

KROGER CO  
Form 10-Q  
December 17, 2009

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

Washington, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended November 7, 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

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**THE KROGER CO.**

(Exact name of registrant as specified in its charter)

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(State or other jurisdiction of incorporation or organization)

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

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

(Address of principal executive offices)

(Zip Code)

**(513) 762-4000**

(Registrant's telephone number, including area code)

**Unchanged**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(do not check if a smaller reporting company)

Smaller reporting company

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

There were 649,891,077 shares of Common Stock (\$1 par value) outstanding as of December 11, 2009.



## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(unaudited)

	Third Quarter Ended		Three Quarters Ended	
	November 7, 2009	November 8, 2008	November 7, 2009	November 8, 2008
Sales	\$ 17,669	\$ 17,615	\$ 58,203	\$ 58,853
Merchandise costs, including advertising, warehousing, and transportation, excluding items shown separately below	13,666	13,545	44,583	45,456
Operating, general and administrative	3,140	3,104	10,263	9,998
Rent	152	152	502	510
Depreciation and amortization	356	335	1,157	1,095
Goodwill impairment charge	1,113		1,113	
Operating profit (loss)	(758)	479	585	1,794
Interest expense	105	106	383	369
Earnings (loss) before income tax expense	(863)	373	202	1,425
Income tax expense	13	136	396	522
Net earnings (loss) including noncontrolling interests	(876)	237	(194)	903
Net earnings (loss) attributable to noncontrolling interests	(1)		(9)	3
Net earnings (loss) attributable to The Kroger Co.	\$ (875)	\$ 237	\$ (185)	\$ 900
Net earnings (loss) attributable to The Kroger Co. per basic common share	\$ (1.35)	\$ 0.36	\$ (0.29)	\$ 1.37
Average number of common shares used in basic calculation	646	649	647	653
Net earnings (loss) attributable to The Kroger Co. per diluted common share	\$ (1.35)	\$ 0.36	\$ (0.29)	\$ 1.36
Average number of common shares used in diluted calculation	646	655	647	659
Dividends declared per common share	\$ .095	\$ .09	\$ .275	\$ .27

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

## THE KROGER CO.

## CONSOLIDATED BALANCE SHEETS

(in millions, except per share amounts)

(unaudited)

	November 7, 2009	January 31, 2009
<b>ASSETS</b>		
Current assets		
Cash and temporary cash investments	\$ 517	\$ 263
Deposits in-transit	669	631
Receivables	817	944
FIFO inventory	6,093	5,659
LIFO credit	(848)	(800)
Prefunded employee benefits		300
Prepaid and other current assets	282	209
Total current assets	7,530	7,206
Property, plant and equipment, net	13,818	13,161
Goodwill	1,158	2,271
Other assets	578	573
Total Assets	\$ 23,084	\$ 23,211
<b>LIABILITIES</b>		
Current liabilities		
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 578	\$ 558
Trade accounts payable	4,169	3,822
Accrued salaries and wages	783	828
Deferred income taxes	344	344
Other current liabilities	2,290	2,077
Total current liabilities	8,164	7,629
Long-term debt including obligations under capital leases and financing obligations		
Face-value long-term debt including obligations under capital leases and financing obligations	7,421	7,460
Adjustment to reflect fair-value interest rate hedges	55	45
Long-term debt including obligations under capital leases and financing obligations	7,476	7,505
Deferred income taxes	436	384
Pension and postretirement benefit obligations	914	1,174
Other long-term liabilities	1,242	1,248
Total Liabilities	18,232	17,940
Commitments and contingencies (see Note 12)		
<b>SHAREOWNERS EQUITY</b>		
Preferred stock, \$100 par per share, 5 shares authorized and unissued		
Common stock, \$1 par per share, 1,000 shares authorized; 957 shares issued in 2009 and 955 shares issued in 2008	957	955
Additional paid-in capital	3,339	3,266

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Accumulated other comprehensive loss	(491)	(495)
Accumulated earnings	7,123	7,489
Common stock in treasury, at cost, 311 shares in 2009 and 306 shares in 2008	(6,145)	(6,039)
Total Shareowners Equity - The Kroger Co.	4,783	5,176
Noncontrolling interests	69	95
Total Equity	4,852	5,271
Total Liabilities and Equity	\$ 23,084	\$ 23,211

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

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions and unaudited)

	Three Quarters Ended	
	November 7, 2009	November 8, 2008
Cash Flows from Operating Activities:		
Net earnings (loss) including noncontrolling interests	\$ (194)	\$ 903
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	1,157	1,095
Goodwill impairment charge	1,113	
Asset impairment charge	44	21
LIFO charge	48	155
Stock-based employee compensation	64	69
Expense for Company-sponsored pension plans	24	35
Deferred income taxes	51	147
Other	15	7
Changes in operating assets and liabilities net of effects from acquisitions of businesses:		
Deposits in-transit	(38)	66
Receivables	(4)	(20)
Inventories	(434)	(669)
Prepaid expenses	228	302
Trade accounts payable	351	293
Accrued expenses	(1)	16
Income taxes receivable and payable	229	(25)
Contribution to Company-sponsored pension plans	(265)	(20)
Other	(13)	(18)
Net cash provided by operating activities	2,375	2,357
Cash Flows from Investing Activities:		
Payments for capital expenditures	(1,766)	(1,613)
Proceeds from sale of assets	7	51
Payments for acquisitions	(23)	(80)
Other	(13)	(10)
Net cash used by investing activities	(1,795)	(1,652)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	505	778
Dividends paid	(176)	(168)
Payments on long-term debt	(426)	(1,017)
Borrowings (payments) on credit facility	(129)	133
Excess tax benefits on stock-based awards	2	13
Proceeds from issuance of capital stock	30	164
Treasury stock purchases	(130)	(626)
Decrease in book overdrafts	(4)	(19)
Other	2	10
Net cash used by financing activities	(326)	(732)
Net increase (decrease) in cash and temporary cash investments	254	(27)



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Cash from Consolidated Variable Interest Entity				65
Cash and temporary cash investments:				
Beginning of year		263		242
End of quarter	\$	517	\$	280
Reconciliation of capital expenditures:				
Payments for capital expenditures	\$	(1,766)	\$	(1,613)
Changes in construction-in-progress payables		(65)		(106)
Total capital expenditures	\$	(1,831)	\$	(1,719)
Disclosure of cash flow information:				
Cash paid during the year for interest	\$	434	\$	404
Cash paid during the year for income taxes	\$	119	\$	444

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

## THE KROGER CO.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS EQUITY

(in millions, except per share amounts)

(unaudited)

	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Gain (Loss)	Accumulated Earnings	Noncontrolling Interest	Total
	Shares	Amount		Shares	Amount				
Balances at February 2, 2008	947	\$ 947	\$ 3,031	284	\$ (5,422)	\$ (122)	\$ 6,480	\$ 7	\$ 4,921
Issuance of common stock:									
Stock options exercised	7	7	155		2				164
Restricted stock issued			(43)	(1)	27				(16)
Treasury stock activity:									
Treasury stock purchases, at cost				17	(448)				(448)
Stock options exchanged				6	(177)				(177)
Tax benefits from exercise of stock options			33						33
Share-based employee compensation			69						69
Other comprehensive gain net of income tax of \$5						7			7
Purchase of non-wholly owned entity								97	97
Other			12		(12)			(11)	(11)
Cash dividends declared (\$0.27 per common share)							(177)		(177)
Net earnings including noncontrolling interests							900	3	903
Balances at November 8, 2008	954	\$ 954	\$ 3,257	306	\$ (6,030)	\$ (115)	\$ 7,203	\$ 96	\$ 5,365
Balances at January 31, 2009	955	\$ 955	\$ 3,266	306	\$ (6,039)	\$ (495)	\$ 7,489	\$ 95	\$ 5,271
Issuance of common stock:									
Stock options exercised	2	2	27		1				30
Restricted stock issued			(56)	(1)	40				(16)
Treasury stock activity:									
Treasury stock purchases, at cost				5	(106)				(106)
Stock options exchanged				1	(24)				(24)
Tax benefits from exercise of stock options			20						20
Share-based employee compensation			64						64
Other comprehensive gain net of income tax of \$2						4			4
Other			18		(17)			(17)	(16)
Cash dividends declared (\$0.275 per common share)							(181)		(181)
Net earnings (loss) including noncontrolling interests							(185)	(9)	(194)
Balances at November 7, 2009	957	\$ 957	\$ 3,339	311	\$ (6,145)	\$ (491)	\$ 7,123	\$ 69	\$ 4,852

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

**1. ACCOUNTING POLICIES**

*Basis of Presentation and Principles of Consolidation*

The accompanying financial statements include the consolidated accounts of The Kroger Co., its wholly-owned subsidiaries, and the Variable Interest Entities ( VIE ) in which the Company is the primary beneficiary. The January 31, 2009 balance sheet was derived from audited financial statements, adjusted for the adoption of the new standards for the Company's noncontrolling interest in a subsidiary and, due to its summary nature, does not include all disclosures required by generally accepted accounting principles ( GAAP ). Significant intercompany transactions and balances have been eliminated. References to the Company in these Consolidated Financial Statements mean the consolidated company.

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

The unaudited information in the Consolidated Financial Statements for the third quarter and three quarters ended November 7, 2009 and November 8, 2008 includes the results of operations of the Company for the 40-week periods then ended.

In the first quarter of 2009, the Company adopted the new standards for a parent's noncontrolling interests in a subsidiary and applied it retrospectively. As a result, the Company reclassified noncontrolling interests in amounts of \$95 from the mezzanine section to equity in the January 31, 2009 Consolidated Balance Sheet. Certain reclassifications to the Consolidated Statements of Operations have been made to prior period amounts to conform to the presentation of the current period under the new standards. Recorded amounts for prior periods previously presented as Net Earnings, which are now presented as Net Earnings Attributable to The Kroger Co., have not changed as a result of the adoption of the new standards.

*Impairment of Long-Lived Assets*

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In accordance with GAAP, 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 based on current market values or discounted future cash flows. The Company records impairment when the carrying value exceeds fair market value. With respect to owned property and equipment held for sale, the value of the property and equipment is adjusted to reflect recoverable values based on previous efforts to dispose of similar assets and current economic conditions. Impairment is recognized for the excess of the carrying value over the estimated fair market value, reduced by estimated direct costs of disposal. The Company recorded asset impairments in the normal course of business totaling \$29 in the third quarter of 2009 and \$5 in the third quarter of 2008. During the first three quarters of 2009 and 2008, the Company recorded asset impairments in the normal course of business totaling \$44 and \$21, respectively. Included in these amounts are asset impairments recorded totaling \$24 in both the third quarter and first three quarters of 2009 for a southern California reporting unit. 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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Store Closing and Other Expense Allowances*

The Company provides for closed store liabilities relating to the present value of the estimated remaining noncancelable lease payments after the closing date, net of estimated subtenant income. The Company estimates the net lease liabilities using a discount rate to calculate the present value of the remaining net rent payments on closed stores. The closed store lease liabilities usually are paid over the lease terms associated with the closed stores, which generally have remaining terms ranging from one to 20 years. Adjustments to closed store liabilities primarily relate to changes in subtenant income and actual exit costs differing from original estimates. Adjustments are made for changes in estimates in the period in which the change becomes known. Store closing liabilities are reviewed quarterly to ensure that any accrued amount that is not a sufficient estimate of future costs, or that no longer is needed for its originally intended purpose, is adjusted to income in the proper period.

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

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

	<b>Future Lease Obligations</b>	
	<b>November 7, 2009</b>	<b>November 8, 2008</b>
Balance at beginning of year	\$ 65	\$ 74
Additions	3	2
Payments	(9)	(10)
Adjustments	(1)	6
Balance at end of third quarter	\$ 58	\$ 72

**2. GOODWILL**

The following table summarizes the changes in the Company's goodwill balance through November 7, 2009.

	<b>Goodwill</b>
Balance at January 31, 2009	
Goodwill	\$ 3,672
Accumulated impairment losses	(1,401)
	2,271
Goodwill impairment charge	(1,113)

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Balance at November 7, 2009	\$	1,158
Balance at November 7, 2009		
Goodwill	\$	3,672
Accumulated impairment losses		(2,514)
Balance at November 7, 2009	\$	1,158

Testing for impairment must be performed annually, or on an interim basis upon the occurrence of a triggering event or a change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company last performed its annual test for impairment during the fourth quarter of 2008 and was scheduled to do so again in the fourth quarter of 2009. In the third quarter of 2009, the Company's operating performance suffered due to deflation and intense competition. Based on the revised forecast for the current year and the initial results of the Company's annual budget process of the supermarket reporting units, management believed that there were circumstances evident to warrant impairment testing at these reporting units as of November 7, 2009. The Company did not test for impairment the variable interest entities with recorded goodwill as no triggering event occurred. All reporting units will be tested in the fourth quarter during our annual review of goodwill.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Based on the results of the Company's step 1 analysis, the Ralphs reporting unit in Southern California was the only reporting unit for which there was a potential impairment. The operating performance of the Ralphs reporting unit was significantly affected by the current economic conditions and responses to competitive actions in Southern California. As a result of this decline in current and future expected cash flows, along with comparable fair value information, management concluded that the carrying value of goodwill for the Ralphs reporting unit exceeded its implied fair value, resulting in a pre-tax impairment charge of \$1.11 billion (\$1.04 billion after tax). Subsequent to the impairment, no goodwill remains at the Ralphs reporting unit.

The Company believes additional goodwill impairments will not be reasonably possible in the fourth quarter of 2009 upon completion of the Company's annual review of goodwill impairment. A 10% reduction in fair value of the other supermarket reporting units would not indicate a potential for impairment of the Company's remaining goodwill balance for these reporting units, except for one supermarket reporting unit with less than \$20 of recorded goodwill.

**3. STOCK OPTION PLANS**

The Company recognized total stock-based compensation of \$19 and \$21 in the third quarter ended November 7, 2009 and November 8, 2009, respectively. The Company recorded \$64 and \$69 of stock-based compensation for the first three quarters ended November 7, 2009 and November 8, 2008, respectively. These costs were recognized as operating, general and administrative costs in the Company's Consolidated Statements of Operations.

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

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

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

*Stock Options*



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	Shares subject to option		Weighted-average exercise price
Outstanding, January 31, 2009	39.7	\$	21.58
Granted	3.5	\$	22.33
Exercised	(1.8)	\$	16.55
Canceled or Expired	(5.2)	\$	27.13
Outstanding, November 7, 2009	36.2	\$	21.10

*Restricted Stock*

	Restricted shares outstanding		Weighted-average grant-date fair value
Outstanding, January 31, 2009	4.1	\$	27.22
Granted	2.5	\$	22.32
Lapsed	(2.1)	\$	27.40
Canceled or Expired	(0.1)	\$	25.69
Outstanding, November 7, 2009	4.4	\$	24.39

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The weighted-average fair value of stock options granted during the first three quarters ended November 7, 2009 and November 8, 2008, was \$6.30 and \$8.67, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option-pricing model, based on the assumptions shown in the table below. The Black-Scholes model utilizes extensive accounting judgment and financial estimates, including the term employees are expected to retain their stock options before exercising them, the volatility of the Company's stock price over that expected term, the dividend yield over the term, and the number of awards expected to be forfeited before they vest. Using alternative assumptions in the calculation of fair value would produce fair values for stock option grants that could be different than those used to record stock-based compensation expense in the Consolidated Statements of Operations.

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

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

**4. DEBT OBLIGATIONS**

Long-term debt consists of:

	November 7, 2009	January 31, 2009
Commercial Paper and Money Market Borrowings	\$	\$ 129
3.90% to 8.05% Senior Notes and Debentures due through 2038	7,308	7,186
5.00% to 9.88% Mortgages due in varying amounts through 2034	108	119
Other	153	163
Total debt, excluding capital leases and financing obligations	7,569	7,597
Less current portion	(547)	(528)
Total long-term debt, excluding capital leases and financing obligations	\$ 7,022	\$ 7,069

On June 1, 2009, the Company repaid \$350 of senior notes bearing an interest rate of 7.25%. During the third quarter of 2009, the Company issued \$500 of senior notes bearing an interest rate of 3.90% due in 2015, the proceeds of which will be used to repay, \$500 of senior notes bearing an interest rate of 8.05% maturing in the first quarter of 2010.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****5. COMPREHENSIVE INCOME**

Comprehensive income is as follows:

	Third Quarter Ended		Year-To-Date	
	November 7, 2009	November 8, 2008	November 7, 2009	November 8, 2008
Net earnings (loss) including noncontrolling interests	\$ (876)	\$ 237	\$ (194)	\$ 903
Unrealized gain on hedging activities, net of tax(1)				3
Amortization of unrealized gains and losses on hedging activities, net of tax(2)	1		2	1
Amortization of amounts included in net periodic pension expense(3)	4	1	2	3
Other				
Comprehensive income	(871)	238	(190)	910
Comprehensive income (loss) attributable to noncontrolling interests	(1)		(9)	3
Comprehensive income (loss) attributable to The Kroger Co.	\$ (870)	\$ 238	\$ (181)	\$ 907

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

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

(3) Amount is net of tax of \$2 for the third quarter of 2009. Amount is net of tax of \$2 for both the first three quarters of 2009 and 2008.

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

**6. BENEFIT PLANS**

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

	Third Quarter			
	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Components of net periodic benefit cost:				
Service cost	\$ 12	\$ 11	\$ 3	\$ 3

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Interest cost	36	40	5	4
Expected return on plan assets	(53)	(40)		
Amortization of:				
Prior service cost	1		(2)	(2)
Actuarial loss	9	8	(2)	
Net periodic benefit cost	\$ 5	\$ 19	\$ 4	\$ 5

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

	Pension Benefits		Year-To-Date		Other Benefits	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit cost:						
Service cost	\$ 28	\$ 32	\$ 8	\$ 8	\$ 8	\$ 8
Interest cost	130	124	15	15	15	15
Expected return on plan assets	(147)	(136)				
Amortization of:						
Prior service cost	2	2	(5)	(5)	(5)	(5)
Actuarial loss	11	13	(4)	(4)	(4)	(4)
Net periodic benefit cost	\$ 24	\$ 35	\$ 14	\$ 18	\$ 14	\$ 18

The Company contributed \$265 to Company-sponsored pension plans in the first three quarters of 2009.

The Company contributed \$88 and \$75 to employee 401(k) retirement savings accounts in the first three quarters of 2009 and 2008, respectively.

The Company also contributes to various multi-employer pension plans based on obligations arising from most of its collective bargaining agreements. These plans provide retirement benefits to participants based on their service to contributing employers. The Company recognizes expense in connection with these plans as contributions are funded.

## 7. INCOME TAXES

The effective income tax rate was 196.0% and 36.6% for the first three quarters of 2009 and 2008, respectively. The 2009 effective income tax rate differed from the federal statutory rate primarily due to the discrete goodwill impairment charge being mostly non-deductible for tax purposes. The 2008 effective income tax rate differed from the federal statutory rate primarily due to the effect of state income taxes. There were no material changes in unrecognized tax benefits during the first three quarters of 2009.

## 8. EARNINGS PER COMMON SHARE

Net earnings (loss) attributable to The Kroger Co. per basic common share equals net earnings (loss) attributable to The Kroger Co. less income allocated to participating securities divided by the weighted average number of common shares outstanding. Net earnings (loss) attributable to The Kroger Co. per diluted common share equals net earnings (loss) attributable to The Kroger Co. less income allocated to participating

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

	Third Quarter Ended November 7, 2009			Third Quarter Ended November 8, 2008		
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Net earnings (loss) attributable to The Kroger Co. per basic common share	\$ (875)	646	\$ (1.35)	\$ 236	649	\$ 0.36
Dilutive effect of stock options					6	
Net earnings (loss) attributable to The Kroger Co. per diluted common share	\$ (875)	646	\$ (1.35)	\$ 236	655	\$ 0.36

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

	Earnings (Numerator)	Year-To-Date November 7, 2009 Shares (Denominator)	Per Share Amount	Earnings (Numerator)	Year-To-Date November 8, 2008 Shares (Denominator)	Per Share Amount
Net earnings (loss) attributable to The Kroger Co. per basic common share	\$ (185)	647	\$ (0.29)	\$ 895	653	\$ 1.37
Dilutive effect of stock options					6	
Net earnings (loss) attributable to The Kroger Co. per diluted common share	\$ (185)	647	\$ (0.29)	\$ 895	659	\$ 1.36

The Company had undistributed and distributed earnings to participating securities totaling \$1 in the third quarter of 2008. For the first three quarters of 2008, the Company had undistributed and distributed earnings to participating securities totaling \$5. Due to the Company having a net loss in both the third quarter and first three quarters of 2009, no allocation was made to participating securities due to the anti-dilutive effect.

For the third quarter and the first three quarters of 2009, net earnings (loss) attributable to The Kroger Co. per diluted common share equals net earnings (loss) attributable to The Kroger Co. per basic common share due to the Company having a net loss in both time periods.

The Company had options outstanding for approximately 12 shares during the third quarter of 2008 that were excluded from the computations of net earnings attributable to The Kroger Co. per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share. For the first three quarters of 2008, the Company had options outstanding for approximately 11 shares that were excluded from the computations of net earnings attributable to The Kroger Co. per diluted common share because their inclusion would have had an anti-dilutive effect on earnings per share.

The share amounts above for the third quarter and first three quarters of 2008 differ from those previously reported due to adopting the new standards that clarify that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities and included in the calculation of basic EPS. The Company adopted the new standards effective February 1, 2009.

## **9. RECENTLY ADOPTED ACCOUNTING STANDARDS**

In December 2007, the FASB amended its existing standards for a parent's noncontrolling interest in a subsidiary and the accounting for future ownership changes with respect to the subsidiary. The new standard defines a noncontrolling interest, previously called a minority interest, as the portion of equity in a subsidiary that is not attributable, directly or indirectly, to a parent. The new standard requires, among other things, that a noncontrolling interest be clearly identified, labeled and presented in the consolidated balance sheet as equity, but separate from the

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parent's equity; that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and that if a subsidiary is deconsolidated, the parent measure at fair value any noncontrolling equity investment that the parent retains in the former subsidiary and recognize a gain or loss in net income based on the fair value of the non-controlling equity investment. The Company adopted the new standard effective February 1, 2009, and applied it retrospectively. As a result, the Company reclassified noncontrolling interests in amounts of \$95 from the mezzanine section to equity in the January 31, 2009 Consolidated Balance Sheet. Certain reclassifications to the Consolidated Statements of Operations have been made to prior period amounts to conform to the presentation of the current period under the new standard. Recorded amounts for prior periods previously presented as Net Earnings, which are now presented as Net Earnings Attributable to The Kroger Co., have not changed as a result of the adoption of the new standard.

Effective February 1, 2009, the Company adopted new standards that deferred the fair value disclosures for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. See Note 14 to the Consolidated Financial Statements for further discussion of the adoption of the new standards.

Effective February 1, 2009, the Company adopted new standards related to business combinations. The new standards expand the definitions of a business and the fair value measurement and reporting in a business combination. All business combinations completed after February 1, 2009, will be accounted for under the new standards.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Effective February 1, 2009, the Company adopted the new standards that require enhanced disclosures on an entity's derivative and hedging activities. The new disclosures required by the new standards are included in Note 13 to the Consolidated Financial Statements.

Effective February 1, 2009, the Company adopted the new standards that clarify that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities and included in the computation of EPS pursuant to the two-class method. See Note 8 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, the Company adopted new standards for subsequent events. The purpose of the new standards is to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new standards require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. See Note 15 to the Consolidated Financial Statements for further discussion of its adoption.

Effective May 24, 2009, the Company adopted new standards that effect the accounting and disclosures related to certain financial instruments including: (a) providing additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased; (b) identifying circumstances that indicate a transaction is not orderly; (c) amending the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements; and (d) requiring disclosures about the fair value of financial instruments on an interim basis in addition to the annual disclosure requirements. The new disclosures required by the new standards are included in Note 14. The adoption of these new standards did not have a material effect on the Company's Consolidated Financial Statements.

**10. RECENTLY ISSUED ACCOUNTING STANDARDS**

In December 2008, the FASB amended its existing standards to provide additional guidance on employers' disclosures about the plan assets of defined benefit pension or other postretirement plans. The new standards require disclosures about how investment allocation decisions are made, the fair value of each major category of plan assets, valuation techniques used to develop fair value measurements of plan assets, the effect of measurements on changes in plan assets when using significant unobservable inputs and significant concentrations of risk in the plan assets. The new standards become effective for fiscal years ending after December 15, 2009. The Company is currently evaluating the effect the adoption of the new standards will have on its Consolidated Financial Statements.

In June 2009, the FASB amended its existing standards to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The new standards will become effective for the Company's fiscal year beginning January 31, 2010. The Company is currently evaluating the effect the adoption of the new standards will have on its Consolidated Financial Statements.

**11. GUARANTOR SUBSIDIARIES**

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The Company's outstanding public debt (the Guaranteed Notes) is jointly and severally, fully and unconditionally guaranteed by The Kroger Co. and certain of its subsidiaries (the Guarantor Subsidiaries). At November 7, 2009, a total of approximately \$7.31 billion of Guaranteed Notes were outstanding. The Guarantor Subsidiaries and non-guarantor subsidiaries are direct or indirect subsidiaries of The Kroger Co. Separate financial statements of The Kroger Co. and each of the Guarantor Subsidiaries are not presented because the guarantees are full and unconditional and the Guarantor Subsidiaries are jointly and severally liable. The Company believes that separate financial statements and other disclosures concerning the Guarantor Subsidiaries would not be material to investors.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following tables present summarized financial information as of November 7, 2009 and January 31, 2009 and for the third quarter, and three quarters ended November 7, 2009 and November 8, 2008:

**Condensed Consolidating****Balance Sheets****As of November 7, 2009**

	The Kroger Co.	Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets</b>				
Cash and temporary cash investments	\$ 27	\$ 490	\$	\$ 517
Deposits in-transit	72	597		669
Receivables	2,159	629	(1,971)	817
Net inventories	500	4,745		5,245
Prepaid and other current assets	86	196		282
<b>Total current assets</b>	<b>2,844</b>	<b>6,657</b>	<b>(1,971)</b>	<b>7,530</b>
Property, plant and equipment, net	1,834	11,984		13,818
Goodwill	5	1,153		1,158
Other assets	810	1,738	(1,970)	578
Investment in and advances to subsidiaries	10,184		(10,184)	
<b>Total assets</b>	<b>\$ 15,677</b>	<b>\$ 21,532</b>	<b>\$ (14,125)</b>	<b>\$ 23,084</b>
<b>Current liabilities</b>				
Current portion of long-term debt including obligations under capital leases and financing obligations	\$ 578	\$	\$	\$ 578
Trade accounts payable	356	3,813		4,169
Other current liabilities	1,077	6,281	(3,941)	3,417
<b>Total current liabilities</b>	<b>2,011</b>	<b>10,094</b>	<b>(3,941)</b>	<b>8,164</b>
<b>Long-term debt including obligations under capital leases and financing obligations</b>				
Face value long-term debt including obligations under capital leases and financing obligations	7,421			7,421
Adjustment to reflect fair-value interest rate hedges	55			55
<b>Long-term debt including obligations under capital leases and financing obligations</b>	<b>7,476</b>			<b>7,476</b>
<b>Other long-term liabilities</b>	<b>1,338</b>	<b>1,254</b>		<b>2,592</b>
<b>Total liabilities</b>	<b>10,825</b>			