HILLIARD LYONS

Consumer Staples
Analyst: Jeffrey S. Thomison, CFA
502.588.9137 / JThomison@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141 / GMoorin@hilliard.com
J.J.B. Hilliard, W.L. Lyons, LLC
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COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

Key Metrics

KR - NYSE (as of 11/30/17)		$25.86
Two Year Price Target		$31.00
52-Week Range		$19.69 - $36.44
Shares Outstanding (mil.) (basic)		887
Market Cap. ($ mil.)		$22,938
3-Mo. Average Daily Volume		16,180,000
Institutional Ownership		80%
Total Debt/Total Capital (11/17)		71%
ROE (TTM ended 11/17)		28%
Book Value/Share (11/17)		$7.00
Price/Book Value		3.7x
Annual Dividend & Yield	$0.50	1.9%
EBITDA Margin (TTM ended 11/17)		4.8%

EPS FY 1/31 (excludes nonrecurring items)

	2016	Prior 2017E	Curr. 2017E ~		Prior 2018E	Curr. 2018E
1Q	$0.71		$0.58	A		$0.60
2Q	$0.47		$0.39	A		$0.40
3Q	$0.41		$0.44	A		$0.45
4Q	$0.53	$0.60	$0.61			$0.55
Year	$2.12	$1.96	$2.02		$1.99	$2.00
P/E	12.2x		12.8x			12.9x

Note: The fiscal year ends on the Saturday closest to January 31 of the following year.
Note: Quarterly EPS figures may not add to annual figure due to rounding.
~Represents a 53-week fiscal year.

Revenue ($ mil)

	2016	Prior 2017E	Curr. 2017E ~		Prior 2018E	Curr. 2018E
1Q	$34,604		$36,285	A		$37,500
2Q	$26,565		$27,597	A		$28,850
3Q	$26,557		$27,749	A		$28,450
4Q	$27,611	$30,518	$30,619			$29,450
Year	$115,337	$121,700	$122,250		$123,300	$124,250

Company Description: *The Kroger Co. is the nation's largest traditional grocery retailer. The company recently operated 2,790 retail food stores and multi-department stores in 35 states and the District of Columbia under roughly two dozen names. The company also recently operated 2,266 pharmacies, 783 convenience stores, 306 fine jewelry stores, 219 retail health clinics, 1,480 supermarket fuel centers, and 38 food processing plants in the U.S. The company has roughly 450,000 employees and is headquartered in Cincinnati, OH.*

The Kroger Co.

KR — NYSE — Long-term Buy-3

3Q Results Suggest Company is Faring Okay in Competitive Environment; Raising Price Target

Investment Highlights

- **We were impressed by 3Q results, particularly given the challenging competitive environment that has existed for much of the year.** Total sales for the period ended 11/4/17 rose 4.5% to $27.749 billion, nearly $300 million above the street consensus view. Core gross margin excluding fuel and other items rose 30 basis points, whereas we were anticipating a slight decline. Total operating expenses rose a bit faster than sales, as expected. Diluted EPS of $0.44 exceeded the year ago figure of $0.41, our estimate of $0.39, and the street consensus figure of $0.40.
- **There were several positives to the quarter, in our view.** We liked the identical store sales gain, increased market share, higher store traffic, pockets of food price inflation, a doubling of digital/online sales, higher fuel margin, higher overall gross margin, and a notable benefit to EPS from share repurchases.
- **Management reiterated its current year EPS guidance of $2.00-$2.05.** This excludes nonrecurring items and reflects an approximate $0.09 benefit from a 53rd week (extra week in 4Q this year). Our annual EPS estimate is raised by $0.06 to $2.02, while our sales estimate is increased by $550 million. For fiscal 2018, we have slightly raised our sales and EPS estimates to reflect our latest views on the business.
- **We maintain our Long-term Buy rating and are raising our two-year price target by $4 to $31 per share.** We believe fundamentals are strong while performance in the current competitive environment is above our expectation. We look for earnings growth to accelerate in 2019 as current growth initiatives become more profitable and cost savings are achieved. We consider KR best suited for risk-tolerant, longer term investors. Given industry dynamics, we suggest an investment time horizon of two years.

Note Important Disclosures on Pages 9-10.
Note Analyst Certification on Page 9.

Exhibit 1
Consolidated Statements of Operations (figures in millions except percentages and per share data)

	3Q Ended			YTD Ended		
	11/4/17	11/5/16	% chg.	11/4/17	11/5/16	% chg.
Total Sales	$27,749	$26,557	4.5%	$91,631	$87,726	4.5%
Merchandise Costs *	21,532	20,653	4.3%	71,422	68,019	5.0%
LIFO Gross Profit	6,217	5,904	5.3%	20,209	19,707	2.5%
Oper., Gen., & Admin. Exp.	4,708	4,443	6.0%	15,606	14,695	6.2%
Rent	196	199	(1.5%)	691	666	3.8%
Deprec. & Amort.	573	549	4.4%	1,871	1,768	5.8%
Operating Expenses	5,477	5,191	5.5%	18,168	17,129	6.1%
Operating Profit	740	713	3.8%	2,041	2,578	(20.8%)
Interest Expense	136	124	9.7%	453	396	14.4%
Earnings Before Taxes	604	589	2.5%	1,588	2,182	(27.2%)
Taxes	215	206	4.4%	552	727	(24.1%)
Net Earnings	389	383	1.6%	1,036	1,455	(28.8%)
Net Earnings Attributable to Noncontrolling Interests	(8)	(8)		(17)	(14)	
Net Earnings Attrib. to Kroger	$397	$391	1.5%	$1,053	$1,469	(28.3%)
Adjustments to Net Earnings:						
Voluntary Retirement Offering	0	0		117	0	
Pension Plan Agreements	0	0		126	71	
Non-GAAP Net Earnings	$397	$391	1.5%	$1,296	$1,540	(15.8%)
Adj. Diluted EPS	**$0.44**	**$0.41**	9.5%	**$1.41**	**$1.59**	(11.3%)
Avg. Diluted Shares Outst.	893	963	(7.3%)	910	962	(5.4%)
As a % of Total Sales:			bp. chg.			bp. chg.
Merchandise Costs	77.60%	77.77%	(17)	77.95%	77.54%	41
Gross Profit (LIFO basis)	22.40%	22.23%	17	22.05%	22.46%	(41)
Gross Profit (FIFO basis)	22.42%	22.20%	21	22.10%	22.49%	(38)
Oper., Gen., & Admin. Exp.	16.97%	16.73%	24	17.03%	16.75%	28
Rent	0.71%	0.75%	(4)	0.75%	0.76%	(1)
Deprec. & Amort.	2.06%	2.07%	(0)	2.04%	2.02%	3
Operating Profit	2.67%	2.68%	(2)	2.23%	2.94%	(71)
Non-GAAP Net Earnings	1.43%	1.47%	(4)	1.41%	1.76%	(34)
Tax Rate	35.60%	34.97%	62	34.76%	33.32%	144

* Merchandise Costs include advertising, warehousing and transportation expenses as well as LIFO (last in, last out) charges.
* FIFO gross margin excludes LIFO charges (which occur more often in times of rising product cost inflation) and credits.
* FIFO gross margin is a common analytical measure for management and the investment community.

Source: Company reports Note: Fiscal year ends on Saturday closest to January 31 of the following year

Comments on fiscal 3Q. We were impressed with Kroger's fiscal 3Q performance, from store-level metrics to income statement highlights. The industry environment remained challenging, as consumers have more options available to them and benefit from price wars among operators. Among the quarter's highlights:

- Total reported sales in 3Q rose 4.5%. Sales excluding fuel increased 3.0% (fuel sales benefited from higher average fuel prices). The September 2016 acquisition of ModernHEALTH (specialty pharmacy services) contributed to overall growth.
- Identical food store sales rose 1.1%, an improvement from an increase of 0.7% in 2Q 2017 and declines of 0.2% in 1Q 2017 and 0.7% in 4Q 2016. Including those two recent quarterly declines, Kroger's identical food store sales have increased in 54 of the past 56 quarters.

- Overall tonnage was positive for the quarter, while the number of total households served and overall market share were also up.
- Produce and meat were among the strongest grocery categories.
- The private label, natural, and organic segments continued to perform well. Kroger's wholly owned brands (typically attractive margin products) represented about 28% of total units sold in 3Q and 26% of the period's sales dollars. This includes the popular *Simple Truth* brand.
- Digital initiatives continued to grow. This includes Kroger's *ClickList* and Harris Teeter's *Express Lane* (online ordering systems featuring curb-side pick-up by customers). The company is approaching 1,000 locations with this service. During 3Q, the company's total digital revenues more than doubled from the year ago level.
- Fuel margins rose due to a higher average retail price per gallon.
- Reported gross margin improved 17 basis points from the prior year period, better than the 39 basis point drop in 2Q 2017. Excluding fuel operations, recent mergers, and a LIFO charge, FIFO gross margin improved about 30 basis points from a year ago.
- Operating expenses, excluding fuel, mergers, and pension contributions, increased 18 basis points as a percent of total sales.
- Diluted earnings per share of $0.44 were up from a year ago when EPS came in at $0.41 (in a calmer environment). This exceeded the street consensus estimate as well as our estimate.
- Share repurchases in recent quarters ($1.7 billion over the past twelve months) led to a significant 7.3% drop in the 3Q weighted average share count, which helped EPS. The company announced a $1 billion repurchase plan in June 2017.

Financial. Total debt at 3Q end was $14.847 billion. This represents senior notes, debentures, capital leases and other financing obligations. This was about $1 billion more than the year ago period due to the recent recognition and funding of various pension liabilities. Total debt as a percentage of total capital (debt plus shareholders' equity) was 71%. Total cash and equivalents were $334 million while shareholders' equity was $6.211 billion. Kroger has historically maintained a leveraged balance sheet that is comfortably supported by cash flow, in our view.

At the end of 3Q, net debt-to-trailing adjusted EBITDA (earnings before interest, taxes, depreciation & amortization) was 2.6x compared to 2.4x in the previous quarter. The increase reflects the aforementioned debt associated with the recognized pension liabilities. The company expects to use a portion of proceeds from the potential sale of assets (possible the convenience store segment) as well as future cash flow to reduce debt and achieve its targeted ratio of 2.2x-2.4x.

Cash flow remains at a considerable level, in our view, allowing for several practical uses. Over the past twelve months, the company has contributed an incremental $1.1 billion to company sponsored pension plans, and spent $1.7 billion on stock buybacks, $446 million in dividends, $2.9 billion on capital projects, and $390 million to acquire ModernHEALTH (September 2016).

Comments on recent investor conference. Kroger conducted a well-attended investor/analyst conference on October 11, 2017, at the New York Stock Exchange. The event included presentations from CEO Rodney McMullen, CFO Mike Scholtman, and various other members of the management team. Broad takeaways included the realization that competitive forces are not likely to ease anytime soon, but recognition of Kroger's strengths that should help it succeed in the periods ahead. These strengths range from physical assets such as a very broad store base to intangible assets such as its skilled management team and industry leading data research capabilities. Among the specific highlights:

- The focus of the conference was the adoption of a new strategic theme, "Restock Kroger" which encompasses the pursuit of market share, improving customer experiences, capital spending plans, cost savings, and free cash flow. The theme is also a not-so-subtle reference to the stock and the desire for higher share price levels.

- Management believes the company can benefit from the changing industry landscape (new services, offerings, and technologies), adaptive actions, and a strategic plan that casts a wider net.
- The company's current profile is compelling: 450,000 associates serving over 9 million customers a day from over 60 million households (half of all U.S. households). Most customers live within 1-2 miles of a company store.
- Management believes the company's potential market is the entire food industry, estimated at $1.5 trillion in annual sales. This includes retail grocery ($800 billion) as well as restaurants/foodservice ($700 billion).
- The company recently opened its first full-service restaurant. Dubbed *Kitchen 1883* (a reference to Kroger's origins), the restaurant features "a fresh take on American comfort food." It is located near, but not inside, an existing Kroger supermarket in northern Kentucky. Other restaurant concepts are likely to be tested at later dates, in our view.
- Management is committed to re-defining the shopping experience, and is budgeting roughly $3 billion in capital expenditures each year. This includes store expansion, re-models, and adoption of customer-friendly technologies and services aimed at greater customer satisfaction.
- The online shopping experience continues to be refined and expanded. *ClickList*, the company's online ordering system, remains a priority and is being rolled out across the company's various divisions. This primarily includes curbside pick-up, but home delivery options are becoming more prevalent.
- In-store shopping will remain a focal point, and technologies are consistently improving the overall customer experience. This will include more efficient front-end store design and easier check-out procedures, with long-term plans for customers to "pick, pack, and go" with use of self-scanning devices (eventually smartphones) while shopping, and no check-out lines.
- Growth areas for the company include produce (rising market share growth), natural and organic (double-digit growth), fresh prepared (including complete meal kits), and *ClickList*.
- Competitive advantages include an approximate 2,800 retail store base covering most of the U.S., a strong private label business featuring numerous brands (such as *Kroger*, *Simple Truth*, *Private Selection*, *Psst* and others), 38 food processing plants, and a massive loyalty/reward card program.
- Management feels a lesser known competitive advantage is the company's *84.51* data research entity (largest collector of food purchase data in the U.S., and wholly owned by Kroger) that analyzes customer behaviors, influences, and motivations. This results in over 3 billion personalized product/shopping recommendations to customers each year.
- Recent hurricanes and the related impact on area stores are reflected in the latest financial guidance. In the situation of a hurricane, there is typically a surge in business followed by a period of low store traffic. The net effect is often a mild positive.
- One surprise announcement was the exploration of strategic alternatives for the company's convenience store division (recently 783 stores under numerous banners such as *Turkey Hill*, *Tom Thumb*, *KwikShop*, and others). According to management, valuations are relatively high in the convenience store industry at this time (greater than KR's valuation), so it feels compelled to explore all options, which could include sale of the business. This consideration does not include the company's fuel centers that are often adjacent to its grocery stores. Revenues (food and fuel) for KR's convenience stores were $4.0 billion last year.
- Operating margins are expected to rise in future years (we estimate beginning in fiscal 2019). This is due largely to operating expense reductions and cost containment efforts, and possibly some gross margin improvement.
- Operating cash flow is expected to approximate $15 billion over the next three years, greater than the $14 billion generated in the past three years.
- Capital investments over the next three years are expected at $9 billion, or roughly $3 billion per year. This will support numerous digital initiatives, new store development and remodels, and various growth projects.

- Free cash flow for the 2015-2017 time frame is projected at roughly $2.1 billion; this is expected to more than double for the 2018-2020 period. This could allow for continued share repurchases and annual dividend increases, in addition to allowing the company to improve its capital structure or consider strategic acquisitions.

Competitive environment. The industry landscape changed earlier this year with Amazon's acquisition of Whole Foods Market, with a wide range of possible strategies and consumer offerings emanating from the combination. Also, some traditional grocery operators have announced expansion plans, while others have become more aggressive on price. Consumer preferences are also changing as it relates to what they eat and how they shop, with trends related to convenience and immediacy.

We have been impressed by Kroger's history of strong market share positions for its various banners. We believe a combination of physical store and online retailing will become the norm for the grocery industry. Importantly, we feel Kroger is dominant with the former and is moving aggressively and effectively with the latter. The company's geographic reach, quality of its store base, digital initiatives, and long history as an industry leader could help as it re-defines itself in this dynamic environment.

Management continues to run the business with the long term in mind, and defending its strong market share position remains a priority. Competition has indeed picked up considerably, yet CEO Rodney McMullen often states Kroger "will not lose on price." Recent strategic moves such as increasing labor hours in stores and increasing wages in certain markets will add to operating expenses, but should improve the quality of the work force and enhance the shopping experience, in our view.

Earnings outlook. Earlier this year, management announced it will no longer provide long-term financial guidance. In the recent past, this outlook included an investment grade debt rating (most debt currently rated BBB by S&P), improving return on invested capital, annual EPS growth of 8%-11% over rolling three to five year time horizons, and annual dividend growth. We do not believe these goals have been terminated, but will likely be kept internal for now. However, the former EPS growth goal would be difficult to achieve in the next few years given the competitive environment, in our view.

Management will continue to provide financial guidance for the current year, and reaffirmed its guidance with the recent earning release. For fiscal 2017, EPS excluding nonrecurring items (primarily pension-related charges) are still projected at $2.00-$2.05. This includes an approximate $0.09 benefit from a 53rd week in the current fiscal year, which ends on the Saturday nearest January 31 of each year (February 3, 2018 for this fiscal year). This compares to EPS of $2.12 in fiscal 2016 (a 52-week period).

We have fine-tuned our fiscal 2017 model with modest changes to various line items. We project net sales to rise 6.0% to $122.2 billion, up $550 million from our previous estimate. This increase reflects 3Q results and our latest views on 4Q. Our EPS estimate is $2.02, or $0.06 above our previous figure and in line with management's guided range of $2.00-$2.05. We believe share buybacks will continue in the final quarter of the fiscal year.

For fiscal 2018, we note a reversion to a 52-week year from the 53-week year in fiscal 2017. We have made minor revisions to our fiscal 2018 estimates, which now include net sales growth of 1.6% to $124.2 billion, an increase of $950 million from our previous estimate. We assume continued gross margin pressure due to competitive factors and some operating margin pressure due to ramping up growth initiatives such as the digital/online business. We expect share repurchases to continue. Our EPS estimate is increased by a penny to $2.00.

Valuation. KR shares are trading at just under 13x our estimate of forward earnings. Roughly one year ago, when the industry environment was more favorable, KR traded at 15x estimated forward earnings. Over the past five years, the shares have traded in a range of roughly 10x to 22x projected forward earnings with a median forward multiple of 15.0x. On a longer term basis, the stock's median forward multiple over the past twenty years is 13.7x.

KR's forward P/E multiple is currently 0.6x the S&P 500's forward multiple, below premium levels from late 2014 through early 2016, and below the median figure of 0.8x over the past five years.

On an Enterprise Value/EBITDA basis, KR shares are trading at about 6.5x based on our projection of twelve-month forward EBITDA. We believe a five year historical range for this measure is 5-9 times.

Opinion. Being mindful of the industry conditions at hand—such as competition and changes in consumer habits and preferences—we believe Kroger is performing relatively well and have no problems with the company's strategies or execution. We consider the company to be digging in its heels in a competitive sense, while devoting considerable resources to meet customers' wants and needs in a dynamic period for the grocery industry.

We have favorable views on the company's pursuit of growth opportunities through the digital/online area, home delivery options, store renovations, and acquisitions. We expect shareholder friendly uses of discretionary cash flow such as dividends, share buybacks, and potentially acquisitions to continue in the years ahead.

We expect compounded annual EPS growth to be moderate in the next few years due to the impact of greater competition and higher costs of meeting customers' shopping needs. This includes remaining competitive on price and expanding the online shopping service, which represents a drag on earnings in the early stages due to start-up expenses. We expect EPS growth to accelerate in fiscal 2019. Free cash flow (after capital expenditures) over the next few years could be substantial, in our view. This could allow for significant amounts for uses such as dividends, share repurchases, debt reduction, or acquisitions.

We recommend purchase of KR and reiterate our preference for a two-year investment time frame rather than one year. We believe this longer time frame should allow the company to navigate the challenges at hand, and maintain strengths such as industry leadership, integration of technology, and a focus on shareholder value. Considering all factors, including the trend of stiffer competition, we believe KR shares deserve to trade below recent median valuation levels but we feel the current level is too bearish.

Our two-year target is $31 per share, up $4 from our previous figure. Our previous target reflected recent earnings declines and much uncertainty regarding the competitive environment, and therefore a more conservative valuation assumption. Our new target reflects a generally healthier environment and outlook, but still assumes stock valuations below recent historical averages. We have tried to reflect the current competitive landscape, a higher operating cost structure to defend market share positions, and some additional risks associated with new business initiatives. Offsetting positives include apparent momentum in operations, growing market share, and potential fine-tuning of the company's portfolio of businesses.

Our target is based on our projection of forward earnings per share two years and a 13.6x multiple. This is below the five-year median forward multiple and similar to the twenty year median, as noted above. Additionally, our target represents an Enterprise Value/EBITDA multiple of 6.8x based on our projection of forward EBITDA two years from now, above the current valuation but below the mid-point of the five-year historical range.

Suitability. Our Suitability rating on KR is 3. This reflects the competitive environment (current and projected, especially in light of the Amazon/Whole Foods combination) and uncertainty regarding the potential duration of such an environment. We also consider Kroger's degree of unionized labor and its debt level in determining our suitability rating. Favorable factors include the company's large sales base, diversity among geographic regions and store concepts/banners, strong market share positions, favorable historical operating results, and large market capitalization.

Risks and Considerations. The competitive environment is a key risk factor, in our view. The industry has always been quite competitive, but recent developments include new entrants to the industry and new ways of connecting with customers. This includes online sales, with either in-store pick-up or home delivery. We believe Amazon's recent purchase of Whole Foods Market is a testament to the heightened competitive landscape yet also the attractiveness of the industry.

We believe another risk factor with Kroger is its labor profile. A majority of the company's approximate 450,000 employees are covered by collective bargaining agreements negotiated with local unions affiliated with one of several international unions. There are approximately 300 such agreements currently in place, typically with terms of three to five years. Thus, the company has numerous labor agreements that come up for negotiation each year. Common key issues are health care and pension costs. Potential work stoppages could have an adverse effect on operating results.

Other factors that could affect operations include the success of future growth plans, capital spending decisions, completion and integration of acquired businesses, strategic investments, food prices (including periods of sustained deflation and inflation), overall commodity prices, promotional industry environments, industry consolidation, fuel prices, consumer spending, unemployment levels, adverse weather conditions, and the state of financial markets (access to capital).

Exhibit 2
Consolidated Statements of Operations (figures in millions except percentages and per share data)

	FY18E	% chg.	FY17E ~	% chg.	FY16	% chg.	FY15	% chg.
Total Sales	$124,250	1.6%	$122,250	6.0%	$115,337	5.0%	$109,830	1.3%
Merchandise Costs *	97,025	1.9%	95,230	6.4%	89,502	4.7%	85,496	(0.0%)
LIFO Gross Profit	27,225	0.8%	27,020	4.6%	25,835	6.2%	24,334	6.0%
Oper., Gen., & Admin. Exp.	20,550	1.2%	20,305	5.9%	19,178	6.9%	17,946	4.6%
Rent	930	1.1%	920	4.4%	881	21.9%	723	2.3%
Deprec. & Amort.	2,510	1.6%	2,470	5.6%	2,340	12.0%	2,089	7.2%
Operating Expenses	23,990	1.2%	23,695	5.8%	22,399	7.9%	20,758	4.8%
Operating Profit	3,235	(2.7%)	3,325	(3.2%)	3,436	(3.9%)	3,576	14.0%
Interest Expense	575	(0.9%)	580	11.1%	522	8.3%	482	(1.2%)
Earnings Before Taxes	2,660	(3.1%)	2,745	(5.8%)	2,914	(5.8%)	3,094	16.8%
Taxes	918	(3.1%)	947	(1.0%)	957	(8.4%)	1,045	15.9%
Net Earnings	1,742	(3.1%)	1,798	(8.1%)	1,957	(4.5%)	2,049	17.3%
Net Earnings Attributable to Noncontrolling Interests	(17)		(20)		(18)		10	
Net Earnings Attrib. to KR	$1,759	(3.2%)	$1,818	(8.0%)	$1,975	(3.1%)	$2,039	18.0%
Adjusted EPS, Excluding Nonrecurring Items	**$2.00**	(1.0%)	**$2.02**	(4.7%)	**$2.12**	2.9%	**$2.06**	17.0%
Avg. Diluted Shares Outst.	880	(2.2%)	900	(6.1%)	958	(2.2%)	980	(1.3%)
As a % of Total Sales:		**bp. chg.**		**bp. chg.**		**bp. chg.**		**bp. chg.**
Merchandise Costs	78.09%	19	77.90%	30	77.60%	(24)	77.84%	(99)
Gross Profit (LIFO basis)	21.91%	(19)	22.10%	(30)	22.40%	24	22.16%	99
Gross Profit (FIFO basis) **	21.95%	(20)	22.15%	(26)	22.42%	23	22.18%	88
Oper., Gen., & Admin. Exp.	16.54%	(7)	16.61%	(2)	16.63%	29	16.34%	52
Rent	0.75%	(0)	0.75%	(1)	0.76%	11	0.66%	1
Deprec. & Amort.	2.02%	(0)	2.02%	(1)	2.03%	13	1.90%	11
Operating Expenses	19.31%	(7)	19.38%	(4)	19.42%	52	18.90%	63
Operating Profit	2.60%	(12)	2.72%	(26)	2.98%	(28)	3.26%	36
Net Earnings Attrib. to KR	1.42%	(7)	1.49%	(23)	1.71%	(14)	1.86%	26
Tax Rate	34.50%	0	34.50%	166	32.84%	(93)	33.78%	(28)

~ 53-week fiscal year

* Merchandise Costs include advertising, warehousing and transportation expenses as well as LIFO (last in, first out) charges.

** FIFO (first-in, first-out) gross margin excludes LIFO charges (occur more often in times of rising product cost inflation) and credits.

** FIFO gross margin is a common analytical measure for management and the investment community.

Source: Company reports and Hilliard Lyons estimates Note: Fiscal year ends on Saturday closest to January 31 of the following year

Additional information is available upon request.

Prices of other stocks mentioned: Amazon.com Inc. - AMZN - $1176.75

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

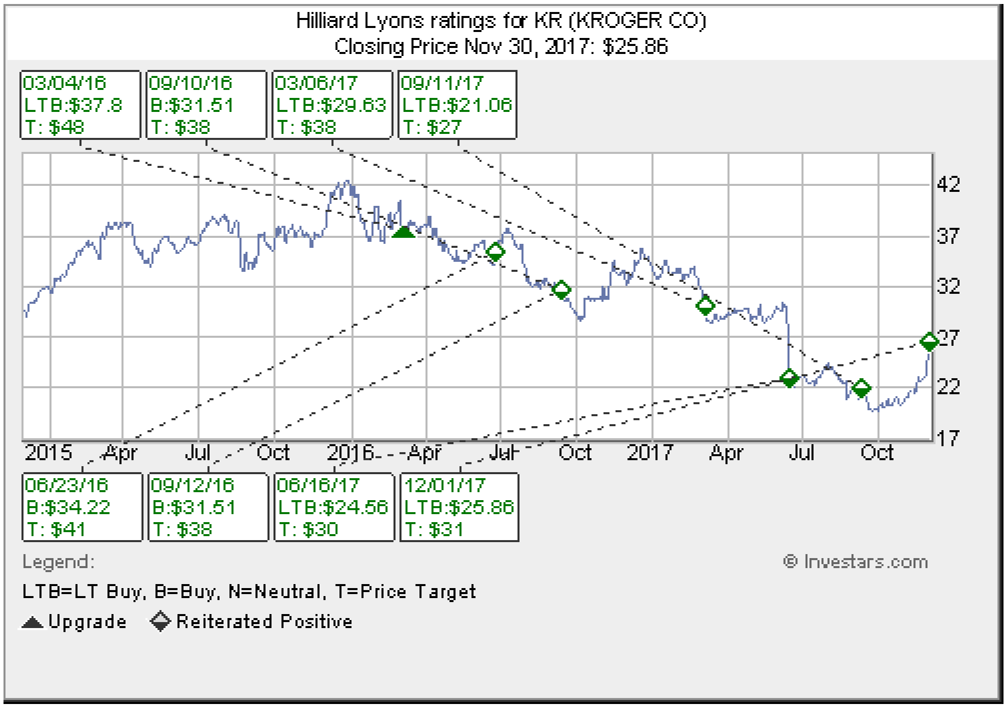
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

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