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The Kroger Co. (KR)

Investor Day

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen thank you for joining Kroger's 2021 Investor Day, leading with fresh, accelerating with digital. You may enter a question at any point during today's presentation using the question entry field located within the viewing platform. Please state the company you were with at the start of your question. Now we will begin today's presentation.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

Hello and thank you for joining us today. Before we begin, I would like to take a moment to acknowledge the devastating events of the last two weeks. On March 16, we lost three associates to violence in the Oconomowoc Distribution Center in Wisconsin. And then our world was again turned upside down by another senseless act of violence – and our King Soopers store in Boulder, Colorado on March 22. This horrific event resulted in the deaths of 10 people including three of our associates and a Boulder Police Department officer. And while our Kroger family is grieving – there is light and hope. We've also heard so many stories of how our associates selflessly helped one another and our customers to safety in these situations. I am so proud of our teams in Wisconsin and Colorado who are leading with empathy and strength and are a model to us all, and to all over our associates across the organization who have reached out to offer help and support. I am so grateful that we have each other now more than ever.

I also want to express our deep condolences to the families of those lost in these horrific events and our profound appreciation to the first responders who support and protect our associates and communities every day, including Officer Eric Talley, who heroically lost his life in service to others. Our community, our Kroger family has shown strength and resilience beyond measure. They are the heart and soul of our organization and for that I am forever grateful.

Thank you and now we'll begin today's meeting.

Rebekah Manis

Director-Investor Relations, The Kroger Co.

Good morning and thank you for joining us. I'm Rebekah Manis, Director of Investor Relations and I'd like to welcome you to Kroger's 2021 Spring Investor Day. We are so glad you could join. Our leadership team is excited to share with you Kroger's growth strategy and how we are winning with customers by leading with fresh and accelerating with digital. Within their presentations, you will hear additional details surrounding our digital strategy, alternative profits and the role of Ocado in our seamless ecosystem, which we know are important topics based on your feedback. Following the prepared presentations, we will take a 15-minute break before starting Q&A. All presentations and transcripts will be posted at our website at ir.kroger.com.

Before we begin, I do have a few important disclosures. I want to remind you that today's discussions will include forward-looking statements. We want to caution you that such statements are predictions and actual events or results can differ materially. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings. The Kroger company assumes no obligation to update that information. During this presentation, we may discuss certain non-GAAP financial measures. For reconciliation of non-GAAP measures as well as other information regarding these measures, please refer to the investor relations section of our website.

Now, I'm pleased to turn the morning over to Kroger's Chairman and Chief Executive Officer Rodney McMullen.

[Video Presentation] (00:04:30-00:06:02)

W. Rodney McMullen

Chairman & Chief Executive Officer, The Kroger Co.

Thank you, Rebecca. Good morning everyone and thank you for joining us for our 2021 Virtual Investor Day. When the pandemic hit last year, our world changed dramatically. What remained constant was people's need for food. And we were there to meet that need through new channels and formats with a relentless focus on quality, value and convenience. We not only met our customer's immediate needs but we also used this unique period to accelerate our own transformation. Thanks to our team's response and by leading with our purpose and our values, we converted the crisis into a catalysts for sustainable growth.

Our goal today is to give you a closer look at how we're positioning Kroger to win for the long term by Leading With Fresh and Accelerating With Digital. Throughout today's presentations, you'll hear three key themes. First, our fresh food leadership will enable us to win share. Second, digital is now a growth engine and we have a clear path to digital profitability with retail media, economies of scale and technology and process improvements that will lower our cost to serve. And third, with the power of the Kroger platform, we are well-positioned to compete and win in a post-COVID world. Our four competitive moats: Seamless, Personalization, Fresh and Our Brands are stronger today than ever before, reinforcing our confidence in our ability to grow sales and market share. We are committed to delivering consistent and attractive total shareholder return of 8% to 11% per year, underpinned by a financial model that now includes a higher operating profit base and a clear path to deliver earnings growth of 3% to 5% and strong and growing free cash flow to invest in our growth initiatives.

But before we look to the future, let's start with the past. Restock Kroger transformed us. Our primary business, food, never goes out of fashion. But in 2017, we were facing continuing challenges from low margins, new competition and changes in buying and consuming habits, especially the increasing demand for a seamless customer experience that we forecasted. We knew we had to build a war chest to remake ourselves in order to turn these headwinds into tailwinds.

Through Restock Kroger, we took over $3 billion in costs out of the business freeing up resources to invest in people technology and price. We strengthened our competitive moats. We established a flywheel to monetize the traffic and data generated by our core business. We improved talent development at all levels of the business placing the right people in the right roles. And we made a series of bold commitments to advance our Zero Hunger | Zero Waste vision at the center of our ESG portfolio. And while not everything went according to plan, we learned and adjusted throughout – transforming our business model and making changes that proved advantageous when COVID-19 hit in February of last year. COVID-19 changed us. When the pandemic arrived, we acted quickly to protect our associates and customers and deploy our expertise to make sure people's need for food and the need to obtain it in evolving ways were met reliably, safely and cost effectively.

Indeed we recognized that in the depths of the crisis, food had become not just a necessity but a core comfort, a reminder that life would go on and get better. So we built up on that powerful sentiment to deepen our connection with customers. The pandemic nearly doubled the amount of customers looking for a seamless shopping experience. We now have almost 50,000 associates dedicated for pickup, delivery or shipped. Because of our previous investments and innovations that were part of the Restock Kroger commitment, we were able to support this increase in pickup business in 2020. So, just a huge hats-off to our team. Knowing that an ounce of prevention is worth a pound of cure, we also took immediate steps to safeguard our associates and make sure our customers could continue to rely on us to supply them despite rapidly changing buying patterns. Our investments in these areas continue to make a difference today for our associates and our customers and you'll see that in the following video.

[Video Presentation] (00:11:12-00:12:32)

Kroger is in a position of strength today because of our transformation. We've deepened our connection with customers and associates. We accelerated digital sales and profitability by several years and identified new customer-centric innovations for tomorrow. As a result of this strong foundation we've built we invested in our associates, communities, gained market share and delivered record-breaking sales above our TSR model in 2020. Leveraging Kroger's unique strengths in fresh food, combined with our increasingly profitable digital business, creates an unmatched combination that positions us better than anyone to continue to win share in a highly fragmented $1.4 trillion market.

Today, we have a 10% share of food at home with number one or number two market share positions and the vast majority of the major markets in which we operate which makes the opportunity for growth ahead of us incredibly exciting. As we think about the future of grocery in a post-COVID era, we see three major trends shaping the industry: e-commerce, cooking at home and prepared meals to go. It's true that the shift to spending more time at home and eating less at restaurants was a tailwind for our industry and that we will face tough comps as a result.

But we also believe that those who are able to convert on this short-term boost into long-term competitive advantages will emerge as winners and that's exactly what we've been doing. As society has leapt into a new digital era, so as Kroger. Our team mobilized quickly taking what has been working well both prior to and during the pandemic to meet the needs of our communities and advanced and adapted our long-term strategy.

Today our digital sales are over $10 billion that is a massive shift from where we were just a few years ago. But there's still a huge opportunity in front of us. So, how will we drive total shareholder return today and in the future. By leading with fresh and accelerating with digital we will grow our share of wallet by leading with fresh food. We will grow our profitability by accelerating with digital. And we will widen and deepen the competitive moats that support and enhance our food platform including through alternative profit streams, positioning Kroger to compete and win in a post-COVID world.

At Kroger, we have always believed that everyone deserves to have fresh affordable food. We also know that customers make decisions about where to shop based on their perception of the freshness of that retailer's food in this way food is our core platform. Our fresh offering is both an important sales driver for Kroger and a competitive advantage because customers rank our fresh departments higher than that of all large national retailers.

Digital is also a significant growth opportunity. By digital, we mean the Kroger seamless ecosystem we've built over the past few years to be able to deliver anything, anytime, anywhere regardless of channel whether pickup, delivery or shipped. Today, we are seeing more and more new customers engaging in our seamless ecosystem. Since the pandemic, we have more than doubled our digital business in 2020. We will continue to build on this momentum. And we have a clear path to drive profitability. We have also been evolving our customer fulfillment network leveraging our existing network of assets and strategic partnerships to meet heightened demand. As we expand and strengthen our distribution network, our selection of products increase which leads to higher customer engagement and greater sales. You've heard us talk before about our competitive moats, which include our Fresh offerings, Our Brands, Data and Personalization and our Seamless ecosystem. Each of these are strategic differentiators. Things we do differently or better than our competitors, each one generates customer loyalty and sustainable growth momentum and because of customer behavior changes during the pandemic each advantage has become even more important and more essential. I spoke about Fresh earlier but now let me spend a moment on our brands which truly provide a unique reason to shop at Kroger. Simply put, customers tell us they love our brands and choose them over other leading competitor brands. Our Brands business, if it were a standalone company, would rank 8th on the Fortune 500 listing of CPGs.

When it comes to the customer, a more personalized experience will continue to drive loyalty. We have a customer base with connections to over 60 million households that we are able to leverage into new growth opportunities and the scale of our digital business has grown so rapidly that during 2020, we had over 1.3 billion customer interactions across digital, a 30% increase over last year. Our significant reach allows us to meaningfully personalize the customer experience. At the same time, our ecosystem monetizes the traffic and data insights generated by our enhanced customer experience.

We are leveraging our assets in new ways – through these fast-growing, asset-light and margin-rich businesses. This includes new businesses like our retail media business, Kroger Precision Marketing and mature businesses like Kroger Personal Finance and our data analytics firm 84.51°. All of these contribute to incremental operating profit growth and margin.

At Kroger, we are fortunate that our core products and services are, simply put, essential to human health happiness and life. They are essential to a thriving society, a thriving planet and thriving systems that support both. Our reliable provision of affordable and healthy food vaccines and other health products and services are in fact fulfilling our purpose to feed the human spirit. We also know that how we do what we do matters and increases our positive societal impacts while adding shareholder value, increasing community support and protecting our reputation.

Before last year's social justice movement rightly focused the world's attention on diversity, equity and inclusion, our board of directors has been comprised of racially, ethnically and gender-diverse members. Our programs to increase sustainable packaging, eliminate waste, reduce energy and water use and decrease emissions are all part of the good for the planet, our investors and stakeholders. Our responsible sourcing programs and recruitment of women and minority-owned suppliers help protect the reliability of our supply chain as well as our acceptance in local communities. In fact, we have already invested more than $3.4 billion with diverse suppliers and we plan to grow that to $10 billion in 10 years.

And our focus on fresh, organic and better-for-you products is not only well-placed to meet escalating demand for healthy food but it also contributes to human health in our communities. We've always understood to be part of our communities we have to reflect our communities. We are proud that the diversity of our employee base mirrors that of the communities we serve. We are building a connected culture that embraces speed, agility and collaboration. That also means a more personalized associate experience. In addition to our continuing investment in wages and benefits, we are also applying technology to provide a personalized Kroger associate experience. We are often the company that provides an employee with their first job. We use that opportunity to build loyalty both from our associates and from our customers. We want to meet our associates where they are and provide them with tools and pathways to grow within our company because the jobs of the future will grow and evolve just like our business and today's growth-minded associate will deliver tomorrow's solution for our customers.

In summary, we have a tremendous opportunity ahead. Food is a necessity and a comfort, and we are positioned to win share with our leadership in fresh food. We also have tremendous growth opportunities in digital. And as we look at a post-COVID world, we are confident that our strategic moats will position us to compete and win. Today, you're going to hear from an outstanding team of leaders who represents thousands of people across our company. These leaders will outline how we will deliver consistent profitable growth, which drives our commitment to an 8% to 11% total shareholder return.

Yael Cosset, our Chief Information Officer, will discuss digital strategy and our plans to accelerate market share gains and increased profitability through seamless digital customer experience. Our digital strategy is directly linked to our powerful and best-in-class supply chain and manufacturing network. And you will hear from Gabriel Arreaga, our Chief Supply Chain Officer to learn about our crucial role our distribution network plays in the customer experience and profitability. Then, Cara Pratt, our leader of Kroger Precision Marketing will discuss the significant contributions our retail media business is making to drive digital profitability.

Next, we will focus on fresh beginning with Stuart Aitken, our Chief Merchant, who will outline why we are so confident about sales and market share growth by having the most fresh and unique assortment available to customers when and how they want it. Mandy Rossi, Vice President of Marketing, will then discuss how we are creating unique brand positioning and personalizing our marketing approaches to further deepen our customer connection and grow sales. To showcase how we're elevating the customer experience at Kroger, both in-store and through pickup and delivery, we will hear from Mary Ellen Adcock, our Senior Vice President of Operations. Then, our Chief Financial Officer, Gary Millerchip will conclude with a discussion on how our proven value creation model will deliver sustained earnings growth and total shareholder return.

I'd like to conclude by thanking our Kroger family of associates. Throughout the pandemic, our team has never lost sight of our goals, and focused on serving our customers when they needed us the most. More than ever, our performance over this past year is owed to them a huge, huge thank you.

And now, I'd like to turn it over to Yael Cosset. Yael?

Yael Cosset

Chief Information Officer & Senior Vice President, The Kroger Co.

Thank you very much, Rodney. Good morning, everyone. My name is Yael Cosset, and I lead our technology and digital teams and our alternative profits portfolio. 2020 was a year like no other, and there is no question that the pandemic created a massive shift in consumer behavior. While we saw more and more customers engage with us digitally before the pandemic, this past year was a catalyst to accelerate our digital growth for years to come. And I'm excited by the opportunity to share with you where we are headed.

My goal today is to leave you with three key takeaways. First, I will share with you why we are confident in our digital strategy and how we will continue to win with our customers. Second, I will outline our strategy levers to increase market share, and double our digital sales by the end of 2023. And third, I will share our roadmap to double our pass-through profitability rate by the end of 2023. After I share more color on our digital strategy, Gabriel will talk about our distribution network, including Ocado, and how it will supercharge our strategy. He will be followed by Cara Pratt, who will share the critical role of our media platform in driving digital profitability.

Starting with a look back on 2020, as we entered the pandemic and dynamic shifted rapidly, the investment we had made in building a seamless ecosystem enabled us to respond quickly, reinforcing our competitive advantage. In 2020, we were ready for our customers at a time when they needed us the most and they rewarded us with their loyalty, driving our growth and share gains. Our seamless ecosystem is what enabled and will continue to enable us to accelerate our growth trajectory.

Our growth rate in 2020 was five times our 2019 growth rate. And in 2020, we more than doubled digital sales to reach and exceed the $10 billion mark, growing e-commerce share by 50% and doubling the number of digital households within our network. The growth acceleration in 2020 was only possible because of the foundation we invested in as part of Restock Kroger. Our platform was ready, our associates were ready and everyone embraced the challenge and showed agility to adapt to accelerated customer behavior changes.

As we look ahead, our seamless ecosystems will remain a competitive advantage, leveraging our moats, bringing the most relevant fresh food solution to our customers, we are providing what customers need and want from fresh and ready-to-eat solutions to restaurant-quality meals, meal kits, quality ingredients and specialty items. Equally important, we are providing what customers need and want in a way that fits the context of their day, whether it's coming to our stores, picking it up, delivering to a convenient location or directly shipping to their homes.

In short, we are providing the right assortment through these options, the modalities that fit our customers' lives. Lastly, as we shared in the past, we are providing these options to our customers with the added convenience of simplified shopping and access to value and offers with our personalization platform to ensure the most relevant experiences. The comprehensive and connected nature of the experience continues to be a key differentiator.

Our seamless customers, which we define as customers who are engaging with us across more than one modality, shop with us more frequently, spend more than twice as much and are more loyal to Kroger. In fact, we see retention rates of our seamless customers reach 98%, 98%, which shows how much the seamless experience matter to them and how it will contribute to our long-term growth. Our seamless ecosystem is a competitive advantage and continues to contribute to establishing Kroger as the fresh food destination for our customers.

Looking ahead, Kroger is positioned for sustained digital growth and profitability. I'd like to share how we will capitalize on our real momentum to both accelerate market share gains and increase digital profitability over the next few years. First, as it relates to accelerating our market share gains and our plan to double our e-commerce sales by the end of 2023, our strategic levers are leveraging our assets and increasing our customer reach, expanding our assortment and improving its relevance with our marketplace, and continually evolving our personalization platform to drive loyalty. Then, we will share how we will continue to increase the profitability of our digital business, and our plan to double our pass-through profitability rate by the end of 2023.

Our strategic levers to do so revolve around leveraging our stores and accelerating productivity improvements, expanding our supply chain and fulfillment network, and accelerating our retail media platform to drive overall digital profitability. Let me dive deeper into our plan to accelerate market share gains.

First, we will accelerate share gains by increasing customer reach. As I mentioned earlier, we more than doubled our e-commerce business in 2020. This was made possible by the seamless ecosystem we already had in place, which enabled us to immediately increase the capacity of our platform and meet the customer demand. We had weeks early in the pandemic where we 10x-ed our delivery volume. Early on, we more than tripled the number of orders from our stores in a matter of days across all of our stores. This agility relied on our technology capabilities and our store teams, who were able to respond quickly to the increased demand leveraging our digital platform. Over the next few years, we plan to double our capacity just from our stores, making it ever more convenient for our customers to shop with us in-store, for pickup and delivery with the option in time that best fits their day.

We also confirm throughout 2020 that proximity continues to matter. As an example, we launched an initiative to support first responders, creating pickup locations in local hospital parking lots to make it easier for them to get their groceries, where and when it was most convenient, without compromising on the experience. We saw firsthand how much of a difference that made in their lives to give them that time back. We are taking these learnings, the capabilities we pull together and making a pickup service available to new geographies and customers who do not have the immediate access to one of our stores. This pilot, we are calling Hometown Pickup, brings the Kroger fresh food experience to new communities with the potential to significantly increase customer reach and convenience.

Lastly, with the opening of our second Ocado-powered facility later this spring, we are expanding customer reach by entering entirely new geographies with the launch of cargo delivery in Florida. And Gabriel will talk about these exciting launches later on this morning. To summarize, we have both existing and future opportunities to increase customer reach. Today, it's all about increasing convenience and availability for our customers. And we will do so with expanded capacity from our existing store network and as we roll out customer fulfillment centers in current markets. In the future, we have opportunities to increase availability, proximity and convenience for many communities in both existing and new geographies.

The second strategic lever to accelerate our growth is the relevance and expansion of our assortment. Another huge proof point from 2020 was the importance of quality fresh food solution and how much it matters to our customers. As we look ahead, we will leverage the competitive moats we have around our brands and fresh food solutions, engaging our customers across our seamless ecosystem.

First, we are doubling down on some key categories with huge upside potential. These range from adult beverage to plant-based products, including our brands, but also some of our specialty categories such as Murray's Cheese, the number one cheese platform in our markets, but also our meal kit subscription platform via Home Chef, which saw accelerated growth in 2020 and continues to show great momentum going into 2021.

Second, we are accelerating the ramp-up of our third-party sellers' marketplace. We launched additional categories throughout 2020. And we'll see an uptick in the coverage and assortment in 2021 and beyond with the addition of millions of items over the next few years. This continues to be a great growth opportunity as we leverage the increased traffic we saw last year and monetize our customers' engagement through e-commerce and media growth in an asset-light margin-rich model.

Lastly, we will expand our meal solutions assortment, building on our existing offering from ready-to-eat dinners to meal kits and also continuing on with our pilot we launched last year around ghost kitchen capabilities in order to accelerate our ready-to-eat and restaurant quality meal solutions. Customers continue to turn to Kroger to satisfy their food needs. Our goal is that when they think of food, they think Kroger. Our continued investment in the assortment expansion, bringing quality, fresh and value to our customers is our second focus area to drive market share growth for 2021 and beyond.

Our third strategic lever to accelerate digital share gain is our evolving personalization platform. Our focus over the last few years in personalizing every touch point, leveraging terabytes of data being generated every single day and innovating in personalization science is a massive differentiator and contributes to our competitive advantage.

To give you a sense of the impact of our personalization already today, last year alone, we presented over 0.5 trillion personalized recommendations to our customers across our digital ecosystem, 0.5 trillion. And we apply it across the customer journey, while in-store, using our app, at home, through e-mail, push notifications, shopping online via our apps, relevance matters. And we continue to see industry leading open rate and redemption rates at four times the industry average, four times. This is a critical unlock of how we continue to grow our digital customer engagement, their shopping trip frequency and overall retention.

As I mentioned before, when a customer adds a digital channel to their engagement with Kroger, we see our retention rate of 98%. Personalization and relevance make a huge difference. Personalization is about simplifying the customer journey, making it more personal, making their lives easier, regardless of what matters most to them. It could be convenience, the items that are most relevant to me based on the day, the time of day, but also my shopping behaviors. It could be value with offers most applicable to me as a shopper. Or it could be inspiration, presenting ideas, recipes or introducing new items that are relevant to me and make me more engaged.

Our conversion rate last year more than doubled. People tend to focus heavily on traffic growth and it is critical as growing traffic means you are a destination. But conversion is equally critical because it guarantees our customers come back and increase their loyalty. And personalization is what drives conversion. It is a critical piece of the puzzle, both for our top line growth, driving the repeat visits, the additional items, the additional mills, and also a critical component of our retail media platform, which supports bottom line growth.

We will continue to drive personalized relevance through our loyalty and membership programs, applying it at every touch point across the customer journey. For some customers, it will be value. Others may over index in our healthcare services, pharmacy, Little Clinic. Others may prize the convenience of delivery or pickup, while some customers will rely on our fuel savings. We believe that bringing a personalized dimension to our membership model will differentiate our offering from competitors. And you will continue to see this in our programs as we expand our membership portfolio.

To recap, these are the three strategic levers we will be focusing on in 2021 and beyond, and double our e-commerce sales by 2023: increasing customer reach across the options relevant to them, expanding our relevant assortment, and evolving our personalization platform.

Let me now dive into the strategic levers we will focus on to double our digital profitability rate by the end of 2023. They are leveraging our stores and accelerating productivity improvements, expanding our supply chain and fulfillment network, and accelerating our retail media platform to drive overall digital profitability. I'll talk briefly about leveraging our stores, and then Gabriel and Cara will talk about our fulfillment network and the retail media business respectively.

Our number one asset is our stores. They are our number one asset, due to their proximity to our customers and the uplifting customer experience they enable our associates to deliver. While we invested the past few years to make pickup and delivery available across our stores with close to 2,500 stores offering pickup or delivery in as little as one hour, we also have been investing in associate training and technology capabilities to improve the overall experience, while enhancing productivity.

In 2020 alone, we reduce the cost to serve from our stores by 14%, and we accomplished this through investment in our store associates, innovation in our business processes and technology enhancements; and did this while improving the overall customer experience, which Mary Ellen will cover later and share some of the amazing achievements from our store teams across the US.

Over the next few years, we will continue to invest in our associates and our technology platforms and expect to improve our cost to serve from our stores by more than 30%. This is a huge economic advantage. And as Gabriel will make clear, our stores are part of our overall e-commerce distribution network and supply chain strategy. To be able to improve the productivity of fulfillment from our store by so much in a short period of time is a huge boost to our overall digital profitability. And importantly, this is before the significant benefits we expect from the automation and scale of our dedicated fulfillment centers. We are extremely excited about the years ahead, where we have the opportunity to capitalize on our seamless ecosystem investments, and deliver accelerated market share gains and increase profitability, doubling both digital sales and our pass-through profitability rate by the end of 2023, and reinforcing our competitive advantage through all of it.

With that, I will turn it over to Gabriel.

Gabriel Arreaga

Senior Vice President-Supply Chain, The Kroger Co.

Thank you, Yael. My name is Gabriel Arreaga. And I oversee Kroger supply chain. As the newest member of the team, I joined Kroger in September after spending 20 years at three large consumer goods companies leading supply chain. Kroger supply chain is responsible for making sure that every item you buy from Kroger, whether it's in one of our stores or delivered to your door, is always fresh, nutritious and inspiring.

This is the fundamental reason our customers shop at Kroger. They know our produce is fresher than our competitors, and they know that they can depend on the quality of our products to be consistently high. Our supply chain is a competitive advantage today, and I'm going to outline why that is true. We also believe the addition of Ocado powered customer fulfillment centers will accelerate our business in the future.

Yael talked about our commitment to double our pass-through profitability rate by the end of 2023. And I'll provide specifics on how supply chain is part of the plan to drive efficiency, while providing a differentiated customer experience. Our goal is to continue that excellence and extend it across the entire Kroger ecosystem to create a gratifying and seamless customer experience. As you heard from Yael, we are expanding our supply chain and fulfillment network for the future to support seamless and increase profitability.

Let me begin by walking you through how our existing supply chain network is a competitive advantage. At Kroger, we differentiate ourselves from big box or e-commerce pure-play competitors through our quality, freshness and efficiency. Our distribution model was built specifically to achieve these outcomes. Fewer touches, great quality controls, partnerships, insourcing and the use of science and automation all make a real difference to Kroger shoppers, a difference they can taste.

One example of our current capability is how we source fresh products like strawberries from multiple suppliers in various regions. Every purchase is carried out based on quality and efficiency. When we purchase from the field, it takes us little as a day before our customer is enjoying it at their table. That level of speed, efficiency and customer centricity is a differentiator and difficult for our competitors to replicate. Over time, we have learned how to leverage our existing asset base to increase the agility and resilience of our supply chain.

As a result of many years of fine tuning, we built a distribution network that is a key growth driver in itself. Today, our e-commerce supports our in-store and e-commerce network to serve our customers across modalities. Whether a customer comes into our store, visits our app or kroger.com to order groceries for delivery or choose a convenient time to pick them up from a local store, we are providing an experience that is full and fresh, and we are doing it fast and cost effectively.

Next, I'd like to address one of the questions we often hear from our investors. What is the future of our supply chain strategy to meet the vision that Yael outlined, and how do we see our stores and customer fulfillment centers working together to deliver for the customer and drive profitable growth.

Stores will always play a key role, where the majority of our shoppers live within two miles of a store and 45% of the US population is within reach. Stores provide an efficient way to satisfy customers' needs with [indiscernible] (00:44:44) pickup or convenience store visits. At the same time, we're rolling out our new customer fulfillment centers, which will enable even more customers to access more products, even faster and in more markets. Our customer fulfillment centers will create an opportunity to serve 75% of the US population within a 90-mile radius. Where our strategy gets really exciting is the interplay between our stores and dedicated customer fulfillment centers working together to deliver for our customers regardless of their set of needs.

When combined, our stores and customer fulfillment centers create an ecosystem where brick-and-mortar and distribution automation and AI, can deliver to customers from the most efficient solution without sacrificing the customer experience or assortment. As we continue to expand our network, cost of delivery will continue to decline due to customer proximity and density. In my experience leading supply chains in different economies and geographies, reach matters in creating an ecosystem that captures rapid market share and lowers operational cost aggressively, and that is why we invest in CFCs that cover a vast population with one single building versus other competitors that invest in hundreds of facilities. We will scale faster.

We've invested in Ocado, because it will supercharge our anything, anytime, anywhere strategy for even more growth and profitability in the future. In the countries where Ocado state-of-the-art automation and AI are being leveraged, the result is a consistently superior customer experience with 99% order accuracy and 95% of orders delivered on time, the customer experience is second to none.

In Canada, the first North America location to go live, Sobeys have shared that they have achieved an 87% Net Promoter Score, a market leading NPS. As a reminder, each facility is fully automated through machine learning and robotics. Orders are optimally routed based on a number of proprietary factors and depending on the customers' preference grouped and placed on Kroger's temperature control delivery vans to maintain optimal freshness and quality. Upon arrival, customers will be greeted by our team of highly trained drivers, who will respond to feedback and ensure continued improvement on each subsequent visit. It is a return to the trusted neighborhood delivery person with the same friendly and responsive service that our customers find in our stores. To close the loop, each fulfillment site will be connected to Kroger's data insights to personalize the shopping experience for each returning customer.

We believe that this optimized processing and transportation, coupled with an enhanced customer experience, will generate an increase in returning loyal customers and improve profitability over the long-term. In fact, through a potent combination of automation AI, optimized routing and reduced shrink which together lower the cost to fulfill an order, we expect overall profitability from our customer fulfillment centers to be at least as high, if not higher than our store profitability model. By year three, we expect our customer fulfillment centers to achieve site profitability. And by year four, we expect the centers will reach parity with the store operating profit rate. Over the long-term we expect the unit economics of these facilities to be lower than our stores.

Over 2022 and 2023, we expect to open up to six more centralized fulfillment centers across the US, and further solidify our leading position in the market. The result of all this is the distribution network that enables us to deliver a truly seamless experience with the outstanding quality of products that Kroger is known for. Customers want convenience, while still receiving the value and exceptional experience that they have come to expect from Kroger stores. We're leveraging our unique data to design a dynamic ecosystem across our stores and customer fulfillment centers that will meet all customer needs from immediacy to next day, and do it profitably. We're leveraging our strong foundation and we'll continue to reinvest in our powerful network to deliver the best experience for every customer. Thank you.

I will now turn it over to Cara to tell you more about Kroger's retail media business, and how it's also fueling our long-term profitability for the company. Cara?

Cara Pratt

Senior Vice President-Kroger Precision Marketing & 84.51°, The Kroger Co.

Thank you, Gabriel. My name is Cara Pratt and oversee Kroger Precision Marketing or KPM. As Yael mentioned, our retail media business will increase digital profitability. I'm excited to share how we are uniquely positioned as an industry leader within retail media and why we are so confident about the tremendous opportunities for growth in the future.

First, here's a quick video to reintroduce you to KPM.

[Video Presentation] (00:49:41-00:51:05)

KPM is among an elite group that is creating a new and more effective advertising channel. We have the ability to create a connection between an audience and commerce and measure that end to end. This is a key driver of digital profitability. As content and commerce converge CPGs and the respective agencies are accelerating their investments in media where they can get closest to their customers. Our category is projected to grow nearly 30% this year, well beyond the 16% for the rest of the media industry. As a result, it is expected that retail media share of media investment will grow more than 80 basis points to 8.4% in 2021 and continue to climb to over 11% by 2024.

We see the potential for a multi-billion dollar retail media business over the next few years. But where will this growth come from. In a Merkle survey of CPG marketers 95% of respondents shared that their digital media spend with retailers is incremental to existing shopper or trade programs. Further, 85% of CPGs shared that they are planning to move more marketing dollars to retail media networks.

The ad industry is realigning itself for the future. Marketers don't want to be constrained by old budget silos of brand advertising versus trade or promotion marketing. Instead they want to spend dollars wherever they are more effective. And increasingly that means more dollars are moving into retail media. The demand for retail media was accelerated by COVID-19, but there have been several long-term marketing trends already pushing the advertising industry in our direction.

First, third-party cookies are going away. As a result, brands need first-party data to reach the right households. Second, consumers expect seamless commerce so brands need to make more of their advertising shoppable. And finally, brands want to make data driven advertising investment decisions. Therefore, they need ad partners with data they can trust. We've built Kroger Precision Marketing to solve these problems by being addressable, actionable, and accountable.

We're addressable. We identify the right shopper with our first party data. Our relationship with shoppers is more important to brands than ever before. We're actionable. We have the right digital experience for grocery shoppers. We are helping brands meet the seamless shopping needs of consumers, connecting them directly into our commerce platform to buy online for pickup, delivery or direct ship to home. And we're accountable. We have the data, the tools, and the expertise to measure business impact.

Brands know that advertising with KPM will result in performance metrics they can trust to make data driven advertising decisions. This is critically important and what has become increasingly an opaque industry with a complicated media supply chain particularly when it comes to evaluating media impact. The industry is too sophisticated to let vanity metrics like click through rate and viewable impressions be the leading KPI on performance.

It's time to elevate the dialogue. Kroger Precision Marketing offers a powerful media network for brands with touch points across the consumers' entire purchase decision journey. And advertisers are recognizing KPM for having best-in-class media capabilities among retailers. When we engage with CPGs directly whether it's through their e-commerce team, brand marketing team, shopper marketing team or with their respective agencies, we speak to them about an ability to both leverage our audience intelligence and our closed loop measurement.

The Path to Purchase Institute has surveyed CPG marketers on their perception of retail media networks over the last three years. In the most recent results released in January 2021, KPM has taken a leadership position overtaking national retail and e-commerce players for the highest ranking retail network in key categories like targeting effectiveness and measurement, and at the front of the pack for delivering CPG sales growth. We are uniquely positioned to transform the media landscape. This affirms our advertisers recognize our ability to drive marketing results and media accountability more effectively than other retailers. The difference between Kroger Precision Marketing and other retail media networks is the strength of Kroger's customer relationships.

Kroger's loyalty card program has created a trusted value exchange with consumers. For over 20 years, consumers have joined the program allowing us to match purchase data on 96% of sales. In exchange, consumers earn fuel points, receive personalized offers, and are inspired by relevant innovation. The result is a longitudinal view of purchase behavior anchored in 10 petabytes of consumer behavior data, which is extremely valuable to CPG brands and sets the foundation for media activation opportunities. We use this longitudinal view of the customer to help brands make data driven ad investments in three ways.

First, we identify the best households. Our targeting science applies unparalleled purchase data to machine learning models with over 3,000 features that have been built by a robust team of data scientists. We're able to identify the most qualified audience for every campaign. Across our offsite channels, this precision has proven to deliver 3 times the sales impact as compared to the average household.

Second, we reduce wasted ad impressions. With audience fragmentation in media, advertisers tend to buy more and more ads to reach their intended audience. This creates wasted ad impressions and increased advertising costs. In a comparison against third-party targeting data, a campaign using KPM data science generated 10 times the sales with half as many impressions. The end result is that brands can run fewer impressions to get the same or better results making their advertising investment more efficient.

Lastly, we optimize the media mix. Our planning tools help brands understand based on their goals which media channels they should be using across off property media touch points, like Facebook, Pinterest, Meredith and Roku or our owned and operated highly performance media such as search, display, emails or targeted offers. Through our closed loop measurement, we know that cross-channel campaigns outperform single-channel campaigns 70% of the time, which is why many brands engage across a mix of our assets.

Kroger is in the business of connecting brand inspiration to commerce through shopping experiences. Brands are using retail media to help consumers discover products during moments that matter. The future of the digital ad ecosystem needs to be less about interrupting consumers and more about delighting them. Here's how it all comes together to make brand advertising more addressable, actionable and accountable.

Kroger Precision Marketing is a strong media partner because we help companies like Kraft Heinz reach relevant consumers effectively. Thanks to our data driven approach, we're able to serve up a variety of Kraft Heinz branded consumer solutions on our platforms to millions of shoppers, which has led to an increase in new and repeat purchases for Kraft Heinz. Using Kroger Precision Marketing's transparent one to one measurement, we saw these activations have a five times return on ad spend throughout 2020 resulting in Kraft Heinz further strengthening its position as Kroger's leading supplier in several areas including pickup and delivery sales last year.

Our success for brands has also created success for Kroger. As a driver for Kroger's alternative revenue and digital profitability Kroger Precision Marketing is delivering both new advertisers and new revenue. In fiscal 2020, we experienced 135% revenue growth from over 1,300 brands engaged across our media portfolio, retaining 85% of the brands we worked with in 2019. And on average, those brands spent 200% more last year. We are on a mission to be a preferred media company for CPG advertisers. We're proud of the impact we've made to transform the media ecosystem. And we look forward to continued success as a leader in this dynamic industry and to contributing to Kroger's increasing digital profitability.

I'll now turn it over to Stuart to outline how Kroger will continue to grow with food and lead with Fresh, which obviously is the platform that generates the traffic that grows our retail media business.

Stuart W. Aitken

Senior Vice President-Alternative Business, The Kroger Co.

Thank you, Kara. My name is Stuart Aitken. As Kroger's Chief Merchant and Marketing Officer, I'm responsible for our Fresh strategy, which as you've heard from others today is central to our ability to grow market share. Rodney spoke about our four competitive moats earlier, and Yael covered seamless. Now, we'll discuss the other three fresh, our brands and personalization, which are key accelerators of market share growth. I look forward to outlining why Fresh is where we lead all large national retailers and why our brands are truly differentiated. Then Mandy Rassi will share how we've transformed marketing and now taking personalization to the next level to promote our fresh and our brands products. Finally we'll hear from Mary Ellen Adcock on how we are driving a differentiated full fresh and friendly customer experience through operational excellence.

Before I dive in let me recap 2020. As difficult as it was, 2020 was truly an incredible year. We grew our sales by $14.4 billion. That's like adding three entire divisions to our platform. 1%. We also had a record identical sales without fuel of 14.1% We had to pivot quickly leveraging our data to ensure we understood the customer and what they needed from us. We learned quickly and made the necessary adjustments to achieve the trust we garnered from the customer.

We are proud of these achievements. We know our customers trust in us is what got us here. And our customers acknowledge what we were doing by choosing Kroger over other retailers. We are connecting with our customers. We grew market share resulting in an incremental $2.1 billion in sales. Our fresh departments including produce, meat, deli bakery all over-indexed on market share versus the total store.

We know Fresh drive store choice. 70% of customers choose their grocery store based on quality of fresh categories. We'll leverage our position of strength like being the number one retailer in floral, in deli, in sushi to drive even more shopping trips to our stores. We are going to build on our success and grow fresh in 2021 and beyond.

So how will we differentiate the fresh experience at Kroger. Maximizing our strengths in supply chain, in technology, in operations. We look at the entire process starting with sourcing, supply chain all the way to the shelf and at every step along the way to make sure our customers are getting the freshest product.

We're increasing days of freshness for the customer. We're doing this by optimizing assortment, reducing days of supply in our distribution centers and our stores, expediting transit time and strategically aligning with suppliers who share our vision for quality and freshness.

One example is milk. We offer 10 days of shelf life. No one else does this, and we've guaranteed freshness for years. But produce is the number one influencer on store choice. We're enhancing the customer experience through our efforts to improve Fresh through our reimagined end-to-end process. Our focus is on the products that our customers say are most important bananas, berries, tomatoes, and bagged salads. These four categories combined for more than 28% of sales in the produce department. When we deliver even higher quality and freshness in these areas will earn even more customer loyalty and additional sales.

Kroger significantly leads large national retailers in fresh. When we compare ourselves with large national retailers in freshness, we lead the pack. The fresh equity score is our 360 degree view of how customers perceive us as well as where we rank with competition. We will use this measure to hold ourselves accountable and increase our competitive lead. This score will become stronger as we implement our Fresh strategy in 2021 and communicate our proof points or reasons to believe to our customers. And Mandy will share more on that shortly.

A big part of our Fresh strategy is helping answer the daily dilemma of what's for dinner with simple, convenient and delicious meal solutions. Leveraging our brands, our prepared chicken strategy will feature Simple Truth and Home Chef. In the next two years chicken will be a $1 billion business for Kroger. We've also created a variety of ready-to-cook, ready-to-heat and ready-to-eat meal solutions through our Home Chef business. These meals are easy and meet the needs of many discerning palate.

Our Home Chef brand had an incredible year. Sales increased a 118% in 2020. We've positioned the brand to capture even more value through culinary innovation and e-commerce growth in 2021. The Home Chef brand will be the next billion dollar brand for Kroger. We are constantly innovating, testing and learning new partnerships that can provide unique offerings for our customers. We are currently partnering with innovative companies ClusterTruck is a delivery and pickup solution to satisfy everyone's cravings with restaurant quality offerings. We have a new pilot yet to be announced that is coming soon and offers meal solutions for the entire family. Saladworks gives customers premade or made to order healthy options.

Innovation is the lifeblood in Fresh. We may fail with some, but when we do we'll fail fast. That said when we detect a home run, we'll scale it at pace that matters. That will move the needle for Kroger. Our commitment to Fresh uniquely positions us to grow exponentially in e-commerce. Freshness is our number one priority, which is why we go to great lengths to make sure everything is delivered to the customers call or home. Isn't just fresh, but it's fresher than fresh. And our commitment to fresh makes the delivery and pick up experience truly unique.

Our specially trained associates pick the freshest products. So customers get the same great quality delivered to their car or home that they would find in our stores. And customers are rewarding us for these high standards. We are earning strong approval ratings from our customers. We wish you could be here in person for a store tour of our Fresh department. Instead, let's have Dan, our Group Vice President of Fresh take us through a virtual tour.

[Video Presentation] (01:07:39-01:10:04)

Speaking of Fresh, our brands is a pathway to deepen and widen our competitive moats. It's a $26 billion business that differentiates Kroger across the entire store and all modalities. Simple Truth alone hit $3 billion in sales last year. If the Simple Truth brand was a CPG, it would be the second largest brand in our stores. Our brands is our not so secret weapon that we intend to scale and leverage with even greater focus. Our brands is also a fresh differentiator through powerhouse brands such as Home Chef and Murray's Cheese. These brands are only available at Kroger and draw customers to shop with us.

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In center store, our brands is equally as strong. Our tiered strategy is anchored by mega brands such as Kroger, Private Selection, and Simple Truth. These products appeal to a vast swath of customer needs such as natural, organic, epicurean and value. Customers love our brands and they tell us in three main ways.

First, with their purchasing behavior. It's a CPG tucked inside our business, but it's anything but small. It's a business that's 8 times larger than the largest CPG company that sells products in our stores. Customers also tell us a Net Promoter Scores, our NPS is 30% to 40% higher for Kroger Simple Truth and Private Selection versus comparable competitive store brands. And finally, in product comparisons; 100% of our new our brands items in 2020 are rated as good or better than the leading CPGs. Our innovation team knows food. They perform more than 10,000 product validations last year and we'll continue to be a key lever in our innovation strategy well into the future.

Innovation is a growth pool that is worth billions to Kroger. And with our brands and our national brand partners, we'll win here as well. This year we'll launch more than 660 exciting new our brands items, nearly 60% of these will be under the Simple Truth or Private Selection brands, the brands that provide us the highest margins. And it's not just innovating in our brands, but with our national brand partners as well. We'll be working with them to bring innovative first to market items that grow our collective businesses.

Innovation is now and innovation will continue to be our future. And speaking of innovation, I'd like to introduce you to Mandy Rassi, Kroger's Vice President of Marketing. Quite frankly, Mandy has reinvented marketing for

Kroger over the last 18 months and she'll be sharing the journey and the future of Kroger marketing with you. This next video we'll take you on our branding journey over the last 18 months.

[Video Presentation] (01:13:18-01:15:21)

Mandy Rassi

Vice President, Head of Marketing, The Kroger Co.

Thanks, Stuart. Hello, everyone. My name is Mandy Rassi, and I'm proud to lead the talented team responsible for Brand Strategy, Planning, Performance Marketing and Media. This video gives you a taste of the brand journey we've been on over the past 18 months. We launched our campaign Fresh for Everyone a little over a year ago and are thrilled with the performance to-date. We've seen a 20% increase in ROI, and an 80% increase in advertising effectiveness. The chart here shows third-party copy results from iSpot, which measures how customers engage with advertising in the market. While all brands see some variability from spot to spot, we are very pleased with the engagement that we have seen with some exceptionally strong spots under the new campaign.

Kroger's prior average pre-campaign was 4.1. As we are cutting through the sea of sameness and differentiating our brand message, we are seeing our ads test significantly higher in terms of customer engagement, putting us on a new level. You heard both Yael and Cara talk about the power of personalization. We are harnessing that in our marketing approaches, leveraging the industry-leading data and science that 84.51° brings to help us personalize even more of our plans. Cara talked about the difference this makes for our CPG partners and the same is true for us. This approach allows us to reduce waste in our media plans, getting the right message to the right person in the right context.

We will now go beyond our one-to-one channels like direct mail, email and mobile messaging to apply this data and science to paid media channels like social, display, streaming audio and video, doubling the amount of our media that is personalized by the end of 2021. This drives relevance for our customers and creates a better experience for them and also increases our ROI. For example, we've seen up to a 60% improvement in ROI as we shift from mass channels to their addressable counterparts. As we look at 2021, we will be focused on four key priorities. First is fresh, Stuart discussed our innovation and the lengths we go to to ensure our fresh is Fresher Than Fresh. We are so excited to tell these stories to our customers, showing them all the way as we make sure they get all the fresh they want, how they want it at Kroger, and we will do this in a fun distinctive way via our animated campaign.

Second, we know that value will continue to be critical to our customers in 2021. Last year, we launched our Lower Than Low message to communicate our value equation, and it has really resonated with our customers. We took a fun approach and customers got in on it too making their own YouTube videos and TikToks riffing on the ad. In fact just since the start of this year, we've seen over 45 million earned impressions from these customer videos. We will continue this Lower Than Low messaging in new and creative ways in 2021 and you'll be able to see it at the break. Third is eCommerce. Marketing plays a critical role in fueling our eCommerce growth. This includes continuing to drive our pickup and delivery businesses in existing markets, introducing our brands to new geographies like Florida as you heard from Gabriel, and fueling our rapidly growing ship business. And finally, we will deliver all of this through an increasingly personalized approach. We will meet each customer with the right message in the right context at the right time based on their needs driving continued growth in our ROI.

And with that, I'd like to turn it over to Mary Ellen to talk about how we are elevating the customer experience.

Mary Ellen Adcock

Senior Vice President-Retail Operations, The Kroger Co.

Thank you, Mandy. I'm Mary Ellen Adcock, and I lead operations. I'm excited to showcase today how we are elevating the customer experience to drive sales, win market share and increase profitability across our seamless ecosystem. At Kroger the customer experience is central to everything we do. The best experiences consist of Full, Fresh and Friendly behaviors, meaning products are consistently in stock, fresh products are high quality and associates are welcoming, knowledgeable and friendly. They are all directly linked, and combined together, yield powerful results and increased sales. Our ability to deliver on the Kroger promise on full, fresh and friendly for every customer, every time, no matter how they shop is how we define operational excellence.

Building on our established track record of consistent execution and operational excellence, we are proud of our results here. Our rigorous focus on execution has delivered strong year-on-year improvements. The pandemic did present new challenges for the entire industry, particularly around in stocks creating a temporary dip. However, our associates responded to the pandemic with speed and agility, improving our in stocks and implementing new processes that allowed us to serve customers and increase sales, ending the year with an all-time best results for both Fresh and Friendly. Looking forward, Full, Fresh and Friendly remain fundamental and essential to the customer experience.

On the other hand, the pandemic has changed customer behavior, and Kroger is meeting new customer expectations that emerge from pandemic trends. Importantly, we believe these new expectations will continue beyond the pandemic, establishing additional focus areas for the customer experience. The first is curbside pickup, with fast contact-free and convenient service. Second, customers want contact-free checkout options. Because we know how important the value of the loyalty card is to our customers, we have combined payments and loyalty into one easy to use feature on the Kroger app. And third, clean and safe stores will remain important and customer shop with Kroger because of our commitment to their health and safety.

Operational excellence underscores every aspect of our business. Kroger excels in fresh. You have seen that customers rate Kroger higher than big box retailers and fresh perception. Stewart has already walked you through how maintaining fresh leadership is essential for Kroger in terms of merchandising. It is also an advantage as it relates to store operations and curbside pickup. Our strategy is to lean into our leadership in this area because we know that fresh is the leading category customers assess when choosing where to shop. In fact 70% of our customers choose where to shop based on the quality of fresh products. Kroger is committed to taking fresh to the next level in 2021 and strengthening our competitive moat with enhanced operational processes that continue to improve the fresh experience across all channels for our customers.

Pickup and delivery is increasingly important to the customer experience. Customers who have never shopped Kroger before, and who are looking for fresh, high quality products in a safe and convenient way are experiencing Kroger for the first time. In 2020 Kroger outpaced many other retailers in expanding capacity. We went out fast and early adding over 240 new pickup locations to increase our footprint over 2,200 locations. Also expanding capacity in existing locations increased orders per day by over 128%. As you heard from Yael, the store is a strong asset that we continue to leverage as part of our digital strategy. In addition to expanding capacity to capture sales, Kroger improved cost to serve by 14% to enhance profitability and contribute to the bottom line.

Operational excellence extends to pickup and delivery by implementing process change and new technology to both increase efficiency and improve the customer experience. We are using the operational data and insights for additional efficiency efforts as part of our profit growth plan. And while improving the cost to serve, meaningful progress was also made in the customer experience. Customers value their time and so do we. Technology such as on my way in our app and real time data at a customer level enable a 30% reduction in wait time. Our customers are recognizing a differentiated experience. Here are just a few examples of feedback from our customers.

[Video Presentation] (01:23:55-01:25:10)

Thank you. I'd now like to introduce my colleague, Gary Millerchip. Gary?

Gary Millerchip

Chief Financial Officer & Senior Vice President, The Kroger Co.

Thank you, Mary Ellen and good morning, everyone. I hope you enjoyed the presentations this morning. As you have heard, we as a management team are energized by the opportunities ahead of us. My role is to share how our growth strategy will deliver strong and sustainable total shareholder return for our investors. There are three key messages I hope to leave you with today. First, Kroger has a strong value creation model. We are outperforming this model and expect to exceed our total shareholder return commitment of 8% to 11% over the three-year period 2019 to 2021. Second, our team is laser focused on delivering profitable growth beyond 2021. And finally, we will continue to be disciplined in our approach to capital allocation, which will be a key lever in enabling our future growth.

Kroger's value creation model is underpinned by our leading position in food. We continue to invest in areas of the business that matter most to our customers and deepen our competitive moats to drive sales growth in our retail supermarket business, including fuel and pharmacy. This in turn generates the data and traffic that enables our fast growing alternative profit streams. 18 months on from first sharing our value creation model, we are now even more confident in our ability to generate consistent net earnings growth of 3% to 5%. And our resilient free cash flow will allow us to continue to return cash to investors via a combination of share repurchases and dividends, resulting in total shareholder return of between 8% and 11%.

Looking back at 2020 for a moment, the investments we made during Restock Kroger enabled us to capitalize on tailwinds related to the pandemic and dramatically accelerate our work in the shift to digital. As our customers placed even greater emphasis on fresh quality food and a seamless digital experience, we were there to meet that need, and successfully grew market share in-store and online. Without question, 2020 was a unique year, and given our exceptionally strong results, comparisons between 2020 and 2021 will be less relevant. One of our goals today is to give you clear insights into how to measure and track the underlying momentum we have built, which will position us to compete and win in a post-COVID world. Our guidance for 2021 which we introduced on our fourth quarter call and are reconfirming today highlights the strength in our business model.

While there remains uncertainty surrounding trends in the food at home market in the coming year, we are confident in our ability to navigate these unknowns, and we'll continue to leverage the structural tailwinds and major trends shaping our industry that Rodney highlighted earlier. As we shared during our earnings call, we believe evaluating our performance using a two-year period more accurately measures our underlying momentum. Looking at 2020 and 2021, we expect to deliver performance well above our TSR commitment. Specifically, we expect our two-year stacked identical sales without fuel to be in the range of 9% to 11%, and adjusted FIFO operating profit is expected to grow at a compounded annual growth rate of between 5.4% and 8.5%. The midpoint of our 2021 net operating profit guidance is approximately $200 million higher than the midpoint of the earnings growth contemplated when we originally shared our total shareholder return model back in 2019.

I'd now like to go a little deeper into our value creation model, and share additional color on our plans to grow earnings through increased sales and margin expansion. As you have heard extensively from the team today, we expect to grow sales by leveraging our competitive moats in fresh, our brands, personalization and accelerating digital. You also heard that we are committed to continue investing in initiatives that widen our moats and deliver for our customers. The strength of our execution and confidence in our future plans has led us to raise our sales expectations in our growth algorithm from 2% to 3% to 2% to 4%. Turning now to operating margin expansion, we will achieve improvement through continued cost savings, acceleration of alternative profits, and improve digital profitability, which will more than offset continued planned investments in our associates and customers.

Cost saving has become a core competency for Kroger. Since 2018, our operations and sourcing teams have delivered over $1 billion annually in incremental cost savings, and we expect to deliver another $1 billion during 2021. These cost savings are focused on removing activities that don't add value for the customer, and becoming more efficient by simplifying the associate experience. We see a long runway for further improvements in productivity as we continue to optimize sourcing practices and leverage our data and technology in new ways. Our second lever to drive margin expansion is alternative profit streams, which are built on the platform of our food business and the robust traffic and data this generates.

We are experiencing tremendous growth in this part of our model, building on the $250 million of incremental profit achieved over 2019 and 2020, we expect to deliver an additional $100 million to $150 million of incremental profit growth in 2021. That represents another year of double-digit growth in alternative profits. And we expect to achieve continued double-digit year-over-year growth for the foreseeable future. We have defined four key alternative profit pillars; Kroger personal finance, retail media, data insights and ventures. These four pillars represent the alternative profit streams that most meaningfully impact our results today, including our two largest businesses, retail media and personal finance. We continue to identify new ways to leverage our traffic and data, which will drive innovation and new revenue streams in the future.

The value we create from alternative profit streams allows us to reinvest in the customer experience and drive traffic back into the Kroger ecosystem, creating a flywheel effect in our value creation model. As Yael shared earlier, we have a clear roadmap to improve digital profitability. Under our current model, we typically see a pass-through profit rate north of 15% on a traditional brick-and-mortar sale, and mid single-digits for a digital sale. Through our focus on cost efficiency, growing media revenue, plus the economies of scale and mix improvements that come from accelerating digital sales, we expect digital pass-through profitability to double over the next three years. As we bring our new customer fulfillment centers powered by Ocado online, we see further opportunity to accelerate this momentum.

While Ocado will be a headwind to operating profit in the early years, as we ramp up volume in each CFC, by year three we would expect the CFC to achieve site profitability, and by year four to be at least on par with the store operating profit rate. While we are taking action to improve our operating margin, we also remain committed to investing in the business to drive sales growth. One of the largest investments during the last several years has been our most important resource, our associates. This includes wage investments, training and development and addressing the underfunding of multiemployer pension plans. In 2021 we plan to invest an incremental $350 million to increase the average hourly rate of our associates. Ongoing investments in associate hourly rates are fully-contemplated within our growth model and will be funded by our future cost saving initiatives.

Turning now to financial strategy, our overall approach to capital allocation remains unchanged. We continue to use our free cash flow to invest in the business to drive long term sustainable earnings growth through the identification of high return projects that support our strategy. At the same time we are committed to maintaining our current investment grade debt rating and returning cash to shareholders via share repurchase and dividends. We view capital allocation as a core element of our value creation model. We continue to be disciplined in deploying capital towards projects that exceed our hurdle rate of return, and prioritize the highest return opportunities supporting the plans discussed today to drive 3% to 5% earnings growth.

As Stuart and Mary Ellen shared earlier, we continue to invest in our stores via remodels and merchandising initiatives to deepen our competitive moats, enhance the customer experience and ultimately drive identical sales. Compared to the prior three years, we are shifting more spend to accelerate digital and support our plans to expand capacity, broaden assortment and improve the customer experience. This includes our investment in customer fulfillment centers powered by Ocado. We will continue to be swift and agile in deploying capital in digital as necessitated by customer demand and opportunities to enhance profitability. We are also allocating more dollars in 2021 to drive margin expansion via technology investments that will lower costs, improve productivity and eliminate waste.

As we committed to in 2019, our ROIC is improving as our Restock Kroger investments have gained traction. We expect ROIC to be higher in 2021 compared to 2019, and expect continued gradual improvement over time due to the strong business performance, which includes improved digital profitability and our disciplined approach to capital deployment. A key component of Kroger's financial model is the strength of our balance sheet and the consistency of our free cash flow. Looking at 2017 through 2021 we expect to generate over $11 billion in adjusted free cash flow, and an average adjusted free cash flow yield of over 8%. Since 2017 we have returned $7.3 billion to shareholders through share repurchases and dividends.

Our dividend has grown at a compounded annual growth rate of approximately 13% since reinstatement in 2006. We remain committed to returning cash to investors at a rate consistent with our TSR model, which will continue to be achieved through a combination of share repurchases and a growing dividend over time. During 2020 we reduced our net debt by $2 billion, creating significant financial flexibility in our model. Our current debt-to-EBITDA ratio is 1.75 times compared to our target range of 2.3 to 2.5 times.

Over the next six months, we will be aggressively evaluating how to best deploy excess cash with a focus on opportunities that accelerate profitable growth in food, digital and alternative profits. We will share more as we complete this work.

Kroger has a combination of highly valuable assets that provide us tremendous platform for growth. These assets are built on data insights from 60 million households and include our fast growing $10 billion digital business. As we look forward, we see significant opportunities to accelerate our growth model. These opportunities, many of which you've heard about today, build on our strengths and allow us to serve our customers in new and exciting ways. We will remain disciplined in our test and learn approach. Our expansion into new geographies with Kroger hometown and Ocado in Florida are great examples. These initiatives expand the reach of our differentiated customer proposition without the need for significant investment in a store footprint. We will be monitoring early results closely to evaluate potential future new geographic expansion.

In summary, the Kroger leadership team is focused on driving sustainable growth and delivering our total shareholder return commitment of 8% to 11%. The plans we have outlined today to grow future and accelerate digital combined with our cost savings and growth in alternative profit streams will enable Kroger to achieve our 2021 guidance and deliver profitable growth beyond 2021. We believe this creates a compelling investment thesis, underpinned by a strong balance sheet, consistent free cash flow, and a highly valuable asset base that creates exciting future growth opportunities. And as an organization, we are ready.

[Video Presentation] (01:38:15-01:39:40)

Rebekah Manis
Director-Investor Relations, The Kroger Co.

This concludes our prepared presentations. We look forward to taking your questions after a 15-minute break. Please feel free to begin submitting your questions now. Thank you.

[Break] (01:39:55-01:55:05)

Welcome back. We hope you enjoyed all the commercials. We know our customers certainly do, and they're sure to put a smile on your face. We would now like to begin our Q&A session where we look forward to taking your questions over the next 60 minutes. As a reminder, you can submit your questions at any point using the question entry field located in your viewing platform. In addition to the speakers you have heard throughout the morning, it's my pleasure to welcome Tim Massa, Kroger's Senior Vice President of Human Relations, and Mike Donnelly, Kroger's Executive Vice President and Chief Operating Officer. Many of you know Mike. He's been instrumental to the Kroger family for the last 42 years. He's recently announced his retirement to enjoy more time with his family. Mike, you will be missed, and we're glad you could join for one last IR Day.

QUESTION AND ANSWER SECTION

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

So with that let's dive into our first question. It comes from Ken Goldman with JPMorgan. This question is for Rodney and Gary. I'm curious how you think about balancing the desire to invest in digital capabilities with the need to spend ongoing store renovations. Is there a risk that as your capital and attention shift towards the higher growth part of your business, that you spend fewer resources than you typically would on improving the basic in-store experience of your brick-and-mortar shoppers? Would you ever consider raising capital so that you could spend more right now on both parts of the business without sacrificing one or the other?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Thanks, Rebecca for the question and Ken. It's a question that I think is outstanding, and I think about this one all the time. And when you look at some of the work we did at the beginning of Restock Kroger in terms of cost reductions, and as you know over the last three years we've been able to take over $3 billion of cost out, some of that the objective of being able to do that is the very question that you asked. And if you look at 2021, we've committed to being able to take another $1 billion of costs out. And when you look at those resources we freed up, we've reinvested a lot of those. And if you look at the fundamental customer experience on Full, Fresh and Friendly, on Full, obviously we've made great progress, during the pandemic there was a dip.

But if you look at over the last several months we've continued to make progress back on that, and would expect by the end of this year to be where we were even before the pandemic. If you look at the experience in terms of our associate experience, the friendliness of that, we've continued to make progress throughout the pandemic, and it's something I'm super proud of our team. And if you look at Fresh we were able to do the same. If you look at on the other side from a capital standpoint, the business continues to generate great free cash flow, which is something that's obviously incredibly important to be able to fund both the physical store and making sure our physical stores stay up to date.

And one of the things that we did several years ago was reduce the number of store openings and increase the amount of capital spending on technology, and seamless, and we've continued to do those. So those parts obviously are incredibly important, and it's incredibly important having the strong free cash flow as well. So all of those things are something that we look at the overall ecosystem because what we find is a customer that becomes a digital shopper, still physically comes into the store, and they still expect a great experience on all modalities, and it's incredibly important. So it's a great question. It's something we worry about. We track in terms of how are we doing on a regular basis, and it's our direct customer feedback in terms of how we use. So with that Gary, I'll let you answer the other parts of that question.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Sure. Thanks Rodney, and thanks for the question Ken. Yeah. I agree with Rodney's comments. Both of the channels that you heard hopefully from all the presentations this morning are hugely important to the ecosystem that we're building, and we continue to invest in stores and in the digital channel to make sure we're creating the right experience. I think you may have seen with some of the numbers that we've talked about with our guidance for 2021 that we are increasing capital somewhat as we accelerate digital. And as Rodney mentioned, we've been able to really pivot capital in stores to have less of a focus on new stores. So we're really focusing the new store spend in those high growth markets, and we've been able to allocate more capital to digital without really impacting the dollars that we're spending on the in-store experience and continue to invest in our stores.

I'd also be pleased to say that the investments that we're making in digital and in-store, we do expect to generate a return. So we continue to stay focused on improving the experience, driving sales and making sure that we're achieving our hurdle rates on those investments. I think the only other thing I would add to Rodney's comment is that, you probably sensed it through the theme of this morning that our goal is to continue to drive higher growth within our TSR models. So the more successful we can be at continuing to find those capital investments that drive higher sales growth and allow us to expand margin and profitability, we'll continue to look for those opportunities. And as we get more confident in that model, we'll certainly make sure that we're spending dollars where it can truly accelerate our overall growth in the business.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Raising capital.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Absolutely.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

We really don't see the need for that.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

No.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

All right.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thank you. Our next question comes from Greg Badishkanian from Wolfe Research. This one's for you Stuart. Can you talk about your quarter-to-date trends, and what is the mix of eCommerce trending at quarter-to-date?

Stuart W. Aitken
Senior Vice President-Alternative Business, The Kroger Co.

A

Thank you, Rebecca. Good morning again. Our trends headed into 2021 were strong across the three metrics that matter the most for our business, sales, margin and market share. And as we've moved in to 2021 those trends have continued, and it's largely because of some of the customer metrics we're looking at. Think about food away from home still being strong, customers loving to cook and enjoy that product. We're also seeing that trend of premiumization stay in place, which for us helps from a margin perspective as well, and our brands deliver on that and then some. We expect those trends to continue through the rest of the quarter and in line with the guidance Rodney and Gary have shared with you thus far. Mike, anything you would add to that?

Michael Joseph Donnelly
Chief Operating Officer & Executive Vice President, The Kroger Co.

A

No. I think you said it all correctly. We're excited about the momentum that we have. And I would tell you, we're looking forward to what's in front of us. So yeah, good stuff.

Stuart W. Aitken
Senior Vice President-Alternative Business, The Kroger Co.

A

From an eCommerce perspective, the trends we're seeing are just as strong. Again, customers enjoying that seamless experience that you heard from Yael earlier, and we're delivering and delighting customers and really looking forward to opening our first two sheds in the coming weeks.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thanks. The next one comes from Ed Kelly with Wells Fargo. Another one your way, Stuart. It looks like we see elevated food price inflation at some point this year. What's your expectation for food price inflation this year? Are you optimistic the market will pass it through in a timely manner? And just remind us of the impact inflation has historically had on your business.

Stuart W. Aitken
Senior Vice President-Alternative Business, The Kroger Co.

A

Well, inflation over the last few years have been relatively low. As we look out in 2021, as you've heard from Rodney and Gary in the past, we're expecting about a 1% to 2% inflation. We are expecting some volatility of course. And you'll remember what happened to the meat commodity in Q2 of last year. So we'll be lapping some deflation there. Right now we are seeing some inflation in our produce area, and we're mitigating that as we transition to spring and summer selling, so think berries and stone fruit. The inflation we're seeing right now is largely weather driven in the commodities like apples and citrus. Meat, middle meats, we're seeing some inflation, but post Easter, we expect that to moderate some as well. So that's how we're seeing inflation. And the guidance we've given remains the guidance we'll share now for the year between 1% and 2%.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thank you. The next question comes from Michael Montani with Evercore. Rodney and Gary this is a modeling question. Can you aggregate the total EBITDA tailwinds this year? Everything from fading COVID costs to normal cost savings activities, the Walgreens JV, reduced dotcom losses, private label expansion versus headwinds, and things like shrink price, investment, wages, transportation, freight. Is the $1 billion a year of gross cost savings sustainable moving forward?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah. Gary, I'll let you get started on that one. At least the hard part of it.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Thanks, Rodney. Yeah. Thanks for the question, Michael. As you know, we talked about on our Q4 earnings call our guidance for 2021. And I think one of the big themes we want to make sure we're conveying is, as we've really built out the ecosystem that we've created, now the value creation model if you like that I talked about earlier today, we feel very comfortable in our ability to flexibly manage through the uncertain times that we know we're currently facing as we look at 2021. So we don't need to think for a moment that we believe we have this perfect crystal ball around exactly how trends will play out. But we thought it was important as we've gained more confidence in our ability to navigate the changes that are happening in the market to really share how we see the year shaping up.

I'll maybe take the question in two parts. I'll cover little bit around the sort of the major moving parts in the plan for 2021 and how it shaped our guidance, and then we can talk a little bit more about the cost saving strategy, and I'll bring Mary Ellen in on that as well because she's done a tremendous amount of work for the company in building that into our culture and helping us see a clear path forward. But first of all, taken the model, you kind of covered quite a long list there. And I would agree with you, there's many moving parts in the model for 2021 as we cycle through what was an incredible year in 2020. As you think about the headwinds, first of all, obviously as we start to see sales lap year-over-year, you start to see some deleverage in the model, things like expenses in gross shrink, advertising of sales turn negative as we've guided that they will in 2021.

In addition to that, of course you start to see other deleverage activity in the model as well. So that's a fairly significant headwind in our model in 2021. And we also see some gross margin downward pressure as well because of the change in mix. So if you think we would expect pharmacy to continue to have positive IV sales in 2021, but some of the fresh departments with higher margin may not. That's going to change the mixing in gross margin as well. As you think beyond the sales side of the sort of the headwinds, fuel is going to be another area where we think we'll see very nice growth in fuel gallons as we cycle through the COVID pandemic in 2021. But on the other side of things, the fuel margin that we saw in 2020 was extremely high by any standard. And so, we'd expect that to be a headwind to the model this year.

In addition to those two kind of business headwinds, if you like, we will also continue to invest in the business of course to make sure that we're growing long-term momentum in our model, and that would include investments in the customer, whether it's personalization in pricing or fresh experiences Stuart talked about earlier, but also in our associates, and continuing to increase the average hourly rate to make sure that our most important asset in our business, our people are motivated and trained and skilled and driving execution at the highest possible level as Mary Ellen talked about earlier. So they're all the, if you like, the headwinds that we'll face during the year. Of course alongside that, we're going to see some significant tailwinds as well as we come out the other side of the COVID off cycle, I should say, the first year of the COVID pandemic.

First of all, on some of the business trends, we would expect health and wellness to be a tailwind for us in 2021, partly as we are implementing the vaccination program and seeing over 30% of new customers to our pharmacy as part of that program. But also as customers start to return to more normal habit of picking up new scripts and using more of the services that are available in that part of the store. In addition to health and wellness as we shared on our guidance and then more detail today, we expect alternative profits to be a continued tailwind, and our guidance is for $100 million to $150 million of incremental profit from alternative profit streams in 2021.

And then the final part of your question around cost savings, and there's really, I would say, three major cost saving buckets that will come into play in 2021. The first is, while we'll expect to continue to see some COVID costs continue into 2021 around cleaning, leave of absence, rewarding our associates, we would expect that to be significantly lower than it was in 2020 as we continue to fine tune our practices and as we start to hopefully come through the other side of the pandemic. Secondly, our incentive plans obviously are perfectly aligned to the growth plans that we have for this year and driving long-term growth to make sure that the team is highly motivated by our current plan and future year plans. And so there will be more of a normalization in terms of incentive costs.

And then finally, obviously, the sort of final part of your question, we continue to identify new ways to take costs out of our business, whether that be through leveraging the learnings from COVID around reducing administrative costs, also through applying technology to simplify our business model, and also continuing to improve our sourcing practices to drive efficiency there as well, which in example would include the GPO that we have with Walgreens. So we feel very good about the puts and takes in the model, and our overall confidence in our ability to manage the different pieces of that puzzle in 2021, hence, why we felt comfortable giving guidance to the market for this coming year. So that's really how we think about the overall puts and takes. I'll maybe let Mary Ellen comment a little bit more on how we think about cost savings going forward, and how they are important to our model overall.

Mary Ellen Adcock
Senior Vice President-Retail Operations, The Kroger Co. A

Absolutely. So we definitely have had a strong track record of delivering the cost savings, and we do see that sustainable as we are going forward, at the same time, continuing to improve the customer experience. As Rodney mentioned, and we showed how we've made great progress there, and we will continue that and have clear plans to do that. At the same time, we also have a pipeline of how we'll continue to take cost out in ways that are not relevant to the customer experience. So for example, simplifying additional processes for our associates, using robotics where we can replace tasks that are not relevant to the customer. And we also identify process change that makes the selecting process even more efficient for our curbside pickup to take cost out there. So we see that sustainable in ways that are not relevant, while at the same time we will continue on the customer experience both in-store, and as we know that matter fresh where we're leaning into even improving that further, as well as that curbside pickup and delivery, we've made great progress improving that customer experience, reducing wait time in areas that are important. And so we see that continuing, and we're committed to that, taking cost out without sacrificing the customer experience.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

It really ties to Mary Ellen and Gary's points both. But if you look at, we really view that taking costs out the right way is something that's an advantage Kroger has now because we've made it a skill that we have. And we've partnered with a couple of outside companies, and Mike and the whole leadership team is something that everybody is leaning in. And we just view that it's something that we have great skills at. And we'll continue to focus to make sure we do it in places where the customer doesn't care about. And one of the things I'm really have been proud of is, if you look at our technology team and how they partner with all aspects of the business, if you look at operations, seamless merchandising, and then Ocado going forward, all of those things are things that will continue to leverage to take costs out. So I'm incredibly excited, as Mary Ellen said, is it's a skill that we have and it's a skill that we'll continue to use going forward.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Our next question is from Karen Short at Barclays. Can you provide color on how you think about e-Com profitability and flow through using the Ocado sheds. And can you parse this out including and excluding any media dollar contribution. Secondly, can you provide an update on the cost per shed maybe on a square footage basis since the sheds have a wide range of square footage. Rodney, do you want to start this?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Yeah. If you look at in terms of – we think it's incredibly important to look at the overall ecosystem. So when you look at Kroger in total it's we just look at all those pieces as just one additional piece of in connecting with the customer. What we find is almost every customer that engages with us from a digital standpoint they still come into the physical store. And when we're able to serve a customer that way, our retention rate is 98% with that customer. So we think it's incredibly important to have the overall – the total seamless experience for that customer.

And when you look at media, it's just one piece of the puzzle. And when you look at the profitability of Ocado shed as Gabriel said in his remarks earlier is that we believe breakeven is in year three, year four is when that shed becomes basically the same as a store. And that's including the startup period of that. So for us it's just part of the overall system together that's really what's important that tied together. And with I don't know Gabriel if you want to add a couple comments and then Yael, Gary if anything else you'd like to add.

Gabriel Arreaga
Senior Vice President-Supply Chain, The Kroger Co.

A

Sure. That's a great question. I think the ecosystem plays a huge part in making the whole logistics network and the pick accuracy and everything that has to do with the efficiency of getting what the customer actually is ordering. The key takeaway here is basically the way that we look at it, one shed is equal to 20 stores worth of sales. Each one of those shed only requires 60% of the capital, and they only require 60% of the labor as well. Most of that labor is actually in delivery trucks. Those delivery trucks create this great customer experience that the customer actually expects on walking into the store. And now we'll actually see at their homes. That together with pick up and everything else makes for a great ecosystem to actually create that profitability. The one thing that I would also add is when you look at year four plus we also expect that profitability coming out of the sheds and overall e-commerce to exceed the profitability that's coming out of a store as well.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Great, thank you. Our next question comes from Brandon Fletcher at Bernstein. Many retailers share that the omni-channel customer is a better customer experience in terms of spend and loyalty. Are they just richer customers? Does the omni-channel focus abandon your lower income customer? Yael, thoughts?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Good question Brandon. We don't look at the digital customer as like better or richer. We look for to create an experience for our customer's that allows them to engage with us in a relevant way that matters to them, so all digital customers across all of our customer segments are critical. And if you look at the growth especially we accelerated in 2020, that has come customer segments are critical. And if you look at the growth especially accelerated in 2020 that has come from all of our customers across all of our customer segments because the reach, the quality of the experience, the availability of that experience, the quality of the assortment, the importance of the personalization to create that convenience that value access for the customer, it matters to everybody in certain different ways depending on the customers. But it's a relevant engagement point.

If you look at the 5.2 million households that we added last year to our digital family, they all engaging with us more frequently, visiting our stores or digital properties 1.5 times more frequently than our store-only customers. They are spending two – more than twice as much across all of the channels. And as Rodney mentioned earlier, they also show a retention rate of 98%. And that comes from all of our customers and because the quality of the experience, the relevance of the experience is meeting their needs.

When you look at our loyalty proposition and how we apply personalization to our loyalty and membership programs that also is a good way of understanding how it comes to life for our customers. Our customers collected over 100 billion fuel points last year and 10 millions of these customers redeem these fuel points on a monthly basis. So for them, for that customer group regardless of their loyalty segments fuel points was an important part of their value proposition. For others, it's the digital offers that are personalized as we mentioned earlier over 0.5 trillion recommendation across our digital ecosystem and billions of offers personalized specifically for every households to deliver value that matters and is relevant to them. So we don't look at the digital customers as better or richer. They're just more engaged, more loyal, more committed to Kroger because they get more of that value whether it's through the convenience, the access to offers, the values or a set of our services.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Thank you, Yael. The next question comes from Paul Lejuez from Citi. And Stuart this one is for you. Can you please talk about how much you're thinking about pricing and how much you will take a proactive approach towards investing in price versus a more wait and see approach?

Stuart W. Aitken
Senior Vice President-Alternative Business, The Kroger Co.

A

Thanks, Rebecca; and thanks, Paul. As we look at pricing heading into 2021 we're in a strong position. We're very happy with where we're at. If you look at the investments we made across price and promotion in 2020 they were strong and it's a key part of our strategy. But for Kroger, it's much broader than just a pricing value proposition. It's a total value proposition and that value proposition yes does come in pricing and promotion, but it also comes with our fuel points which are a key differentiator for Kroger. It also comes with our differentiated customer experience, Mary Ellen spoke about it earlier in-store and Gabrielle just talked about it from a digital perspective as well. And we will differentiate on that customer experience not to mention how we will differentiate our experience around fresh and our brands across that portfolio of a total proposition is how we think about where our investments will be. That said as we look at the environment right now we really do see a rational environment both from a national perspective as well as from a regional perspective. And we don't see that changing this quarter anyway.

Mike, anything you would add to that?

Michael Joseph Donnelly
Chief Operating Officer & Executive Vice President, The Kroger Co.

A

No, well said. I think you're exactly right on all counts. We will follow our strategy as we have in the past. But like you said I don't see the market any different today than it has been for the last three years. So we will press forward and adapt where needed.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thank you. Our next question comes from Scott Mushkin with R5 Capital. It's a two part question, so I'll read the first question is directed toward Rodney and Gary. How does the company think about future M&A opportunities? Kroger historically has been a consolidator.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Scott, first of all thanks for the question. And as you look at M&A obviously over the last few years you've seen us do some mergers to create capabilities. When you think about Home Chef some of the technology pieces that we've done, and we would continue to look at in both buckets. One would be we believe our industry will continue to consolidate. And where are the opportunities to merge with companies that bring capabilities either an area to us or strength to us that we don't have and further spread our footprint too. And it will be important for those companies to be strong companies and viable on their own. And we really look at the best of both. And then what are the companies that bring capabilities that we just don't have. And we would continue to look at both of those and we think those are incredibly important and would have an interest accordingly. And I always tell people if something comes on the market you should assume that we'll take a look at it.

I don't know, Gary, anything you want to add to that.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

I'd agree. Thanks for the question, Scott, completely agree with Rodney. The only maybe additional color that I would add I think it ties a little bit to some of my comments earlier this morning around you know our growth strategy isn't dependent on M&A. We have a really clear plan for how we plan to grow the business 3% to 5% earnings growth and generate strong free cash flow. That being said, we do think we're in a really interesting time both from an industry perspective and from Kroger's position of strength as we look to continue to grow momentum as we come through the pandemic. And we'll continue to evaluate with the free cash flow that we're generating where are the best ways to accelerate our model and how can we take advantage of the opportunities that Yael talked about in digital. And Hewitt talked around in food and Karen alluded to some of the components of alternative profit streams. And so our focus will be on what's one of the best opportunities, the best investment opportunities whether that be through our building capability, our partnering or if M&A as Rodney mentioned and some great examples I think in recent times like Home Chef where it makes sense to accelerate our model using an M&A opportunity then we will evaluate all those options to make sure that they're creating additional growth in the company if it makes sense.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. The second part of the question is for you Mary Ellen. How is the company addressing the checkout process to make it more seamless for the consumer? Many companies are offloading the checkout process to the customer as a means to save labor costs. Others are attempting to make it more convenient easier by having technology, making it seamless. How is Kroger going to make checkout in overall experience better for the customers?

Mary Ellen Adcock
Senior Vice President-Retail Operations, The Kroger Co.

A

Great. Thanks for the question. Our customers want a convenience and options in many areas of the experience and checkout is no exception. And so we have a number of things available in various ranges from test and learn to scale from our self-checkout only store that we opened recently to contact free pay to Kroger pay on the mobile app to a smart cart where the customer can check out at the cart, scan bag and go, and of course pickup and delivery. And so these are examples of how we continue to be change adaptive to meet the needs and the changing needs of our customers. And when you look at that then also combined with the additional enhancements that we're making at curbside pickup and delivery overall in terms of additional technology to improve that checkout experience as well as the wait time and make that more seamless, it just shows how our being changed adaptive and combined make a really compelling offering and experience for our customers. No matter how they choose to shop with us – and I think that's part the key is they want different options across different channels. And we're looking at it all across all the channels.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thank you, Mary Ellen. Our next question comes from Simeon Gutman from Morgan Stanley. Rodney and Gary, this is for you. You've provided a helpful framework to think about the economics of online grocery that it takes three years to four years for the omni-shopper to be as profitable as an in-store shopper. How does Ocado impact this math? Ocado – is Ocado already factored into this or does it speed it up as a result. Similarly, how does Ocado change the incremental margin math mid-single digits for the online versus mid-teens for the in-store purchases.

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Short-term it's factored in the math – and obviously as we're opening up the sheds you have the startup costs associated with that shed. Once we get at – not capacity but reasonable level of consistency then the margins are similar to a store. And as Gabriel said earlier at maturity a facility actually has a higher margin than a store. So if you look at that the overall ecosystem we believe the ecosystem itself will create momentum especially like on alternative profits. And if you think about the retail media channel that is growing aggressively and when you look at tying all the pieces together we see an acceleration even in the retail media channel that will further bring profitability to all the pieces as well. So, for us, our goal and our job always has been job one, don't lose the customer. Job two is to figure out how to deepen our loyalty with that customer. And we've great job with that. And then over time as Mary Ellen mentioned continuing with process changes they cross sell the system when you look at somebody that's doing a store pickup. If you look at somebody that's getting served through an Ocado shed, the incremental profitability that is very efficient and then when you add retail media on top of it all of that becomes an overall ecosystem that is a great experience for the customer creates great loyalty for that customer, but it also creates a great margin for our shareholders as well.

Gary, anything you want to add to that.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

I don't think I would add Rodney – thanks again for the question, Simeon, would be I think we tried to explain this morning that we see our current digital business on a very clear path to grow and improve profitability and Ocado will accelerate that model. But it's not one or the other they actually both are important parts of the strategy. The store continues to be an important part of the model even for the digital customer, the digital experience. And as Rodney shared earlier we have clear plans to double the profitability the pass-through rate when you look at all the cost associated with a digital transaction and then the incremental value we create through the higher sales through the media revenue and any fees that are involved in that transaction.

So irrespective of the continued work and the excitement that we have for the Ocado solutions that will augment our overall approach to digital, we have a really clear path as to how we see continuing to grow and continuing to improve profitability. Really Ocado creates that acceleration of the model as Rodney mentioned and gives us the ability to really achieve the same profitability as a store and potentially higher based on some of the data we've seen recently. So I just think it's important as we tried to convey this morning, you think about it is it's not one or the other. It's actually a strategy that combines the two where we think it creates the real value and the competitive advantage.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Our next question is from Michael Lasser at UBS. I think this one's for you, Yael. If the digital business is expected to double between now and 2023, what is the scene for in-store sales? Similarly, how much of the digital growth is expected to come from existing customers and existing markets versus new customers and existing customers – and new customers and new markets like Florida? So, I think in short it's how much is coming from new versus existing markets?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Good question, Michael. I think at the macro level, when you look at the trends or the sales trends for 2021 and beyond, Stuart kind of shared some of that trajectory and there's some volatility in the number. When you zoom out, I think we see a definite continuation of the Transform 2020. We doubled our sales in 2020 and expect to double our sales through 2023, partly by maintaining and increasing our share of wallet in some markets, increasing our market share as we did in 2020, where we added 50% market share through our e-commerce customers. So, this will continue to take place.

And I think the second part of the question is new markets versus existing markets, and new customers versus existing customers. Last year, we grew both through new customers. As we mentioned before 5.2 million families joined our digital ecosystem in 2020. And we expect and intend to continue to grow that by continuing to build great relevant experiences for our customers. So part of our growth is through new market share and new customer acquisition.

The second part is to continue to build that relevant experience, so that we increase that share of wallet from every customer, who interacts with us digitally. And that is largely mostly reliant on our existing asset, our existing footprint, leveraging our stores, as Mary Ellen mentioned earlier, really driving the quality of experience, leveraging that proximity to the customer, and the capacity that we have in our stores to continue to build and double our sales over the next few years.

The second part on new markets or even going beyond our existing geographies, as we shared, we have started the pilot of reaching communities that are further away from our existing stores and giving them access to that digital experience, that Kroger experience further away without necessarily having a direct access to the store. The continuation is through the Ocado launch in Florida. That is a brand new market. So the way I would look at it is we would say the incrementality of a store or an existing customer, existing market still is in that 50-plus-percent range, whereas when you go to a brand-new market or a new geographic as we are doing in Florida, obviously, that is 100% incrementality, and will continue to be a tailwind in years to come. But if you look at the next two or three years of doubling our existing e-commerce business, that continues to come largely from our existing footprint and a mix of existing and new customers.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Thank you, Yael. Rodney, we're getting a lot of incoming questions on Kroger's leadership role in the vaccine process. Can you speak a little bit about our position in that process and if that's leading to any sort of additional sales or traffic inside our stores?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Okay. Thanks, Rebekah. And thanks for the question. And, Tim, I'll let you add to my comments as well. As everybody knows, health and wellness is an incredibly critical part of the overall Kroger service. And one of the things we find is when a customer is a health and wellness customer with us, they're more loyal to us. And if you look at one of the – this most trusted profession is the pharmacy profession itself. And that is incredibly important in terms of creating that loyalty with the shopper and creating services for the shopper.

The other thing relative to vaccines, by having the ability to do vaccines, it also allows us to make sure that our associates are vaccinated as well. And we're approaching right at 100,000 of our associates now have been vaccinated, and about 2 million customers have received vaccines. So, when you look at all of that, it's just part of the overall thing in terms of getting that customer connected with us and connected even in a deeper way. And I know I had a chance to be at a couple of the big events. And the customers are incredibly appreciative of one, they didn't have to wait in line very long; and two, the service they got, and obviously, the number one thing I heard is, I'll soon get to be able to hug my grandkids or my grandparents were the two comments I heard most often.

When you look at the people that are coming in for vaccines with us, about a third of those people have not been engaged with us historically. And obviously, we're creating a positive relationship with that customer and we will expect to be able to continue that positive relationship and continue deepening over time with that customer by making things – making them aware of what Kroger offers on a relevant basis.

So, with that, Tim, I'll let you fill in and talk a little bit about what we're – how we're incentivizing our associates and other things as well.

Timothy A. Massa
Chief People Officer & SVP-Human Resources, The Kroger Co.

A

Thanks, Rodney. Thank you very much, Rodney. As Rodney said, yesterday was quite a milestone. We did just go over the 2 million vaccines for customers, and over 100,000 vaccines for our associates. We did announce an incentive of $100 for every associate, once they complete the vaccine process, whether that's a one dose or a two dose method, and that's been very well received across our enterprise. We believe this offering, along with continued education to our associates on the benefits of taking the vaccine and driving health and safety for our associates as well as our customers, has been very well received. And we'll continue to do that.

And as Rodney indicated, a big shout-out to our Kroger Health team along with technology and partnering together in providing a scheduler for both customers and associates to have a seamless experience and setting up their schedule. We're just so proud of our men and women that work in Kroger Health to make this vaccine available, and also in our partnership with the Health and Human Services' Federal Pharmacy partnership. We're now in 34 states where associates are eligible to take the vaccine. And we're continuing to work with local, state and government officials to make the vaccine available to as many associates as fast as possible. We truly believe that the shot in the arm, the vaccine in the arm is the best next step to getting back to our new normal.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Our next question comes from Goldman Sachs, Kate McShane. This one's for you, Cara. Can you talk about why you expect media spend from CPG companies to be incremental versus just a shift from in-store? And what differentiates Kroger for providing these services versus other large peers?

Cara Pratt
Senior Vice President-Kroger Precision Marketing & 84.51°, The Kroger Co.

A

Thanks for the question, Kate. I think, it's really important to take a step back and recognize that there's two distinctly different, yet incredibly important, forces that are influencing the sustainability and strength of retail media now and importantly for the future. The first is consumer-driven, and that's really anchored in e-commerce acceleration. Media mix investment follows consumer behavior, and e-commerce is in the early stages, particularly grocery and particularly in the United States, it's in the early stages of an upward trajectory. Brands want to get closer to influence purchase. Brand marketers are looking to do that, recognizing that, more than ever, consumers are making decisions in a digitally constrained shelf.

In our environment, we see that 85% of our top 500 keyword searches are unbranded search terms. That means our consumers are coming to us, and they are searching for cereal, instead of searching for Cheerios or Frosted Flakes. It's an incredibly powerful performance opportunity for brands to inspire through food inspiration, and that works. Brands are recognizing that one out of every two searches on advertise placements are added to basket and they're new customers to their portfolio. So, consumer driven force is one major factor.

The second factor is market driven. There is an incredible change happening in the media ad tech landscape, and frankly the entire media supply chain. As appropriately privacy regulations are continuing to evolve, brand marketers are looking at brand safety now more than ever, and purpose-driven advertising placements. There is going to be a fracturing of this media supply chain, as it relates to third-party data, and the role of third-party data in influencing both targeting on audiences as well as ad attribution on the back end. Those are two powerful components in the market space.

The Interactive Advertising Bureau, IAB, which is an incredibly important organization that sets brand standards and safety standards in digital media, they've identified that in 2020 alone $12.3 billion was spent on third-party audiences. The value associated to those third-party audiences is going to diminish particularly as cookies are redacted, mobile identifiers are redacted. Advertisers need to use different, more accessible, more performant ways to connect with customers in a meaningful way and drive advertising value.

The media ecosystem is continuing to grow. The numbers that you saw earlier this morning with 30% year-over-year growth for retail media relative to 16% overall, that's going to continue to grow over time. The eMarketer is suggesting that from fiscal 2021 to 2024, there's going to be a 26% growth in total media, but 42% in digital and a subset in digital is retail media, e-commerce and that's going to drive 70% growth. So, it's an incredible opportunity now more than ever, critically important to leverage Kroger as the number one digital grocery destination as measured by Comscore to allow brands to tap in dry food inspiration and ultimately bring a more performant media supply chain to the future. Hopefully, that helps, Kate. Thank you so much for the question.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Our next question comes from John Heinbockel with Guggenheim. It's a two part question. Yael, Gary, this is directed your way. With respect to the digital opportunity, one, where does the incremental improvement in store productivity come from versus the 15%? And two, how do you believe the incremental $10 billion in annual digital sales will break down between click and collect, delivery from stores, and delivery from CFCs?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Yeah. Happy to start. Gary, you can jump in. I think on the productivity, as Mary Ellen touched on earlier, investment in our associates, wages and training; investment in evolving and optimizing the business processes, the picking process, for example, in our stores; and also investment in technology capabilities that are enabling our associates to be more productive, more effective that has a cost impact that is quite significant, and as mentioned with an improvement of 14% in 2020 and projected improvement of 30% over the next few years. That's not the only side of the improvement in productivity and, therefore, impact on profit. It's also the quality of the experience is driving larger order size and larger baskets. And that is also contributing to making our infrastructure, our capabilities more efficient.

The second point is on leveraging our existing assets to drive the growth. When the pandemic hit in March-April last year, and we saw a massive shift of customer behavior, our store teams, our associates were able to triple the capacity from our stores in a matter of days. That is a testament to the quality of the process, the talent that is behind our service that we're offering for our customers and the expected doubling of that capacity without compromising – in fact, improving the quality of the customer experience further leverages the investments we've made in our associates and technology, and will drive the productivity you're asking about, John.

The second part about the split between what is fulfilled from stores and fulfilled from a centralized facility and Ocado sheds, that is a little bit harder one to explain or answer. The shed, as Gabriel mentioned earlier, has a ramp-up time. You opened a facility and you slowly ramp or quickly ramp the utilization of that capacity. So in isolation, if you just look at one facility over the next couple of years, that may not look as meaningful, but when you look at it in aggregate for our overall business, that is a massive tailwind. And we'll continue to drive not only increased growth reach of our customers and have a significant impact long-term on our overall digital profitability. But, Gary, I don't know if you wanted to.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Yeah. I think you said it well, Yael. The only maybe one additional point I would make is that, John's second question is, I do think that click and collect or pickup at store and delivery of both going to be critical to our plan. We see customers continue to gravitate to both of those modalities for different reasons. And from a loyalty perspective, some of the data that Yael has talked about, as we think about, our customers engagers in our ecosystem when they're using either or both of those channels, it creates a much more expanded relationship with the customer. And so for us, it's about making sure whether for the customers through both those channels and then making sure we're optimizing the backend to deliver the best experience at the most efficient cost.

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

And maybe good point, Gary, to add. We would not single out delivery as a modality or as an offering fulfilled from one facility or another. We optimize the fulfillment of pickup and delivery across the entire network, whether it's leveraging a store or leveraging a centralized facility. And in fact, from a customer perspective, it will be completely transpired and visible. It's really about leveraging the assets we have, leveraging the capabilities we have to deliver the best experience and the highest unit economic.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

The next question comes from Oppenheimer, Rupesh Parikh. This is guidance related. So we'll start with you, Gary. Two questions on the 2% to 4% ID sales growth, how do you think of ticket and traffic also presumably food at home could see bigger headwinds next year and beyond as consumer behavior starts to normalize? How have you contemplated this within the ID sales guidance?

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Thanks, Rebekah, and thanks, Rupesh, for the question. I'm going to maybe let Stuart kick this off, and talk a little bit about the sales plan and trajectory. And then, I can maybe come back in around the longer term guidance. So, Stuart?

Stuart W. Aitken
Senior Vice President-Alternative Business, The Kroger Co.

A

Perfect. Thank you, Gary. Thank you, Rupesh. As we've looked at sales for this year, we've incorporated an incredible amount of data, both internal data, and I'll get into a little bit of that in a moment. But also external data, CDC data, et cetera. And the fortunate thing Kroger has is to be in multiple markets around the country. And because of that, we can see what happens to customer behavior as markets open up and close down.

And we've used the food away from home data as well to see the impact that that's had. What encourages us enormously is something Rodney frequently talks about and the fact that customers have learned to love to cook. And when you think about that from a generational perspective, the pandemic has driven many, many more people to learn to cook and love to cook. And so as we see markets open up that food away from home number stays strong. What also stays strong is this premiumization and looking for natural organic healthy foods, all of which Kroger provides in abundance, with brands that only customers can buy at Kroger. So, as we've looked at sales and markets opening up, we feel very, very comfortable with the guidance we've provided thus far. Gary?

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Yeah. Thanks, Stuart. The only thing I would like to add, I think Stuart covered it all around how we think about the short term and the data that Stuart and the team are using. I think there's a part of the question [ph] repatriates (02:45:04) around the sort of longer-term model as well here. So, I think just to kind of share as much clarity as we can from what we're intending to convey when we share the guidance that we are and as we think about beyond 2021. And I think there are three things that we believe we see very clearly. One is that we believe COVID has been and will be a tailwind because of some of the consumer changes that Rodney alluded to earlier in the day, we believe COVID will be a tailwind to the food at home market and we believe that we're exceptionally well positioned to be a leader in maximizing that opportunity and that change with the consumer because of all the investments that we've made and because of the competitive moats that we've created.

We also believe that because of that we wanted to be clear in our guidance that we expect that as of the end of 2021, we're holding ourselves accountable as a team and we believe we have a plan to deliver on that we're creating a new base line in our model to demonstrate that, where our operating profit will be $200 million higher than what the midpoint would have been prior to the pandemic when we launched the TSR commitment back in November 2019. So, we're really clear in our mind that there's a there's a consumer change that we're well positioned to take advantage of that and to continue to grow and we see tremendous opportunity to continue to grow the business in the future. Hopefully, you heard many of those examples this morning whether it's around some of the trends in food away from home the digital commitments that Yael talked about earlier today and then the alternative profit streams that continue to build momentum.

So when we shared all that we wanted to make it clear how we think about the future growth. What we're not trying to do at this point is to give specific guidance around 2022. We're holding ourselves to an expectation that we'll grow from 2021 but we're not trying to convey what the numbers should look like specifically in 2022. We think it's too early to be trying to provide that kind of guidance and there's, obviously, a lot more a lot more to unfold in the way that the pandemic world will hopefully start to draw to an end as we as we go through 2021.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

The next question comes from Joe Feldman with TAG. I know a couple of us are involved with hometowns. So maybe we'll start with you Mary Ellen on this one. Can you provide any more details about how hometown pickup works?

Mary Ellen Adcock
Senior Vice President-Retail Operations, The Kroger Co.

A

Great. Yes. Thank you. So certainly the pandemic has brought a greater need for customers in terms of how they have different ways to use our seamless options. As we've talked about a curbside pickup, delivery, Ocado come in, a home town is another way to enhance that overall strategy. So in terms of how it works to the customer on the front side it's very similar. They'd go and do a pickup order just like they would at their location. It allows us to have locations in other areas and more of a pop-up, if you will, on flexible locations. So it gives us more flexibility in terms of where we have that to expand our reach and flexibility to the customer. And as you saw from the video, we're getting really strong customer feedback because it's giving more options of what customers want of our great products, fresh products more offering in places that you might not have access to before.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

And Yael, if you want to add anything to that?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

That's a good point. It's really one of the growth lever that will contribute to accelerating our digital growth over the next few years, leveraging our network, our assets, the capabilities we have and bringing that Kroger assortment, relevant assortment through a digital experience with the value that our customers like and appreciate to communities more broadly, again leveraging our network. So it's a very promising and exciting program.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

The next question comes from Kelly Bania with BMO Capital Markets. Rodney, Gary. This is on Ocado. Where is Kroger with respect to the original commitment for 20 sheds? There is a mention of opening six more sheds. What is the commitment today and also what is the pricing strategy for the Ocado offering. How will it compare to what you offer today via Instacart and through your own pickup services?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Thanks, Kelly, for the question and I'll start with it. And then let Gary and Gabriel finished with some of the details. Overall, if you look at Ocado in total, we're incredibly excited. And if you look at – Ocado continues to improve and you will recall when we announced Ocado originally, one of the things that we were excited about Ocado is they continue to develop, continue to get better and continue to improve their offering and their NPS scores. And they've done all of those things. They've continued to make a couple of acquisitions to even accelerate their technology and capabilities.

So when you look at Ocado overall, we feel great about their offering and what they're doing. And we continue to work with Ocado on incrementally making commitments in terms of incremental sheds and getting those open. And we worked together in terms of reducing the costs and accelerating the speed in which to get them open, but incredibly excited about the partnership overall and where it's headed. With that, Gary, I'll let you and Gabriel get some more of the details.

Gary Millerchip
Chief Financial Officer & Senior Vice President, The Kroger Co.

A

Sure. Thanks, Rodney. The only thing I would maybe add before I'll hand it over to Gabriel is I think we've talked about this and Gabriel to do it in his prepared remarks earlier as well that I completely agree with Rodney about what the excitement we have and so thrilled now to have a facility that we can actually [indiscernible] (02:50:32) and start to continue to learn and grow and innovate together on and as you heard earlier in the day and Kelly called out. We've announced multiple facilities.

In addition to that, of course, you heard Yael talk about the growth opportunity for digital. And so, we think there's still tremendous opportunity for growth and to drive profitable growth by partnering with Ocado on continuing to expand the opportunity for the network. I think part of that we worked through together is what are the right size and types of facilities because as you've also heard it's a complex network and making sure that we're building the right size and the right shape of network to be able to support that exciting growth that we are committing to in the future is something that we continue to work through together to make sure that we're building the outer platform for success.

Gabriel, do you want to talk about that a bit more specifically about plans?

Gabriel Arreaga
Senior Vice President-Supply Chain, The Kroger Co.

A

Thank you, Gary. And, and that's a great question, Kelly. Let me answer in two parts. The first part, I want to address the fact that when we actually think about Ocado, and a lot of people think that we are starting here in the US. There's a long history about in Canada, in France, in the UK along how, how Ocado has been successful. So, when you think about what is the difference between those retailers and those regions and geographies on what's our advantage here in the US, is that we already have an existing e-commerce business. And everything that we do with Ocado is additive in nature.

The one thing that is – drives our decisions to continue to actually commit to more sheds and put more shovels in the ground is always, is the market behavior and what we've learned advantageous enough to actually go into more and more markets. As of today, we have committed and we actually have 11 sheds that are in the process of being built are actually ready to go live like in the case of Florida and in the case of the one in Monroe, Ohio. And that would actually give us – and remember these are 20 stories worth of sales. So, it is a quite impactful top line driver when you think about letting go and live between this year and 2022. So, we'll learn a lot this year.

Well, we have we have been able to actually bring costs down. We have been able to bring economics down from what we learned in other regions. But it is truly when you drop it into the Kroger ecosystem that things start to actually shape much better than what we've seen in different regions. Now, the one takeaway the customer experience as we've seen in other regions is one of the key drivers to actually make those sales absolutely relevant. So if we can be relevant in the market after those 11 sheds and we continue to bring costs down and reduce the ramp up curve, you'll see more and more of our releases saying that which markets we're going to go next. But as of now it's 11 sheds and then we'll continue to grow as the market grows as well.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Okay. Thank you. Our last question is from Patricia Baker with Scotiabank. The 98% retention rate you referenced for your digital customers is impressive. How does that compare to retention rates from customers that are not engaging with you digitally or historically store-based customer retention rates? Yael?

Yael Cosset
Chief Information Officer & Senior Vice President, The Kroger Co.

A

Yeah. Good question, Patricia. I would say we're – the 98% of the omni-channel customer is meaningfully – debt retention rate is meaningfully larger than the store omni customer. But I think the important part is how we continue to expose our customers who may only be shopping with us or engaging with us in-store. How do we expose them to that digital experience even if they prefer to transact in our stores. We are not forcing them to go down the e-commerce path. So more investments we're making in stores and Mary Ellen mentioned some of them around the checkout experience is to bring that digital experience even to the store customers. And that's how we're seeing improvement even in our store on the customer retention rate. So not quite as high as the 98% of our omni-channel customers but definitely improving and we expect at some point that they will come close to parity.

Rebekah Manis
Director-Investor Relations, The Kroger Co.

A

Thank you, Yael, for that. Rodney?

W. Rodney McMullen
Chairman & Chief Executive Officer, The Kroger Co.

A

Thanks, Rebecca. And thanks to everyone. Really appreciate you joining us today. And you can hear from everybody's presentations how together we're confident and comfortable, we'll continue to generate a TSR of 8% to 11%. As you look forward in terms of how we're going to do that, there's really three points that we want you to remember and walk away with. We are winning market share leading with fresh. And the number one reason that people decide where to shop is based on fresh and we continue to widen our gap versus our competition which is incredibly important and incredibly exciting.

You heard throughout every presentation the continued opportunity to grow in digital the thing that's even more important, if you look at digital originally as I said earlier, it was just make sure we kept our customer. With all the things in the overall ecosystem we have a clear path to profitability and a clear path to where the profitability of that digital shopper is the same as in store, which is, obviously, incredibly exciting. When you look at the strategic moats that we have, we continue to gain ground on all of those strategic moats in terms of full fresh and friendly. And Stuart talked about it – but one of the things that customers have learned because of COVID is learning how to cook.

They are also learning that it's fun to cook and it's fun to cook as a family. Those are tailwinds that will support us going forward. And as we continue to improve on the digital seamless experience and we continue to improve with our moats in terms of a full in-stock position, incredibly fresh product and friendliness as you can't get anywhere else. That's the glue that brings it all together.

So, incredibly excited about the future and hopefully as you met all the team, you can see our excitement in terms of the team working together and the team creating something that hasn't been done for the customer in the past and that we will in the future. So – and we're really looking forward to being able to start meeting in person again as we get through COVID. Together, we are incredibly excited, together we're going to continue to win in this market and take care of our customers and our associates. And with that, thanks again for joining us today.