

KELLOGG CO  
Form 10-Q  
November 05, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**  
**QUARTERLY REPORT UNDER SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the quarterly period ended October 2, 2010

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-4171

**KELLOGG COMPANY**

State of Incorporation Delaware

IRS Employer Identification No.38-0710690

One Kellogg Square, P.O. Box 3599, Battle Creek, MI 49016-3599

Registrant's telephone number: 269-961-2000

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

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Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

Yes ☐ No ☒

Common Stock outstanding as of October 30, 2010 368,213,884 shares

**Table of Contents**

**KELLOGG COMPANY**

**INDEX**

|                                                                                                                           |             |
|---------------------------------------------------------------------------------------------------------------------------|-------------|
| <b><u>PART I Financial Information</u></b>                                                                                | <b>Page</b> |
| <b><u>Item 1:</u></b><br>Financial Statements                                                                             |             |
| <u>Consolidated Balance Sheet</u> <u>October 2, 2010 and January 2, 2010</u>                                              | 2           |
| <u>Consolidated Statement of Income</u> <u>quarter and year-to-date periods ended October 2, 2010 and October 3, 2009</u> | 3           |
| <u>Consolidated Statement of Equity</u> <u>year ended January 2, 2010 and year-to-date period ended October 2, 2010</u>   | 4           |
| <u>Consolidated Statement of Cash Flows</u> <u>year-to-date periods ended October 2, 2010 and October 3, 2009</u>         | 5           |
| <u>Notes to Consolidated Financial Statements</u>                                                                         | 6-23        |
| <b><u>Item 2:</u></b><br>Management's Discussion and Analysis of Financial Condition and Results of Operations            | 24-32       |
| <b><u>Item 3:</u></b><br>Quantitative and Qualitative Disclosures about Market Risk                                       | 33          |
| <b><u>Item 4:</u></b><br>Controls and Procedures                                                                          | 33          |
| <b><u>PART II Other Information</u></b>                                                                                   |             |
| <b><u>Item 1A:</u></b><br>Risk Factors                                                                                    | 34          |
| <b><u>Item 2:</u></b><br>Unregistered Sales of Equity Securities and Use of Proceeds                                      | 34          |
| <b><u>Item 6:</u></b><br>Exhibits                                                                                         | 34          |
| <b><u>Signatures</u></b>                                                                                                  | 35          |
| <b><u>Exhibit Index</u></b>                                                                                               | 36          |
| Rule 13a-14(e)/15d-14(a) Certification from A. D. David Mackay                                                            |             |
| Rule 13a-14(e)/15d-14(a) Certification from Ronald L. Dissinger                                                           |             |
| Section 1350 Certification from A. D. David Mackay                                                                        |             |
| Section 1350 Certification from Ronald L. Dissinger                                                                       |             |

**Table of Contents****Part I FINANCIAL INFORMATION****Item 1. Financial Statements.****Kellogg Company and Subsidiaries****CONSOLIDATED BALANCE SHEET**

(millions, except per share data)

|                                                                     | October 2,<br>2010<br>(unaudited) | January 2,<br>2010<br>* |
|---------------------------------------------------------------------|-----------------------------------|-------------------------|
| <b>Current assets</b>                                               |                                   |                         |
| Cash and cash equivalents                                           | \$ 559                            | \$ 334                  |
| Accounts receivable, net                                            | 1,211                             | 1,093                   |
| Inventories:                                                        |                                   |                         |
| Raw materials and supplies                                          | 232                               | 214                     |
| Finished goods and materials in process                             | 720                               | 696                     |
| Deferred income taxes                                               | 148                               | 128                     |
| Other prepaid assets                                                | 135                               | 93                      |
| <b>Total current assets</b>                                         | <b>3,005</b>                      | <b>2,558</b>            |
| Property, net of accumulated depreciation of \$4,666 and \$4,520    | 3,015                             | 3,010                   |
| Goodwill                                                            | 3,644                             | 3,643                   |
| Other intangibles, net of accumulated amortization of \$46 and \$45 | 1,457                             | 1,458                   |
| Pension                                                             | 208                               | 160                     |
| Other assets                                                        | 395                               | 371                     |
| <b>Total assets</b>                                                 | <b>\$ 11,724</b>                  | <b>\$ 11,200</b>        |
| <b>Current liabilities</b>                                          |                                   |                         |
| Current maturities of long-term debt                                | \$ 948                            | \$ 1                    |
| Notes payable                                                       | 594                               | 44                      |
| Accounts payable                                                    | 1,145                             | 1,077                   |
| Accrued advertising and promotion                                   | 454                               | 409                     |
| Accrued income taxes                                                | 133                               | 33                      |
| Accrued salaries and wages                                          | 161                               | 322                     |
| Other current liabilities                                           | 344                               | 402                     |
| <b>Total current liabilities</b>                                    | <b>3,779</b>                      | <b>2,288</b>            |
| Long-term debt                                                      | 3,929                             | 4,835                   |
| Deferred income taxes                                               | 431                               | 425                     |
| Pension liability                                                   | 441                               | 430                     |
| Other liabilities                                                   | 926                               | 947                     |

**Commitments and contingencies**

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|                                               |                  |           |
|-----------------------------------------------|------------------|-----------|
| <b>Equity</b>                                 |                  |           |
| Common stock, \$.25 par value                 | <b>105</b>       | 105       |
| Capital in excess of par value                | <b>485</b>       | 472       |
| Retained earnings                             | <b>6,087</b>     | 5,481     |
| Treasury stock, at cost                       | <b>(2,528)</b>   | (1,820)   |
| Accumulated other comprehensive income (loss) | <b>(1,931)</b>   | (1,966)   |
| <b>Total Kellogg Company equity</b>           | <b>2,218</b>     | 2,272     |
| <b>Noncontrolling interests</b>               |                  | 3         |
| <b>Total equity</b>                           | <b>2,218</b>     | 2,275     |
| <b>Total liabilities and equity</b>           | <b>\$ 11,724</b> | \$ 11,200 |

\* Condensed from audited financial statements.

Refer to Notes to Consolidated Financial Statements.

**Table of Contents****Kellogg Company and Subsidiaries****CONSOLIDATED STATEMENT OF INCOME**

(millions, except per share data)

|                                                                   | Quarter ended      |                    | Year-to-date period ended |                    |
|-------------------------------------------------------------------|--------------------|--------------------|---------------------------|--------------------|
|                                                                   | October 2,<br>2010 | October 3,<br>2009 | October 2,<br>2010        | October 3,<br>2009 |
| (Results are unaudited)                                           |                    |                    |                           |                    |
| <b>Net sales</b>                                                  | <b>\$ 3,157</b>    | <b>\$ 3,277</b>    | <b>\$ 9,537</b>           | <b>\$ 9,675</b>    |
| <b>Cost of goods sold</b>                                         | <b>1,788</b>       | <b>1,837</b>       | <b>5,438</b>              | <b>5,529</b>       |
| <b>Selling, general and administrative expense</b>                | <b>828</b>         | <b>873</b>         | <b>2,438</b>              | <b>2,497</b>       |
| <b>Operating profit</b>                                           | <b>541</b>         | <b>567</b>         | <b>1,661</b>              | <b>1,649</b>       |
| <b>Interest expense</b>                                           | <b>62</b>          | <b>65</b>          | <b>188</b>                | <b>199</b>         |
| <b>Other income (expense), net</b>                                | <b>1</b>           | <b>(10)</b>        | <b>9</b>                  | <b>(1)</b>         |
| <b>Income before income taxes</b>                                 | <b>480</b>         | <b>492</b>         | <b>1,482</b>              | <b>1,449</b>       |
| <b>Income taxes</b>                                               | <b>143</b>         | <b>132</b>         | <b>427</b>                | <b>416</b>         |
| <b>Earnings (loss) from joint ventures</b>                        |                    |                    |                           | <b>(1)</b>         |
| <b>Net income</b>                                                 | <b>\$ 337</b>      | <b>\$ 360</b>      | <b>\$ 1,055</b>           | <b>\$ 1,032</b>    |
| <b>Net income (loss) attributable to noncontrolling interests</b> | <b>(1)</b>         | <b>(1)</b>         | <b>(3)</b>                | <b>(4)</b>         |
| <b>Net income attributable to Kellogg Company</b>                 | <b>\$ 338</b>      | <b>\$ 361</b>      | <b>\$ 1,058</b>           | <b>\$ 1,036</b>    |
| <b>Per share amounts:</b>                                         |                    |                    |                           |                    |
| <b>Basic</b>                                                      | <b>\$ 0.91</b>     | <b>\$ 0.94</b>     | <b>\$ 2.80</b>            | <b>\$ 2.71</b>     |
| <b>Diluted</b>                                                    | <b>\$ 0.90</b>     | <b>\$ 0.94</b>     | <b>\$ 2.78</b>            | <b>\$ 2.70</b>     |
| <b>Dividends per share</b>                                        | <b>\$ 0.4050</b>   | <b>\$ 0.3750</b>   | <b>\$ 1.1550</b>          | <b>\$ 1.0550</b>   |
| <b>Average shares outstanding:</b>                                |                    |                    |                           |                    |
| <b>Basic</b>                                                      | <b>373</b>         | <b>382</b>         | <b>378</b>                | <b>382</b>         |
| <b>Diluted</b>                                                    | <b>376</b>         | <b>384</b>         | <b>381</b>                | <b>383</b>         |
| <b>Actual shares outstanding at period end</b>                    |                    |                    | <b>368</b>                | <b>379</b>         |

Refer to Notes to Consolidated Financial Statements.

**Table of Contents****Kellogg Company and Subsidiaries****CONSOLIDATED STATEMENT OF EQUITY**

(millions)

| (unaudited)                       | Common stock |              | Capital in excess of | Retained       | Treasury stock |                  | Accumulated other           | Total Kellogg   | Non-                  | Total           | Total                       |
|-----------------------------------|--------------|--------------|----------------------|----------------|----------------|------------------|-----------------------------|-----------------|-----------------------|-----------------|-----------------------------|
|                                   | shares       | amount       | par value            | earnings       | shares         | amount           | comprehensive income (loss) | Company equity  | controlling interests | equity          | comprehensive income (loss) |
| Balance, January 3, 2009          | 419          | \$105        | \$438                | \$4,836        | 37             | (\$1,790)        | (\$2,141)                   | \$ 1,448        | \$ 7                  | \$ 1,455        |                             |
| Common stock repurchases          |              |              |                      |                | 4              | (187)            |                             | (187)           |                       | (187)           |                             |
| Net income (loss)                 |              |              |                      | 1,212          |                |                  |                             | 1,212           | (4)                   | 1,208           | \$1,208                     |
| Dividends                         |              |              |                      | (546)          |                |                  |                             | (546)           |                       | (546)           |                             |
| Other comprehensive income        |              |              |                      |                |                |                  | 175                         | 175             |                       | 175             | 175                         |
| Stock compensation                |              |              | 37                   |                |                |                  |                             | 37              |                       | 37              |                             |
| Stock options exercised and other |              |              | (3)                  | (21)           | (3)            | 157              |                             | 133             |                       | 133             |                             |
| Balance, January 2, 2010          | 419          | \$105        | \$472                | \$5,481        | 38             | (\$1,820)        | (\$1,966)                   | \$ 2,272        | \$ 3                  | \$ 2,275        | \$1,383                     |
| Common stock repurchases          |              |              |                      |                | 18             | (907)            |                             | (907)           |                       | (907)           |                             |
| Net income (loss)                 |              |              |                      | 1,058          |                |                  |                             | 1,058           | (3)                   | 1,055           | 1,055                       |
| Dividends                         |              |              |                      | (435)          |                |                  |                             | (435)           |                       | (435)           |                             |
| Other comprehensive income (loss) |              |              |                      |                |                |                  | 35                          | 35              |                       | 35              | 35                          |
| Stock compensation                |              |              | 16                   |                |                |                  |                             | 16              |                       | 16              |                             |
| Stock options exercised and other |              |              | (3)                  | (17)           | (5)            | 199              |                             | 179             |                       | 179             |                             |
| <b>Balance, October 2, 2010</b>   | <b>419</b>   | <b>\$105</b> | <b>\$485</b>         | <b>\$6,087</b> | <b>51</b>      | <b>(\$2,528)</b> | <b>(\$1,931)</b>            | <b>\$ 2,218</b> | <b>\$</b>             | <b>\$ 2,218</b> | <b>\$1,090</b>              |

Refer to Notes to Consolidated Financial Statements.

**Table of Contents****Kellogg Company and Subsidiaries****CONSOLIDATED STATEMENT OF CASH FLOWS**

(millions)

| (unaudited)                                                     |  | Year-to-date period ended |                    |
|-----------------------------------------------------------------|--|---------------------------|--------------------|
|                                                                 |  | October 2,<br>2010        | October 3,<br>2009 |
| <b>Operating activities</b>                                     |  |                           |                    |
| Net income                                                      |  | \$ 1,055                  | \$ 1,032           |
| Adjustments to reconcile net income to operating cash flows:    |  |                           |                    |
| Depreciation and amortization                                   |  | 265                       | 282                |
| Deferred income taxes                                           |  | (53)                      | (9)                |
| Other                                                           |  | 116                       | (18)               |
| Postretirement benefit plan contributions                       |  | (45)                      | (93)               |
| Changes in operating assets and liabilities:                    |  |                           |                    |
| Trade receivables                                               |  | (125)                     | (240)              |
| Inventories                                                     |  | (43)                      | 35                 |
| Accounts payable                                                |  | 68                        | (54)               |
| Accrued income taxes                                            |  | 63                        | 84                 |
| Accrued interest expense                                        |  | (18)                      | (33)               |
| Accrued and prepaid advertising, promotion and trade allowances |  | 33                        | 151                |
| Accrued salaries and wages                                      |  | (161)                     | 9                  |
| All other current assets and liabilities                        |  | (76)                      | 84                 |
| <b>Net cash provided by operating activities</b>                |  | <b>1,079</b>              | <b>1,230</b>       |
| <b>Investing activities</b>                                     |  |                           |                    |
| Additions to properties                                         |  | (252)                     | (252)              |
| Other                                                           |  | 2                         | 1                  |
| <b>Net cash used in investing activities</b>                    |  | <b>(250)</b>              | <b>(251)</b>       |
| <b>Financing activities</b>                                     |  |                           |                    |
| Net issuances (reductions) of notes payable                     |  | 547                       | (915)              |
| Issuances of long-term debt                                     |  |                           | 745                |
| Reductions of long-term debt                                    |  | (1)                       |                    |
| Net issuances of common stock                                   |  | 178                       | 34                 |
| Common stock repurchases                                        |  | (907)                     | (187)              |
| Cash dividends                                                  |  | (435)                     | (403)              |
| Other                                                           |  | 7                         | 2                  |
| <b>Net cash used in financing activities</b>                    |  | <b>(611)</b>              | <b>(724)</b>       |
| Effect of exchange rate changes on cash and cash equivalents    |  | 7                         | 17                 |
| Increase in cash and cash equivalents                           |  | 225                       | 272                |
| Cash and cash equivalents at beginning of period                |  | 334                       | 255                |
| <b>Cash and cash equivalents at end of period</b>               |  | <b>\$ 559</b>             | <b>\$ 527</b>      |



Refer to Notes to Consolidated Financial Statements.

**Table of Contents****Notes to Consolidated Financial Statements****for the quarter ended October 2, 2010 (unaudited)****Note 1 Accounting policies*****Basis of presentation***

The unaudited interim financial information of Kellogg Company (the Company) included in this report reflects normal recurring adjustments that management believes are necessary for a fair statement of the results of operations, financial position, equity and cash flows for the periods presented. This interim information should be read in conjunction with the financial statements and accompanying notes contained on pages 27 to 56 of the Company's 2009 Annual Report on Form 10-K.

The condensed balance sheet data at January 2, 2010 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. The results of operations for the quarterly period ended October 2, 2010 are not necessarily indicative of the results to be expected for other interim periods or the full year.

***New accounting standard***

In December 2009, the FASB amended the Accounting Standards Codification related to the consolidation provisions that apply to variable interest entities. This guidance is effective for fiscal years that begin after November 15, 2009 and was adopted by the Company on a prospective basis as of January 3, 2010 without material impact to its consolidated financial statements.

**Note 2 Goodwill and other intangible assets**

Changes in the carrying amount of goodwill for the year-to-date period ended October 2, 2010 are presented in the following table. Certain of the Company's goodwill balances are subject to foreign currency translation adjustments. Fluctuations in exchange rates contributed to the change in goodwill balance for the period.

***Carrying amount of goodwill***

| (millions)                      | North America  | Europe      | Latin America | Asia Pacific (a) | Consolidated   |
|---------------------------------|----------------|-------------|---------------|------------------|----------------|
| January 2, 2010                 | \$3,539        | \$62        | \$            | \$42             | \$3,643        |
| Currency translation adjustment |                | (1)         |               | 2                | 1              |
| <b>October 2, 2010</b>          | <b>\$3,539</b> | <b>\$61</b> | <b>\$</b>     | <b>\$44</b>      | <b>\$3,644</b> |

(a) Includes Australia, Asia and South Africa.

***Intangible assets subject to amortization***

| (millions)   | Gross carrying amount |                 | Accumulated amortization |                 |
|--------------|-----------------------|-----------------|--------------------------|-----------------|
|              | October 2, 2010       | January 2, 2010 | October 2, 2010          | January 2, 2010 |
| Trademarks   | \$19                  | \$19            | \$16                     | \$15            |
| Other        | 41                    | 41              | 30                       | 30              |
| <b>Total</b> | <b>\$60</b>           | <b>\$60</b>     | <b>\$46</b>              | <b>\$45</b>     |

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For intangible assets in the preceding table, amortization was less than \$1 million for each of the current and prior year comparable quarters. The currently estimated aggregate annual amortization expense for full-year 2010 and each of the four succeeding fiscal years is approximately \$2 million.

### *Intangible assets not subject to amortization*

| (millions) | Total carrying amount |                    |
|------------|-----------------------|--------------------|
|            | October 2,<br>2010    | January 2,<br>2010 |
| Trademarks | \$1,443               | \$1,443            |

**Table of Contents****Note 3 Exit or disposal activities**

The Company views its continued spending on cost-reduction activities as part of its ongoing operating principles to provide greater visibility in achieving its long-term profit growth targets. Initiatives undertaken are currently expected to recover cash implementation costs within a five-year period of completion. Upon completion (or as each major stage is completed in the case of multi-year programs), the project begins to deliver cash savings and/or reduced depreciation.

**2010 activities**

During the third quarter of 2010, the Company incurred exit costs related to two ongoing programs which will result in cost of goods sold (COGS) and selling, general and administrative (SGA) expense savings. The COGS program relates to Kellogg's lean, efficient, and agile network (K LEAN). The SGA programs focus on the efficiency and effectiveness of various support functions.

Total charges incurred during the quarter and year-to-date periods ended October 2, 2010 were as follows:

| (millions)              | Quarter ended, October 2, 2010 |                 |       | Year-to-date period ended, October 2, 2010 |                 |       |
|-------------------------|--------------------------------|-----------------|-------|--------------------------------------------|-----------------|-------|
|                         | COGS<br>program                | SGA<br>programs | Total | COGS<br>program                            | SGA<br>programs | Total |
| Employee severance      | \$                             | \$1             | \$1   | \$2                                        | \$2             | \$4   |
| Other cash costs (a)    |                                | 1               | 1     |                                            | 6               | 6     |
| Retirement benefits (b) |                                | 5               | 5     | 1                                          | 5               | 6     |
| Total                   | \$                             | \$7             | \$7   | \$3                                        | \$13            | \$16  |

(a) Includes cash costs for equipment removal and relocation.

(b) Pension plan curtailment losses and special termination benefits.

Total program costs incurred through October 2, 2010 were as follows:

|                         | Total program costs through<br>October 2, 2010 |                 |       |
|-------------------------|------------------------------------------------|-----------------|-------|
|                         | COGS<br>program                                | SGA<br>programs | Total |
| Employee severance      | \$17                                           | \$19            | \$36  |
| Other cash costs (a)    | 6                                              | 14              | 20    |
| Retirement benefits (b) | 4                                              | 5               | 9     |
| Total                   | \$27                                           | \$38            | \$65  |

(a) Includes cash costs for equipment removal and relocation.

(b) Pension plan curtailment losses and special termination benefits.

In 2009, the Company commenced K LEAN. Refer to page 35 of the Company's 2009 Annual Report on Form 10-K for further information on this initiative. Based on forecasted foreign exchange rates, the Company currently expects to incur \$35 million in total exit costs; \$27 million has been incurred to date which represents employee severance and other cash costs associated with the elimination of hourly and salaried positions at various global manufacturing facilities. Costs for this program impacted the following operating segments for the quarter and year-to-date periods ended October 2, 2010 and October 3, 2009 as follows:

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| (millions)       | COGS program                     |                 |                                              |                 |
|------------------|----------------------------------|-----------------|----------------------------------------------|-----------------|
|                  | Quarter ended<br>October 2, 2010 | October 3, 2009 | Year-to-date period ended<br>October 2, 2010 | October 3, 2009 |
| North America    | \$                               | \$2             | \$1                                          | \$12            |
| Europe           |                                  | 4               | 2                                            | 5               |
| Asia Pacific (a) |                                  | 1               |                                              | 1               |
| Total            | \$                               | \$7             | \$3                                          | \$18            |

(a) Includes Australia, Asia and South Africa.

**Table of Contents**

In 2009, the Company commenced various SGA programs which will result in an improvement in the efficiency and effectiveness of various support functions. Refer to page 35 of the Company's 2009 Annual Report on Form 10-K for further information on this initiative. Based on forecasted foreign exchange rates, the Company currently expects to incur \$40 million in total exit costs; \$38 million has been incurred to date which represents severance and other cash costs associated with the elimination of salaried positions. These programs are expected to be substantially complete by the end of 2010. Costs for these programs impacted the following operating segments for the quarter and year-to-date periods ended October 2, 2010 and October 3, 2009 as follows:

| (millions)       | SGA programs                        |                    |                                                 |                    |
|------------------|-------------------------------------|--------------------|-------------------------------------------------|--------------------|
|                  | Quarter ended<br>October 2,<br>2010 | October 3,<br>2009 | Year-to-date period ended<br>October 2,<br>2010 | October 3,<br>2009 |
| North America    | \$6                                 | \$                 | \$10                                            | \$5                |
| Europe           | 1                                   | 5                  | 1                                               | 5                  |
| Asia Pacific (a) |                                     |                    | 2                                               |                    |
| Total            | \$7                                 | \$5                | \$13                                            | \$10               |

(a) Includes Australia, Asia and South Africa.

Reserves for the COGS and SGA programs are primarily for employee severance and will be paid out by the end of 2010. The detail is as follows:

| (millions)                 | Balance<br>January 2, 2010 | Accruals | Payments | Balance<br>October 2, 2010 |
|----------------------------|----------------------------|----------|----------|----------------------------|
|                            |                            |          |          |                            |
| COGS program               | \$6                        | \$2      | \$(5)    | \$3                        |
| SGA programs               | 12                         | 2        | (12)     | 2                          |
| Manufacturing optimization | 7                          |          | (6)      | 1                          |
| Total                      | \$25                       | \$4      | \$(23)   | \$6                        |

**Other prior year activities**

The Company also incurred \$6 million of exit costs for the quarter ended October 3, 2009 for two programs: the European manufacturing optimization plan in Bremen Germany; and the supply chain rationalization in Latin America. These costs were recorded in COGS within the Europe and Latin America operating segments.

The programs were completed as of the end of 2009. Refer to page 36 of the Company's 2009 Annual Report on Form 10-K for further information on these initiatives.

The following tables present the total exit costs for these programs for the quarter and year-to-date periods ended October 3, 2009.

| (millions)                   | Quarter ended, October 3, 2009 |                         |                     |                            |
|------------------------------|--------------------------------|-------------------------|---------------------|----------------------------|
|                              | Employee<br>severance          | Other cash<br>costs (a) | Asset<br>write-offs | Retirement<br>benefits (b) |
| Manufacturing optimization   | \$1                            | \$                      | \$                  | \$                         |
| Supply chain rationalization | 2                              |                         | 3                   |                            |
| Total                        | \$3                            | \$                      | \$3                 | \$                         |

- (a) Includes cash costs for equipment removal and relocation.
- (b) Pension plan curtailment losses and special termination benefits.

**Table of Contents**

| (millions)                   | Year-to-date period ended, October 3, 2009 |                      |                  |                         | Total |
|------------------------------|--------------------------------------------|----------------------|------------------|-------------------------|-------|
|                              | Employee severance                         | Other cash costs (a) | Asset write-offs | Retirement benefits (b) |       |
| Manufacturing optimization   | \$7                                        | \$                   | \$               | \$                      | \$ 7  |
| Supply chain rationalization | 2                                          |                      | 3                |                         | 5     |
| Total                        | \$9                                        | \$                   | \$3              | \$                      | \$12  |

(a) Includes cash costs for equipment removal and relocation.

(b) Pension plan curtailment losses and special termination benefits.

**Note 4 Equity****Earnings per share**

Basic earnings per share is determined by dividing net income attributable to Kellogg Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is similarly determined, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued. Dilutive potential common shares consist principally of employee stock options issued by the Company, and to a lesser extent, certain contingently issuable performance shares. Basic earnings per share is reconciled to diluted earnings per share in the following table. The total number of anti-dilutive potential common shares excluded from the reconciliation were 9 million and 4 million for the quarter and year-to-date periods ended October 2, 2010, respectively, and 12 million and 20 million for the quarter and year-to-date periods ended October 3, 2009, respectively.

Quarters ended October 2, 2010 and October 3, 2009:

| (millions, except per share data) | Net income attributable to Kellogg Company | Average shares outstanding | Earnings per share |
|-----------------------------------|--------------------------------------------|----------------------------|--------------------|
| <b>2010</b>                       |                                            |                            |                    |
| Basic                             | \$338                                      | 373                        | \$ 0.91            |
| Dilutive potential common shares  |                                            | 3                          | (0.01)             |
| Diluted                           | \$338                                      | 376                        | \$ 0.90            |
| <b>2009</b>                       |                                            |                            |                    |
| Basic                             | \$361                                      | 382                        | \$0.94             |
| Dilutive potential common shares  |                                            | 2                          |                    |
| Diluted                           | \$361                                      | 384                        | \$ 0.94            |

Year-to-date periods ended October 2, 2010 and October 3, 2009:

| (millions, except per share data) | Net income attributable to Kellogg Company | Average shares outstanding | Earnings per share |
|-----------------------------------|--------------------------------------------|----------------------------|--------------------|
| <b>2010</b>                       |                                            |                            |                    |
| Basic                             | \$1,058                                    | 378                        | \$ 2.80            |
| Dilutive potential common shares  |                                            | 3                          | (0.02)             |
| Diluted                           | \$1,058                                    | 381                        | \$ 2.78            |
| <b>2009</b>                       |                                            |                            |                    |
| Basic                             | \$1,036                                    | 382                        | \$ 2.71            |
| Dilutive potential common shares  |                                            | 1                          | (0.01)             |
| Diluted                           | \$1,036                                    | 383                        | \$ 2.70            |



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During the year-to-date period ended October 2, 2010, the Company issued 0.2 million shares to employees and directors under various benefit plans and stock purchase programs, as further discussed in Note 5.

On April 23, 2010, the Company's board of directors authorized a \$2.5 billion three-year share repurchase program for 2010 through 2012. This authorization replaced the previous share buyback program which authorized stock repurchases of up to \$1,113 million for 2010. During the year-to-date period ended October 2, 2010, the Company repurchased 18

**Table of Contents**

million shares of common stock for a total of \$907 million. During the year-to-date period ended October 3, 2009, the Company spent \$187 million to purchase approximately 4 million shares.

***Comprehensive income***

Comprehensive income includes net income and all other changes in equity during a period except those resulting from investments by or distributions to shareholders. Other comprehensive income for all periods presented consists of foreign currency translation adjustments, fair value adjustments associated with cash flow hedges and adjustments for net experience losses and prior service cost related to employee benefit plans.

Pre-tax adjustments to the Company's other comprehensive income balances related to pension and post-retirement benefits arising during the periods for net experience gain (loss) and prior service credit (costs) are summarized as follows:

| (millions)                      | Quarter ended   |                 | Year-to-date period ended |                 |
|---------------------------------|-----------------|-----------------|---------------------------|-----------------|
|                                 | October 2, 2010 | October 3, 2009 | October 2, 2010           | October 3, 2009 |
| Census-related valuation update | \$              | \$              | (\$16)                    | (\$42)          |
| Foreign currency remeasurement  | (29)            |                 | 4                         | (48)            |
| Total                           | (\$29)          | \$              | (\$12)                    | (\$90)          |

During the first quarter of 2010, the Company amended its U.S. postretirement healthcare benefit plan, which resulted in a \$17 million decrease of a deferred tax asset.

**Table of Contents**

Quarter ended October 2, 2010:

| (millions)                                  | Pre-tax<br>amount | Tax (expense)<br>or benefit | After-tax<br>amount |
|---------------------------------------------|-------------------|-----------------------------|---------------------|
| <b>2010</b>                                 |                   |                             |                     |
| Net income                                  |                   |                             | <b>\$337</b>        |
| Other comprehensive income:                 |                   |                             |                     |
| Foreign currency translation adjustments    | <b>\$163</b>      | <b>\$</b>                   | <b>163</b>          |
| Cash flow hedges:                           |                   |                             |                     |
| Unrealized gain (loss) on cash flow hedges  | <b>(2)</b>        | <b>1</b>                    | <b>(1)</b>          |
| Reclassification to net earnings            | <b>6</b>          | <b>(1)</b>                  | <b>5</b>            |
| Postretirement and postemployment benefits: |                   |                             |                     |
| Amounts arising during the period:          |                   |                             |                     |
| Net experience gain (loss)                  | <b>(27)</b>       | <b>8</b>                    | <b>(19)</b>         |
| Prior service credit (cost)                 | <b>(2)</b>        |                             | <b>(2)</b>          |
| Reclassification to net earnings:           |                   |                             |                     |
| Net experience loss                         | <b>25</b>         | <b>(8)</b>                  | <b>17</b>           |
| Prior service cost                          | <b>3</b>          | <b>(1)</b>                  | <b>2</b>            |
|                                             | <b>\$166</b>      | <b>(1)</b>                  | <b>165</b>          |
| Total comprehensive income                  |                   |                             | <b>\$502</b>        |

Quarter ended October 3, 2009:

| (millions)                                  | Pre-tax<br>amount | Tax (expense)<br>or benefit | After-tax<br>amount |
|---------------------------------------------|-------------------|-----------------------------|---------------------|
| <b>2009</b>                                 |                   |                             |                     |
| Net income                                  |                   |                             | <b>\$360</b>        |
| Other comprehensive income:                 |                   |                             |                     |
| Foreign currency translation adjustments    | <b>(\$5)</b>      | <b>\$</b>                   | <b>(5)</b>          |
| Cash flow hedges:                           |                   |                             |                     |
| Unrealized gain (loss) on cash flow hedges  | <b>(26)</b>       | <b>9</b>                    | <b>(17)</b>         |
| Reclassification to net earnings            | <b>18</b>         | <b>(6)</b>                  | <b>12</b>           |
| Postretirement and postemployment benefits: |                   |                             |                     |
| Amounts arising during the period:          |                   |                             |                     |
| Net experience gain (loss)                  |                   |                             |                     |
| Prior service credit (cost)                 |                   |                             |                     |
| Reclassification to net earnings:           |                   |                             |                     |
| Net experience loss                         | <b>16</b>         | <b>(5)</b>                  | <b>11</b>           |
| Prior service cost                          | <b>3</b>          | <b>(1)</b>                  | <b>2</b>            |
|                                             | <b>\$6</b>        | <b>(\$3)</b>                | <b>3</b>            |
| Total comprehensive income                  |                   |                             | <b>\$363</b>        |

**Table of Contents**

Year-to-date period ended October 2, 2010:

| (millions)                                  | Pre-tax<br>amount | Tax (expense)<br>or benefit | After-tax<br>amount |
|---------------------------------------------|-------------------|-----------------------------|---------------------|
| <b>2010</b>                                 |                   |                             |                     |
| Net income                                  |                   |                             | <b>\$1,055</b>      |
| Other comprehensive income:                 |                   |                             |                     |
| Foreign currency translation adjustments    | <b>\$5</b>        | <b>\$</b>                   | <b>5</b>            |
| Cash flow hedges:                           |                   |                             |                     |
| Unrealized gain (loss) on cash flow hedges  | <b>(41)</b>       | <b>12</b>                   | <b>(29)</b>         |
| Reclassification to net earnings            | <b>37</b>         | <b>(10)</b>                 | <b>27</b>           |
| Postretirement and postemployment benefits: |                   |                             |                     |
| Amounts arising during the period:          |                   |                             |                     |
| Net experience gain (loss)                  | <b>(12)</b>       | <b>3</b>                    | <b>(9)</b>          |
| Prior service credit (cost)                 |                   | <b>(17)</b>                 | <b>(17)</b>         |
| Reclassification to net earnings:           |                   |                             |                     |
| Net experience loss                         | <b>76</b>         | <b>(24)</b>                 | <b>52</b>           |
| Prior service cost                          | <b>9</b>          | <b>(3)</b>                  | <b>6</b>            |
|                                             | <b>\$74</b>       | <b>(\$39)</b>               | <b>35</b>           |
| Total comprehensive income                  |                   |                             | <b>\$1,090</b>      |

Year-to-date period ended October 3, 2009:

| (millions)                                  | Pre-tax<br>amount | Tax (expense)<br>or benefit | After-tax<br>amount |
|---------------------------------------------|-------------------|-----------------------------|---------------------|
| <b>2009</b>                                 |                   |                             |                     |
| Net income                                  |                   |                             | <b>\$1,032</b>      |
| Other comprehensive income:                 |                   |                             |                     |
| Foreign currency translation adjustments    | <b>\$107</b>      | <b>\$</b>                   | <b>107</b>          |
| Cash flow hedges:                           |                   |                             |                     |
| Unrealized gain (loss) on cash flow hedges  | <b>(8)</b>        | <b>3</b>                    | <b>(5)</b>          |
| Reclassification to net earnings            | <b>(5)</b>        | <b>2</b>                    | <b>(3)</b>          |
| Postretirement and postemployment benefits: |                   |                             |                     |
| Amounts arising during the period:          |                   |                             |                     |
| Net experience gain (loss)                  | <b>(73)</b>       | <b>23</b>                   | <b>(50)</b>         |
| Prior service credit (cost)                 | <b>(17)</b>       | <b>6</b>                    | <b>(11)</b>         |
| Reclassification to net earnings:           |                   |                             |                     |
| Net experience loss                         | <b>47</b>         | <b>(15)</b>                 | <b>32</b>           |
| Prior service cost                          | <b>8</b>          | <b>(3)</b>                  | <b>5</b>            |
|                                             | <b>\$59</b>       | <b>\$16</b>                 | <b>75</b>           |
| Total comprehensive income                  |                   |                             | <b>\$1,107</b>      |

Accumulated other comprehensive income (loss) as of October 2, 2010 and January 2, 2010 consisted of the following:

| (millions)                               | <b>October 2,<br/>2010</b> | January 2,<br>2010 |
|------------------------------------------|----------------------------|--------------------|
| Foreign currency translation adjustments | <b>(\$766)</b>             | <b>(\$771)</b>     |
| Cash flow hedges unrealized net loss     | <b>(32)</b>                | <b>(30)</b>        |

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|                                                     |           |           |
|-----------------------------------------------------|-----------|-----------|
| Postretirement and postemployment benefits:         |           |           |
| Net experience loss                                 | (1,061)   | (1,104)   |
| Prior service cost                                  | (72)      | (61)      |
| Total accumulated other comprehensive income (loss) | (\$1,931) | (\$1,966) |

**Table of Contents****Note 5 Stock compensation**

The Company uses various equity-based compensation programs to provide long-term performance incentives for its global workforce. Currently, these incentives consist principally of stock options, and to a lesser extent, executive performance shares and restricted stock grants. Additionally, the Company awards restricted stock to its non-employee directors. The interim information below should be read in conjunction with the disclosures included on pages 40 to 43 of the Company's 2009 Annual Report in Form 10-K.

The Company classifies pre-tax stock compensation expense in selling, general and administrative expense principally within its corporate operations. For the periods presented, compensation expense for all types of equity-based programs and the related income tax benefit recognized were as follows:

| (millions)                   | Quarter ended   |                 | Year-to-date period ended |                 |
|------------------------------|-----------------|-----------------|---------------------------|-----------------|
|                              | October 2, 2010 | October 3, 2009 | October 2, 2010           | October 3, 2009 |
| Pre-tax compensation expense | <b>\$1</b>      | \$9             | <b>\$24</b>               | \$37            |
| Related income tax benefit   | <b>\$</b>       | \$3             | <b>\$8</b>                | \$13            |

As of October 2, 2010, total stock-based compensation cost related to non-vested awards not yet recognized was \$40 million and the weighted-average period over which this amount is expected to be recognized was 2 years.

***Stock options***

During the year-to-date periods ended October 2, 2010 and October 3, 2009, the Company granted non-qualified stock options to eligible employees as presented in the following activity tables. Terms of these grants and the Company's methods for determining grant-date fair value of the awards were consistent with that described on pages 41 and 42 of the Company's 2009 Annual Report on Form 10-K.

Year-to-date period ended October 2, 2010:

|                                     | Shares<br>(millions) | Weighted-<br>average<br>exercise<br>price | Weighted-<br>average<br>remaining<br>contractual<br>term<br>(yrs.) | Aggregate<br>intrinsic<br>value<br>(millions) |
|-------------------------------------|----------------------|-------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------|
| Employee and director stock options |                      |                                           |                                                                    |                                               |
| Outstanding, beginning of period    | <b>26</b>            | <b>\$45</b>                               |                                                                    |                                               |
| Granted                             | <b>4</b>             | <b>53</b>                                 |                                                                    |                                               |
| Exercised                           | <b>(4)</b>           | <b>44</b>                                 |                                                                    |                                               |
| Forfeitures and expirations         |                      |                                           |                                                                    |                                               |
| Outstanding, end of period          | <b>26</b>            | <b>\$46</b>                               | <b>6.5</b>                                                         | <b>\$129</b>                                  |
| Exercisable, end of period          | <b>20</b>            | <b>\$46</b>                               | <b>5.7</b>                                                         | <b>\$104</b>                                  |

Year-to-date period ended October 3, 2009:

|                                     | Shares<br>(millions) | Weighted-<br>average<br>exercise<br>price | Weighted-<br>average<br>remaining<br>contractual<br>term<br>(yrs.) | Aggregate<br>intrinsic<br>value<br>(millions) |
|-------------------------------------|----------------------|-------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------|
| Employee and director stock options |                      |                                           |                                                                    |                                               |
| Outstanding, beginning of period    | <b>26</b>            | <b>\$45</b>                               |                                                                    |                                               |
| Granted                             | <b>4</b>             | <b>40</b>                                 |                                                                    |                                               |

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|                             |     |      |     |       |
|-----------------------------|-----|------|-----|-------|
| Exercised                   | (1) | 36   |     |       |
| Forfeitures and expirations |     |      |     |       |
| Outstanding, end of period  | 29  | \$45 | 6.7 | \$134 |
| Exercisable, end of period  | 24  | \$45 | 6.1 | \$102 |

**Table of Contents**

The weighted-average fair value of options granted was \$7.90 per share for the year-to-date period ended October 2, 2010 and \$6.33 per share for the year-to-date period ended October 3, 2009. The fair value was estimated using the following assumptions:

|                                                              | Weighted-<br>average expected<br>volatility | Weighted-<br>average expected<br>term (years) | Weighted-<br>average risk-<br>free interest<br>rate | Dividend<br>yield |
|--------------------------------------------------------------|---------------------------------------------|-----------------------------------------------|-----------------------------------------------------|-------------------|
| Grants within the year-to-date period ended October 2, 2010: | 20.00%                                      | 4.94                                          | 2.54%                                               | 2.80%             |

The total intrinsic value of options exercised was \$40 million for the year-to-date period ended October 2, 2010 and \$4 million for the year-to-date period ended October 3, 2009.

***Performance shares***

In the first quarter of 2010, the Company granted performance shares to a limited number of senior executive-level employees, which entitle these employees to receive a specified number of shares of the Company's common stock on the vesting date, provided cumulative three-year operating profit and internal net sales growth targets are achieved.

The 2010 target grant currently corresponds to approximately 210,000 shares, with a grant-date fair value of \$48 per share. The actual number of shares issued on the vesting date could range from 0 to 200% of target, depending on actual performance achieved. Based on the market price of the Company's common stock at October 2, 2010, the maximum future value that could be awarded to employees on the vesting date for all outstanding performance share awards was as follows:

| (millions) | October 2, 2010 |
|------------|-----------------|
| 2008 Award | <b>\$16</b>     |
| 2009 Award | <b>\$18</b>     |
| 2010 Award | <b>\$21</b>     |

The 2007 performance share award, payable in stock, was settled at 150% of target in February 2010 for a total dollar equivalent of \$14 million.

**Note 6 Employee benefits**

The Company sponsors a number of U.S. and foreign pension, other nonpension postretirement and postemployment plans to provide various benefits for its employees. These plans are described on pages 43 to 47 of the Company's 2009 Annual Report on Form 10-K. Components of Company plan benefit expense for the periods presented are included in the tables below.



**Table of Contents****Pension**

| (millions)                                      | Quarter ended   |                 | Year-to-date period ended |                 |
|-------------------------------------------------|-----------------|-----------------|---------------------------|-----------------|
|                                                 | October 2, 2010 | October 3, 2009 | October 2, 2010           | October 3, 2009 |
| Service cost                                    | \$22            | \$20            | \$66                      | \$60            |
| Interest cost                                   | 52              | 49              | 151                       | 147             |
| Expected return on plan assets                  | (82)            | (80)            | (238)                     | (237)           |
| Amortization of unrecognized prior service cost | 4               | 4               | 11                        | 10              |
| Recognized net loss                             | 20              | 12              | 60                        | 35              |
| Total pension expense                           | \$16            | \$5             | \$50                      | \$15            |

**Other nonpension postretirement**

| (millions)                                      | Quarter ended   |                 | Year-to-date period ended |                 |
|-------------------------------------------------|-----------------|-----------------|---------------------------|-----------------|
|                                                 | October 2, 2010 | October 3, 2009 | October 2, 2010           | October 3, 2009 |
| Service cost                                    | \$5             | \$4             | \$15                      | \$13            |
| Interest cost                                   | 16              | 16              | 48                        | 49              |
| Expected return on plan assets                  | (16)            | (17)            | (48)                      | (51)            |
| Amortization of unrecognized prior service cost | (1)             | (1)             | (2)                       | (2)             |
| Recognized net loss                             | 4               | 3               | 13                        | 9               |
| Total postretirement benefit expense            | \$8             | \$5             | \$26                      | \$18            |

**Postemployment**

| (millions)                           | Quarter ended   |                 | Year-to-date period ended |                 |
|--------------------------------------|-----------------|-----------------|---------------------------|-----------------|
|                                      | October 2, 2010 | October 3, 2009 | October 2, 2010           | October 3, 2009 |
| Service cost                         | \$1             | \$2             | \$4                       | \$5             |
| Interest cost                        | 1               | 1               | 3                         | 3               |
| Recognized net loss                  | 1               | 1               | 3                         | 3               |
| Total postemployment benefit expense | \$3             | \$4             | \$10                      | \$11            |

Company contributions to employee benefit plans are summarized as follows:

| (millions)                        | Pension | Nonpension postretirement | Total |
|-----------------------------------|---------|---------------------------|-------|
| <b>Quarter ended:</b>             |         |                           |       |
| October 2, 2010                   | \$ 6    | \$ 3                      | \$ 9  |
| October 3, 2009                   | \$ 6    | \$ 3                      | \$ 9  |
| <b>Year-to-date period ended:</b> |         |                           |       |
| October 2, 2010                   | \$ 35   | \$ 10                     | \$ 45 |
| October 3, 2009                   | \$ 83   | \$ 10                     | \$ 93 |
| <b>Full year:</b>                 |         |                           |       |
| Fiscal year 2010 (projected)      | \$335   | \$280                     | \$615 |
| Fiscal year 2009 (actual)         | \$ 87   | \$ 13                     | \$100 |

Plan funding strategies may be modified in response to management's evaluation of tax deductibility, market conditions, and competing investment alternatives.

During the first quarter of 2010, the Company amended its U.S. postretirement healthcare benefit plan, which resulted in a decrease of a deferred tax asset of \$17 million. This impact was recorded in other comprehensive income.



**Table of Contents****Note 7 Income taxes**

The consolidated effective income tax rate for 2010 as compared to 2009 is as follows:

|                                   | Effective income<br>tax rate |
|-----------------------------------|------------------------------|
| <b>Quarter ended:</b>             |                              |
| October 2, 2010                   | <b>30%</b>                   |
| October 3, 2009                   | 27%                          |
| <b>Year-to-date period ended:</b> |                              |
| October 2, 2010                   | <b>29%</b>                   |
| October 3, 2009                   | 29%                          |

The consolidated effective tax rate for the quarter ended October 2, 2010 was higher than the prior period due to the positive impact of various provision-to-return adjustments.

As of October 2, 2010, the Company classified \$48 million of unrecognized tax benefits as a current liability, representing several income tax positions under examination in various jurisdictions. Management's estimate of reasonably possible changes in unrecognized tax benefits during the next twelve months consists of the current liability balance, expected to be settled within one year, offset by \$11 million of projected additions. Management is currently unaware of any issues under review that could result in significant additional payments, accruals or other material deviation in this estimate.

Following is a reconciliation of the Company's total gross unrecognized tax benefits for the year-to-date period ended October 2, 2010; \$106 million of this total represents the amount that, if recognized, would affect the Company's effective income tax rate in future periods.

**Table of Contents**

|                                        |               |
|----------------------------------------|---------------|
| (millions)                             |               |
| January 2, 2010                        | <b>\$ 130</b> |
| Tax positions related to current year: |               |
| Additions                              | <b>10</b>     |
| Tax positions related to prior years:  |               |
| Additions                              | <b>2</b>      |
| Reductions                             | <b>(10)</b>   |
| Settlements                            | <b>(4)</b>    |
| <b>October 2, 2010</b>                 | <b>\$ 128</b> |

The current portion of the Company's unrecognized tax benefits is presented in the balance sheet within accrued income taxes and the amount expected to be settled after one year is recorded in other liabilities.

The Company classifies income tax-related interest and penalties as interest expense and SGA expense, respectively.

|                                                                                |              |
|--------------------------------------------------------------------------------|--------------|
| (millions)                                                                     |              |
| Interest expense recognized for the year-to-date period ending October 2, 2010 | <b>\$ 4</b>  |
| Interest accrued at October 2, 2010                                            | <b>\$ 27</b> |

**Note 8 Derivative instruments and fair value measurements**

The Company is exposed to certain market risks such as changes in interest rates, foreign currency exchange rates, and commodity prices, which exist as a part of its ongoing business operations. Management uses derivative financial and commodity instruments, including futures, options, and swaps, where appropriate, to manage these risks. Instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract.

The Company designates derivatives as cash flow hedges, fair value hedges, net investment hedges, or other contracts used to reduce volatility in the translation of foreign currency earnings to U.S. dollars. The fair value of derivative instruments is recorded in other prepaid assets, other assets, other current liabilities or other liabilities. Gains and losses representing either hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or hedges of translational exposure are recorded in the Consolidated Statement of Income in other income (expense), net. Within the Consolidated Statement of Cash Flows, settlements of cash flow and fair value hedges are classified as an operating activity; settlements of all other derivatives are classified as a financing activity. As a matter of policy, the Company does not engage in trading or speculative hedging transactions.

Total notional amounts of the Company's derivative instruments at October 2, 2010 and January 2, 2010 were as follows:

| (millions)                          | <b>October 2,<br/>2010</b> | January 2,<br>2010 |
|-------------------------------------|----------------------------|--------------------|
| Foreign currency exchange contracts | <b>\$1,206</b>             | \$1,588            |
| Interest rate contracts             | <b>1,900</b>               | 1,900              |
| Commodity contracts                 | <b>207</b>                 | 213                |
| Total                               | <b>\$3,313</b>             | \$3,701            |

**Cash flow hedges**

Qualifying derivatives are accounted for as cash flow hedges when the hedged item is a forecasted transaction. Gains and losses on these instruments are recorded in other comprehensive income until the underlying transaction is recorded in earnings. When the hedged item is realized, gains or losses are reclassified from accumulated other comprehensive income (loss) (AOCI) to the Consolidated Statement of Income on the same line item as the underlying transaction.

**Fair value hedges**

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Qualifying derivatives are accounted for as fair value hedges when the hedged item is a recognized asset, liability, or firm commitment. Gains and losses on these instruments are recorded in earnings, offsetting gains and losses on the hedged item.

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**Table of Contents**

***Net investment hedges***

Qualifying derivative and nonderivative financial instruments are accounted for as net investment hedges when the hedged item is a nonfunctional currency investment in a subsidiary. Gains and losses on these instruments are included in foreign currency translation adjustments in AOCI.

***Other contracts***

The Company also periodically enters into foreign currency forward contracts and options to reduce volatility in the translation of foreign currency earnings to U.S. dollars. Gains and losses on these instruments are recorded in other income (expense), net, generally reducing the exposure to translation volatility during a full-year period.

***Foreign currency exchange risk***

The Company is exposed to fluctuations in foreign currency cash flows related primarily to third-party purchases, intercompany transactions and nonfunctional currency denominated third-party debt. The Company is also exposed to fluctuations in the value of foreign currency investments in subsidiaries and cash flows related to repatriation of these investments. Additionally, the Company is exposed to volatility in the translation of foreign currency denominated earnings to U.S. dollars. Management assesses foreign currency risk based on transactional cash flows and translational volatility and enters into forward contracts, options, and currency swaps to reduce fluctuations in net long or short currency positions. Forward contracts and options are generally less than 18 months duration. Currency swap agreements are established in conjunction with the term of underlying debt issues.

For foreign currency cash flow and fair value hedges, the assessment of effectiveness is generally based on changes in spot rates. Changes in time value are reported in other income (expense), net.

***Interest rate risk***

The Company is exposed to interest rate volatility with regard to future issuances of fixed rate debt. The Company periodically uses interest rate swaps, including forward-starting swaps, to reduce interest rate volatility and funding costs associated with certain debt issues, and to achieve a desired proportion of variable versus fixed rate debt, based on current and projected market conditions.

Fixed-to-variable interest rate swaps are accounted for as fair value hedges and the assessment of effectiveness is based on changes in the fair value of the underlying debt, using incremental borrowing rates currently available on loans with similar terms and maturities.

***Price risk***

The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials, fuel, and energy. The Company has historically used the combination of long-term contracts with suppliers, and exchange-traded futures and option contracts to reduce price fluctuations in a desired percentage of forecasted raw material purchases over a duration of generally less than 18 months.

Commodity contracts are accounted for as cash flow hedges. The assessment of effectiveness for exchange-traded instruments is based on changes in futures prices. The assessment of effectiveness for over-the-counter transactions is based on changes in designated indices.

***Credit-risk-related contingent features***

Certain of the Company's derivative instruments contain provisions requiring the Company to post collateral on those derivative instruments that are in a liability position if the Company's credit rating falls below BB+ (S&P), or Baa1 (Moody's). The fair value of all derivative instruments with credit-risk-related contingent features in a liability position on October 2, 2010 was \$39 million. If the credit-risk-related contingent features were triggered as of October 2, 2010, the Company would be required to post collateral of \$39 million. In addition, certain derivative instruments contain provisions that would be triggered in the event the Company defaults on its debt agreements. There were no collateral posting requirements as of October 2, 2010 triggered by credit-risk-related contingent features.

***Fair value measurements***

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Following is a description of each category in the fair value hierarchy and the financial assets and liabilities of the Company that are included in each category at October 2, 2010 and January 2, 2010.

*Level 1* Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market. For the Company, level 1 financial assets and liabilities consist primarily of commodity derivative contracts.

**Table of Contents**

*Level 2* Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

For the Company, level 2 financial assets and liabilities consist of interest rate swaps and over-the-counter commodity and currency contracts.

The Company's calculation of the fair value of interest rate swaps is derived from a discounted cash flow analysis based on the terms of the contract and the interest rate curve. Commodity derivatives are valued using an income approach based on the commodity index prices less the contract rate multiplied by the notional amount. Foreign currency contracts are valued using an income approach based on forward rates less the contract rate multiplied by the notional amount. The Company's calculation of the fair value of level 2 financial assets and liabilities takes into consideration the risk of nonperformance, including counterparty credit risk.

*Level 3* Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability. The Company did not have any level 3 financial assets or liabilities as of October 2, 2010 or January 2, 2010.

Fair values of these assets and liabilities in the Consolidated Balance Sheet measured at fair value on a recurring basis consists of derivatives designated as hedging instruments, and as of October 2, 2010 and January 2, 2010 were as follows:

|                                      | Level 1    |            | Level 2    |            | Total      |            |
|--------------------------------------|------------|------------|------------|------------|------------|------------|
|                                      | October 2, | January 2, | October 2, | January 2, | October 2, | January 2, |
| (millions)                           | 2010       | 2010       | 2010       | 2010       | 2010       | 2010       |
| <b>Assets:</b>                       |            |            |            |            |            |            |
| Foreign currency exchange contracts: |            |            |            |            |            |            |
| Other prepaid assets                 | \$         | \$         | \$34       | \$7        | \$34       | \$7        |
| Interest rate contracts:             |            |            |            |            |            |            |
| Other prepaid assets                 |            |            | 1          |            | 1          |            |
| Other assets                         |            |            | 82         | 44         | 82         | 44         |
| Commodity contracts:                 |            |            |            |            |            |            |
| Other prepaid assets                 | 6          | 4          |            |            | 6          | 4          |
| Total assets                         | \$6        | \$4        | \$117      | \$51       | \$123      | \$55       |
| <b>Liabilities:</b>                  |            |            |            |            |            |            |
| Foreign currency exchange contracts: |            |            |            |            |            |            |
| Other current liabilities            | \$         | \$         | (\$11)     | (\$31)     | (\$11)     | (\$31)     |
| Interest rate contracts:             |            |            |            |            |            |            |
| Other liabilities                    |            |            |            | (1)        |            | (1)        |
| Commodity contracts:                 |            |            |            |            |            |            |
| Other current liabilities            | (3)        |            | (11)       | (6)        | (14)       | (6)        |
| Other liabilities                    |            |            | (30)       | (14)       | (30)       | (14)       |
| Total liabilities                    | (\$3)      | \$         | (\$52)     | (\$52)     | (\$55)     | (\$52)     |



**Table of Contents**

The effect of derivative instruments on the Consolidated Statement of Income for the quarters ended October 2, 2010 and October 3, 2009 were as follows:

| Derivatives in fair value hedging relationships (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income |                 |
|------------------------------------------------------------|----------------------------------------------|----------------------------------|-----------------|
|                                                            |                                              | October 2, 2010                  | October 3, 2009 |
| Foreign currency exchange contracts                        | Other income (expense), net                  | \$26                             | \$(30)          |
| Interest rate contracts                                    | Interest expense                             | 9                                | 9               |
| <b>Total</b>                                               |                                              | <b>\$35</b>                      | <b>\$(21)</b>   |

| Derivatives in cash flow hedging relationships (millions) | Gain (loss) recognized in AOCI |                 | Location of gain (loss) reclassified from AOCI | Gain (loss) reclassified from AOCI into income |                 | Location of gain (loss) recognized in income (a) | Gain (loss) recognized in income(a) |                 |
|-----------------------------------------------------------|--------------------------------|-----------------|------------------------------------------------|------------------------------------------------|-----------------|--------------------------------------------------|-------------------------------------|-----------------|
|                                                           | October 2, 2010                | October 3, 2009 |                                                | October 2, 2010                                | October 3, 2009 |                                                  | October 2, 2010                     | October 3, 2009 |
| Foreign currency exchange contracts                       | \$ 2                           | \$(16)          | COGS                                           | \$(8)                                          | \$ (3)          | Other income (expense), net                      | \$                                  | \$              |
| Foreign currency exchange contracts                       | (2)                            | 1               | SGA expense                                    | (1)                                            |                 | Other income (expense), net                      |                                     |                 |
| Interest rate contracts                                   |                                |                 | Interest expense                               | (1)                                            | (1)             | N/A                                              |                                     |                 |
| Commodity contracts                                       | (2)                            | (11)            | COGS                                           | 4                                              | (14)            | Other income (expense), net                      |                                     | (2)             |
| <b>Total</b>                                              | <b>\$(2)</b>                   | <b>\$(26)</b>   |                                                | <b>\$(6)</b>                                   | <b>\$(18)</b>   |                                                  | <b>\$</b>                           | <b>\$(2)</b>    |

| Derivatives not designated as hedging instruments (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income |                 |
|--------------------------------------------------------------|----------------------------------------------|----------------------------------|-----------------|
|                                                              |                                              | October 2, 2010                  | October 3, 2009 |
| Foreign currency exchange contracts                          | Other income (expense), net                  | \$                               | \$              |
| <b>Total</b>                                                 |                                              | <b>\$</b>                        | <b>\$</b>       |

(a) Includes the ineffective portion and amount excluded from effectiveness testing.

**Table of Contents**

The effect of derivative instruments on the Consolidated Statement of Income for the year-to-date periods ended October 2, 2010 and October 3, 2009 were as follows:

| Derivatives in fair value hedging relationships (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income |                 |
|------------------------------------------------------------|----------------------------------------------|----------------------------------|-----------------|
|                                                            |                                              | October 2, 2010                  | October 3, 2009 |
| Foreign currency exchange contracts                        | Other income (expense), net                  | \$(25)                           | \$(38)          |
| Interest rate contracts                                    | Interest expense                             | 29                               | 18              |
| <b>Total</b>                                               |                                              | <b>\$ 4</b>                      | <b>\$(20)</b>   |

| Derivatives in cash flow hedging relationships (millions) | Gain (loss) recognized in AOCI |                 | Location of gain (loss) reclassified from AOCI | Gain (loss) reclassified from AOCI into income |                 | Location of gain (loss) recognized in income (a) | Gain (loss) recognized in income(a) |                 |
|-----------------------------------------------------------|--------------------------------|-----------------|------------------------------------------------|------------------------------------------------|-----------------|--------------------------------------------------|-------------------------------------|-----------------|
|                                                           | October 2, 2010                | October 3, 2009 |                                                | October 2, 2010                                | October 3, 2009 |                                                  | October 2, 2010                     | October 3, 2009 |
| Foreign currency exchange contracts                       | \$(10)                         | \$(19)          | COGS                                           | \$(21)                                         | \$15            | Other income (expense), net                      | \$                                  | \$(1)           |
| Foreign currency exchange contracts                       |                                | 3               | SGA expense                                    | (1)                                            | (2)             | Other income (expense), net                      |                                     |                 |
| Interest rate contracts                                   |                                | 2               | Interest expense                               | (3)                                            | (4)             | N/A                                              |                                     |                 |
| Commodity contracts                                       | (31)                           | 6               | COGS                                           | (12)                                           | (4)             | Other income (expense), net                      | (1)                                 | (2)             |
| <b>Total</b>                                              | <b>\$(41)</b>                  | <b>\$ (8)</b>   |                                                | <b>\$(37)</b>                                  | <b>\$ 5</b>     |                                                  | <b>\$(1)</b>                        | <b>\$(3)</b>    |

| Derivatives not designated as hedging instruments (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income |                 |
|--------------------------------------------------------------|----------------------------------------------|----------------------------------|-----------------|
|                                                              |                                              | October 2, 2010                  | October 3, 2009 |
| Foreign currency exchange contracts                          | Other income (expense), net                  | \$                               | \$1             |
| <b>Total</b>                                                 |                                              | <b>\$</b>                        | <b>\$1</b>      |

(a) Includes the ineffective portion and amount excluded from effectiveness testing.

**Financial instruments**

The carrying values of the Company's short-term items, including cash, cash equivalents, accounts receivable, accounts payable and notes payable approximate fair value. The fair value of the Company's long-term debt is calculated based on broker quotes and was as follows at October 2, 2010:

| (millions)                           | Fair Value      | Carrying Value  |
|--------------------------------------|-----------------|-----------------|
| Current maturities of long-term debt | \$ 975          | \$ 948          |
| Long-term debt                       | 4,567           | 3,929           |
| <b>Total</b>                         | <b>\$ 5,542</b> | <b>\$ 4,877</b> |

***Credit risk concentration***

The Company is exposed to credit loss in the event of nonperformance by counterparties on derivative financial and commodity contracts. Management believes a concentration of credit risk with respect to derivative counterparties is

## **Table of Contents**

limited due to the credit ratings of the counterparties and the use of master netting and reciprocal collateralization agreements.

Master netting agreements apply in situations where the Company executes multiple contracts with the same counterparty. Certain counterparties represent a concentration of credit risk to the Company. If those counterparties fail to perform according to the terms of derivative contracts, this would result in a loss to the Company of \$57 million as of October 2, 2010.

For certain derivative contracts, reciprocal collateralization agreements with counterparties call for the posting of collateral in the form of cash, treasury securities or letters of credit if a fair value loss position to the Company or our counterparties exceeds a certain amount. There were no collateral balance requirements at October 2, 2010.

Management believes concentrations of credit risk with respect to accounts receivable is limited due to the generally high credit quality of the Company's major customers, as well as the large number and geographic dispersion of smaller customers. However, the Company conducts a disproportionate amount of business with a small number of large multinational grocery retailers, with the five largest accounts encompassing approximately 28% of consolidated trade receivables at October 2, 2010.

### **Note 9 Voluntary product recall**

On June 25, 2010, the Company announced a voluntary recall of select packages of Kellogg's cereal in the U.S. due to an odor from waxy resins found in the package liner. Estimated customer returns and consumer rebates were recorded as a reduction of net sales; costs associated with returned product and the disposal and write-off of inventory were recorded as COGS; and other recall costs were recorded as SGA expenses. During the quarter, the Company refined the estimated costs of the recall, which resulted in a reduction of \$1 million, for a year-to-date expense through October 2, 2010 of \$47 million, or \$.09 per share on a diluted basis. In addition to the costs of the voluntary recall, the Company also lost sales of the impacted products in the second and third quarters of 2010.

### **Note 10 Operating segments**

Kellogg Company is the world's leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, fruit snacks, frozen waffles, and veggie foods. Kellogg products are manufactured and marketed globally. Principal markets for these products include the United States and United Kingdom. The Company currently manages its operations in four geographic operating segments, consisting of North America and the three International operating segments of Europe, Latin America, and Asia Pacific.

**Table of Contents**

| (millions)                      | Quarter ended      |                    | Year-to-date period ended |                    |
|---------------------------------|--------------------|--------------------|---------------------------|--------------------|
|                                 | October 2,<br>2010 | October 3,<br>2009 | October 2,<br>2010        | October 3,<br>2009 |
| <b>Net sales</b>                |                    |                    |                           |                    |
| North America                   | \$2,130            | \$2,187            | \$6,469                   | \$6,574            |
| Europe                          | 564                | 631                | 1,730                     | 1,805              |
| Latin America                   | 247                | 262                | 709                       | 750                |
| Asia Pacific (a)                | 216                | 197                | 629                       | 546                |
| Consolidated                    | \$3,157            | \$3,277            | \$9,537                   | \$9,675            |
| <b>Segment operating profit</b> |                    |                    |                           |                    |
| North America                   | \$404              | \$415              | \$1,261                   | \$1,244            |
| Europe                          | 102                | 105                | 307                       | 304                |
| Latin America                   | 34                 | 51                 | 126                       | 157                |
| Asia Pacific (a)                | 25                 | 28                 | 82                        | 74                 |
| Corporate                       | (24)               | (32)               | (115)                     | (130)              |
| Consolidated                    | \$541              | \$567              | \$1,661                   | \$1,649            |

(a) Includes Australia, Asia and South Africa.

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**Table of Contents**

**KELLOGG COMPANY**

**PART I FINANCIAL INFORMATION**

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

**Results of operations**

***Overview***

Kellogg Company is the world's leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, fruit snacks, frozen waffles and veggie foods. Kellogg products are manufactured and marketed globally. We currently manage our operations in four geographic operating segments, consisting of North America and the three International operating segments of Europe, Latin America and Asia Pacific.

We manage our Company for sustainable performance defined by our long-term annual growth targets. These targets are low single-digit (1 to 3%) for internal net sales, mid single-digit (4 to 6%) for internal operating profit, and high single-digit (7 to 9%) for net earnings per share on a currency neutral basis. Internal net sales and internal operating profit exclude the impact of foreign currency translation, acquisitions, dispositions and shipping day differences. See the Foreign currency translation section for an explanation of management's definition of currency neutral.

For the quarter ended October 2, 2010, our reported net sales decreased 4% compared to the same period last year; internal net sales decreased 2%. Consolidated operating profit decreased 5%, while internal operating profit decreased 3%. Diluted earnings per share (EPS) declined 4% to \$0.90, compared to \$0.94 in the comparable prior period. EPS on a currency neutral basis was down 2%.

On a year-to-date basis, our reported net sales were down 1%, with internal net sales down 2%. Consolidated operating profit increased 1% on a reported basis and 1% on an internal basis. Diluted EPS was up 3%, at \$2.78, compared to \$2.70 in the prior year. EPS on a currency neutral basis was up 4%.

We have lowered our guidance for the full year to reflect weaker performance in some of our core cereal markets, continued competitive intensity and the impact of the voluntary cereal recall in the U.S. which is discussed further in the Voluntary product recall section. For the full year, we now expect our internal net sales to be down approximately 1%. Internal operating profit is expected to be approximately flat compared to the prior year and currency neutral earnings per share is expected to grow 4 to 5%.

For 2011, we expect to grow internal net sales by low single-digits. Internal operating profit is expected to be flat to down 2%. EPS on a currency-neutral basis is expected to grow low single-digits.

**Table of Contents****Net sales and operating profit**

The following table provides an analysis of net sales and operating profit performance for the third quarter of 2010 versus 2009:

| (dollars in millions)             | North<br>America | Europe        | Latin<br>America | Asia<br>Pacific<br>(a) | Corporate      | Consoli-<br>dated |
|-----------------------------------|------------------|---------------|------------------|------------------------|----------------|-------------------|
| <b>2010 net sales</b>             | <b>\$ 2,130</b>  | <b>\$ 564</b> | <b>\$ 247</b>    | <b>\$ 216</b>          | <b>\$</b>      | <b>\$ 3,157</b>   |
| <b>2009 net sales</b>             | <b>\$ 2,187</b>  | <b>\$ 631</b> | <b>\$ 262</b>    | <b>\$ 197</b>          | <b>\$</b>      | <b>\$ 3,277</b>   |
| <b>% change 2010 vs. 2009:</b>    |                  |               |                  |                        |                |                   |
| Volume (tonnage) (b)              | -4.2%            | -4.9%         | -3.8%            | 11.1%                  |                | -3.4%             |
| Pricing/mix                       | 1.3%             | -.5%          | 8.4 %            | -9.4%                  |                | .9%               |
| <b>Subtotal internal business</b> | <b>-2.9%</b>     | <b>-5.4%</b>  | <b>4.6 %</b>     | <b>1.7 %</b>           |                | <b>-2.5%</b>      |
| Foreign currency impact           | .3%              | -5.0%         | -10.1%           | 7.3%                   |                | -1.1%             |
| <b>Total change</b>               | <b>-2.6%</b>     | <b>-10.4%</b> | <b>-5.5%</b>     | <b>9.0%</b>            |                | <b>-3.6%</b>      |
| (dollars in millions)             | North<br>America | Europe        | Latin<br>America | Asia<br>Pacific<br>(a) | Corporate      | Consoli-<br>dated |
| <b>2010 operating profit</b>      | <b>\$ 404</b>    | <b>\$ 102</b> | <b>\$ 34</b>     | <b>\$ 25</b>           | <b>\$ (24)</b> | <b>\$ 541</b>     |
| <b>2009 operating profit</b>      | <b>\$ 415</b>    | <b>\$ 105</b> | <b>\$ 51</b>     | <b>\$ 28</b>           | <b>\$ (32)</b> | <b>\$ 567</b>     |
| <b>% change 2010 vs. 2009:</b>    |                  |               |                  |                        |                |                   |
| Internal business                 | -2.9%            | 2.4%          | -18.2%           | -16.8%                 | 20.7%          | -3.0%             |
| Foreign currency impact           | .3%              | -5.4%         | -14.0%           | 6.9%                   | %              | -1.7%             |
| <b>Total change</b>               | <b>-2.6%</b>     | <b>-3.0%</b>  | <b>-32.2%</b>    | <b>-9.9%</b>           | <b>20.7%</b>   | <b>-4.7%</b>      |

(a) Includes Australia, Asia, and South Africa.

(b) We measure the volume impact (tonnage) on revenues based on the stated weight of our product shipments.

Our consolidated net sales were down 4% reflecting weakness in our core cereal markets, competitive pressures, and the impact of the second quarter 2010 voluntary recall of select packages of breakfast cereals. Reported net sales was positively impacted by currency, resulting in an internal net sales decline of 2%.

Internal net sales for our North America operating segment declined 3%. North America has three product groups: retail cereal, retail snacks and frozen and specialty channels. Retail cereal's internal net sales declined by 6% in the quarter. Heavy promotional pricing drove deflation into the category. Despite the deflation, the cereal category continued to be weak and we experienced a decrease in consumption. Consumer consumption impacts purchases by retailers, who are our primary customers. Our consumption was negatively impacted by the ongoing effect of the voluntary cereal recall that occurred in the second quarter of 2010. The brands involved in the recall, our kids' brands, were the cornerstone of our back-to-school promotions in the third quarter. While we tried to re-work our promotional plans, our competitors were more aggressive than we expected and benefited from our supply issues resulting from the recall. We have also been impacted by less support from non-measured channels this year.

The retail snack product group (cookies, crackers, toaster pastries, cereal bars, and fruit snacks) grew by less than 1%. The modest growth was driven by *Pop-Tarts* and strong wholesome snack bar sales including our bar innovations such as *FiberPlus* Chocolate Peanut Butter and *Special K* Fruit Crisps. The good performance in wholesome snacks was masked by weaker performance in cookies.

Internal net sales in the frozen and specialty channels (frozen foods, food service and vending) decreased by 5%. In our waffle business, our customers are not resetting their shelves as quickly as we had expected and the pace of consumers' response is slower than projected.

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Our International operating segments' internal net sales were down 2% compared to the prior year. Europe's internal net sales declined 5% in the third quarter. We are seeing price deflation in many food categories across Europe, especially in the U.K. Continued weakness in the Russia snack business drove lower volumes and contributed to Europe's lower top line results. Latin America's internal net sales growth was up 5%, on top of last year's strong 9% growth. Cereal growth across the region mitigated a decline in snacks. Our decline in snacks is largely driven by Venezuela where we import products from Mexico. The imports have been impacted by exchange rate controls in Venezuela. Internal net sales in Asia Pacific grew 2% driven by strong performance across Asia and South Africa. This was muted by a decline in Australia where the cereal category is facing price deflation.

Consolidated operating profit declined by 5% on an as reported basis and by 3% on an internal basis, when excluding the impact of foreign currency translation. Softness in sales, increased investment in advertising, a decrease in volume going



**Table of Contents**

through our manufacturing plants and increased costs more than offset the benefit of lower incentive compensation expense, resulting in an overall decline in operating profit. Incentive compensation is based upon the Company's actual results compared to our targets. Given results are lower than expected, incentive compensation decreased in the third quarter, including a year-to-date adjustment.

Internal operating profit in North America decreased by 3%, Europe's grew by 2%, Latin America's declined by 18% and Asia Pacific's declined by 17%. North America's operating profit was negatively impacted by increased promotional activity in the cereal category, the ongoing impact of the second quarter 2010 voluntary recall as well as a slower than anticipated rebound in our waffle business. In addition, higher supply chain costs and increased advertising contributed to the decline. This was partially offset by lower up-front costs and lower incentive compensation expense. Europe's increase in internal operating profit was attributable to supply chain efficiencies, lower up-front costs and a decrease in incentive compensation expense. Latin America's decline was due primarily to increased commodity costs, incremental operating and distribution costs in Mexico as well as overhead inflation and a modest increase in advertising. Asia Pacific's decline was due to increased investments in advertising and promotion. Corporate benefited from lower incentive compensation expense.

The following tables provide analysis of our net sales to operating performance for the year-to-date periods of 2010 compared to 2009. Our weak top-line growth in the second and third quarter of 2010 has more than offset our first quarter increase, resulting in a decrease in year-to-date internal net sales of 1%. Internal operating profit is up 1% compared to the prior year due to lower up-front costs and reduced incentive compensation expense which more than offset the softness in the business.

| (dollars in millions)             | North America   | Europe          | Latin America | Asia Pacific (a) | Corporate       | Consolidated    |
|-----------------------------------|-----------------|-----------------|---------------|------------------|-----------------|-----------------|
| <b>2010 net sales</b>             |                 |                 |               |                  |                 | <b>\$ 9,537</b> |
|                                   | <b>\$ 6,469</b> | <b>\$ 1,730</b> | <b>\$ 709</b> | <b>\$ 629</b>    | <b>\$</b>       |                 |
| <b>2009 net sales</b>             | <b>\$ 6,574</b> | <b>\$ 1,805</b> | <b>\$ 750</b> | <b>\$ 546</b>    | <b>\$</b>       | <b>\$ 9,675</b> |
| <b>% change 2010 vs. 2009:</b>    |                 |                 |               |                  |                 |                 |
| Volume (tonnage) (b)              | -2.8%           | -2.3%           | -3.7%         | 3.0%             |                 | -2.4%           |
| Pricing/mix                       | .5%             | .2%             | 7.3%          | -.9%             |                 | .9%             |
| <b>Subtotal internal business</b> | <b>-2.3%</b>    | <b>-2.1%</b>    | <b>3.6%</b>   | <b>2.1%</b>      |                 | <b>-1.5%</b>    |
| Foreign currency impact           | .7%             | -2.0%           | -9.1%         | 13.0%            |                 | .1%             |
| <b>Total change</b>               | <b>-1.6%</b>    | <b>-4.1%</b>    | <b>-5.5%</b>  | <b>15.1%</b>     |                 | <b>-1.4%</b>    |
| (dollars in millions)             | North America   | Europe          | Latin America | Asia Pacific (a) | Corporate       | Consolidated    |
| <b>2010 operating profit</b>      | <b>\$ 1,261</b> | <b>\$ 307</b>   | <b>\$ 126</b> | <b>\$ 82</b>     | <b>\$ (115)</b> | <b>\$ 1,661</b> |
| <b>2009 operating profit</b>      | <b>\$ 1,244</b> | <b>\$ 304</b>   | <b>\$ 157</b> | <b>\$ 74</b>     | <b>\$ (130)</b> | <b>\$ 1,649</b> |
| <b>% change 2010 vs. 2009:</b>    |                 |                 |               |                  |                 |                 |
| Internal business                 | .5%             | 4.3%            | -9.3%         | -5.7%            | 11.1%           | .9%             |
| Foreign currency impact           | .8%             | -3.3%           | -10.1%        | 17.0%            |                 | -.2%            |
| <b>Total change</b>               | <b>1.3%</b>     | <b>1.0%</b>     | <b>-19.4%</b> | <b>11.3%</b>     | <b>11.1%</b>    | <b>.7%</b>      |

(a) Includes Australia, Asia, and South Africa.

(b) We measure the volume impact (tonnage) on revenues based on the stated weight of our product shipments.

**Table of Contents****Margin performance**

Margin performance for the third quarter and year-to-date periods of 2010 versus 2009 is as follows:

| Quarter          | 2010          | 2009   | Change vs.<br>prior year<br>(pts.) |
|------------------|---------------|--------|------------------------------------|
| Gross margin (a) | <b>43.4%</b>  | 43.9%  | <b>-0.5</b>                        |
| SGA% (b)         | <b>-26.3%</b> | -26.6% | <b>0.3</b>                         |
| Operating margin | <b>17.1%</b>  | 17.3%  | <b>-0.2</b>                        |
| Year-to-date     | 2010          | 2009   | Change                             |
| Gross margin (a) | <b>43.0%</b>  | 42.9%  | <b>0.1</b>                         |
| SGA% (b)         | <b>-25.6%</b> | -25.9% | <b>0.3</b>                         |
| Operating margin | <b>17.4%</b>  | 17.0%  | <b>0.4</b>                         |

(a) Gross profit as a percentage of net sales. Gross profit is equal to net sales less cost of goods sold.

(b) Selling, general, and administrative expense as a percentage of net sales.

As illustrated in the preceding table, our consolidated gross margin decreased by 50 basis points in the quarter due primarily to lower volume. While we are achieving savings from our cost reduction initiatives, we continue to experience inflationary cost pressures for fuel, energy, commodities and employee benefits. Our selling, general and administrative (SGA) expenses were down in the quarter due a reduction in incentive compensation expense.

On a year-to-date basis, gross margin was flat compared to the prior year comparable period. We expect our full year gross margin to be flat or down slightly. Our SGA expenses on a year-to-date basis were down due to the third quarter adjustment for lower incentive compensation expense.

**Foreign currency translation**

The reporting currency for our financial statements is the U.S. dollar. Certain of our assets, liabilities, expenses and revenues are denominated in currencies other than the U.S. dollar, primarily in the Euro, British pound, Mexican peso, Australian dollar and Canadian dollar. To prepare our consolidated financial statements, we must translate those assets, liabilities, expenses and revenues into U.S. dollars at the applicable exchange rates. As a result, increases and decreases in the value of the U.S. dollar against these other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. This could have significant impact on our results if such increase or decrease in the value of the U.S. dollar is substantial.

Volatility in the foreign exchange markets has limited our ability to forecast future U.S. dollar reported earnings. As such, we are measuring diluted earnings per share growth and providing guidance on future earnings on a currency neutral basis, assuming earnings are translated at the prior year's exchange rates. This non-GAAP financial measure is being used to focus management and investors on local currency business results, thereby providing visibility to the underlying trends of the Company. Management believes that excluding the impact of foreign currency from EPS provides a useful measurement of comparability given the volatility in foreign exchange markets.

| Consolidated results                 | Quarter ended   |                 | Year-to-date ended |                 |
|--------------------------------------|-----------------|-----------------|--------------------|-----------------|
|                                      | October 2, 2010 | October 3, 2009 | October 2, 2010    | October 3, 2009 |
| Diluted net earnings per share (EPS) | <b>\$ 0.90</b>  | \$ 0.94         | <b>\$ 2.78</b>     | \$ 2.70         |
| Translational impact (a)             | <b>0.02</b>     | 0.06            | <b>0.02</b>        | 0.23            |
| Currency neutral EPS                 | <b>\$ 0.92</b>  | \$ 1.00         | <b>\$ 2.80</b>     | \$ 2.93         |
| Currency neutral EPS growth (b)      | <b>-2%</b>      |                 | <b>4%</b>          |                 |

- (a) Translation impact is the difference between reported EPS and the translation of current year net profits at prior year exchange rates, adjusted for gains (losses) on translational hedges, if applicable.
- (b) Calculated as a percentage of growth from the prior year's reported EPS.

**Table of Contents*****Voluntary product recall***

On June 25, 2010, we announced a voluntary recall of select packages of Kellogg's cereal in the U.S. due to an odor from waxy resins found in the package liner. Estimated customer returns and consumer rebates were recorded as a reduction of net sales; costs associated with returned product and the disposal and write-off of inventory were recorded as cost of goods sold (COGS); and other recall costs were recorded as selling, general and administrative expenses. During the quarter, we refined the estimated costs of the recall, which resulted in a reduction of \$1 million, for a year-to-date expense through October 2, 2010 of \$47 million, or \$.09 per share on a diluted basis. In addition to the costs of the voluntary recall, we also lost sales of the impacted products in the second and third quarters of 2010.

***Other cost reduction initiatives***

We view our continued spending on cost reduction initiatives as part of our ongoing operating principles to provide greater visibility in achieving our long-term profit growth targets. Initiatives undertaken are currently expected to recover cash implementation costs within a five-year period of completion. Each cost reduction initiative is normally up to three years in duration. Upon completion (or as each major stage is completed in the case of multi-year programs), the project begins to deliver cash savings and/or reduced depreciation. Certain of these initiatives represent exit or disposal plans for which material charges will be incurred. See further discussion in Note 3. We include these charges in our measure of operating segment profitability. In 2009, we announced our intention to achieve \$1 billion plus of annual cost savings in three years (beginning in 2012). These initiatives are integral to meeting our \$1 billion plus savings challenge.

***2010 activities***

We incurred costs related to our cost reduction initiatives which do not qualify as exit costs under generally accepted accounting principles in the United States. These represent cash costs for consulting and other charges for our COGS and selling, general and administrative (SGA) programs.

Costs incurred during the quarter and year-to-date period ended October 2, 2010 were as follows:

| (millions)    | Quarter ended, October 2, 2010 |              |       | Year-to-date period ended, October 2, 2010 |              |       |
|---------------|--------------------------------|--------------|-------|--------------------------------------------|--------------|-------|
|               | COGS programs                  | SGA programs | Total | COGS programs                              | SGA programs | Total |
| North America | \$                             | \$1          | \$1   | \$12                                       | \$2          | \$14  |
| Europe        | 3                              |              | 3     | 9                                          |              | 9     |
| Latin America | 1                              |              | 1     | 2                                          |              | 2     |
| Asia Pacific  | 1                              |              | 1     | 2                                          |              | 2     |
| Corporate     |                                | 1            | 1     |                                            | 3            | 3     |
| Total         | \$5                            | \$2          | \$7   | \$25                                       | \$5          | \$30  |

**Table of Contents**

Total program costs incurred to date were as follows:

| (millions)    | Total program costs through October 2, 2010 |                 |       |
|---------------|---------------------------------------------|-----------------|-------|
|               | COGS<br>programs                            | SGA<br>programs | Total |
| North America | \$62                                        | \$15            | \$ 77 |
| Europe        | 19                                          | 2               | 21    |
| Latin America | 7                                           |                 | 7     |
| Asia Pacific  | 7                                           |                 | 7     |
| Corporate     |                                             | 3               | &nb   |