial Statements.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP No. EITF 03-6-1). FSP No. EITF 03-6-1 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. FSP No. EITF 03-6-1 will become effective for our fiscal year beginning February 1, 2009. We are currently evaluating the effect the adoption of FSP No. EITF 03-6-1 will have 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 sales growth; 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, believe, anticipate, and similar. 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 \$2.00-\$2.05 for 2009. This represents earnings per share growth of approximately 4%-7% in 2009, excluding the \$0.02 per diluted share charge in 2008 related to Hurricane Ike. In addition, our shareholder return is enhanced by our dividend by over 1%.
- We expect identical supermarket sales growth, excluding fuel sales, of 3%-4% in 2009, assuming product cost inflation of 1%-2%.
- In 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 with operating cost reductions. We expect non-fuel operating margins to improve slightly in 2009, excluding the benefit of an expected lower LIFO charge.
- In 2009, we expect fuel margins to be approximately \$0.11 per gallon, as well as continued strong growth in gallons sold.
- In 2009, we expect the LIFO charge to be \$75 million, assuming product cost inflation of 1%-2%.
- 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 increase 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 investment for 2009 to be in the range of \$1.9-\$2.1 billion, excluding acquisitions. Total food store square footage is expected 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.



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- 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 37%.
- 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 2008 and do not anticipate being required to do so in 2009, we contributed \$20 million to these plans in 2008 and we made a \$200 million contribution in 2009 on February 2, 2009. 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 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 and capital market conditions. In addition, we believe our contributions to multi-employer pension plans could as much as double over the next several years after 2009.
- We expect our expense from the credit extended to our customers through our company branded credit card in 2009 to be comparable to 2008 of \$14 million. The 2008 expense represents an increase in net charge-offs of approximately \$8 million, compared to 2007, due to the weak economy, higher outstanding balances, and portfolio maturation. This rate is still below the credit card industry average and the credit portfolio continues to have an above-average credit score.

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.
- We have various labor agreements that will be negotiated in 2009, covering associates in Albuquerque, Arizona, Atlanta, Dallas, Dayton, Denver and Portland. 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 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; 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.

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- 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 and variable interest entities, an impairment loss for any excess of the carrying value of the division's goodwill over the implied fair value would need 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 fail to slightly improve as 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 differs 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 was 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 and include assumptions on variables such as inflation, the economy and market competition.
- 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.

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

*Financial Risk Management*



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

We manage our exposure to interest rates and changes in the fair value of our debt instruments primarily through the strategic use of variable and fixed rate debt, and interest rate swaps. Our current program relative to interest rate protection contemplates hedging the exposure to changes in the fair value of fixed-rate debt attributable to changes in interest rates. To do this, we use the following guidelines: (i) use average daily outstanding borrowings to determine annual debt amounts subject to interest rate exposure, (ii) limit the average annual amount of debt subject to interest rate reset and the amount of floating rate debt to a combined total of \$2.5 billion or less, (iii) include no leveraged products, and (iv) hedge without regard to profit motive or sensitivity to current mark-to-market status.

As of January 31, 2009, we did not have any outstanding interest rate swaps designated as fair value or cash flow hedges.

In 2008, we terminated nine fair value interest rate swaps with a total notional amount of \$900 million. Three of these terminated interest rate swaps were purchased and became ineffective fair value hedges in 2008. The proceeds received at termination were credited to interest expense in the amount of \$15 million. We have unamortized proceeds from twelve interest rate swaps once classified as fair value hedges totaling approximately \$45 million. 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.

In addition to the interest rate swaps noted above, in 2005 we entered into three forward-starting interest rate swap agreements with a notional amount totaling \$750 million. A forward-starting interest rate swap is an agreement that effectively hedges future benchmark interest rates on debt for an established period of time. We entered into the forward-starting interest rate swaps in order to lock into fixed interest rates on forecasted issuances of debt in 2007 and 2008. In 2007, we terminated two of these forward-starting interest rate swaps with a notional amount of \$500 million. In 2008, we terminated the remaining forward interest rate swap with a notional amount of \$250 million. The unamortized payments and proceeds on 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 hedge relates are made. As of February 2, 2008, other long-term liabilities totaling \$18 million were recorded to reflect the fair value of these agreements.

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

The table below provides information about our underlying debt portfolio as of January 31, 2009. The amounts shown for each year represent the contractual maturities of long-term debt, excluding capital leases as of January 31, 2009. Interest rates reflect the weighted average rate for the outstanding instruments. The variable component of each variable rate debt is based on the U.S. dollar LIBOR using the forward yield curve as of January 31, 2009. The Fair-Value column includes the fair-value of our debt instruments as of January 31, 2009. Refer to Notes 5, 6 and 7 of our Consolidated Financial Statements:

|             | Expected Year of Maturity |      |      |      |      |            | Total | Fair Value |
|-------------|---------------------------|------|------|------|------|------------|-------|------------|
|             | 2009                      | 2010 | 2011 | 2012 | 2013 | Thereafter |       |            |
| <b>Debt</b> | (In millions)             |      |      |      |      |            |       |            |

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|                       |    |       |    |       |    |       |    |         |    |         |    |         |    |         |    |         |
|-----------------------|----|-------|----|-------|----|-------|----|---------|----|---------|----|---------|----|---------|----|---------|
| Fixed rate            | \$ | (384) | \$ | (535) | \$ | (490) | \$ | (1,359) | \$ | (1,008) | \$ | (3,538) | \$ | (7,314) | \$ | (7,637) |
| Average interest rate |    | 6.78% |    | 6.67% |    | 6.57% |    | 6.61%   |    | 6.68%   |    | 6.77%   |    |         |    |         |
| Variable rate         | \$ | (144) | \$ | (7)   | \$ | (54)  | \$ | (55)    | \$ | (11)    | \$ | (12)    | \$ | (283)   | \$ | (283)   |
| Average interest rate |    | 2.27% |    | 5.14% |    | 4.35% |    | 7.27%   |    | 7.72%   |    | 8.10%   |    |         |    |         |

*Commodity Price Protection*





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

Some of the product we purchase is shipped in corrugated cardboard packaging. We sell corrugated cardboard when it is economical to do so. As of January 31, 2009, we 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 No. 133, *Accounting for Derivative Investments and Hedging Activities*, as amended. Accordingly, the change in the fair value of this instrument is marked-to-market in our Consolidated Statements of Operations in OG&A expenses. As of January 31, 2009, the fair value of this instrument was insignificant.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

**Report of Independent Registered Public Accounting Firm**

To the Shareowners and Board of Directors of

The Kroger Co.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and changes in shareowners' equity present fairly, in all material respects, the financial position of The Kroger Co. and its subsidiaries at January 31, 2009 and February 2, 2008, and the results of their operations and their cash flows for each of the three years in the period ended January 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 14 to the consolidated financial statements, the Company adopted the measurement date provision of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of January 31, 2009, the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, for financial assets and financial liabilities as of February 3, 2008, the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, as of February 4, 2007 and the recognition and disclosure provisions of SFAS No. 158 as of February 3, 2007.

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

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

/s/ PricewaterhouseCoopers LLP

Cincinnati, Ohio

March 31, 2009

## THE KROGER CO.

## CONSOLIDATED BALANCE SHEETS

| (In millions, except par values)  | January 31,<br>2009 | February 2,<br>2008 |
|---|---------------------|---------------------|
| <b>ASSETS</b>   |                     |                     |
| Current assets  |                     |                     |
| Cash and temporary cash investments   | \$ 263              | \$ 242              |
| Deposits in-transit   | 631                 | 676                 |
| Receivables   | 944                 | 786                 |
| FIFO Inventory  | 5,659               | 5,453               |
| LIFO credit   | (800)               | (604)               |
| Prefunded employee benefits   | 300                 | 300                 |
| Prepaid and other current assets  | 209                 | 255                 |
| Total current assets  | 7,206               | 7,108               |
| Property, plant and equipment, net  | 13,161              | 12,498              |
| Goodwill  | 2,271               | 2,144               |
| Other assets  | 573                 | 543                 |
| Total Assets  | \$ 23,211           | \$ 22,293           |
| <b>LIABILITIES</b>  |                     |                     |
| Current liabilities   |                     |                     |
| Current portion of long-term debt including obligations under capital leases and financing obligations  | \$ 558              | \$ 1,592            |
| Trade accounts payable  | 3,822               | 3,867               |
| Accrued salaries and wages  | 828                 | 815                 |
| Deferred income taxes   | 344                 | 239                 |
| Other current liabilities   | 2,077               | 2,170               |
| Total current liabilities   | 7,629               | 8,683               |
| Long-term debt including obligations under capital leases and financing obligations                     |                     |                     |
| Face value long-term debt including obligations under capital leases and financing obligations          | 7,460               | 6,485               |
| Adjustment to reflect fair value interest rate hedges   | 45                  | 44                  |
| Long-term debt including obligations under capital leases and financing obligations                     | 7,505               | 6,529               |
| Deferred income taxes   | 384                 | 367                 |
| Pension and postretirement benefit obligations  | 1,174               | 554                 |
| Other long-term liabilities   | 1,248               | 1,246               |
| Total Liabilities   | 17,940              | 17,379              |
| Minority interests  | 95                  |                     |
| Commitments and Contingencies (See Note 11)   |                     |                     |
| <b>SHAREOWNERS EQUITY</b>   |                     |                     |
| Preferred stock, \$100 par, 5 shares authorized and unissued  |                     |                     |
| Common stock, \$1 par, 1,000 shares authorized: 955 shares issued in 2008 and 947 shares issued in 2007 | 955                 | 947                 |
| Additional paid-in capital  | 3,266               | 3,031               |
| Accumulated other comprehensive loss  | (495)               | (122)               |
| Accumulated earnings  | 7,489               | 6,480               |

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|  |           |           |
|--|-----------|-----------|
| Common stock in treasury, at cost, 306 shares in 2008 and 284 shares in 2007 | (6,039)   | (5,422)   |
| Total Shareowners Equity   | 5,176     | 4,914     |
| Total Liabilities and Shareowners Equity                                     | \$ 23,211 | \$ 22,293 |

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

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended January 31, 2009, February 2, 2008 and February 3, 2007

| (In millions, except per share amounts)  | 2008<br>(52 weeks) | 2007<br>(52 weeks) | 2006<br>(53 weeks) |
|--|--------------------|--------------------|--------------------|
| Sales  | \$ 76,000          | \$ 70,235          | \$ 66,111          |
| Merchandise costs, including advertising, warehousing, and transportation,<br>excluding items shown separately below | 58,564             | 53,779             | 50,115             |
| Operating, general and administrative  | 12,884             | 12,155             | 11,839             |
| Rent   | 659                | 644                | 649                |
| Depreciation and amortization  | 1,442              | 1,356              | 1,272              |
| Operating Profit   | 2,451              | 2,301              | 2,236              |
| Interest expense   | 485                | 474                | 488                |
| Earnings before income tax expense   | 1,966              | 1,827              | 1,748              |
| Income tax expense   | 717                | 646                | 633                |
| Net earnings   | \$ 1,249           | \$ 1,181           | \$ 1,115           |
| Net earnings per basic common share  | \$ 1.92            | \$ 1.71            | \$ 1.56            |
| Average number of common shares used in basic calculation  | 652                | 690                | 715                |
| Net earnings per diluted common share  | \$ 1.90            | \$ 1.69            | \$ 1.54            |
| Average number of common shares used in diluted calculation  | 659                | 698                | 723                |
| Dividends declared per common share  | \$ .36             | \$ .30             | \$ .26             |

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

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended January 31, 2009, February 2, 2008 and February 3, 2007

| (In millions)   | 2008<br>(52 weeks) | 2007<br>(52 weeks) | 2006<br>(53 weeks) |
|---|--------------------|--------------------|--------------------|
| <b>Cash Flows From Operating Activities:</b>  |                    |                    |                    |
| Net earnings  | \$ 1,249           | \$ 1,181           | \$ 1,115           |
| Adjustments to reconcile net earnings to net cash provided by operating activities:         |                    |                    |                    |
| Depreciation and amortization   | 1,442              | 1,356              | 1,272              |
| LIFO charge   | 196                | 154                | 50                 |
| Stock-based employee compensation   | 91                 | 87                 | 72                 |
| Expense for Company-sponsored pension plans   | 44                 | 67                 | 161                |
| Deferred income taxes   | 341                | (86)               | (60)               |
| Other   | (36)               | 37                 | 20                 |
| Changes in operating assets and liabilities net of effects from acquisitions of businesses: |                    |                    |                    |
| Store deposits in-transit   | 45                 | (62)               | (125)              |
| Inventories   | (193)              | (381)              | (173)              |
| Receivables   | (28)               | (17)               | (90)               |
| Prepaid expenses  | 47                 | 3                  | (43)               |
| Accounts payable  | (53)               | 165                | 220                |
| Accrued expenses  | (33)               | 174                | 134                |
| Income taxes receivable (payable)   | (206)              | 43                 | (4)                |
| Contribution to Company-sponsored pension plans   | (20)               | (51)               | (150)              |
| Other   | 10                 | (89)               | (48)               |
| <b>Net cash provided by operating activities</b>  | <b>2,896</b>       | <b>2,581</b>       | <b>2,351</b>       |
| <b>Cash Flows From Investing Activities:</b>  |                    |                    |                    |
| Payments for capital expenditures   | (2,149)            | (2,126)            | (1,683)            |
| Proceeds from sale of assets  | 59                 | 49                 | 143                |
| Payments for acquisitions   | (80)               | (90)               | (47)               |
| Other   | (9)                | (51)               | (47)               |
| <b>Net cash used by investing activities</b>  | <b>(2,179)</b>     | <b>(2,218)</b>     | <b>(1,587)</b>     |
| <b>Cash Flows From Financing Activities:</b>  |                    |                    |                    |
| Proceeds from issuance of long-term debt  | 1,377              | 1,372              | 10                 |
| Payments on long-term debt  | (1,048)            | (560)              | (556)              |
| Borrowings (payments) on bank revolver  | (441)              | 218                | 352                |
| Excess tax benefits on stock-based awards   | 15                 | 36                 | 38                 |
| Proceeds from issuance of capital stock   | 172                | 188                | 168                |
| Treasury stock purchases  | (637)              | (1,421)            | (633)              |
| Dividends paid  | (227)              | (202)              | (140)              |
| Increase in book overdrafts   | 2                  | 61                 | 1                  |
| Other   | 18                 | (2)                | (25)               |
| <b>Net cash used by financing activities</b>  | <b>(769)</b>       | <b>(310)</b>       | <b>(785)</b>       |
| <b>Net increase (decrease) in cash and temporary cash investments</b>                       | <b>(52)</b>        | <b>53</b>          | <b>(21)</b>        |

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|   |    |                |    |         |            |
|---|----|----------------|----|---------|------------|
| Cash from Consolidated Variable Interest Entity |    | <b>73</b>      |    |         |            |
| Cash and temporary cash investments:            |    |                |    |         |            |
| Beginning of year                               |    | <b>242</b>     |    | 189     | 210        |
| End of year                                     | \$ | <b>263</b>     | \$ | 242     | \$ 189     |
| Reconciliation of capital expenditures:         |    |                |    |         |            |
| Payments for capital expenditures               | \$ | <b>(2,149)</b> | \$ | (2,126) | \$ (1,683) |
| Changes in construction-in-progress payables    |    | <b>(4)</b>     |    | 66      | (94)       |
| Total capital expenditures                      | \$ | <b>(2,153)</b> | \$ | (2,060) | \$ (1,777) |
| Disclosure of cash flow information:            |    |                |    |         |            |
| Cash paid during the year for interest          | \$ | <b>485</b>     | \$ | 477     | \$ 514     |
| Cash paid during the year for income taxes      | \$ | <b>641</b>     | \$ | 640     | \$ 615     |

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



## THE KROGER CO.

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREOWNERS EQUITY

Years Ended January 31, 2009, February 2, 2008 and February 3, 2007

| (In millions, except per share amounts)                  | Common Stock |        | Additional      | Treasury Stock |            | Accumulated                     | Accumulated | Total    |
|--|--------------|--------|-----------------|----------------|------------|---------------------------------|-------------|----------|
|  | Shares       | Amount | Paid-In Capital | Shares         | Amount     | Other Comprehensive Gain (Loss) | Earnings    |          |
| Balances at January 28, 2006                             | 927          | \$ 927 | \$ 2,536        | 204            | \$ (3,403) | \$ (243)                        | \$ 4,573    | \$ 4,390 |
| Issuance of common stock:                                |              |        |                 |                |            |                                 |             |          |
| Stock options and warrants exercised                     | 9            | 9      | 95              | (1)            | 30         |                                 |             | 134      |
| Restricted stock issued                                  | 1            | 1      | 13              |                | (5)        |                                 |             | 9        |
| Treasury stock activity:                                 |              |        |                 |                |            |                                 |             |          |
| Treasury stock purchases, at cost                        |              |        |                 | 18             | (374)      |                                 |             | (374)    |
| Stock options and restricted stock exchanged             |              |        |                 | 11             | (259)      |                                 |             | (259)    |
| Tax benefits from exercise of stock options and warrants |              |        | 39              |                |            |                                 |             | 39       |
| Share-based employee compensation                        |              |        | 72              |                |            |                                 |             | 72       |
| Other comprehensive gain net of income tax of \$63       |              |        |                 |                |            | 102                             |             | 102      |
| SFAS No. 158 adjustment net of income tax of \$(71)      |              |        |                 |                |            | (120)                           |             | (120)    |
| Other  |              |        |                 |                |            | 2                               |             | 2        |
| Cash dividends declared (\$0.26 per common share)        |              |        |                 |                |            |                                 | (187)       | (187)    |
| Net earnings   |              |        |                 |                |            |                                 | 1,115       | 1,115    |
| Balances at February 3, 2007                             | 937          | 937    | 2,755           | 232            | (4,011)    | (259)                           | 5,501       | 4,923    |
| Issuance of common stock:                                |              |        |                 |                |            |                                 |             |          |
| Stock options exercised                                  | 10           | 10     | 175             |                | 3          |                                 |             | 188      |
| Restricted stock issued                                  |              |        | (25)            | (1)            | 11         |                                 |             | (14)     |
| Treasury stock activity:                                 |              |        |                 |                |            |                                 |             |          |
| Treasury stock purchases, at cost                        |              |        |                 | 43             | (1,151)    |                                 |             | (1,151)  |
| Stock options and restricted stock exchanged             |              |        |                 | 10             | (270)      |                                 |             | (270)    |
| Tax benefits from exercise of stock options              |              |        | 35              |                |            |                                 |             | 35       |
| Share-based employee compensation                        |              |        | 87              |                |            |                                 |             | 87       |
| Other comprehensive gain net of income tax of \$82       |              |        |                 |                |            | 137                             |             | 137      |
| Other  |              |        | 4               |                | (4)        |                                 | 4           | 4        |
| Cash dividends declared (\$0.30 per common share)        |              |        |                 |                |            |                                 | (206)       | (206)    |
| Net earnings   |              |        |                 |                |            |                                 | 1,181       | 1,181    |
| Balances at February 2, 2008                             | 947          | 947    | 3,031           | 284            | (5,422)    | (122)                           | 6,480       | 4,914    |
| Issuance of common stock:                                |              |        |                 |                |            |                                 |             |          |
| Stock options exercised                                  | 8            | 8      | 162             |                | 3          |                                 |             | 173      |
| Restricted stock issued                                  |              |        | (46)            | (1)            | 30         |                                 |             | (16)     |
| Treasury stock activity:                                 |              |        |                 |                |            |                                 |             |          |
| Treasury stock purchases, at cost                        |              |        |                 | 16             | (448)      |                                 |             | (448)    |
| Stock options and restricted stock exchanged             |              |        |                 | 7              | (189)      |                                 |             | (189)    |
| Tax benefits from exercise of stock options              |              |        | 15              |                |            |                                 |             | 15       |
| Share-based employee compensation                        |              |        | 91              |                |            |                                 |             | 91       |
|  |              |        |                 |                |            | (373)                           |             | (373)    |

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|   |     |    |      |    |       |     |       |         |       |       |    |       |    |       |
|---|-----|----|------|----|-------|-----|-------|---------|-------|-------|----|-------|----|-------|
| Other comprehensive loss net of income tax of \$(224) |     |    |      |    |       |     |       |         |       |       |    |       |    |       |
| Other   | 13  |    | (13) |    |       |     | (3)   |         | (3)   |       |    |       |    |       |
| Cash dividends declared (\$0.36 per common share)     |     |    |      |    |       |     | (237) |         | (237) |       |    |       |    |       |
| Net earnings  |     |    |      |    |       |     | 1,249 |         | 1,249 |       |    |       |    |       |
| Balances at January 31, 2009                          | 955 | \$ | 955  | \$ | 3,266 | 306 | \$    | (6,039) | \$    | (495) | \$ | 7,489 | \$ | 5,176 |

Comprehensive income:

|   | 2008     | 2007     | 2006     |
|---|----------|----------|----------|
| Net earnings  | \$ 1,249 | \$ 1,181 | \$ 1,115 |
| Unrealized gain (loss) on hedging activities, net of income tax of \$2 in 2008, \$(13) in 2007 and \$5 in 2006          | 3        | (21)     | 7        |
| Amortization of unrealized gains and losses on hedging activities, net of income tax of \$(2)                           | (3)      |          |          |
| Additional minimum pension liability adjustment, net of income tax of \$58 in 2006                                      |          |          | 95       |
| Change in pension and other postretirement defined benefit plans, net of income tax of \$(224) in 2008 and \$95 in 2007 | (373)    | 158      |          |
| Comprehensive income  | \$ 876   | \$ 1,318 | \$ 1,217 |

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

All dollar amounts are in millions except share and per share amounts.

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

**1. ACCOUNTING POLICIES**

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

*Description of Business, Basis of Presentation and Principles of Consolidation*

The Kroger Co. (the Company) was founded in 1883 and incorporated in 1902. As of January 31, 2009, the Company was one of the largest retailers in the United States based on annual sales. The Company also manufactures and processes food for sale by its supermarkets. The accompanying financial statements include the consolidated accounts of the Company, its wholly-owned subsidiaries and the Variable Interest Entities ( VIE ) in which the Company is the primary beneficiary. Significant intercompany transactions and balances have been eliminated.

*Fiscal Year*



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The Company's fiscal year ends on the Saturday nearest January 31. The last three fiscal years consist of the 52-week period ended January 31, 2009, the 52-week period ended February 2, 2008, and the 53-week period ended February 3, 2007.

### *Pervasiveness of Estimates*



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The preparation of financial statements in conformity with generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of consolidated revenues and expenses during the reporting period also is required. Actual results could differ from those estimates.

*Cash and temporary cash investments*





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Cash and temporary cash investments represent store cash, escrow deposits and Euros held to settle Euro-denominated contracts. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 52, *Foreign Currency Translation*, the Company valued its carrying amount of Euros at the spot rates as of January 31, 2009 and February 2, 2008.

### *Inventories*



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Inventories are stated at the lower of cost (principally on a last-in, first-out LIFO basis) or market. In total, approximately 98% and 97% of inventories for 2008 and 2007, respectively, were valued using the LIFO method. Cost for the balance of the inventories, including substantially all fuel inventories, was determined using the first-in, first-out ( FIFO ) method. Replacement cost was higher than the carrying amount by \$800 at January 31, 2009 and \$604 at February 2, 2008. The Company follows the Link-Chain, Dollar-Value LIFO method for purposes of calculating its LIFO charge or credit.

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

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

*Property, Plant and Equipment*



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Property, plant and equipment are recorded at cost. 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. Buildings and land improvements are depreciated based on lives varying from 10 to 40 years. All new purchases of store equipment are assigned lives varying from three to nine years. Some store equipment acquired as a result of the Fred Meyer merger was assigned a 15-year life. The life of this equipment was not changed. Leasehold improvements are amortized over the shorter of the lease term to which they relate, which varies from four to 25 years, or the useful life of the asset. Manufacturing plant and distribution center equipment is depreciated over lives varying from three to 15 years. Information technology assets are generally depreciated over five years. Depreciation and amortization expense was \$1,442 in 2008, \$1,356 in 2007 and \$1,272 in 2006.

Interest costs on significant projects constructed for the Company's own use are capitalized as part of the costs of the newly constructed facilities. Upon retirement or disposal of assets, the cost and related accumulated depreciation are removed from the balance sheet and any gain or loss is reflected in net earnings.

### *Deferred Rent*

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

### *Goodwill*

The Company reviews goodwill for impairment during the fourth quarter of each year, and also upon the occurrence of trigger events. The reviews are performed at the operating division level. Generally, fair value is determined using a multiple of earnings, or discounted projected future cash flows, and is compared to the carrying value of a division for purposes of identifying potential impairment. Projected future cash flows are based on management's knowledge of the current operating environment and expectations for the future. If potential for impairment is identified, the fair value of a division is measured against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the division's goodwill. Goodwill impairment is recognized for any excess of the carrying value of the division's goodwill over the implied fair value. Results of the goodwill impairment reviews performed during 2008, 2007 and 2006 are summarized in Note 2 to the Consolidated Financial Statements.

### *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 based on 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 \$26, \$24 and \$61 in 2008, 2007 and 2006, 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 Costs*





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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 noncancellable 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 closed that were closed in the normal course of business:

|                             | <b>Future Lease Obligations</b> |      |
|-----------------------------|---------------------------------|------|
| Balance at February 3, 2007 | \$                              | 89   |
| Additions                   |                                 | 8    |
| Payments                    |                                 | (16) |
| Adjustments                 |                                 | (7)  |
| Balance at February 2, 2008 |                                 | 74   |
| Additions                   |                                 | 4    |
| Payments                    |                                 | (13) |
| Balance at January 31, 2009 | \$                              | 65   |

### *Interest Rate Risk Management*

The Company uses derivative instruments primarily to manage its exposure to changes in interest rates. The Company's current program relative to interest rate protection and the methods by which the Company accounts for its derivative instruments are described in Note 6.

*Commodity Price Protection*



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*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, manufacturing facilities and administrative offices. The Company enters into commitments expecting to take delivery of and to utilize those resources in the conduct of the normal course of business. The Company's current program relative to commodity price protection and the methods by which the Company accounts for its purchase commitments are described in Note 6.*



*Benefit Plans*





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Effective February 3, 2007, the Company adopted the recognition and disclosure provisions (except for the measurement date change) of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statement No. 87, 99, 106 and 132(R)* (SFAS 158), which requires the recognition of the funded status of its retirement plans on the Consolidated Balance Sheet. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized are required to be recorded as a component of Accumulated Other Comprehensive Income ( AOCI ). The Company adopted the measurement date provisions of SFAS 158 effective February 3, 2008. The majority of our pension and postretirement plans previously used a December 31 measurement date. All plans are now measured as of the Company's fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareholders' equity by approximately \$5 (\$3 after-tax) and increased long-term liabilities by approximately \$5. There was no effect on the Company's results of operations.

The determination of the obligation and expense for Company-sponsored pension plans and other post-retirement benefits is dependent on the selection of assumptions used by actuaries and the Company in calculating those amounts. Those assumptions are described in Note 13 and include, among others, 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 future periods. While the Company believes that the assumptions are appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the pension and other post-retirement obligations and future expense.

The Company also participates in various multi-employer plans for substantially all union employees. Pension expense for these plans is recognized as contributions are funded. Refer to Note 13 for additional information regarding the Company's benefit plans.

### *Stock Based Compensation*



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The Company accounts for stock options under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)). Under this method, the Company recognizes compensation expense for all share-based payments granted after January 29, 2006, as well as all share-based payments granted prior to, but not yet vested as of, January 29, 2006, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), the Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award. In addition, the Company accounts for restricted stock awards under SFAS 123(R). The Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying stock on the grant date of the award, over the period the awards lapse.

### *Deferred Income Taxes*

Deferred income taxes are recorded to reflect the tax consequences of differences between the tax basis of assets and liabilities and their financial reporting basis. Refer to Note 4 for the types of differences that give rise to significant portions of deferred income tax assets and liabilities. Deferred income taxes are classified as a net current or noncurrent asset or liability based on the classification of the related asset or liability for financial reporting purposes. A deferred tax asset or liability that is not related to an asset or liability for financial reporting is classified according to the expected reversal date.

### *Uncertain Tax Positions*

Effective February 4, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of *FASB Statement No. 109* ( FIN No. 48 ), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

Various taxing authorities periodically audit the Company's income tax returns. These audits include questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income to various tax jurisdictions. In evaluating the exposures connected with these various tax filing positions, including state and local taxes, the Company records allowances for probable exposures. A number of years may elapse before a particular matter, for which an allowance has been established, is audited and fully resolved. As of January 31, 2009, the most recent examination concluded by the Internal Revenue Service covered the years 2002 through 2004.

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

#### *Self-Insurance Costs*

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

The following table summarizes the changes in the Company's self-insurance liability through January 31, 2009.

|                      | 2008   |    | 2007  |    | 2006  |
|----------------------|--------|----|-------|----|-------|
| Beginning balance    | \$ 470 | \$ | 440   | \$ | 445   |
| Expense              | 189    |    | 215   |    | 196   |
| Claim payments       | (191)  |    | (185) |    | (201) |
| Ending balance       | 468    |    | 470   |    | 440   |
| Less current portion | (192)  |    | (183) |    | (165) |
| Long-term portion    | \$ 276 | \$ | 287   | \$ | 275   |

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

The Company is also similarly self-insured for property-related losses. The Company has purchased stop-loss coverage to limit its exposure to losses in excess of \$25 on a per claim basis, except in the case of an earthquake, for which stop-loss coverage is in excess of \$50 per claim, up to \$200 per claim in California and \$300 outside of California.

#### *Revenue Recognition*

Revenues from the sale of products are recognized at the point of sale of the Company's products. Discounts provided to customers by the Company at the time of sale, including those provided in connection with loyalty cards, are recognized as a reduction in sales as the products are sold. Discounts provided by vendors, usually in the form of paper coupons, are not recognized as a reduction in sales provided the coupons are redeemable at any retailer that accepts coupons. Pharmacy sales are recorded when provided to the customer. Sales taxes are not recorded as a component of sales. The Company does not recognize a sale when it sells gift cards and gift certificates. Rather, a sale is recognized when the gift card or gift certificate is redeemed to purchase the Company's products.

#### *Merchandise Costs*

The Merchandise costs line item of the Consolidated Statements of Operations includes product costs, net of discounts and allowances; advertising costs (see separate discussion below); inbound freight charges; warehousing costs, including receiving and inspection costs; transportation costs; and manufacturing production and operational costs. Warehousing, transportation and manufacturing management salaries are also included in the Merchandise costs line item; however, purchasing management salaries and administration costs are included in the Operating, general, and administrative line item along with most of the Company's other managerial and administrative costs. Rent expense and depreciation expense are shown separately in the Consolidated Statements of Operations.

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

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

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

#### *Advertising Costs*

The Company's advertising costs are recognized in the periods the related expenses are incurred and are included in the Merchandise costs line item of the Consolidated Statements of Operations. The Company's pre-tax advertising costs totaled \$532 in 2008, \$506 in 2007 and \$508 in 2006. The Company does not record vendor allowances for co-operative advertising as a reduction of advertising expense.

#### *Deposits In-Transit*

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

#### *Consolidated Statements of Cash Flows*

For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be temporary cash investments. Book overdrafts, which are included in accounts payable, represent disbursements that are funded as the item is presented for payment. Book overdrafts totaled \$663, \$661 and \$600 as of January 31, 2009, February 2, 2008, and February 3, 2007, respectively, and are reflected as a financing activity in the Consolidated Statements of Cash Flows.

#### *Segments*



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The Company operates retail food and drug stores, multi-department stores, jewelry stores, and convenience stores throughout the United States. The Company's retail operations, which represent substantially all of the Company's consolidated sales, are its only reportable segment. All of the Company's operations are domestic.



## 2. GOODWILL

The annual evaluation of goodwill performed during the fourth quarter of 2008, 2007 and 2006 did not result in impairment.

The following table summarizes the changes in the Company's net goodwill balance through January 31, 2009.

|                                 | <b>Goodwill</b> |       |
|---------------------------------|-----------------|-------|
| Balance at January 28, 2006     | \$              | 2,192 |
| Goodwill recorded               |                 |       |
| Purchase accounting adjustments |                 |       |
| Balance at February 3, 2007     |                 | 2,192 |
| Goodwill recorded               |                 | 23    |
| Effect of FIN 48 adoption       |                 | (71)  |
| Balance at February 2, 2008     |                 | 2,144 |
| Goodwill recorded               |                 | 127   |
| Purchase accounting adjustments |                 |       |
| Balance at January 31, 2009     | \$              | 2,271 |

In December 2008, the FASB issued FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FAS 140-4 and FIN 46(R)-8). FAS 140-4 and FIN 46(R)-8 require additional disclosures about an entity's involvement with variable interest entities and transfers of financial assets. Effective January 31, 2009, the Company has adopted FAS 140-4 and FIN 46(R)-8.

In the first quarter of 2008, the Company made an investment in The Little Clinic LLC (TLC). TLC operates supermarket walk-in medical clinics in seven states, primarily in the Midwest and Southeast. At the date of investment, TLC was determined to be a variable-interest entity (VIE) under FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), with the Company being the primary beneficiary. The Company was deemed the primary beneficiary due to its current ownership interest and half of its written put options being at a floor price. As a result, the Company consolidated TLC in accordance with FIN 46R. The minority interest was recorded at fair value on the acquisition date. The fair value of TLC was determined based on the amount of the investment made by the Company and the percentage acquired. The Company's assessment of goodwill represents the excess of this amount over the fair value of TLC's net assets as of the investment date. Creditors of TLC have no recourse to the general credit of the Company. Conversely, creditors of the Company have no recourse to the assets of TLC. In addition, if requested by TLC's Board of Directors by January 1, 2010, the Company has agreed to make a pro rata portion of an additional capital contribution.

The table below shows the unaudited amounts of assets and liabilities from TLC included in the Company's consolidated results, after eliminating intercompany items, as of January 31, 2009:

|                                    | <b>2008</b> |    |
|------------------------------------|-------------|----|
| Current assets                     | \$          | 31 |
| Property, plant and equipment, net |             | 7  |

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|                     |    |     |
|---------------------|----|-----|
| Goodwill            |    | 102 |
| Other assets        |    | 1   |
| Total Assets        | \$ | 141 |
| Current liabilities | \$ | 4   |
| Minority interests  | \$ | 82  |

In the fourth quarter of 2008, the Company became the primary beneficiary of i-wireless, LLC a VIE in which the Company has a 25% ownership interest. The Company was deemed the primary beneficiary due to its current ownership interest, \$25 line of credit guarantee, and \$8 loan to i-wireless, LLC. The Company became the primary beneficiary, in the fourth quarter of 2008, under FIN 46R after lending \$8 to i-wireless, LLC. i-wireless, LLC sells prepaid phones primarily in Company stores. The minority interest was recorded at fair value. The fair value of i-wireless, LLC was determined based on the amount of the investment made by the Company in the fourth quarter of 2007 and the percentage acquired. The Company's assessment of goodwill represents the excess of this amount over the fair value of i-wireless, LLC's net assets as of the date of the loan. The Company has guaranteed the indebtedness of i-wireless, LLC, up to \$25, which is collateralized by \$8 of inventory located in the Company's stores. The creditors of the Company have no recourse to the assets of i-wireless, LLC.

The table below shows the preliminary and unaudited amounts of assets and liabilities from i-wireless, LLC included in the Company's consolidated results, after eliminating intercompany items, as of January 31, 2009:

|                                    | <b>2008</b> |           |
|------------------------------------|-------------|-----------|
| Current assets                     | \$          | 10        |
| Property, plant and equipment, net |             | 2         |
| Goodwill                           |             | 25        |
| Other assets                       |             | 5         |
| <b>Total Assets</b>                | <b>\$</b>   | <b>42</b> |
| Current liabilities                | \$          | 5         |
| Long-term debt                     | \$          | 30        |
| Minority interests                 | \$          | 1         |

The proforma effects of these acquisitions are not material to previously reported results.

### 3. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consists of:

|  | <b>2008</b> |                 | <b>2007</b> |               |
|--|-------------|-----------------|-------------|---------------|
| Land   | \$          | <b>1,944</b>    | \$          | 1,779         |
| Buildings and land improvements                                |             | <b>6,457</b>    |             | 5,875         |
| Equipment  |             | <b>8,993</b>    |             | 8,620         |
| Leasehold improvements   |             | <b>5,076</b>    |             | 4,626         |
| Construction-in-progress                                       |             | <b>880</b>      |             | 965           |
| Leased property under capital leases and financing obligations |             | <b>550</b>      |             | 571           |
| <b>Total property, plant and equipment</b>                     |             | <b>23,900</b>   |             | 22,436        |
| Accumulated depreciation and amortization                      |             | <b>(10,739)</b> |             | (9,938)       |
| <b>Property, plant and equipment, net</b>                      | <b>\$</b>   | <b>13,161</b>   | <b>\$</b>   | <b>12,498</b> |

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Accumulated depreciation for leased property under capital leases was \$283 at January 31, 2009, and \$286 at February 2, 2008.

Approximately \$396 and \$540, original cost, of Property, Plant and Equipment collateralized certain mortgages at January 31, 2009 and February 2, 2008, respectively.

#### 4. TAXES BASED ON INCOME

The provision for taxes based on income consists of:

|                 | 2008   | 2007   | 2006   |
|-----------------|--------|--------|--------|
| Federal         |        |        |        |
| Current         | \$ 304 | \$ 661 | \$ 652 |
| Deferred        | 331    | (62)   | (52)   |
|                 | 635    | 599    | 600    |
| State and local |        |        |        |
| Current         | 46     | 71     | 55     |
| Deferred        | 36     | (24)   | (22)   |
|                 | 82     | 47     | 33     |
| Total           | \$ 717 | \$ 646 | \$ 633 |

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

|  | 2008   | 2007   | 2006   |
|--|--------|--------|--------|
| Statutory rate                                 | 35.0%  | 35.0%  | 35.0%  |
| State income taxes, net of federal tax benefit | 2.7%   | 1.7%   | 1.9%   |
| Credits  | (1.0)% | (0.9)% | (0.8)% |
| Favorable resolution of issues                 |        | (1.9)% |        |
| Deferred tax adjustment                        |        |        | (1.2)% |
| Other changes, net                             | (0.2)% | 1.5%   | 1.3%   |
|  | 36.5%  | 35.4%  | 36.2%  |

During the third quarter of 2007, the Company resolved favorably certain tax issues. This resulted in a 2007 tax benefit of approximately \$40.

In 2006, during the reconciliation of the Company's deferred tax balances, after the filing of annual federal and state tax returns, the Company identified adjustments to be made in the prior years' deferred tax reconciliation. These deferred tax balances were corrected in the Company's Consolidated Financial Statements for the year ended February 3, 2007, which resulted in a reduction of the Company's 2006 provision for income tax expense of approximately \$21. The Company does not believe these adjustments are material to its Consolidated Financial Statements for the year ended February 3, 2007, or to any prior years' Consolidated Financial Statements. As a result, the Company has not restated any prior year amounts.

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

|   | 2008            |    | 2007         |
|---|-----------------|----|--------------|
| <b>Current deferred tax assets:</b>             |                 |    |              |
| Net operating loss and credit carryforwards     | \$ 2            | \$ | 16           |
| Compensation related costs                      | 43              |    | 53           |
| Other   |                 |    | 8            |
| <b>Total current deferred tax assets</b>        | <b>45</b>       |    | <b>77</b>    |
| <b>Current deferred tax liabilities:</b>        |                 |    |              |
| Insurance related costs                         | (104)           |    | (104)        |
| Inventory related costs                         | (242)           |    | (212)        |
| Other   | (43)            |    |              |
| <b>Total current deferred tax liabilities</b>   | <b>(389)</b>    |    | <b>(316)</b> |
| <b>Current deferred taxes</b>                   | <b>\$ (344)</b> | \$ | <b>(239)</b> |
| <b>Long-term deferred tax assets:</b>           |                 |    |              |
| Compensation related costs                      | \$ 461          | \$ | 268          |
| Lease accounting                                | 100             |    | 102          |
| Closed store reserves                           | 65              |    | 68           |
| Insurance related costs                         | 64              |    | 64           |
| Net operating loss and credit carryforwards     | 51              |    | 35           |
| Other   | 13              |    | 23           |
| <b>Long-term deferred tax assets, net</b>       | <b>754</b>      |    | <b>560</b>   |
| <b>Long-term deferred tax liabilities:</b>      |                 |    |              |
| Depreciation                                    | (1,138)         |    | (926)        |
| Other   |                 |    | (1)          |
| <b>Total long-term deferred tax liabilities</b> | <b>(1,138)</b>  |    | <b>(927)</b> |
| <b>Long-term deferred taxes</b>                 | <b>\$ (384)</b> | \$ | <b>(367)</b> |

At January 31, 2009, the Company had net operating loss carryforwards for state income tax purposes of \$451 that expire from 2009 through 2028. The utilization of certain of the Company's net operating loss carryforwards may be limited in a given year.

At January 31, 2009, the Company had State credits of \$20, some of which expire from 2009 through 2027. The utilization of certain of the Company's credits may be limited in a given year.

The Company adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes* on February 4, 2007. As of adoption, the total amount of gross unrecognized tax benefits for uncertain tax positions, including positions impacting only the timing of tax benefits, was \$694. A reconciliation of the beginning and ending amount of unrecognized tax benefits as of January 31, 2009 and February 2, 2008 is as follows:

|   | 2008 |      | 2007 |       |
|---|------|------|------|-------|
| Beginning balance   | \$   | 469  | \$   | 694   |
| Additions based on tax positions related to the current year  |      | 53   |      | 49    |
| Reductions based on tax positions related to the current year |      | (6)  |      | (32)  |
| Additions for tax positions of prior years                    |      | 4    |      | 11    |
| Reductions for tax positions of prior years                   |      | (11) |      | (162) |
| Settlements   |      | (17) |      | (90)  |
| Reductions due to lapse of statute of limitations             |      |      |      | (1)   |
| Ending balance  | \$   | 492  | \$   | 469   |

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

As of January 31, 2009 and February 2, 2008, the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$116 and \$120, respectively.

To the extent interest and penalties would be assessed by taxing authorities on any underpayment of income tax, such amounts have been accrued and classified as a component of income tax expense. During the years ended January 31, 2009 and February 2, 2008, the Company recognized approximately \$6 and \$(11), respectively, in interest and penalties. The Company had accrued approximately \$99 and \$101 for the payment of interest and penalties as of January 31, 2009 and February 2, 2008, respectively.

The IRS concluded a field examination of the Company's 2002-2004 U.S. tax returns during the third quarter of 2007 and is currently auditing years 2005-2007. The audit is not expected to be completed in the next twelve months. Additionally, the Company has a case in the U.S. Tax Court. A decision on this case is not expected within the next 12 months. In connection with this case, the Company has extended the statute of limitations on our tax years after 1991 and those years remain open to examination. States have a limited time frame to review and adjust federal audit changes reported. Assessments made and refunds allowed are generally limited to the federal audit changes reported.

## 5. DEBT OBLIGATIONS

Long-term debt consists of:

|   | 2008 |       | 2007 |       |
|---|------|-------|------|-------|
| Credit facility, commercial paper and money market borrowings | \$   | 129   | \$   | 570   |
| 4.95% to 9.20% Senior notes and debentures due through 2038   |      | 7,186 |      | 6,766 |
| 5.00% to 9.95% Mortgages due in varying amounts through 2034  |      | 119   |      | 166   |
| Other   |      | 163   |      | 137   |

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|                      |          |          |
|----------------------|----------|----------|
| Total debt           | 7,597    | 7,639    |
| Less current portion | (528)    | (1,564)  |
| Total long-term debt | \$ 7,069 | \$ 6,075 |

In 2007, the Company issued \$600 of senior notes bearing an interest rate of 6.4% due in 2017 and \$750 of senior notes bearing an interest rate of 6.15% due in 2020.

In 2008, the Company issued \$400 of senior notes bearing an interest rate of 5.0% due in 2013, \$375 of senior notes bearing an interest rate of 6.9% due in 2038 and \$600 of senior notes bearing an interest rate of 7.5% due in 2014.



As of January 31, 2009, the Company had a \$2,500 Five-Year Credit Agreement maturing in 2011, unless earlier terminated by the Company. Borrowings under the credit agreement bear interest at the option of the Company at a rate equal to either (i) the highest, from time to time of (A) the base rate of JP Morgan Chase Bank, N.A., (B) ½% over a moving average of secondary market morning offering rates for three-month certificates of deposit adjusted for reserve requirements, and (C) ½% over the federal funds rate or (ii) an adjusted Eurodollar rate based upon the London Interbank Offered Rate ( Eurodollar Rate ) plus an applicable margin. In addition, the Company pays a facility fee in connection with the credit agreement. Both the applicable margin and the facility fee vary based upon the Company's achievement of a financial ratio or credit rating. At January 31, 2009, the applicable margin was 0.19%, and the facility fee was 0.06%. The credit facility contains covenants, which, among other things, require the maintenance of certain financial ratios, including fixed charge coverage and leverage ratios. The Company may prepay the credit agreement in whole or in part, at any time, without a prepayment penalty. In addition to the credit agreement, the Company maintained three uncommitted money market lines totaling \$75 in the aggregate. The money market lines allow the Company to borrow from banks at mutually agreed upon rates, usually at rates below the rates offered under the credit agreement. As of January 31, 2009, the Company had no borrowings under its credit agreement and net outstanding commercial paper of \$90, that reduced amounts available under the Company's credit agreement. In addition, as of January 31, 2009, the Company had borrowings under its money market lines totaling \$39. The weighted average interest rate on outstanding commercial paper and borrowings under the Company's money market lines was 1.89% at January 31, 2009. The outstanding letters of credit that reduce funds available under the Company's credit agreement totaled \$337 as of January 31, 2009.

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

The aggregate annual maturities and scheduled payments of long-term debt, as of year-end 2008, and for the years subsequent to 2008 are:

|            |    |       |
|------------|----|-------|
| 2009       | \$ | 528   |
| 2010       |    | 542   |
| 2011       |    | 544   |
| 2012       |    | 1,414 |
| 2013       |    | 1,019 |
| Thereafter |    | 3,550 |
| Total debt | \$ | 7,597 |

## 6. Derivative FINANCIAL INSTRUMENTS

### *Interest Rate Risk Management*



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The Company historically has used derivatives to manage its exposure to changes in interest rates. The interest differential to be paid or received is accrued as interest expense. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, 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.

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 million 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.

The table below summarizes the outstanding interest rate swaps designated as fair value hedges as of January 31, 2009, and February 2, 2008.

|                       | 2008         |           | 2007                                |           |
|-----------------------|--------------|-----------|-------------------------------------|-----------|
|                       | Pay Floating | Pay Fixed | Pay Floating                        | Pay Fixed |
| Notional amount       | \$           | \$        | \$ 1,050                            | \$        |
| Number of contracts   |              |           | 6                                   |           |
| Duration in years     |              |           | 2.07                                |           |
| Average variable rate |              |           | 5.97%                               |           |
| Average fixed rate    |              |           | 6.74%                               |           |
| Maturity              |              |           | Between March 2008 and January 2015 |           |

As of February 2, 2008, other long-term assets totaling \$11 were recorded to reflect the fair value of these agreements, offset by increases in the fair value of the underlying debt.

In 2008, the Company terminated nine fair value interest rate swaps with a total notional amount of \$900. Three of these terminated interest rate swaps were purchased and became ineffective fair value hedges in 2008. The proceeds received at termination were credited to interest expense in the amount of \$15. The Company has unamortized proceeds from twelve interest rate swaps once classified as fair value hedges totaling approximately \$45. 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.

In addition to the interest rate swaps noted above, in 2005 the Company entered into three forward-starting interest rate swap agreements with a notional amount totaling \$750. A forward-starting interest rate swap is an agreement that effectively hedges future benchmark interest rates on debt for an established period of time. The Company entered into the forward-starting interest rate swaps in order to lock into fixed interest rates on forecasted issuances of debt in 2007 and 2008. In 2007, the Company terminated two of these forward-starting interest rate swaps with a notional amount of \$500. In 2008, the Company terminated the remaining forward-starting interest rate swap with a notional amount of \$250. The unamortized payments and proceeds on 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 hedge relates are made. As of February 2, 2008, other long-term liabilities totaling \$18 were recorded to reflect the fair value of these agreements.

*Commodity Price Protection*



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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.

Some of the product the Company purchases is shipped in corrugated cardboard packaging. The corrugated cardboard is sold when it is economical to do so. As of January 31, 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 No. 133, *Accounting for Derivative Investments and Hedging Activities*, as amended. 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 ( O&A ) expense. As of January 31, 2009, the fair value of this instrument was insignificant.

## 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

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 *Partial Deferral of the 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. Effective February 3, 2008, the Company adopted SFAS 157, except for non-financial assets and non-financial liabilities as deferred until February 1, 2009 by FSP 157-2.

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 January 31, 2009:

### Fair Value Measurements Using

| Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total |
|--|---|--|-------|
|--|---|--|-------|



|                               |    |    |    |    |    |
|-------------------------------|----|----|----|----|----|
| Available-for-Sale Securities | \$ | 11 | \$ | \$ | 11 |
|-------------------------------|----|----|----|----|----|

**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 the respective year-ends. At January 31, 2009, the fair value of total debt was \$7,920 compared to a carrying value of \$7,597. At February 2, 2008, the fair value of total debt was \$7,973 compared to a carrying value of \$7,639.

*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 January 31, 2009 and February 2, 2008, the carrying and fair value of practicable long-term investments was \$67 and \$75, respectively.

### 8. LEASES AND LEASE-FINANCED TRANSACTIONS

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

Rent expense (under operating leases) consists of:

|                           | 2008          | 2007          | 2006          |
|---------------------------|---------------|---------------|---------------|
| Minimum rentals           | \$ 762        | \$ 747        | \$ 753        |
| Contingent payments       | 12            | 11            | 10            |
| Tenant income             | (115)         | (114)         | (114)         |
| <b>Total rent expense</b> | <b>\$ 659</b> | <b>\$ 644</b> | <b>\$ 649</b> |

Minimum annual rentals and payments under capital leases and lease-financed transactions for the five years subsequent to 2008 and in the aggregate are:

|   | Capital<br>Leases | Operating<br>Leases | Lease<br>Financed<br>Transactions |
|---|-------------------|---------------------|-----------------------------------|
| 2009  | \$ 53             | \$ 778              | \$ 4                              |
| 2010  | 51                | 738                 | 4                                 |
| 2011  | 57                | 674                 | 5                                 |
| 2012  | 48                | 624                 | 5                                 |
| 2013  | 45                | 575                 | 5                                 |
| Thereafter  | 219               | 3,274               | 111                               |
|   | 473               | \$ 6,663            | \$ 134                            |
| Less estimated executory costs included in capital leases               | (1)               |                     |                                   |
| Net minimum lease payments under capital leases                         | 472               |                     |                                   |
| Less amount representing interest                                       | (185)             |                     |                                   |
| <b>Present value of net minimum lease payments under capital leases</b> | <b>\$ 287</b>     |                     |                                   |

Total future minimum rentals under noncancellable subleases at January 31, 2009, were \$334.



## 9. EARNINGS PER COMMON SHARE

Basic earnings per common share equals net earnings divided by the weighted average number of common shares outstanding. Diluted earnings per common share equals net earnings divided by the weighted average number of common shares outstanding after giving effect to dilutive stock options and warrants.

The following table provides a reconciliation of earnings and shares used in calculating basic earnings per share to those used in calculating diluted earnings per share.

| (in millions, except per share amounts)                | For the year ended<br>January 31, 2009 |                              |                        | For the year ended<br>February 2, 2008 |                              |                        | For the year ended<br>February 3, 2007 |                              |                        |
|--|--|------------------------------|------------------------|--|------------------------------|------------------------|--|------------------------------|------------------------|
|  | Earnings<br>(Numer-<br>ator)           | Shares<br>(Denomi-<br>nator) | Per<br>Share<br>Amount | Earnings<br>(Numer-<br>ator)           | Shares<br>(Denomi-<br>nator) | Per<br>Share<br>Amount | Earnings<br>(Numer-<br>ator)           | Shares<br>(Denomi-<br>nator) | Per<br>Share<br>Amount |
| Basic EPS  | \$ 1,249                               | 652                          | \$ 1.92                | \$ 1,181                               | 690                          | \$ 1.71                | \$ 1,115                               | 715                          | \$ 1.56                |
| Dilutive effect of stock option<br>awards and warrants |  | 7                            |                        |  | 8                            |                        |  | 8                            |                        |
| Diluted EPS  | \$ 1,249                               | 659                          | \$ 1.90                | \$ 1,181                               | 698                          | \$ 1.69                | \$ 1,115                               | 723                          | \$ 1.54                |

For the years ended January 31, 2009, February 2, 2008 and February 3, 2007, there were options outstanding for approximately 11.8 million, 2.0 million and 25.4 million shares of common stock, respectively, that were excluded from the computation of diluted EPS. These shares were excluded because their inclusion would have had an anti-dilutive effect on EPS.

## 10. STOCK OPTION PLANS

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. The Company accounts for stock options under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)). Under this method, the Company recognizes compensation expense for all share-based payments granted after January 29, 2006, as well as all share-based payments granted prior to, but not yet vested as of, January 29, 2006, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), the Company recognizes share-based compensation expense, net of an estimated forfeiture rate, over the requisite service period of the award. Equity awards may be made at one of four meetings of its Board of Directors occurring shortly after the Company's release of quarterly earnings. The 2008 primary grant was made in conjunction with the June meeting of the Company's Board of Directors.

Stock options typically expire 10 years from the date of grant. Stock options vest between one and five years from the date of grant, or for certain stock options, the earlier of the Company's stock reaching certain pre-determined and appreciated market prices or nine years and six months from the date of grant. At January 31, 2009, approximately 25 million shares of common stock were available for future option grants under these plans.



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In addition to the stock options described above, the Company awards restricted stock to employees under various plans. The restrictions on these awards generally lapse between one and five years from the date of the awards. Under SFAS 123(R), the Company records expense for restricted stock awards in an amount equal to the fair market value of the underlying stock on the grant date of the award, over the period the awards lapse. As of January 31, 2009, approximately one million shares of common stock were available for future restricted stock awards under the 2005 Long-Term Incentive Plan (the Plan). The Company has the ability to convert shares available for stock options under the Plan to shares available for restricted stock awards. Four shares available for common stock option awards can be converted into one share available for restricted stock awards.

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

*Stock Options*

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

|                            | Shares<br>subject<br>to option<br>(in millions) | Weighted-<br>average<br>exercise<br>price |
|----------------------------|---|---|
| Outstanding, year-end 2005 | 59.3  | \$ 19.03                                  |
| Granted                    | 3.2   | \$ 20.05                                  |
| Exercised                  | (9.5)   | \$ 13.34                                  |
| Canceled or Expired        | (1.1)   | \$ 21.01                                  |
| Outstanding, year-end 2006 | 51.9  | \$ 20.09                                  |
| Granted                    | 3.4   | \$ 28.21                                  |
| Exercised                  | (10.1)  | \$ 19.05                                  |
| Canceled or Expired        | (0.4)   | \$ 20.79                                  |
| Outstanding, year-end 2007 | 44.8  | \$ 20.94                                  |
| Granted                    | 3.5   | \$ 28.49                                  |
| Exercised                  | (8.3)   | \$ 21.04                                  |
| Canceled or Expired        | (0.3)   | \$ 23.08                                  |
| Outstanding, year-end 2008 | 39.7  | \$ 21.58                                  |

A summary of options outstanding and exercisable at January 31, 2009 follows:

| Range of Exercise Prices | Number<br>outstanding<br>(in millions) | Weighted-<br>average<br>remaining<br>contractual life<br>(in years) | Weighted-<br>average<br>exercise price | Options<br>exercisable<br>(in millions) | Weighted-<br>average<br>exercise price |
|--------------------------|--|---|--|---|--|
| \$13.78 - \$14.93        | 4.2                                    | 3.86  | \$ 14.91                               | 4.2                                     | \$ 14.91                               |
| \$14.94 - \$16.39        | 4.6                                    | 6.16  | \$ 16.35                               | 3.3                                     | \$ 16.34                               |
| \$16.40 - \$17.31        | 7.6                                    | 3.42  | \$ 16.98                               | 6.2                                     | \$ 17.00                               |
| \$17.32 - \$22.99        | 7.4                                    | 4.74  | \$ 21.72                               | 5.3                                     | \$ 21.93                               |
| \$23.00 - \$31.91        | 15.9                                   | 4.51  | \$ 26.99                               | 9.8                                     | \$ 26.38                               |
| \$13.78 - \$31.91        | 39.7                                   | 4.47  | \$ 21.58                               | 28.8                                    | \$ 20.71                               |

The weighted-average remaining contractual life for options exercisable at January 31, 2009, was approximately 3.6 years.

*Restricted stock*

|                            | Restricted<br>shares<br>outstanding<br>(in millions) | Weighted-average<br>grant-date<br>fair value |
|----------------------------|--|--|
| Outstanding, year-end 2005 | 0.7  | \$ 17.85                                     |
| Granted                    | 2.2  | \$ 20.16                                     |
| Lapsed                     | (0.4)  | \$ 17.46                                     |
| Canceled or Expired        | (0.1)  | \$ 19.41                                     |
| Outstanding, year-end 2006 | 2.4  | \$ 20.02                                     |
| Granted                    | 2.5  | \$ 28.20                                     |
| Lapsed                     | (1.4)  | \$ 19.90                                     |
| Canceled or Expired        | (0.1)  | \$ 22.69                                     |
| Outstanding, year-end 2007 | 3.4  | \$ 25.89                                     |
| Granted                    | 2.5  | \$ 28.42                                     |
| Lapsed                     | (1.7)  | \$ 26.48                                     |
| Canceled or Expired        | (0.1)  | \$ 25.70                                     |
| Outstanding, year-end 2008 | 4.1  | \$ 27.22                                     |

The weighted-average fair value of stock options granted during 2008, 2007 and 2006 was \$8.65, \$9.66 and \$6.90, 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 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:

|   | 2008      | 2007      | 2006      |
|---|-----------|-----------|-----------|
| Weighted average expected volatility        | 27.89%    | 29.23%    | 27.60%    |
| Weighted average risk-free interest rate    | 3.63%     | 5.06%     | 5.07%     |
| Expected dividend yield                     | 1.50%     | 1.40%     | 1.50%     |
| Expected term (based on historical results) | 6.8 years | 6.9 years | 7.5 years |

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

Total stock compensation recognized in 2008, 2007 and 2006 was \$91, \$87 and \$72, respectively. Stock option compensation recognized in 2008, 2007 and 2006 was \$35, \$51 and \$50, respectively. Restricted shares compensation recognized in 2008, 2007 and 2006 was \$56, \$36 and

\$22 respectively.

The total intrinsic value of options exercised was \$18, \$33 and \$79 in 2008, 2007 and 2006, respectively. The total amount of cash received in 2008 by the Company from the exercise of options granted under share-based payment arrangements was \$172. As of January 31, 2009, there was \$118 of total unrecognized compensation expense remaining related to non-vested share-based compensation arrangements granted under the Company's equity award plans. This cost is expected to be recognized over a weighted-average period of approximately one year. The total fair value of options that vested was \$53, \$53 and \$44 in 2008, 2007 and 2006, respectively.

Shares issued as a result of stock option exercises may be newly issued shares or reissued treasury shares. Proceeds received from the exercise of options, and the related tax benefit, may be utilized to repurchase shares of the Company's stock under a stock repurchase program adopted by the Company's Board of Directors. During 2008, the Company repurchased approximately seven million shares of stock in such a manner.

For share-based awards granted prior to the adoption of SFAS 123(R), the Company's stock option grants generally contained retirement-eligibility provisions that caused the options to vest upon the earlier of the stated vesting date or retirement. Compensation expense was calculated over the stated vesting periods, regardless of whether certain employees became retirement-eligible during the respective vesting periods. Upon the adoption of SFAS 123(R), the Company continued this method of recognizing compensation expense for awards granted prior to the adoption of SFAS 123(R). For awards granted on or after January 29, 2006, options vest based on the stated vesting date, even if an employee retires prior to the vesting date. The requisite service period ends, however, on the employee's retirement-eligible date. As a result, the Company recognizes expense for stock option grants containing such retirement-eligibility provisions over the shorter of the vesting period or the period until employees become retirement-eligible (the requisite service period). As a result of retirement eligibility provisions in stock option awards granted on or after January 29, 2006, approximately \$9 of compensation expense was recognized in 2008 prior to the completion of stated vesting periods.

## 11. COMMITMENTS AND CONTINGENCIES

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

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

The principal contingencies are described below:

*Insurance* The Company's workers' compensation risks are self-insured in 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 January 31, 2009, an adverse decision would require a cash payment up to approximately \$436, including interest.

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 in 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 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 effect 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 January 31, 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 25% ownership interest. The Company's share of the responsibility, as of January 31, 2009, should the entity be unable to meet its obligations, totals approximately \$25 and is collateralized by approximately \$8 of inventory located in the Company's stores. In addition, the Company has guaranteed half of the lease payments of a location leased by an entity in which Kroger has a 50% ownership interest. The net present value of the guaranteed rental payments is approximately \$6.

*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.

## 12. STOCK

### *Preferred Stock*





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The Company has authorized five million shares of voting cumulative preferred stock; two million were available for issuance at January 31, 2009. The stock has a par value of \$100 per share and is issuable in series.

### *Common Stock*



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The Company has authorized one billion shares of common stock, \$1 par value per share. On May 20, 1999, the shareholders authorized an amendment to the Amended Articles of Incorporation to increase the authorized shares of common stock from one billion to two billion when the Board of Directors determines it to be in the best interest of the Company.

### *Common Stock Repurchase Program*

The Company maintains stock repurchase programs that comply with Securities Exchange Act Rule 10b5-1 to allow for the orderly repurchase of Kroger stock, from time to time. The Company made open market purchases totaling \$448, \$1,151 and \$374 under these repurchase programs in fiscal 2008, 2007 and 2006, respectively. In addition to these repurchase programs, in December 1999, the Company began a program to repurchase common stock to reduce dilution resulting from its employee stock option plans. This program is solely funded by proceeds from stock option exercises, and the related tax benefit. The Company repurchased approximately \$189, \$270 and \$259 under the stock option program during fiscal 2008, 2007 and 2006, respectively.

### 13. BENEFIT PLANS

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

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

Effective February 3, 2007, the Company adopted the recognition and disclosure provisions (except for the measurement date change) of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statement No. 87, 99, 106 and 132(R)* (SFAS 158), which requires the recognition of the funded status of its retirement plans on the Consolidated Balance Sheet. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized are required to be recorded as a component of Accumulated Other Comprehensive Income (AOCI). The Company adopted the measurement date provisions of SFAS 158 effective February 3, 2008. The majority of our pension and postretirement plans previously used a December 31 measurement date. All plans are now measured as of the Company's fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareholders' equity by approximately \$5 (\$3 after-tax) and increased long-term liabilities by approximately \$5. There was no effect on the Company's results of operations.

Amounts recognized in AOCI as of January 31, 2009 consist of the following (pre-tax):

| January 31, 2009                         | Pension Benefits | Other Benefits | Total  |
|--|------------------|----------------|--------|
| Unrecognized net actuarial loss (gain)   | \$ 882           | \$ (89)        | \$ 793 |
| Unrecognized prior service cost (credit) | 7                | (28)           | (21)   |
| Unrecognized transition obligation       | 1                |                | 1      |
| Total liabilities                        | \$ 890           | \$ (117)       | \$ 773 |

Amounts in AOCI expected to be recognized as components of net periodic pension or postretirement benefit costs in 2009 are as follows (pre-tax):

| January 31, 2009            | Pension Benefits | Other Benefits | Total  |
|-----------------------------|------------------|----------------|--------|
| Net actuarial loss (gain)   | \$ 8             | \$ (5)         | \$ 3   |
| Prior service cost (credit) | 2                | (6)            | (4)    |
| Total liabilities           | \$ 10            | \$ (11)        | \$ (1) |

Other changes recognized in other comprehensive income in 2008 are as follows (pre-tax):

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| <b>January 31, 2009</b>  | <b>Pension Benefits</b> |      | <b>Other Benefits</b> |      | <b>Total</b> |
|--|-------------------------|------|-----------------------|------|--------------|
| Incurring prior service cost   | \$                      | 3    | \$                    |      | \$ 3         |
| Incurring net actuarial loss (gain)  |                         | 660  |                       | (54) | 606          |
| Amortization of prior service credit (cost)                                  |                         | (2)  |                       | 7    | 5            |
| Amortization of net actuarial gain (loss)                                    |                         | (19) |                       | 3    | (16)         |
| Total recognized in other comprehensive income                               |                         | 642  |                       | (44) | 598          |
| <br>   |                         |      |                       |      |              |
| Total recognized in net periodic benefit cost and other comprehensive income | \$                      | 687  | \$                    | (26) | \$ 661       |

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

|   | Pension Benefits |          |                    |          |                |          |
|---|------------------|----------|--------------------|----------|----------------|----------|
|   | Qualified Plans  |          | Non-Qualified Plan |          | Other Benefits |          |
|   | 2008             | 2007     | 2008               | 2007     | 2008           | 2007     |
| Change in benefit obligation:                         |                  |          |                    |          |                |          |
| Benefit obligation at beginning of fiscal year        | \$ 2,342         | \$ 2,419 | \$ 139             | \$ 113   | \$ 320         | \$ 373   |
| Service cost  | 39               | 42       | 2                  | 2        | 10             | 10       |
| Interest cost   | 151              | 141      | 10                 | 9        | 18             | 19       |
| Plan participants contributions                       | 1                | 1        |                    |          | 8              | 9        |
| Amendments  |                  | 2        | 3                  |          |                |          |
| Actuarial (gain) loss                                 | (148)            | (143)    | 12                 | 23       | (55)           | (65)     |
| Benefits paid   | (123)            | (120)    | (8)                | (8)      | (26)           | (26)     |
| Other   | 4                |          | 2                  |          | 3              |          |
| Benefit obligation at end of fiscal year              | \$ 2,266         | \$ 2,342 | \$ 160             | \$ 139   | \$ 278         | \$ 320   |
| Change in plan assets:                                |                  |          |                    |          |                |          |
| Fair value of plan assets at beginning of fiscal year | \$ 2,230         | \$ 2,098 | \$                 | \$       | \$             | \$       |
| Actual return on plan assets                          | (619)            | 200      |                    |          |                |          |
| Employer contributions                                | 20               | 51       | 8                  | 8        | 17             | 17       |
| Plan participants contributions                       | 1                | 1        |                    |          | 9              | 9        |
| Benefits paid   | (123)            | (120)    | (8)                | (8)      | (26)           | (26)     |
| Other   | 4                |          |                    |          |                |          |
| Fair value of plan assets at end of fiscal year       | \$ 1,513         | \$ 2,230 | \$                 | \$       | \$             | \$       |
| Funded status at end of fiscal year                   | \$ (753)         | \$ (112) | \$ (160)           | \$ (139) | \$ (278)       | \$ (320) |
| Net liability recognized at end of fiscal year        | \$ (753)         | \$ (112) | \$ (160)           | \$ (139) | \$ (278)       | \$ (320) |

Other current liabilities as of both January 31, 2009 and February 2, 2008 include \$17 of net liability recognized.

As of January 31, 2009 and February 2, 2008, pension plan assets included no shares of The Kroger Co. common stock.

| Weighted average assumptions                            | Pension Benefits |       |       | Other Benefits |       |       |
|---|------------------|-------|-------|----------------|-------|-------|
|   | 2008             | 2007  | 2006  | 2008           | 2007  | 2006  |
| Discount rate Benefit obligation                        | 7.00%            | 6.50% | 5.90% | 7.00%          | 6.50% | 5.90% |
| Discount rate Net periodic benefit cost                 | 6.50%            | 5.90% | 5.70% | 6.50%          | 5.90% | 5.70% |
| Expected return on plan assets                          | 8.50%            | 8.50% | 8.50% |                |       |       |
| Rate of compensation increase Net periodic benefit cost | 2.99%            | 3.56% | 3.50% |                |       |       |
| Rate of compensation increase Benefit Obligation        | 2.92%            | 2.99% | 3.56% |                |       |       |

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The Company's discount rate assumption was intended to reflect the rate at which the pension benefits could be effectively settled. It takes into account the timing and amount of benefits that would be available under the plan. The Company's methodology for selecting the discount rate as of year-end 2008 was to match the plan's cash flows to that of a yield curve that provides the equivalent yields on zero-coupon corporate bonds for each maturity. Benefit cash flows due in a particular year can theoretically be settled by investing them in the zero-coupon bond that matures in the same year. The discount rate is the single rate that produces the same present value of cash flows. The selection of the 7.00% discount rate as of year-end 2008 represents the equivalent single rate under a broad-market AA yield curve constructed by an outside consultant. We utilized a discount rate of 6.50% for year-end 2007. The 50 basis point increase in the discount rate decreased the projected pension benefit obligation as of January 31, 2009, by approximately \$147.

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To determine the expected return on pension plan assets, the Company contemplates current and forecasted plan asset allocations as well as historical and forecasted returns on various asset categories. The average annual return on pension plan assets was 4.1% for the ten calendar years ended December 31, 2008, net of all fees and expenses. Our actual return for the pension plan calendar year ending December 31, 2008, on that same basis, was (26.1)%. The Company utilized a pension return assumption of 8.5% in 2008, 2007 and 2006 based on the assumption that future returns will achieve the same level of performance as the long-term historical average annual return for the various markets in which the plan invests.

The fair value of plan assets decreased in 2008 compared to 2007 due to deteriorating conditions in the global financial markets. This decrease caused the Company's underfunded status to increase at January 31, 2009.

The Company uses the RP-2000 projected 2015 mortality table in calculating the pension obligation.

|  | Pension Benefits |       |        |                    |       |       |                |       |       |
|--|------------------|-------|--------|--------------------|-------|-------|----------------|-------|-------|
|  | Qualified Plans  |       |        | Non-Qualified Plan |       |       | Other Benefits |       |       |
|  | 2008             | 2007  | 2006   | 2008               | 2007  | 2006  | 2008           | 2007  | 2006  |
| Components of net periodic benefit cost: |                  |       |        |                    |       |       |                |       |       |
| Service cost                             | \$ 39            | \$ 42 | \$ 123 | \$ 2               | \$ 2  | \$ 2  | \$ 10          | \$ 10 | \$ 13 |
| Interest cost                            | 151              | 141   | 130    | 10                 | 9     | 6     | 18             | 19    | 20    |
| Expected return on plan assets           | (178)            | (165) | (152)  |                    |       |       |                |       |       |
| Amortization of:                         |                  |       |        |                    |       |       |                |       |       |
| Transition asset                         |                  |       | (1)    |                    |       |       |                |       |       |
| Prior service cost                       |                  | 1     | 3      | 2                  | 2     | 2     | (7)            | (6)   | (7)   |
| Actuarial (gain) loss                    | 11               | 31    | 41     | 8                  | 6     | 2     | (3)            |       |       |
| Curtailement charge                      |                  |       | 5      |                    |       |       |                |       |       |
| Net periodic benefit cost                | \$ 23            | \$ 50 | \$ 149 | \$ 22              | \$ 19 | \$ 12 | \$ 18          | \$ 23 | \$ 26 |

The following table provides the projected benefit obligation ( PBO ), accumulated benefit obligation ( ABO ) and the fair value of plan assets for all Company-sponsored pension plans.

|  | Qualified Plans |          | Non-Qualified Plan |        |
|--|-----------------|----------|--------------------|--------|
|  | 2008            | 2007     | 2008               | 2007   |
| PBO at end of fiscal year                | \$ 2,266        | \$ 2,342 | \$ 160             | \$ 139 |
| ABO at end of fiscal year                | \$ 2,096        | \$ 2,144 | \$ 138             | \$ 118 |
| Fair value of plan assets at end of year | \$ 1,513        | \$ 2,230 | \$                 | \$     |

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

|      | Pension Benefits | Other Benefits |
|------|------------------|----------------|
| 2009 | \$ 118           | \$ 19          |
| 2010 | \$ 125           | \$ 20          |
| 2011 | \$ 132           | \$ 21          |



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|      |      |    |     |    |     |
|------|------|----|-----|----|-----|
| 2012 |      | \$ | 142 | \$ | 21  |
| 2013 |      | \$ | 153 | \$ | 22  |
| 2014 | 2018 | \$ | 922 | \$ | 133 |

The Company discontinued the accrual of additional benefits under the Company's cash balance formula of the Consolidated Retirement Benefit Plan (the Cash Balance Plan) effective January 1, 2007. Participants in the Cash Balance Plan will continue to earn interest credits on their accrued benefit balance as of December 31, 2006, based on average Treasury rates, but will no longer accrue cash balance pay credits under the Cash Balance Plan after December 31, 2006. Projected pension benefit payments, as noted above, are lower than estimates in prior years as a result of the discontinuation of benefit accruals under the Cash Balance Plan. As a result of the decision to curtail benefits under the Cash Balance Plan, the Company recorded a charge totaling \$5, pre-tax, in fiscal 2006, which represented the previously unrecognized prior service costs.

Net periodic benefit cost decreased in 2008 and 2007 compared to 2006 due to participants in the Cash Balance formula of the Consolidated Retirement Benefit Plan being moved to a 401(k) retirement savings account plan effective January 1, 2007. Participants under that formula continue to earn interest on prior contributions but no additional pay credits will be earned. The 401(k) retirement savings plan provides to eligible employees both matching contributions and automatic contributions from the Company based on participant contributions, plan compensation, and length of service. The Company contributed and expensed \$92 and \$90 to employee 401(k) retirement savings accounts in 2008 and 2007, respectively.

The following table provides information about the target and actual pension plan asset allocations. Allocation percentages are shown as of December 31 for each respective year. The pension plan measurement date is the December 31st nearest the fiscal year-end.

|   | Target<br>allocations<br>2008 | 2008          | Actual<br>allocations<br>2007 |
|---|-------------------------------|---------------|-------------------------------|
| Pension plan asset allocation, as of December 31: |                               |               |                               |
| Domestic equity securities                        | 15.6%                         | 11.0%         | 15.2%                         |
| International equity securities                   | 16.4                          | 13.9          | 21.4                          |
| Investment grade debt securities                  | 16.0                          | 17.9          | 21.6                          |
| High yield debt securities                        | 10.0                          | 12.7          | 9.9                           |
| Private equity                                    | 5.5                           | 9.2           | 5.9                           |
| Hedge funds                                       | 22.0                          | 22.9          | 17.2                          |
| Real estate                                       | 3.0                           | 3.2           | 1.7                           |
| Other   | 11.5                          | 9.2           | 7.1                           |
| <b>Total</b>                                      | <b>100.0%</b>                 | <b>100.0%</b> | <b>100.0%</b>                 |

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

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

The current target allocations shown represent 2008 targets that were originally established in 2007 and modified during 2008. To maintain actual asset allocations consistent with target allocations, assets are reallocated or rebalanced periodically. In addition, cash flow from employer contributions and participant benefit payments can be used to fund underweight asset classes and divest overweight asset classes, as appropriate. The Company expects that cash flow will be sufficient to meet most rebalancing needs. Although the Company is not required to make cash contributions to its Company-sponsored pension plans during fiscal 2009, it made a \$200 cash contribution on February 2, 2009. Additional contributions may be made if required under the Pension Protection Act to avoid any benefit restrictions. The Company expects any voluntary contributions made during 2009 will reduce its minimum required contributions in future years.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The Company used a 7.80% initial health care cost trend rate and a 4.50% ultimate health care cost trend rate to determine its expense. A one-percentage-point change in the

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assumed health care cost trend rates would have the following effects:

|   | 1% Point<br>Increase |    | 1% Point<br>Decrease |      |
|---|----------------------|----|----------------------|------|
| Effect on total of service and interest cost components | \$                   | 4  | \$                   | (3)  |
| Effect on postretirement benefit obligation             | \$                   | 29 | \$                   | (24) |

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.

The Company recognizes expense in connection with these plans as contributions are funded, in accordance with GAAP. The Company made contributions to these funds, and recognized expense, of \$219 in 2008, \$207 in 2007, and \$204 in 2006.

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 substantially exceeds the value of the assets held in trust to pay benefits. Moreover, if the Company were to exit certain markets or otherwise cease making contributions to these funds, the Company could trigger a substantial withdrawal liability. Any adjustment for withdrawal liability will be recorded when it is probable that a liability exists and can be reasonably estimated, in accordance with GAAP.

The Company also administers other defined contribution plans for eligible union and non-union employees. The cost of these plans for 2008, 2007 and 2006 was \$8.

#### 14. RECENTLY ADOPTED ACCOUNTING STANDARDS

Effective January 31, 2009, the Company adopted FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FAS 140-4 and FIN 46(R)-8). FAS 140-4 and FIN 46(R)-8 require additional disclosures about an entity's involvement with variable interest entities and transfers of financial assets. See Note 2 for further discussion of the adoption of FAS 140-4 and FIN 46(R)-8.

**Effective February 3, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157), except for non-financial assets and non-financial liabilities as deferred until February 1, 2009 by FASB Staff Position (FSP) 157-2 *Partial Deferral of the Effective Date of Statement No. 157* (FSP 157-2). SFAS 157 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. FSP 157-2 deferred the effective date of SFAS 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. See Note 7 for further discussion of the adoption of SFAS 157.**

Effective February 4, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (FIN No. 48), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. See Note 4 for further discussion of the adoption of FIN No. 48.

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Effective February 3, 2007, the Company adopted the recognition and disclosure provisions (except for the measurement date change) of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statement No. 87, 99, 106 and 132(R)* (SFAS 158), which requires the recognition of the funded status of its retirement plans on the Consolidated Balance Sheet. Actuarial gains or losses, prior service costs or credits and transition obligations that have not yet been recognized are required to be recorded as a component of Accumulated Other Comprehensive Income ( AOCI ). The Company adopted the measurement date provisions of SFAS 158 effective February 3, 2008. The majority of the Company's pension and postretirement plans previously used a December 31 measurement date. All plans are now measured as of the Company's fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareholders' equity by approximately \$5 (\$3 after-tax) and increased long-term liabilities by approximately \$5. There was no effect on the Company's results of operations. See Note 13 for further discussion of the adoption of this standard.

## 15. RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51* (SFAS 160). SFAS 160 will require the consolidation of noncontrolling interests as a component of equity. SFAS 160 will become effective for the Company's fiscal year beginning February 1, 2009. The Company is currently evaluating the effect the adoption of SFAS 160 will have on its Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R), which replaces SFAS 141. SFAS 141R further expands the definitions of a business and the fair value measurement and reporting in a business combination. SFAS 141R will become effective for the Company's fiscal year beginning February 1, 2009. Because the standard will only impact transactions entered into after February 1, 2009, SFAS 141R will not effect our Consolidated Financial Statements upon adoption.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 requires enhanced disclosures on an entity's derivative and hedging activities. SFAS 161 will become effective for the Company's fiscal year beginning February 1, 2009. The Company is currently evaluating the effect the adoption of SFAS 161 will have on its Consolidated Financial Statements.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP No. EITF 03-6-1). FSP No. EITF 03-6-1 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. FSP No. EITF 03-6-1 will become effective for the Company's fiscal year beginning February 1, 2009. The Company is currently evaluating the effect the adoption of FSP No. EITF 03-6-1 will have on its Consolidated Financial Statements.

## 16. GUARANTOR SUBSIDIARIES

The Company's outstanding public debt (the *Guaranteed Notes*) is jointly and severally, fully and unconditionally guaranteed by The Kroger Co. and some of its subsidiaries (the *Guarantor Subsidiaries*). At January 31, 2009, a total of approximately \$7,186 of *Guaranteed Notes* was outstanding. The *Guarantor Subsidiaries* and non-guarantor subsidiaries are wholly-owned 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 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 is not separately presented 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, except, however, the obligations of each guarantor under its guarantee are limited to the maximum amount as will result in obligations of such guarantor under its guarantee not constituting a fraudulent conveyance or fraudulent transfer for purposes of Bankruptcy Law, the Uniform Fraudulent Conveyance Act, the Uniform Fraudulent Transfer Act, or any similar Federal or state law (e.g., adequate capital to pay dividends under

corporate laws).

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The following tables present summarized financial information as of January 31, 2009 and February 2, 2008 and for the three years ended January 31, 2009.

**Condensed Consolidating**

**Balance Sheets**

**As of January 31, 2009**

|  | The Kroger Co.   | Guarantor<br>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              |
| <b>Total current assets</b>  | <b>2,998</b>     | <b>6,179</b>              | <b>(1,971)</b>     | <b>7,206</b>     |
| Property, plant and equipment, net   | 1,747            | 11,414                    |                    | 13,161           |
| Goodwill   | 132              | 2,139                     |                    | 2,271            |
| Adjustment to reflect fair value interest rate hedges  |                  |                           |                    |                  |
| Other assets   | 797              | 1,562                     | (1,786)            | 573              |
| Investment in and advances to subsidiaries   | 10,266           |                           | (10,266)           |                  |
| <b>Total Assets</b>  | <b>\$ 15,940</b> | <b>\$ 21,294</b>          | <b>\$ (14,023)</b> | <b>\$ 23,211</b> |
| <b>Current liabilities</b>   |                  |                           |                    |                  |
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 558           | \$                        | \$                 | \$ 558           |
| Accounts payable   | 386              | 3,436                     |                    | 3,822            |
| Other current liabilities  | 879              | 6,127                     | (3,757)            | 3,249            |
| <b>Total current liabilities</b>   | <b>1,823</b>     | <b>9,563</b>              | <b>(3,757)</b>     | <b>7,629</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         | 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            |
| <b>Total Liabilities</b>   | <b>10,669</b>    | <b>11,028</b>             | <b>(3,757)</b>     | <b>17,940</b>    |
| Minority interests   | 95               |                           |                    | 95               |
| Shareowners' Equity  | 5,176            | 10,266                    | (10,266)           | 5,176            |
| <b>Total Liabilities and Shareowners' equity</b>   | <b>\$ 15,940</b> | <b>\$ 21,294</b>          | <b>\$ (14,023)</b> | <b>\$ 23,211</b> |





## Condensed Consolidating

## Balance Sheets

As of February 2, 2008

|  | The Kroger Co.   | Guarantor<br>Subsidiaries | Eliminations       | Consolidated     |
|--|------------------|---------------------------|--------------------|------------------|
| <b>Current assets</b>  |                  |                           |                    |                  |
| Cash and temporary cash investments  | \$ 26            | \$ 216                    | \$                 | \$ 242           |
| Deposits in-transit  | 76               | 600                       |                    | 676              |
| Receivables  | 2,033            | 634                       | (1,881)            | 786              |
| Net inventories  | 420              | 4,429                     |                    | 4,849            |
| Prepaid and other current assets   | 373              | 182                       |                    | 555              |
| Total current assets   | 2,928            | 6,061                     | (1,881)            | 7,108            |
| Property, plant and equipment, net   | 1,684            | 10,814                    |                    | 12,498           |
| Goodwill   | 56               | 2,088                     |                    | 2,144            |
| Adjustment to reflect fair value interest rate hedges  | 11               |                           |                    | 11               |
| Other assets   | 1,412            | 657                       | (1,537)            | 532              |
| Investment in and advances to subsidiaries   | 10,098           |                           | (10,098)           |                  |
| <b>Total Assets</b>  | <b>\$ 16,189</b> | <b>\$ 19,620</b>          | <b>\$ (13,516)</b> | <b>\$ 22,293</b> |
| <b>Current liabilities</b>   |                  |                           |                    |                  |
| Current portion of long-term debt including obligations under capital leases and financing obligations | \$ 1,592         | \$                        | \$                 | \$ 1,592         |
| Accounts payable   | 1,822            | 5,463                     | (3,418)            | 3,867            |
| Other current liabilities  |                  | 3,224                     |                    | 3,224            |
| Total current liabilities  | 3,414            | 8,687                     | (3,418)            | 8,683            |
| Long-term debt including obligations under capital leases and financing obligations                    |                  |                           |                    |                  |
| Face value long-term debt including obligations under capital leases and financing obligations         | 6,485            |                           |                    | 6,485            |
| Adjustment to reflect fair value interest rate hedges  | 44               |                           |                    | 44               |
| Long-term debt including obligations under capital leases and financing obligations                    | 6,529            |                           |                    | 6,529            |
| Other long-term liabilities  | 1,332            | 835                       |                    | 2,167            |
| Total Liabilities  | 11,275           | 9,522                     | (3,418)            | 17,379           |
| Shareowners Equity   | 4,914            | 10,098                    | (10,098)           | 4,914            |
| <b>Total Liabilities and Shareowners equity</b>  | <b>\$ 16,189</b> | <b>\$ 19,620</b>          | <b>\$ (13,516)</b> | <b>\$ 22,293</b> |

**Condensed Consolidating****Statements of Operations****For the Year ended January 31, 2009**

|   | <b>The Kroger Co.</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------|-----------------------------------|---------------------|---------------------|
| Sales   | \$ 9,557              | \$ 67,715                         | \$ (1,272)          | \$ 76,000           |
| Merchandise costs, including warehousing and transportation | 7,816                 | 52,020                            | (1,272)             | 58,564              |
| Operating, general and administrative                       | 1,657                 | 11,227                            |                     | 12,884              |
| Rent  | 128                   | 531                               |                     | 659                 |
| Depreciation and amortization                               | 157                   | 1,285                             |                     | 1,442               |
| Operating profit (loss)                                     | (201)                 | 2,652                             |                     | 2,451               |
| Interest expense  | 480                   | 5                                 |                     | 485                 |
| Equity in earnings of subsidiaries                          | 2,022                 |                                   | (2,022)             |                     |
| Earnings before tax expense                                 | 1,341                 | 2,647                             | (2,022)             | 1,966               |
| Tax expense   | 92                    | 625                               |                     | 717                 |
| Net earnings  | \$ 1,249              | \$ 2,022                          | \$ (2,022)          | \$ 1,249            |

**Condensed Consolidating****Statements of Operations****For the Year ended February 2, 2008**

|   | <b>The Kroger Co.</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------|-----------------------------------|---------------------|---------------------|
| Sales   | \$ 9,022              | \$ 62,482                         | \$ (1,269)          | \$ 70,235           |
| Merchandise costs, including warehousing and transportation | 6,877                 | 48,171                            | (1,269)             | 53,779              |
| Operating, general and administrative                       | 1,666                 | 10,489                            |                     | 12,155              |
| Rent  | 125                   | 519                               |                     | 644                 |
| Depreciation and amortization                               | 148                   | 1,208                             |                     | 1,356               |
| Operating profit  | 206                   | 2,095                             |                     | 2,301               |
| Interest expense  | 468                   | 6                                 |                     | 474                 |
| Equity in earnings of subsidiaries                          | 1,511                 |                                   | (1,511)             |                     |
| Earnings before income tax expense                          | 1,249                 | 2,089                             | (1,511)             | 1,827               |
| Income tax expense  | 68                    | 578                               |                     | 646                 |
| Net earnings  | \$ 1,181              | \$ 1,511                          | \$ (1,511)          | \$ 1,181            |

## Condensed Consolidating

## Statements of Operations

For the Year ended February 3, 2007

|   | The Kroger Co. | Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|----------------|---------------------------|--------------|--------------|
| Sales   | \$ 8,731       | \$ 58,383                 | \$ (1,003)   | \$ 66,111    |
| Merchandise costs, including warehousing and transportation | 6,630          | 44,488                    | (1,003)      | 50,115       |
| Operating, general and administrative                       | 1,697          | 10,142                    |              | 11,839       |
| Rent  | 132            | 517                       |              | 649          |
| Depreciation and amortization                               | 136            | 1,136                     |              | 1,272        |
| Operating profit  | 136            | 2,100                     |              | 2,236        |
| Interest expense  | 480            | 8                         |              | 488          |
| Equity in earnings of subsidiaries                          | 1,843          |                           | (1,843)      |              |
| Earnings before income tax expense                          | 1,499          | 2,092                     | (1,843)      | 1,748        |
| Income tax expense  | 384            | 249                       |              | 633          |
| Net earnings  | \$ 1,115       | \$ 1,843                  | \$ (1,843)   | \$ 1,115     |

## Condensed Consolidating

## Statements of Cash Flows

For the Year ended January 31, 2009

|  | The Kroger Co. | Guarantor<br>Subsidiaries | Consolidated |
|--|----------------|---------------------------|--------------|
| Net cash provided by operating activities                      | \$ (852)       | \$ 3,748                  | \$ 2,896     |
| Cash flows from investing activities:                          |                |                           |              |
| Payments for capital expenditures                              | (257)          | (1,892)                   | (2,149)      |
| Other  | (39)           | 9                         | (30)         |
| Net cash used by investing activities                          | (296)          | (1,883)                   | (2,179)      |
| Cash flows from financing activities:                          |                |                           |              |
| Proceeds from issuance of long-term debt                       | 1,377          |                           | 1,377        |
| Payments on long-term debt                                     | (1,048)        |                           | (1,048)      |
| Proceeds from issuance of capital stock                        | 187            |                           | 187          |
| Treasury stock purchases                                       | (637)          |                           | (637)        |
| Dividends paid   | (227)          |                           | (227)        |
| Other  | (430)          | 9                         | (421)        |
| Net change in advances to subsidiaries                         | 1,854          | (1,854)                   |              |
| Net cash (used) provided by financing activities               | 1,076          | (1,845)                   | (769)        |
| Net increase (decrease) in cash and temporary cash investments | (72)           | 20                        | (52)         |
| Cash from consolidated Variable Interest Entity                | 73             |                           | 73           |
| Cash and temporary cash investments:                           |                |                           |              |
| Beginning of year  | 26             | 216                       | 242          |
| End of year  | \$ 27          | \$ 236                    | \$ 263       |

## Condensed Consolidating

## Statements of Cash Flows

For the Year ended February 2, 2008

|   | The Kroger Co. | Guarantor<br>Subsidiaries | Consolidated |
|---|----------------|---------------------------|--------------|
| Net cash (used) provided by operating activities    | \$ (941)       | \$ 3,522                  | \$ 2,581     |
| Cash flows from investing activities:               |                |                           |              |
| Payments for capital expenditures                   | (210)          | (1,916)                   | (2,126)      |
| Other   | (29)           | (63)                      | (92)         |
| Net cash used by investing activities               | (239)          | (1,979)                   | (2,218)      |
| Cash flows from financing activities:               |                |                           |              |
| Proceeds from issuance of long-term debt            | 1,372          |                           | 1,372        |
| Payments on long-term debt                          | (560)          |                           | (560)        |
| Proceeds from issuance of capital stock             | 224            |                           | 224          |
| Treasury stock purchases                            | (1,421)        |                           | (1,421)      |
| Dividends paid                                      | (202)          |                           | (202)        |
| Other   | 218            | 59                        | 277          |
| Net change in advances to subsidiaries              | 1,550          | (1,550)                   |              |
| Net cash (used) provided by financing activities    | 1,181          | (1,491)                   | (310)        |
| Net increase in cash and temporary cash investments | 1              | 52                        | 53           |
| Cash and temporary cash investments:                |                |                           |              |
| Beginning of year                                   | 25             | 164                       | 189          |
| End of year   | \$ 26          | \$ 216                    | \$ 242       |

## Condensed Consolidating

## Statements of Cash Flows

For the Year ended February 3, 2007

|   | The Kroger Co. | Guarantor<br>Subsidiaries | Consolidated |
|---|----------------|---------------------------|--------------|
| Net cash provided by operating activities           | \$ (755)       | \$ 3,106                  | \$ 2,351     |
| Cash flows from investing activities:               |                |                           |              |
| Payments for capital expenditures                   | (143)          | (1,540)                   | (1,683)      |
| Other   | 56             | 40                        | 96           |
| Net cash used by investing activities               | (87)           | (1,500)                   | (1,587)      |
| Cash flows from financing activities:               |                |                           |              |
| Proceeds from issuance of long-term debt            | 10             |                           | 10           |
| Payments on long-term debt                          | (556)          |                           | (556)        |
| Proceeds from issuance of capital stock             | 206            |                           | 206          |
| Treasury stock purchases                            | (633)          |                           | (633)        |
| Dividends Paid                                      | (140)          |                           | (140)        |
| Other   | 355            | (27)                      | 328          |
| Net change in advances to subsidiaries              | 1,586          | (1,586)                   |              |
| Net cash used by financing activities               | 828            | (1,613)                   | (785)        |
| Net decrease in cash and temporary cash investments | (14)           | (7)                       | (21)         |
| Cash and temporary cash investments:                |                |                           |              |
| Beginning of year                                   | 39             | 171                       | 210          |
| End of year   | \$ 25          | \$ 164                    | \$ 189       |

The above February 2, 2008 condensed consolidating balance sheet and 2007 and 2006 condensed consolidating cash flow statements have been adjusted to conform to current year presentation and properly reflect intra-company receivables.

## 17. QUARTERLY DATA (UNAUDITED)

| 2008   | Quarter             |                      |                     |                      |                          |
|--|---------------------|----------------------|---------------------|----------------------|--------------------------|
|  | First<br>(16 Weeks) | Second<br>(12 Weeks) | Third<br>(12 Weeks) | Fourth<br>(12 Weeks) | Total Year<br>(52 Weeks) |
| Sales  | \$ 23,107           | \$ 18,053            | \$ 17,580           | \$ 17,260            | \$ 76,000                |
| Net earnings   | \$ 386              | \$ 277               | \$ 237              | \$ 349               | \$ 1,249                 |
| Net earnings per basic common share                  | \$ 0.59             | \$ 0.42              | \$ 0.37             | \$ 0.54              | \$ 1.92                  |
| Average number of shares used in basic calculation   | 657                 | 651                  | 649                 | 648                  | 652                      |
| Net earnings per diluted common share                | \$ 0.58             | \$ 0.42              | \$ 0.36             | \$ 0.53              | \$ 1.90                  |
| Average number of shares used in diluted calculation | 664                 | 659                  | 656                 | 655                  | 659                      |

| 2007   | Quarter             |                      |                     |                      |                          |
|--|---------------------|----------------------|---------------------|----------------------|--------------------------|
|  | First<br>(16 Weeks) | Second<br>(12 Weeks) | Third<br>(12 Weeks) | Fourth<br>(12 Weeks) | Total Year<br>(52 Weeks) |
| Sales  | \$ 20,726           | \$ 16,139            | \$ 16,135           | \$ 17,235            | \$ 70,235                |
| Net earnings   | \$ 337              | \$ 267               | \$ 254              | \$ 323               | \$ 1,181                 |
| Net earnings per basic common share                  | \$ 0.48             | \$ 0.38              | \$ 0.37             | \$ 0.48              | \$ 1.71                  |
| Average number of shares used in basic calculation   | 706                 | 702                  | 678                 | 668                  | 690                      |
| Net earnings per diluted common share                | \$ 0.47             | \$ 0.38              | \$ 0.37             | \$ 0.48              | \$ 1.69                  |
| Average number of shares used in diluted calculation | 715                 | 709                  | 685                 | 676                  | 698                      |

Annual amounts may not sum due to rounding.



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

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

As of January 31, 2009, 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. 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 January 31, 2009.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There was no change in Kroger's internal control over financial reporting during the fiscal quarter ended January 31, 2009, that has materially affected, or is reasonably likely to materially affect, Kroger's internal control over financial reporting.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. With the participation of the Chief Executive Officer and the Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management has concluded that the Company's internal control over financial reporting was effective as of January 31, 2009.

The effectiveness of the Company's internal control over financial reporting as of January 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which can be found in Item 8 of this Form 10-K.

**ITEM 9B. OTHER INFORMATION.**

None.



**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information required by this Item not otherwise set forth below is set forth under the headings Election of Directors and Information Concerning the Board of Directors in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission and is hereby incorporated by reference into this Form 10-K.

**SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Based solely on its review of the copies of all Section 16(a) forms received by the Company, or written representations from certain persons that no Forms 5 were required by those persons, the Company believes that during fiscal year 2008 all filing requirements applicable to its officers, directors and 10% beneficial owners were timely satisfied.

**EXECUTIVE OFFICERS OF THE COMPANY**

The following is a list of the names and ages of the executive officers and the positions held by each such person or those chosen to become executive officers as of March 31, 2009. Except as otherwise noted, each person has held office for at least five years. Each officer will hold office at the discretion of the Board for the ensuing year until removed or replaced.

| <b>Name</b>               | <b>Age</b> | <b>Recent Employment History</b>   |
|---------------------------|------------|--|
| Donald E. Becker          | 60         | Mr. Becker was elected Executive Vice President on September 16, 2004 and Senior Vice President on January 26, 2000. Prior to his election, Mr. Becker was appointed President of the Company's Central Marketing Area in 1996. Before this, Mr. Becker served in a number of key management positions in the Company's Cincinnati/Dayton Marketing Area, including Vice President of Operations and Vice President of Merchandising. He joined the Company in 1969.   |
| David B. Dillon           | 58         | Mr. Dillon was elected Chairman of the Board on June 24, 2004 and Chief Executive Officer effective June 26, 2003. Prior to this, he was elected President and Chief Operating Officer effective January 26, 2000. Upon the merger with Fred Meyer, Inc., he was named President of the combined Company. Prior thereto, Mr. Dillon was elected President and Chief Operating Officer of Kroger effective June 18, 1995. Prior to this he was elected Executive Vice President on September 13, 1990, Chairman of the Board of Dillon Companies, Inc. on September 8, 1992, and President of Dillon Companies, Inc. on April 22, 1986. |
| Kevin M. Dougherty        | 56         | Mr. Dougherty was elected Group Vice President, Logistics effective May 6, 2004. Mr. Dougherty joined the Company as Vice President, Supply Chain Operations in 2001. Before joining the Company, he maintained an independent consulting practice focusing on logistics and operational performance.  |
| Joseph A. Grieshaber, Jr. | 51         | Mr. Grieshaber was elected Group Vice President, Perishables Merchandising and Procurement, effective August 4, 2003. Prior to this, he held a variety of management positions within the Company,   |

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most recently serving as Vice President of Merchandising for the Company's Great Lakes Marketing Area. Mr. Grieshaber joined the Company in 1983.

Paul W. Heldman 57 Mr. Heldman was elected Executive Vice President effective May 5, 2006, Senior Vice President effective October 5, 1997, Secretary on May 21, 1992, and Vice President and General Counsel effective June 18, 1989. Prior to his election, he held various positions in the Company's Law Department. Mr. Heldman joined the Company in 1982.

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|                      |    |   |
|----------------------|----|---|
| Scott M. Henderson   | 53 | Mr. Henderson was elected Vice President effective June 26, 2003 and Treasurer effective January 6, 2002. Mr. Henderson joined the Company in 1981 as Manager of Financial Reporting. He held a variety of management positions and was promoted to Vice President of Planning in February 2000.  |
| Christopher T. Hjelm | 47 | Mr. Hjelm joined the Company on August 28, 2005 as Senior Vice President and Chief Information Officer. From February 2005 to July 2005, he was Chief Information Officer of Travel Distribution Services for Cendant Corporation. From July 2003 to November 2004 Mr. Hjelm served as Chief Technology Officer for Orbitz LLC, which was acquired by Cendant Corporation in November 2004. Mr. Hjelm served as Senior Vice President for Technology at eBay Inc. from March 2002 to June 2003, and served as Executive Vice President for Broadband Network Services for At Home Company from June 2001 to February 2002. From January 2000 to June 2001, Mr. Hjelm served as Chairman, President and Chief Executive Officer of ZOHIO Corporation. Prior to that, he held various key roles for 14 years with Federal Express Corporation, including that of Senior Vice President and Chief Information Officer. |
| Carver L. Johnson    | 59 | Mr. Johnson was elected Chief Diversity Officer effective June 22, 2006. Prior to his election, Mr. Johnson served as Group Vice President of Management Information Systems. Prior to joining the Company in December 1999, he served as Vice President and Chief Information Officer of Gymboree. From 1993 to 1998, Mr. Johnson was Senior Systems Director of Corporate Services for Sears, Roebuck & Co. He previously held management positions with Jamesway Corp., Linens n Things, and Pay n Save Stores, Inc.   |
| Calvin J. Kaufman    | 46 | Mr. Kaufman was elected Group Vice President and President of Kroger Manufacturing on May 8, 2008. Prior to his election, Mr. Kaufman was appointed as Senior Director of Logistics in 2006. He joined the Fred Meyer logistics group in 1994 and was appointed Group Vice President of Logistics in 2002 and Vice President of Distribution Engineering in 1999. Before joining the Company, he worked for United Parcel Service first as operations manager and then as engineering department manager.   |
| Lynn Marmer          | 56 | Ms. Marmer was elected Group Vice President, Corporate Affairs effective January 19, 1998. Prior to her election, Ms. Marmer was an attorney in the Company's Law Department. Ms. Marmer joined the Company in 1997. Before joining the Company she was a partner in the law firm of Dinsmore & Shohl.  |
| Don W. McGeorge      | 54 | Mr. McGeorge was elected President and Chief Operating Officer effective June 26, 2003. Prior to that, he was elected Executive Vice President effective January 26, 2000 and Senior Vice President effective August 10, 1997. Before his election, Mr. McGeorge was President of the Company's Columbus Marketing Area effective December 29, 1996; and prior thereto President of the Company's Michigan Marketing Area effective June 20, 1993. Before this he served in a number of key management positions with the Company, including Vice President of Merchandising of the Company's Nashville Marketing Area. Mr. McGeorge joined the Company in 1977.  |
| W. Rodney McMullen   | 48 | Mr. McMullen was elected Vice Chairman effective June 26, 2003. Prior to that he was elected Executive Vice President, Strategy, Planning and Finance effective January 26, 2000, Executive Vice President and Chief Financial Officer effective May 20, 1999, Senior Vice President effective October 5, 1997, and Group Vice President and Chief Financial Officer effective June 18, 1995. Before that he was appointed Vice President, Control and Financial Services on March 4, 1993, and Vice President, Planning and Capital Management effective December 31, 1989. Mr. McMullen joined the Company in 1978 as a part-time stock clerk.  |

|                        |    |  |
|------------------------|----|--|
| M. Marnette Perry      | 57 | Ms. Perry was elected Senior Vice President effective July 20, 2003. Prior to that she was elected Group Vice President of Perishables Merchandising and Procurement on March 3, 2003. Prior to this she held a variety of significant positions with the Company, including President of the Company's Michigan Marketing Area, and President of the Company's Columbus Marketing Area. She joined the Company in 1972. |
| J. Michael Schlotman   | 51 | Mr. Schlotman was elected Senior Vice President effective June 26, 2003, and Group Vice President and Chief Financial Officer effective January 26, 2000. Prior to that he was elected Vice President and Corporate Controller in 1995, and served in various positions in corporate accounting since joining the Company in 1985.   |
| Paul J. Scutt          | 60 | Mr. Scutt was elected Senior Vice President of Retail Operations on September 16, 2004 and he was elected Group Vice President of Retail Operations effective May 21, 2002. He has held a number of significant positions with the Company including Regional Vice President of the Company's Hutchinson operations, and most recently as President of the Company's Central Marketing Area.                             |
| M. Elizabeth Van Oflen | 51 | Ms. Van Oflen was elected Vice President and Controller on April 11, 2003. Prior to her election, she held various positions in the Company's Finance and Tax Departments. Ms. Van Oflen joined the Company in 1982.   |
| Della Wall             | 57 | Ms. Wall was elected Group Vice President, Human Resources effective April 9, 2004. Prior to her election, she held various key positions in the Company's human resources department, manufacturing group and drug store division, most recently serving as Vice President of Human Resources. Ms. Wall joined the Company in 1971.   |
| R. Pete Williams       | 54 | Mr. Williams was elected Senior Vice President on August 19, 2007. Prior to his election, Mr. Williams held a variety of key management positions with the Company, including President of the Company's Mid-Atlantic Marketing Area, Vice President of Operations, Vice President of Merchandising, and Director of Labor Relations. He joined the Company in 1977.   |

**ITEM 11. EXECUTIVE COMPENSATION.**

The information required by this Item is set forth in the sections entitled Compensation Discussion and Analysis, Compensation Committee Report, and Executive Compensation in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission and is hereby incorporated by reference into this Form 10-K.

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

The following table provides information regarding shares outstanding and available for issuance under the Company's existing equity compensation plans.

**Equity Compensation Plan Information**

| Plan Category  | (a)<br>Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b)<br>Weighted-average exercise price of outstanding options, warrants and rights | (c)<br>Number of securities remaining for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|--|--|--|
| Equity compensation plans approved by security holders     | 39,739,548   | \$ 21.58   | 25,146,026   |
| Equity compensation plans not approved by security holders |  | \$   |  |
| <b>Total</b>   | <b>39,739,548</b>  | <b>\$ 21.58</b>  | <b>25,146,026</b>  |

The remainder of the information required by this Item is set forth in the Beneficial Ownership of Common Stock table in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission and is hereby incorporated by reference into this Form 10-K.

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

This information required by this Item is set forth in the sections entitled Related Person Transactions and Information Concerning the Board of Directors-Independence in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission and is hereby incorporated by reference into this Form 10-K.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.****ITEM 1. BUSINESS.**

The information required by this Item is set forth in the section entitled Selection of Auditors Disclosure of Auditor Fees in the definitive proxy statement to be filed by the Company with the Securities and Exchange Commission and is hereby incorporated by reference into this Form 10-K.



**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

(a)1. Financial Statements:

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets as of January 31, 2009 and February 2, 2008  
Consolidated Statements of Operations for the years ended January 31, 2009, February 2, 2008 and February 3, 2007  
Consolidated Statements of Cash Flows for the years ended January 31, 2009, February 2, 2008 and February 3, 2007  
Consolidated Statement of Changes in Shareowners Equity  
Notes to Consolidated Financial Statements

(a)2. Financial Statement Schedules:

There are no Financial Statement Schedules included with this filing for the reason that they are not applicable or are not required or the information is included in the financial statements or notes thereto.

(a)3.(b) Exhibits

- 3.1 Amended Articles of Incorporation are hereby incorporated by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the quarter ended May 20, 2006, filed with the SEC on June 29, 2006.
- 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.
- 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.
- 10.1\* Material Contracts - Non-Employee Directors' Deferred Compensation Plan. Incorporated by reference to Appendix J to Exhibit 99.1 of Fred Meyer, Inc.'s Current Report on Form 8-K dated September 9, 1997, SEC File No. 1-133339.
- 10.2\* The Kroger Co. Deferred Compensation Plan for Independent Directors. Incorporated by reference to Exhibit 10.3 to the Company's Form 10-K for the fiscal year ended January 29, 2005.
- 10.3\* The Kroger Co. Executive Deferred Compensation Plan. Incorporated by reference to Exhibit 10.4 to the Company's Form 10-K for the fiscal year ended January 29, 2005.
- 10.4\* The Kroger Co. 401(k) Retirement Savings Account Restoration Plan. Incorporated by reference to Exhibit 10.4 of The Kroger Co.'s Form 10-K for the fiscal year ended February 3, 2007.
- 10.5\* Dillon Companies, Inc. Excess Benefit Pension Plan. Incorporated by reference to Exhibit 10.5 of The Kroger Co.'s Form 10-K for the fiscal year ended February 3, 2007.
- 10.6\* The Kroger Co. Supplemental Retirement Plans for Certain Benefit Plan Participants. Incorporated by reference to Exhibit 10.6 of The Kroger Co.'s Form 10-K for the fiscal year ended February 3, 2007.
- 10.7\* 2006 Long-Term Bonus Plan. Incorporated by reference to Exhibit 99.1 of The Kroger Co.'s Current Report on Form 8-K filed with the SEC on December 14, 2005.
- 10.8\* The Kroger Co. 2005 Long-Term Incentive Plan. Incorporated by reference to Exhibit 4.2 of The Kroger Co.'s Form S-8 filed with the SEC on June 23, 2005.

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10.9\* Form of Restricted Stock Grant Agreement under Long-Term Incentive Plans. Incorporated by reference to Exhibit 10.9 of The Kroger Co. s Form 10-K for the fiscal year ended February 3, 2007.

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- 10.10\* Form of Non-Qualified Stock Option Grant Agreement under Long-Term Incentive Plans. Incorporated by reference to Exhibit 10.1 of The Kroger Co. s Form 10-Q for the quarter ended May 24, 2008.
- 10.11 Five Year Credit Agreement dated as of November 15, 2006, incorporated by reference to Exhibit 99.1 of The Kroger Co. s Current Report on Form 8-K filed with the SEC on November 20, 2006.
- 10.12 4(2) Commercial Paper Program Dealer Agreement between The Kroger Co., as Issuer and Banc of America Securities, LLC, as Dealer dated as of December 3, 2003, as amended on July 23, 2004, incorporated by reference to Exhibit 10.15 of The Kroger Co. s Annual Report on Form 10-K for the fiscal year ended January 29, 2005.
- 10.13 4(2) Commercial Paper Program Dealer Agreement between The Kroger Co., as Issuer and Citigroup Global Markets Inc., as Dealer dated as of December 3, 2003, as amended on June 9, 2004, incorporated by reference to Exhibit 10.16 of The Kroger Co. s Annual Report on Form 10-K for the fiscal year ended January 29, 2005.
- 10.14\* Disclosure of compensation of non-employee directors. Incorporated by reference to Item 2.02 of The Kroger Co. s Form 8-K dated December 10, 2004.
- 10.15\* The Kroger Co. Employee Protection Plan dated December 13, 2007. Incorporated by reference to Exhibit 10.15 of the Company s Annual Report on Form 10-K for the fiscal year ended February 2, 2008.
- 10.16\* 2008 Long-Term Bonus Plan. Incorporated by reference to Exhibit 10.16 of the Company s Annual Report on Form 10-K for the fiscal year ended February 2, 2008.
- 10.17\* 2008 Long-Term Incentive and Cash Bonus Plan. Incorporated by reference to Exhibit 4.2 of The Kroger Co. s Form S-8 filed with the SEC on June 26, 2008.
- 12.1 Statement of Computation of Ratio of Earnings to Fixed Charges.
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 24.1 Powers of Attorney.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification.
- 32.1 Section 1350 Certifications

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\* Management contract or compensatory plan or arrangement.

**SIGNATURES**

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

THE KROGER CO.

Dated: March 31, 2009

By (\*David B. Dillon)  
David B. Dillon  
Chief Executive Officer  
(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities indicated on the 31st of March 2009.

|   |  |
|---|--|
| (*Reuben V. Anderson)<br>Reuben V. Anderson | Director   |
| (*Robert D. Beyer)<br>Robert D. Beyer       | Director   |
| (*David B. Dillon)<br>David B. Dillon       | Chairman, Chief Executive Officer and Director   |
| (*Susan J. Kropf)<br>Susan J. Kropf         | Director   |
| (*John T. LaMacchia)<br>John T. LaMacchia   | Director   |
| (*David B. Lewis)<br>David B. Lewis         | Director   |
| (*Don W. McGeorge)<br>Don W. McGeorge       | President, Chief Operating Officer, and Director |
| (*W. Rodney McMullen)<br>W. Rodney McMullen | Vice Chairman and Director                       |
| (*Jorge P. Montoya)<br>Jorge P. Montoya     | Director   |
| (*Clyde R. Moore)<br>Clyde R. Moore         | Director   |
| (*Susan M. Phillips)<br>Susan M. Phillips   | Director   |
| Steven R. Rogel                             | Director   |

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(\*James A. Runde)  
James A. Runde

Director

(\*Ronald L. Sargent)  
Ronald L. Sargent

Director

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(\*J. Michael Schlotman)  
J. Michael Schlotman

Chief Financial Officer  
(Principal Financial Officer)

(\*Bobby S. Shackouls)  
Bobby S. Shackouls

Director

(\*M. Elizabeth Van Oflen)  
M. Elizabeth Van Oflen

Vice President & Controller  
(Principal Accounting Officer)

By: (\*Bruce M. Gack)  
Bruce M. Gack  
Attorney-in-fact

**EXHIBIT INDEX**

**Exhibit No.**

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