

KELLOGG CO  
Form 10-Q  
November 06, 2007

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**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 September 29, 2007**

**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.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 26, 2007 393,908,428 shares

KELLOGG COMPANY  
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**Table of Contents****Kellogg Company and Subsidiaries  
CONSOLIDATED BALANCE SHEET**

(millions, except per share data)

	<b>September 29, 2007</b> (unaudited)	December 30, 2006 *
<b>Current assets</b>		
Cash and cash equivalents	\$ 576	\$ 411
Accounts receivable, net	1,157	945
Inventories:		
Raw materials and supplies	227	201
Finished goods and materials in process	608	623
Deferred income taxes	163	116
Other prepaid assets	141	131
<b>Total current assets</b>	<b>2,872</b>	2,427
Property, net of accumulated depreciation of \$4,383 and \$4,102	2,894	2,816
Goodwill	3,448	3,448
Other intangibles, net of accumulated amortization of \$41 and \$49	1,412	1,420
Pension	391	353
Other assets	255	250
<b>Total assets</b>	<b>\$ 11,272</b>	\$ 10,714
<b>Current liabilities</b>		
Current maturities of long-term debt	\$ 466	\$ 723
Notes payable	1,836	1,268
Accounts payable	1,014	910
Accrued advertising and promotion	447	338
Accrued income taxes	73	152
Accrued salaries and wages	269	311
Other current liabilities	386	318
<b>Total current liabilities</b>	<b>4,491</b>	4,020
Long-term debt	2,588	3,053
Deferred income taxes	581	619
Other liabilities	1,105	953
<b>Shareholders equity</b>		
Common stock, \$.25 par value	105	105
Capital in excess of par value	344	292
Retained earnings	4,190	3,630

Treasury stock, at cost	(1,148)	(912)
Accumulated other comprehensive income (loss)	(984)	(1,046)
<b>Total shareholders equity</b>	<b>2,507</b>	<b>2,069</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 11,272</b>	<b>\$ 10,714</b>

\* Condensed from  
audited financial  
statements.

Refer to Notes to Consolidated Financial Statements.

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**Kellogg Company and Subsidiaries**  
**CONSOLIDATED STATEMENT OF EARNINGS**  
(millions, except per share data)

(Results are unaudited)	Quarter ended		Year-to-date period ended	
	<b>September 29, 2007</b>	September 30, 2006	<b>September 29, 2007</b>	September 30, 2006
<b>Net sales</b>	<b>\$ 3,004</b>	\$ 2,823	<b>\$ 8,982</b>	\$ 8,323
<b>Cost of goods sold</b>	<b>1,662</b>	1,549	<b>4,999</b>	4,617
<b>Selling and administrative expense</b>	<b>850</b>	787	<b>2,474</b>	2,285
<b>Operating profit</b>	<b>492</b>	487	<b>1,509</b>	1,421
<b>Interest expense</b>	<b>79</b>	75	<b>233</b>	227
<b>Other income (expense), net</b>	<b>3</b>	2	<b>5</b>	11
<b>Earnings before income taxes</b>	<b>416</b>	414	<b>1,281</b>	1,205
<b>Income taxes</b>	<b>111</b>	133	<b>354</b>	383
<b>Net earnings</b>	<b>\$ 305</b>	\$ 281	<b>\$ 927</b>	\$ 822
<b>Net earnings per share:</b>				
<b>Basic</b>	<b>\$ .77</b>	\$ .71	<b>\$ 2.34</b>	\$ 2.07
<b>Diluted</b>	<b>\$ .76</b>	\$ .70	<b>\$ 2.31</b>	\$ 2.06
<b>Dividends per share</b>	<b>\$ .3100</b>	\$ .2910	<b>\$ .8920</b>	\$ .8460
<b>Average shares outstanding:</b>				
<b>Basic</b>	<b>395</b>	397	<b>397</b>	397
<b>Diluted</b>	<b>399</b>	400	<b>401</b>	399
<b>Actual shares outstanding at period end</b>			<b>394</b>	398

Refer to Notes to Consolidated Financial Statements.

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**Kellogg Company and Subsidiaries**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(millions)

(unaudited)	Year-to-date period ended	
	September 29, 2007	September 30, 2006
<b>Operating activities</b>		
Net earnings	\$ 927	\$ 822
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	275	258
Deferred income taxes	(114)	2
Other (a)	138	140
Postretirement benefit plan contributions	(42)	(38)
Changes in operating assets and liabilities	69	(72)
<b>Net cash provided by operating activities</b>	<b>1,253</b>	<b>1,112</b>
<b>Investing activities</b>		
Additions to properties	(292)	(262)
Investments in joint ventures and other	(4)	5
<b>Net cash used in investing activities</b>	<b>(296)</b>	<b>(257)</b>
<b>Financing activities</b>		
Net issuances of notes payable	566	94
Reductions of long-term debt	(730)	(7)
Issuances of common stock	141	197
Common stock repurchases	(417)	(580)
Cash dividends	(354)	(334)
Other	8	16
<b>Net cash used in financing activities</b>	<b>(786)</b>	<b>(614)</b>
Effect of exchange rate changes on cash	(6)	3
Increase in cash and cash equivalents	165	244
Cash and cash equivalents at beginning of period	411	219

<b>Cash and cash equivalents at end of period</b>	<b>\$</b>	<b>576</b>	<b>\$</b>	<b>463</b>
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(a) Consists principally of non-cash expense accruals for employee compensation and benefit obligations.

Refer to Notes to Consolidated Financial Statements.

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**Notes to Consolidated Financial Statements  
for the quarter and year-to-date periods ended September 29, 2007 (unaudited)**

**Note 1 Accounting policies**

***Basis of presentation***

The unaudited interim financial information included in this report reflects normal recurring adjustments that management believes are necessary for a fair statement of the results of operations, financial position, 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 2006 Annual Report on Form 10-K.

The condensed balance sheet data at December 30, 2006 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 and year-to-date periods ended September 29, 2007 are not necessarily indicative of the results to be expected for other interim periods or the full year.

The Company's fiscal year normally ends on the Saturday closest to December 31 and as a result, a 5<sup>th</sup> week is added approximately every sixth year. Under this convention, the Company's 2006 fiscal year ended on December 30 and its 2007 fiscal year will end on December 29, 2007. Each quarterly period in 2006 and 2007 includes thirteen weeks.

The accounting policies used in preparing these financial statements are the same as those applied in the prior year, except that the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes, as of the beginning of its 2007 fiscal year, which is discussed in Note 10.

Additionally, the Company adopted FASB Statement of Financial Accounting Standard (SFAS) No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, as of the end of its 2006 fiscal year, which affected only the year-end balance sheet presentation of postretirement and postemployment benefit obligations.

Accordingly, the Company's 2007 fiscal year (and interim periods within that year) is the first reporting period for which total comprehensive income will be affected by the adoption of this standard. Refer to page 33 of the Company's 2006 Annual Report on Form 10-K for further information on SFAS No. 158. Lastly, the Company is continuing to evaluate the impact of adopting SFAS No. 157 Fair Value Measurements in the first quarter of its 2008 fiscal year. Based on the work completed so far, management does not currently believe that the adoption will have a material impact on how the Company's assets and liabilities are measured. Refer to page 34 of the Company's 2006 Annual Report on Form 10-K for further information on SFAS No. 157.

**Note 2 Acquisitions, other investments, and intangibles**

***Joint venture arrangement***

During the second quarter of 2007, the Company contributed an additional \$4 million in cash to its Turkish joint venture, in which it owns a 50% equity interest, bringing the total cumulative investment to approximately \$7 million. Refer to page 35 of the Company's 2006 Annual Report on Form 10-K for further information on this arrangement.

***Goodwill and other intangible assets***

For the quarter ended June 30, 2007, the Company recorded impairment losses of \$7 million in corporate selling, general, and administrative expense to write off the remaining carrying value of several individually-insignificant trademarks, which were abandoned as of June 30, 2007. As presented in the following table, associated gross carrying amounts and accumulated amortization of \$16 million were retired from the Company's balance sheet.

**Table of Contents****Intangible assets subject to amortization**

(millions)	Gross carrying amount		Accumulated amortization	
	September 29, 2007	December 30, 2006	September 29, 2007	December 30, 2006
Trademarks	\$14	\$ 30	\$13	\$ 22
Other	29	29	28	27
Total	\$43	\$ 59	\$41	\$ 49

	September 29, 2007	September 30, 2006
Amortization expense		
Year-to-date	\$ 8	\$ 1

For intangible assets in the preceding table, amortization (excluding the aforementioned impairment losses) was less than \$1 million for each of the current and prior-year quarterly periods. The currently-estimated aggregate amortization expense for full-year 2007 and each of the three succeeding fiscal years is approximately \$1 million per year and less than \$1 million per year for the fourth and fifth succeeding years.

**Intangible assets not subject to amortization**

(millions)	Total carrying amount	
	September 29, 2007	December 30, 2006
Trademarks	\$1,410	\$ 1,410

There were no changes in the carrying amount of goodwill for the year-to-date period ended September 29, 2007.

**Carrying amount of goodwill**

(millions)	United States	Europe	Latin America	Asia Pacific (a)	Consolidated
<b>December 30, 2006 and September 29, 2007</b>	<b>\$ 3,446</b>			<b>\$ 2</b>	<b>\$3,448</b>

(a)

Includes  
Australia, Asia  
and South  
Africa.

***Subsequent events***

On November 1, 2007, a subsidiary of the Company acquired Bear Naked, Inc., a leading seller of natural granola products. On November 5, 2007, the Company acquired certain assets and liabilities of the Wholesome & Hearty Foods Company, a U.S. manufacturer of veggie foods marketed under the *Gardenburger*® brand. The Company paid a total of approximately \$122 million in cash for these businesses.

**Note 3 Exit or disposal plans**

The Company views its continued spending on cost-reduction initiatives as part of its ongoing operating principles to reinvest earnings so as to provide greater visibility in meeting long-term growth targets. Initiatives undertaken are currently expected to recover cash implementation costs within a five-year period of completion ( expected pay-back target ). Each cost-reduction initiative is normally one 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, which is then used to fund new initiatives. Certain of these initiatives represent exit or disposal plans for which material charges will be incurred.

In 2006, the Company commenced a multi-year European manufacturing optimization plan to improve utilization of its facility in Manchester, England and to better align production in Europe. Based on forecasted foreign exchange rates, the Company currently expects to incur approximately \$60 million in total project costs (including those already incurred in 2006), largely comprised of voluntary early retirement and severance benefits to eliminate approximately 220 hourly and salaried employee positions from the Manchester facility by the end of 2008.

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For 2006, the Company incurred approximately \$28 million of total project costs and currently expects to incur approximately \$18 million in 2007, with the remainder to be incurred in 2008. (Refer to page 36 of the Company's 2006 Annual Report on Form 10-K for further information on this initiative.)

All of the costs for the European manufacturing optimization plan have been recorded in cost of goods sold within the Company's European operating segment. The following tables present total project costs to date and a reconciliation of employee severance reserves for this initiative. All other cash costs were paid in the period incurred.

Project costs to date (in millions)	Employee severance	Other cash costs (a)	Asset write- offs	Retirement benefits (b)	Total
Year ended December 30, 2006	\$ 12	\$ 2	\$5	\$9	\$28
Quarter ended March 31, 2007	3	1	1		5
Quarter ended June 30, 2007	4	1	2		7
Quarter ended September 29, 2007		2			2
<b>Total project to date</b>	<b>\$ 19</b>	<b>\$ 6</b>	<b>\$8</b>	<b>\$9</b>	<b>\$42</b>

(a) Primarily includes expenditures for equipment removal and relocation, and temporary contracted services to facilitate employee transactions.

(b) Pension plan curtailment losses and special termination benefits recognized under SFAS No. 88 Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination

## Benefits.

Employee severance reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
Year ended December 30, 2006	\$	\$12	\$	\$12
Quarter ended March 31, 2007	12	3	(9)	6
Quarter ended June 30, 2007	6	4	(5)	5
Quarter ended September 29, 2007	5		(5)	
Total project to date		<b>\$19</b>	<b>\$(19)</b>	

In July 2007, management commenced a plan to reorganize the Company's direct store-door delivery (DSD) operations in the southeastern United States. This DSD reorganization plan is intended to integrate the Company's southeastern sales and distribution regions with the rest of its U.S. direct store-door operations, resulting in greater efficiency across the nationwide network. In preparation for this initiative, in June 2007, the Company began to extend offers to exit approximately 517 distribution route franchise agreements with independent contractors, which were substantially accepted as of July 2007. The plan is expected to result in the involuntary termination or relocation of approximately 300 employee positions. Management expects to substantially complete this initiative by the end of 2007 and to incur approximately \$80 million of total project costs during that period, principally consisting of cash expenditures for route franchise settlements and to a lesser extent, for employee separation, relocation, and reorganization.

All of the costs for the U.S. DSD reorganization plan have been recorded in selling, general, and administrative expense within the Company's North America operating segment. The following tables present total project costs to date and a reconciliation of reserves for route franchise settlements and employee severance.

Project costs to date (in millions)	Route		Retirement benefits (a)	Asset write-offs	Total
	franchise settlements	Severance			
Quarter ended June 30, 2007	\$ 38	\$	\$	\$	\$38
Quarter ended September 29, 2007	23	2	2	1	28
Total project to date	<b>\$ 61</b>	<b>\$ 2</b>	<b>\$ 2</b>	<b>\$ 1</b>	<b>\$66</b>

(a) Estimated multiemployer pension plan withdrawal liability.

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Route franchise settlements reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
Quarter ended June 30, 2007	\$	\$38	\$	\$ 38
Quarter ended September 29, 2007	38	23	(51)	10
Total project to date		<b>\$61</b>	<b>\$(51)</b>	

Employee severance reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
Quarter ended June 30, 2007	\$	\$	\$	\$
Quarter ended September 29, 2007		2	(1)	1
Total project to date		<b>\$ 2</b>	<b>\$(1)</b>	

In summary, operating profit for the quarter ended September 29, 2007 included total exit plan-related charges of \$30 million, comprised of \$2 million recorded in cost of goods sold and \$28 million recorded in selling, general, and administrative expense. The operating segment impact of these costs was (in millions): North America-\$28; Europe-\$2. On a year-to-date basis, operating profit included total exit plan-related charges of \$80 million, comprised of \$14 million recorded in cost of goods sold and \$66 million recorded in selling, general, and administrative expense. The operating segment impact of these costs was (in millions): North America-\$66; Europe-\$14. Cost of goods sold for the quarter and year-to-date periods ended September 30, 2006, included total exit plan-related charges of approximately \$9 million and \$36 million, respectively. The total year-to-date amount for 2006 was comprised of \$15 million of asset write-offs, \$4 million attributable to a multiemployer pension plan withdrawal liability, and \$17 million of cash expenditures, which consisted principally of severance, removals, and production relocation costs. For the quarter, the operating segment impact of these costs was (in millions): North America-\$5; Europe-\$4. For the year-to-date period, the operating segment impact was (in millions): North America-\$32; Europe-\$4. The North America costs related to a U.S. bakery consolidation initiative, which was completed in 2006. The details of this initiative are provided on page 37 of the Company's 2006 Annual Report on Form 10-K. The European costs were incurred as part of a multi-year European manufacturing optimization plan described above and on page 36 of the Company's 2006 Annual Report on Form 10-K.

**Subsequent events**

On October 26, 2007, management committed to reorganize certain production processes between the Company's plants in Valls, Spain and Bremen, Germany. Commencement of this plan follows consultation with union representatives at the Bremen facility regarding the elimination of approximately 120 employee positions. This reorganization plan is specifically intended to improve manufacturing and distribution efficiency across the Company's continental European operations, and is expected to be completed by mid 2008.

Based on current foreign exchange rates, management expects to incur approximately \$23 million of total project costs, comprised approximately 50% of asset-write-offs and 50% of employee separation benefits and other cash costs. Based on the current project timetable, virtually all of these costs are expected to be recognized in 2008.

**Note 4 Other income (expense), net**

Other income (expense), net includes non-operating items such as interest income, charitable donations, and foreign exchange gains and losses. Net foreign exchange transaction gains (losses) recognized were (\$3) million and (\$10)

million for the respective quarter and year-to-date periods ended September 29, 2007, as compared to (\$4) million and less than (\$1) million for the respective quarter and year-to-date periods ended September 30, 2006.

**Note 5 Equity**

***Earnings per share***

Basic net earnings per share is determined by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share is similarly determined, except that the

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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 are comprised principally of employee stock options issued by the Company, and to a lesser extent, certain contingently issuable performance shares. Basic net earnings per share is reconciled to diluted net earnings per share in the following table. The total number of anti-dilutive potential common shares excluded from the reconciliation was .2 million and .7 million for the respective quarter and year-to-date periods ended September 29, 2007, as compared to .2 million and .5 million for the respective quarter and year-to-date periods ended September 30, 2006.

<b>Quarter</b> (millions, except per share data)	Net earnings	Average shares outstanding	Net earnings per share
<b>2007</b>			
Basic	\$ 305	395	\$ .77
Dilutive potential common shares		4	(.01)
Diluted	\$ 305	399	\$ .76
<b>2006</b>			
Basic	\$ 281	397	\$ .71
Dilutive potential common shares		3	(.01)
Diluted	\$ 281	400	\$ .70
<b>Year-to-date</b> (millions, except per share data)			
	Net earnings	Average shares outstanding	Net earnings per share
<b>2007</b>			
Basic	\$ 927	397	\$ 2.34
Dilutive potential common shares		4	(.03)
Diluted	\$ 927	401	\$ 2.31
<b>2006</b>			
Basic	\$ 822	397	\$ 2.07
Dilutive potential common shares		2	(.01)
Diluted	\$ 822	399	\$ 2.06

During the year-to-date period ended September 29, 2007, the Company issued 2 million shares to employees and directors under various benefit plans and stock purchase programs, as further discussed in Note 8. To offset these issuances and for general corporate purposes, the Company's Board of Directors has authorized management to repurchase up to \$650 million of the Company's common stock during 2007. In connection with this authorization, during the year-to-date period ended September 29, 2007, the Company spent \$417 million to repurchase approximately 8 million shares. On October 26, 2007, the Board approved a similar stock repurchase authorization for



2008 of up to \$650 million.

***Comprehensive Income***

Comprehensive income includes net earnings 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 pursuant to SFAS No. 52 Foreign Currency Translation and fair value adjustments associated with cash flow hedges pursuant to SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities. Additionally, other comprehensive income for 2007 includes adjustments for net experience losses and prior service cost pursuant to SFAS No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. The Company adopted SFAS No. 158 as of the end of its 2006 fiscal year; however, comprehensive income for certain interim periods of 2006 continued to include minimum pension liability adjustments pursuant to SFAS No. 87 Employers Accounting for Pensions.

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The Company's benefit plan-related net experience losses and prior service cost increased by \$10 million for the quarter and \$23 million for the year-to-date period due to foreign currency remeasurement. Additionally for the year-to-date period, the Company recorded an increase in benefit plan-related experience losses of \$26 million for a census-related valuation update pursuant to SFAS No. 158. These amounts are presented in the following table as amounts arising during the period:

**Quarter**

(millions)	Pre-tax amount	Tax (expense) or benefit	After-tax amount
<b>2007</b>			
Net earnings			\$305
Other comprehensive income:			
Foreign currency translation adjustments	11		11
Cash flow hedges:			
Unrealized gain (loss) on cash flow hedges	5	(2)	3
Reclassification to net earnings	(3)	1	(2)
Postretirement and postemployment benefits:			
Amounts arising during the period:			
Net experience loss	(9)	(3)	(12)
Prior service cost	(1)		(1)
Reclassification to net earnings:			
Net experience loss	23	(8)	15
Prior service cost	3	(1)	2
	29	(13)	16
Total comprehensive income			\$321

(millions)	Pre-tax amount	Tax (expense) or benefit	After-tax amount
<b>2006</b>			
Net earnings			\$281
Other comprehensive income:			
Foreign currency translation adjustments	29		29
Cash flow hedges:			
Unrealized gain (loss) on cash flow hedges	(17)	6	(11)
Reclassification to net earnings	3	(1)	2
	15	5	20
Total comprehensive income			\$301



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(millions)	Pre-tax amount	Tax (expense) or benefit	After-tax amount
<b>2007</b>			
Net earnings			\$ 927
Other comprehensive income:			
Foreign currency translation adjustments	38		38
Cash flow hedges:			
Unrealized gain (loss) on cash flow hedges	22	(8)	14
Reclassification to net earnings	(2)	1	(1)
Postretirement and postemployment benefits:			
Amounts arising during the period:			
Net experience loss	(47)	10	(37)
Prior service cost	(2)		(2)
Reclassification to net earnings:			
Net experience loss	68	(23)	45
Prior service cost	8	(3)	5
	85	(23)	62
Total comprehensive income			\$ 989

(millions)	Pre-tax amount	Tax (expense) or benefit	After-tax amount
<b>2006</b>			
Net earnings			\$ 822
Other comprehensive income:			
Foreign currency translation adjustments	(9)		(9)
Cash flow hedges:			
Unrealized gain (loss) on cash flow hedges	(11)	4	(7)
Reclassification to net earnings	7	(3)	4
	(13)	1	(12)
Total comprehensive income			\$ 810

Accumulated other comprehensive income (loss) as of September 29, 2007 and December 30, 2006 consisted of the following:

(millions)	<b>September 29, 2007</b>	December 30, 2006
Foreign currency translation adjustments	<b>\$ (371)</b>	\$ (409)
Cash flow hedges unrealized net loss	<b>(20)</b>	(33)
Postretirement and postemployment benefits:		
Net experience loss	<b>(532)</b>	(540)
Prior service cost	<b>(61)</b>	(64)
 Total accumulated other comprehensive income (loss)	 <b>\$ (984)</b>	 \$ (1,046)

**Table of Contents****Note 6 Leases and other commitments**

The Company was subject to a maximum residual value guarantee on one operating lease of a snacks manufacturing facility in Chicago, Illinois, for approximately \$13 million, which was scheduled to expire in July 2007. During the first quarter of 2007, the Company recognized a liability in connection with this guarantee of approximately \$5 million, which was recorded in cost of goods sold within the Company's North America operating segment. During the second quarter of 2007, the Company terminated the lease agreement and purchased the facility for approximately \$16 million, which discharged the residual value guarantee obligation.

**Note 7 Debt**

On February 28, 2007, a subsidiary of the Company redeemed Euro 550 million of Guaranteed Floating Rate Notes otherwise due May 2007 for \$728 million. To partially refinance this redemption, the Company and two of its subsidiaries (the Issuers) established a program under which the Issuers may issue euro-commercial paper notes up to a maximum aggregate amount outstanding at any time of \$750 million or its equivalent in alternative currencies. The notes may have maturities ranging up to 364 days and are senior unsecured obligations of the applicable Issuer. Notes issued by subsidiary Issuers are guaranteed by the Company. The notes may be issued at a discount or may bear fixed or floating rate interest or a coupon calculated by reference to an index or formula. On June 13, 2007, management also increased the aggregate principal amount of notes that may be outstanding at any time under the Company's U.S. commercial paper program from \$2.0 billion to \$2.5 billion.

In connection with these financing activities, the Company increased its short-term lines of credit from \$2.2 billion at December 30, 2006 to approximately \$3.3 billion at September 29, 2007. This increase was achieved via a \$400 million unsecured 364-Day Credit Agreement effective January 31, 2007 and a \$700 million 364-Day Credit Agreement effective June 13, 2007. These 364-Day Agreements contain customary covenants, warranties, and restrictions similar to those described for the Five-Year Credit Agreement on page 41 of the Company's 2006 Annual Report on Form 10-K. The Company's credit facilities are available for general corporate purposes, including commercial paper back-up, although management does not currently anticipate any draw-down of the facilities. As of September 29, 2007, notes outstanding under the Company's commercial paper programs were (in millions): U.S.-\$1,790; Europe-\$0; Canada-\$0. Refer to page 40 of the Company's 2006 annual report on Form 10-K for comparable information as of December 30, 2006.

**Note 8 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 stock options and restricted stock to its outside directors. These awards are administered through several plans, as described on pages 41 to 44 of the Company's 2006 Annual Report on Form 10-K.

Beginning in 2006, the Company has followed SFAS No. 123(R) Share-Based Payment to account for its equity-based compensation programs. For the periods presented, the Company classified pre-tax stock compensation expense in selling, general, and administrative expense principally within its corporate operations. For further information on the Company's stock compensation accounting methods, refer to pages 32 and 33 of the Company's 2006 Annual Report on Form 10-K.

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For the periods presented, compensation expense for all types of equity-based programs and the related income tax benefit recognized are as follows:

(millions)	Quarter ended		Year-to-date period ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Pre-tax compensation expense	\$18	\$ 23	\$65	\$ 68
Related income tax benefit	\$ 6	\$ 8	\$23	\$ 24

As of September 29, 2007, total stock-based compensation cost related to nonvested awards not yet recognized was approximately \$43 million and the weighted-average period over which this amount is expected to be recognized was approximately 1.3 years.

**Stock Options**

During the year-to-date periods ended September 29, 2007 and September 30, 2006, the Company granted non-qualified stock options to eligible employees and outside directors 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 page 43 of the Company's 2006 Annual Report on Form 10-K.

Year-to-date period ended September 29, 2007:

Employee and director stock options	Shares (millions)	Weighted-average exercise price	Weighted-average remaining contractual term (yrs.)	Aggregate intrinsic value (millions)
Outstanding, beginning of period	27	\$ 41		
Granted	7	51		
Exercised	(7)	41		
Forfeitures and expirations				
Outstanding, end of period	27	\$ 44	6.2	\$ 263
Exercisable, end of period	21	\$ 42	5.3	\$ 246

Year-to-date period ended September 30, 2006:

Employee and director stock options	Weighted-average	Weighted-average remaining contractual term (yrs.)	Aggregate intrinsic

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	Shares (millions)	exercise price		value (millions)
Outstanding, beginning of period	29	\$ 38		
Granted	8	45		
Exercised	(8)	36		
Forfeitures and expirations	(1)	42		
Outstanding, end of period	28	\$ 41	6.3	\$ 252
Exercisable, end of period	21	\$ 39	5.4	\$ 229

The weighted-average fair value of options granted was \$7.27 per share for the year-to-date period ended September 29, 2007 and \$6.96 per share for the year-to-date period ended September 30, 2006. The total intrinsic value of options exercised was \$75 million for the year-to-date period ended September 29, 2007 and \$89 million for the year-to-date period ended September 30, 2006.



**Table of Contents****Other stock-based awards**

During the periods presented, other stock-based awards consisted principally of executive performance shares granted under the Company's 2003 Long-Term Incentive Plan.

In the first quarter of 2007, 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 cash flow targets are achieved. The 2007 target grant currently corresponds to approximately 206,000 shares, with a grant-date fair value of approximately \$46 per share. The actual number of shares issued on the vesting date could range from zero to 200% of target, depending on actual performance achieved. For information on similar performance share awards in 2005 and 2006, refer to page 44 of the Company's 2006 Annual Report on Form 10-K. Based on the market price of the Company's common stock at September 29, 2007, the maximum future value that could be awarded to employees on the vesting date is (in millions): 2005 award-\$30; 2006 award-\$28; and 2007 award-\$23.

**Note 9 Employee benefits**

The Company sponsors a number of U.S. and foreign pension, other postretirement and postemployment plans to provide various benefits for its employees. These plans are described on pages 44 to 48 of the Company's 2006 Annual Report on Form 10-K. Components of Company plan benefit expense for the periods presented are included in the tables below.

**Pension**

(millions)	Quarter ended		Year-to-date period ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Service cost	\$ 23	\$ 23	\$ 71	\$ 69
Interest cost	47	43	139	127
Expected return on plan assets	(71)	(63)	(209)	(188)
Amortization of unrecognized prior service cost	5	4	10	10
Recognized net loss	16	19	48	58
Total pension expense - Company plans	\$ 20	\$ 26	\$ 59	\$ 76

**Other nonpension postretirement**

(millions)	Quarter ended		Year-to-date period ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Service cost	\$ 6	\$ 4	\$ 14	\$ 13
Interest cost	17	17	51	49
Expected return on plan assets	(15)	(14)	(45)	(43)
Amortization of unrecognized prior service cost	(2)		(2)	(2)
Recognized net loss	6	7	18	23
Postretirement benefit expense	\$ 12	\$ 14	\$ 36	\$ 40

**Postemployment**

(millions)	Quarter ended		Year-to-date period ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Service cost	\$ 2	\$ 1	\$ 4	\$ 3
Interest cost		1	2	2
Recognized net loss	1	1	2	3
Postemployment benefit expense	\$ 3	\$ 3	\$ 8	\$ 8

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Management currently plans to contribute approximately \$33 million to its defined benefit pension plans and \$15 million to its retiree health and welfare benefit plans during 2007, for a total of \$48 million. During 2006, the Company contributed approximately \$86 million to defined benefit pension plans and \$13 million to retiree health and welfare benefit plans, for a total of \$99 million. Plan funding strategies are periodically modified to reflect management's current evaluation of tax deductibility, market conditions, and competing investment alternatives.

**Note 10 Income taxes*****Effective income tax rate***

The consolidated effective income tax rate was approximately 27% for the quarter and 28% for the year-to-date period ended September 29, 2007, as compared to approximately 32% for both the comparable quarter and year-to-date periods of 2006. The third quarter 2007 effective income tax rate was lower than the prior-period rate due primarily to statutory rate reductions, as discussed in the following paragraph. The year-to-date 2007 effective income tax rate also benefited from the reversal of a foreign tax liability of \$40 million, which was triggered by the implementation of an international restructuring initiative in the first quarter of 2007.

In July 2007, the government of the United Kingdom enacted a statutory rate reduction of two percentage points, applicable from April 1, 2008. In August 2007, the government of Germany enacted a federal statutory income tax rate reduction of ten percentage points effective in 2008, partially offset by the effect of other German tax law changes. Accordingly, during the third quarter of 2007, the Company reduced its net deferred income tax liabilities in these jurisdictions to reflect the lower rates, resulting in a decrease to consolidated income tax expense of \$17 million.

***Uncertain tax positions***

The Company adopted Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN No. 48) as of the beginning of its 2007 fiscal year. This interpretation clarifies what criteria must be met prior to recognition of the financial statement benefit, in accordance with FASB Statement No. 109, Accounting for Income Taxes, of a position taken in a tax return.

Prior to adopting FIN No. 48, the Company's policy was to establish reserves that reflected the probable outcome of known tax contingencies. Favorable resolution was recognized as a reduction to the effective income tax rate in the period of resolution. As compared to a contingency approach, FIN No. 48 is based on a benefit recognition model. Provided that the tax position is deemed more likely than not of being sustained, FIN No. 48 permits a company to recognize the largest amount of tax benefit that is greater than 50 percent likely of being ultimately realized upon settlement. The tax position must be derecognized when it is no longer more likely than not of being sustained. The initial application of FIN No. 48 resulted in a net decrease to the Company's consolidated accrued income tax and related interest liabilities of approximately \$2 million, with an offsetting increase to retained earnings.

The Company files income taxes in the U.S. federal jurisdiction, and in various state, local, and foreign jurisdictions. For the past several years, the Company's annual provision for U.S. federal income taxes has represented approximately 70% of the Company's consolidated income tax provision. With limited exceptions, the Company is no longer subject to U.S. federal examinations by the Internal Revenue Service (IRS) for years prior to 2004. During the first quarter of 2007, the IRS commenced an examination of the Company's 2004 and 2005 U.S. federal income tax returns, which is anticipated to be completed during the second half of 2008. The Company is also under examination for income and non-income tax filings in various state and foreign jurisdictions, most notably: 1) a U.S.-Canadian transfer pricing issue pending international arbitration (Competent Authority) with a related advanced pricing agreement for years 1997-2008; and 2) an on-going examination of 2002-2004 U.K. income tax filings, with an examination of the 2005 filing, which began in July 2007.

As of September 29, 2007, the Company has classified approximately \$34 million of unrecognized tax benefits as a current liability, representing several individually insignificant income tax positions under examination in various jurisdictions. Management's estimate of reasonably possible changes in unrecognized tax benefits during the next twelve months is comprised of the aforementioned current liability balance expected to be settled within one year, offset by approximately \$26 million of projected additions related primarily to ongoing intercompany transfer pricing activity. Management is currently unaware of any issues under review that could result in significant additional payments, accruals, or other material deviation in this estimate.



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Following is a reconciliation of the Company's total gross unrecognized tax benefits for the year-to-date period ended September 29, 2007. Approximately \$149 million of this total represents the amount that, if recognized, would affect the Company's effective income tax rate in future periods. This amount differs from the gross unrecognized tax benefits presented in the table due to the decrease in U.S. federal income taxes which would occur upon recognition of the state tax benefits included therein.

(millions)

Balance at December 31, 2006	\$ 143
Tax positions related to current year:	
Additions	24
Reductions	
Tax positions related to prior years:	
Additions	13
Reductions	(8)
Settlements	
Lapses in statutes of limitation	
Balance at September 29, 2007	\$ 172

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 noncurrent liabilities.

The Company classifies income tax-related interest and penalties as interest expense and selling, general, and administrative expense, respectively. For the year-to-date period ended September 29, 2007, the Company recognized \$7 million of tax-related interest and penalties and had approximately \$27 million accrued at September 29, 2007.

**Subsequent events**

In addition to the aforementioned statutory rate reductions enacted in the Company's fiscal third quarter, on October 1, 2007, the government of Mexico enacted a tax reform package. Beginning in 2008, corporate entities will pay the higher of traditional income tax (generally imposed at a rate of 28%) or a new corporate flat tax, which is phased in at a rate of 16.5% in 2008 to 17.5% by 2010. Under the new flat tax, allowable deductions, such as interest expense, are limited. Management is currently studying the impact of the Mexican tax law reform on the Company's Latin American operations; however, we believe this tax reform could result in a slight increase in our consolidated effective income tax rate, beginning in 2008.

**Note 11 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, comprised of North America and the three International operating segments of Europe, Latin America, and Asia Pacific. Prior to 2007, the Asia Pacific operating segment included Australia and Asian markets. Beginning in 2007, this segment also includes South Africa, which was formerly a part of Europe. Prior-year periods have been restated.

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(millions) (Results are unaudited)	Quarter ended		Year-to-date period ended	
	September <b>29,</b> <b>2007</b>	September 30, 2006	September <b>29,</b> <b>2007</b>	September 30, 2006
<b>Net sales</b>				
North America	<b>\$1,960</b>	\$ 1,887	<b>\$5,942</b>	\$ 5,611
Europe	<b>604</b>	542	<b>1,801</b>	1,570
Latin America	<b>270</b>	236	<b>752</b>	676
Asia Pacific (a)	<b>170</b>	158	<b>487</b>	466
Consolidated	<b>\$3,004</b>	\$ 2,823	<b>\$8,982</b>	\$ 8,323
<b>Segment operating profit</b>				
North America	<b>\$ 333</b>	\$ 342	<b>\$1,059</b>	\$ 1,021
Europe	<b>110</b>	104	<b>345</b>	285
Latin America	<b>66</b>	64	<b>168</b>	177
Asia Pacific (a)	<b>18</b>	23	<b>65</b>	72
Corporate	<b>(35)</b>	(46)	<b>(128)</b>	(134)
Consolidated	<b>\$ 492</b>	\$ 487	<b>\$1,509</b>	\$ 1,421

(a) Includes  
Australia, Asia  
and South  
Africa.

**Note 12 Supplemental cash flow data**

(millions)	Year-to-date period ended	
	September <b>29, 2007</b>	September 30, 2006
<b>Changes in operating assets and liabilities</b>		
Trade receivables	<b>\$(210)</b>	\$ (188)
Inventories	<b>(11)</b>	(39)
Accounts payable	<b>103</b>	33
Accrued income taxes	<b>22</b>	39
Accrued interest expense	<b>47</b>	49
Accrued and prepaid advertising, promotion and trade allowances	<b>95</b>	73
Accrued salaries and wages	<b>(42)</b>	(21)
Exit plan-related reserves (a)	<b>(3)</b>	(9)
All other current assets and liabilities (b)	<b>68</b>	(9)

\$ 69

\$ (72)

- (a) Refer to Note 3 for further information.
- (b) Consists of various individually-insignificant business receipts and expenditures, including non-income tax refunds and hedging settlements.

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**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. Principal markets for these products include the United States and United Kingdom. We currently manage our operations in four geographic operating segments, comprised of North America and the three International operating segments of Europe, Latin America, and Asia Pacific. Prior to 2007, the Asia Pacific operating segment included Australia and Asian markets. Beginning in 2007, this segment also includes South Africa, which was formerly a part of Europe. Prior-year periods have been restated.

We currently expect our full-year 2007 internal net sales to increase by mid single-digits. (*Our measure of internal growth rates excludes the impact of currency, and if applicable, acquisitions, dispositions, and shipping day differences.*) Based on year-to-date results, we believe this targeted growth will be fairly broad-based, with our North America, European, and Latin American operating segments all delivering strong sales performance this year. Primarily as a result of lower-than-expected income tax expense for the full year, we have chosen to reinvest in incremental cost-reduction initiatives, which is expected to adversely impact our full-year operating profit growth by one to two percentage points. Accordingly, we currently believe our full-year 2007 internal operating profit growth will increase by low single-digits; this forecasted performance is expected to reflect double-digit growth in advertising investment and an inflation-driven decline in gross margin of approximately 50 basis points. Our net interest expense for 2007 is currently expected to be approximately even with 2006 results and our consolidated effective income tax rate is currently projected to be approximately three percentage points lower than the 2006 rate of 32%. These two factors are expected to provide leverage for purposes of achieving our target of high single-digit growth in 2007 diluted net earnings per share. Lastly, we expect our cash flow performance to remain strong and are currently targeting a level of approximately one billion dollars for 2007.

For the year-to-date period ended September 29, 2007, we reported consolidated net sales growth of 8% with internal growth of 6%. Consolidated operating profit increased 6% on internal growth of 3%. Diluted net earnings per share grew 12%, from \$2.06 for the year-to-date period of 2006 to \$2.31 in the current year-to-date period. Similarly, for the third quarter of 2007, we reported consolidated net sales growth of 6% with internal growth of 4%. Consolidated operating profit grew 1% on a reported basis and declined 2% on an internal basis. This decline was principally attributable to our discretionary investment in cost-reduction initiatives, which reduced third quarter operating profit growth by nearly five percentage points. Diluted net earnings per share grew 9%, from \$.70 in the third quarter of 2006 to \$.76 in the current period. For the quarter, our earnings growth outpaced operating profit performance primarily due to a five percentage point decline in our consolidated effective income tax rate, versus the prior-year period.

***Net sales and operating profit***

The following table provides an analysis of net sales and operating profit performance for the third quarter of 2007 versus 2006:



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(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consolidated
<b>2007 net sales</b>	<b>\$ 1,960</b>	<b>\$ 604</b>	<b>\$ 270</b>	<b>\$ 170</b>	<b>\$</b>	<b>\$ 3,004</b>
<b>2006 net sales</b>	<b>\$ 1,887</b>	<b>\$ 542</b>	<b>\$ 236</b>	<b>\$ 158</b>	<b>\$</b>	<b>\$ 2,823</b>
<i>% change 2007 vs. 2006:</i>						
Volume (tonnage) (b)	-0.3%	0.1%	9.6%	0.2%		0.7%
Pricing/mix	3.5%	3.3%	2.7%	-1.2%		3.1%
<b>Subtotal internal business</b>	<b>3.2%</b>	<b>3.4%</b>	<b>12.3%</b>	<b>-1.0%</b>		<b>3.8%</b>
Foreign currency impact	0.7%	8.2%	1.9%	8.1%		2.6%
<b>Total change</b>	<b>3.9%</b>	<b>11.6%</b>	<b>14.2%</b>	<b>7.1%</b>		<b>6.4%</b>

(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consolidated
<b>2007 operating profit</b>	<b>\$ 333</b>	<b>\$ 110</b>	<b>\$ 66</b>	<b>\$ 18</b>	<b>\$ (35)</b>	<b>\$ 492</b>
<b>2006 operating profit</b>	<b>\$ 342</b>	<b>\$ 104</b>	<b>\$ 64</b>	<b>\$ 23</b>	<b>\$ (46)</b>	<b>\$ 487</b>
<i>% change - 2007 vs. 2006:</i>						
<b>Internal business</b>	<b>-3.6%</b>	<b>-1.7%</b>	<b>1.3%</b>	<b>-26.0%</b>	<b>21.9%</b>	<b>-1.9%</b>
Foreign currency impact	0.8%	7.5%	1.7%	6.7%	0.0%	2.7%
<b>Total change</b>	<b>-2.8%</b>	<b>5.8%</b>	<b>3.0%</b>	<b>-19.3%</b>	<b>21.9%</b>	<b>0.8%</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.

Despite a difficult comparison with 8% reported growth in the prior-year quarter, our solid consolidated net sales performance for the third quarter of 2007 reflects the continuation of broad-based successful innovation, brand-building (advertising and consumer promotion) investment, and in-store execution.

For the quarter, our North America operating segment reported internal net sales growth of 3%, with the retail snacks product group (*wholesome snacks, cookies, crackers, toaster pastries, fruit snacks*) contributing at a rate of 5% and the frozen and specialty (*food service, vending, convenience, drug stores, custom manufacturing*) channels product group contributing at a rate of 6%.

As discussed in the section herein entitled *Exit or disposal plans*, we have implemented a plan to reorganize our direct store-door delivery (DSD) operations in the southeastern United States in order to increase efficiency across our nationwide network. During this period, we successfully accelerated this plan, which we believe has better positioned our North America retail snacks business for strong growth in the future. Despite temporary disruption from DSD reorganization activities, our North America retail snacks product group achieved mid single-digit sales growth for the third quarter of 2007. Based on the success of this plan, we will also convert certain *Kashi* and fruit snack products to DSD distribution, effective January 2008, which we expect to result in some level of sales disruption during the fourth quarter of 2007 and the first quarter of 2008.

Internal sales for our North America retail cereal product group were approximately even with the prior-year period, even though we experienced solid growth in U.S. consumer consumption and Canadian sales of our products. Accordingly, we believe our current-period sales performance primarily reflects the normalization of U.S. retail cereal trade inventory levels, as compared to temporarily-elevated levels in the third quarter of 2006. During this period, we have remained on track with our sustainable innovation and brand-building investment strategies, which we believe has helped to sustain consumer consumption growth at expected levels. Based on this consumption growth and the continuation of normal trade inventory levels, we currently expect strong growth in North America retail cereal sales for the fourth quarter of 2007.

Our International operating segments collectively reported internal net sales growth of approximately 5% with leading dollar contributions from our UK, Italy, Mexico, and Venezuela business units. During the period, we continued to achieve strong sales growth of both cereal and snack products in our Latin America operating segment, due primarily to successful innovation and marketing strategies. Our European sales performance was adversely impacted by a voluntary product recall in the UK; nevertheless, this operating segment achieved low single-digit sales growth for the quarter and maintained its year-to-date internal sales growth at the mid single-digit level. The internal sales decline in our Asia Pacific operating segment (which represents only about 5% of our consolidated results) was attributable to continuing weak performance in our Australian business due to competitive pressures, which offset double-digit sales growth in our Asian and S. Africa markets.

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For the quarter, our consolidated operating profit grew 1% on a reported basis and declined 2% on an internal basis. As further discussed in the section herein entitled *Exit or disposal plans*, this decline was principally attributable to a year-over-year increase in exit plan-related charges of \$21 million. This discretionary investment in cost-reduction initiatives, which is consistent with our reinvestment strategy, reduced third quarter operating profit growth by nearly five percentage points. These operating profit results also reflect double-digit growth in advertising investment and an inflation-driven 40 basis point reduction in gross margin, as further discussed in the next section entitled *Margin performance*.

For the quarter, the allocation of the net increment amount of exit plan-related charges among operating segments reduced North America operating profit by \$23 million and increased Europe operating profit by \$2 million. The allocation within consolidated operating profit resulted in a favorable year-over-year impact on cost of goods sold of \$7 million and an unfavorable impact on selling, general, and administrative expense of \$28 million.

Taking into account these year-over-year segment shifts in exit plan-related charges, the operating profit results for our North America segment mirrored the consolidated performance. In Europe, the internal operating profit decline was primarily attributable to the aforementioned product recall and a significant increase in advertising expenditures as a percentage of sales; nevertheless, internal operating profit increased 11% on a year-to-date basis. As previously predicted, our Latin America operating segment continued to be impacted by corn price inflation and other cost factors, but managed to achieve a small increase in internal operating profit for the quarter. Our internal Asia Pacific operating profit declined by the equivalent of \$6 million, largely related to the sales decline in that segment, significant investment in brand-building, and costs associated with operational efficiency initiatives in Australia. Although we do expect some stabilization in Asia Pacific and continued recovery in Latin America during the remainder of the year, we do not currently believe these segments' full-year 2007 operating profit will exceed the 2006 level.

The following table provides an analysis of net sales and operating profit performance for the year-to-date periods of 2007 versus 2006. On a year-to-date basis, incremental exit plan-related charges were \$44 million and were allocated to segments as follows (in millions): North America-\$34; Europe-\$10. The allocation of the net incremental amount within operating profit resulted in a favorable year-over-year impact on cost of goods sold of \$22 million and an unfavorable impact on selling, general, and administrative expense of \$66 million. Our year-to-date North America operating profit also included a charge of \$5 million related to a lease residual value guarantee. Our year-to-date corporate operating profit included intangible impairment losses of \$7 million. Refer to Notes 6 and 2, respectively, within Notes to Consolidated Financial Statements for further information on these charges.

(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consoli- dated
<b>2007 net sales</b>	<b>\$ 5,942</b>	<b>\$ 1,801</b>	<b>\$ 752</b>	<b>\$ 487</b>	<b>\$</b>	<b>\$ 8,982</b>
<b>2006 net sales</b>	<b>\$ 5,611</b>	<b>\$ 1,570</b>	<b>\$ 676</b>	<b>\$ 466</b>	<b>\$</b>	<b>\$ 8,323</b>
<i>% change - 2007 vs. 2006:</i>						
Volume (tonnage) (b)	1.4%	2.2%	8.2%	-1.9%		2.0%
Pricing/mix	4.2%	3.4%	1.4%	.8%		3.6%
<b>Subtotal internal business</b>	<b>5.6%</b>	<b>5.6%</b>	<b>9.6%</b>	<b>-1.1%</b>		<b>5.6%</b>
Foreign currency impact	.3%	9.1%	1.6%	5.5%		2.3%
<b>Total change</b>	<b>5.9%</b>	<b>14.7%</b>	<b>11.2%</b>	<b>4.4%</b>		<b>7.9%</b>

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(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consolidated
<b>2007 operating profit</b>	<b>\$ 1,059</b>	<b>\$ 345</b>	<b>\$ 168</b>	<b>\$ 65</b>	<b>\$ (128)</b>	<b>\$ 1,509</b>
<b>2006 operating profit</b>	<b>\$ 1,021</b>	<b>\$ 285</b>	<b>\$ 177</b>	<b>\$ 72</b>	<b>\$ (134)</b>	<b>\$ 1,421</b>
<i>% change - 2007 vs. 2006:</i>						
<b>Internal business</b>	<b>3.4%</b>	<b>11.2%</b>	<b>-6.6%</b>	<b>-15.3%</b>	<b>3.9%</b>	<b>3.4%</b>
Foreign currency impact	.3%	10.0%	1.5%	5.4%		2.7%
<b>Total change</b>	<b>3.7%</b>	<b>21.2%</b>	<b>-5.1%</b>	<b>-9.9%</b>	<b>3.9%</b>	<b>6.1%</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 2007 versus 2006 is presented in the following table:

<b>Quarter</b>	<b>2007</b>	2006	<i>Change vs. prior year (pts.)</i>
Gross margin (a)	<b>44.7%</b>	45.1%	<b>-0.4</b>
SGA% (b)	<b>-28.3%</b>	-27.8%	<b>-0.5</b>
Operating margin	<b>16.4%</b>	17.3%	<b>-0.9</b>
<b>Year-to-date</b>	<b>2007</b>	2006	<i>Change</i>
Gross margin (a)	<b>44.3%</b>	44.5%	<b>-0.2</b>
SGA% (b)	<b>-27.5%</b>	-27.4%	<b>-0.1</b>
Operating margin	<b>16.8%</b>	17.1%	<b>-0.3</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 tables, our consolidated gross margin declined versus the prior-year periods, principally due to significant, continuing commodity, fuel, and energy price inflation. Partially mitigating factors primarily included savings from cost-reduction initiatives and price/mix improvements. For the periods presented, our SGA% was adversely impacted by incremental exit plan-related charges, which more than offset a favorable impact on gross margin and resulted in a net unfavorable exit plan-related impact on operating margin of 70 basis points for the quarter and 50 basis points for the year-to-date period.

Based on our year-to-date performance, we currently expect that our full-year 2007 consolidated gross margin will decline by approximately 50 basis points. This forecast incorporates approximately \$200 million of year-over-year commodity, fuel, and energy price inflation, net of a modest reduction in employee benefit costs. Approximately 60%

of this price inflation was absorbed in the year-to-date period. As compared to our original 2007 price inflation forecast of \$110-\$130 million (discussed on page 14 of our 2006 Annual Report on Form 10-K), our most recent projection incorporates higher, current market prices for packaging and ingredient purchases, primarily dairy, eggs, and wheat.

Despite the full-year 2007 forecasted gross margin decline, we achieved incremental gross profit of \$277 million, which provides more than enough funds to invest aggressively in our brands while delivering on earnings growth targets.

***Exit or disposal plans***

As discussed on pages 14-15 of our 2006 Annual Report on Form 10-K, we view our continued spending on cost-reduction initiatives as part of our ongoing operating principles to reinvest earnings so as to provide greater visibility in meeting long-term growth targets. Initiatives undertaken are currently expected to recover cash implementation costs within a five-year period of completion ( expected pay-back target ). 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, which is then reinvested in the business. Certain of these initiatives represent exit or disposal plans for which material charges will be incurred. We include these charges in our measure of operating segment profitability. As discussed in the following paragraphs of this section, we are currently committed to exit plans that are expected to generate approximately \$100 million of related charges for the full year of 2007 as compared to \$82 million in 2006. Additionally, we currently expect full-year 2007 cash requirements for these projects to approximate our forecast of exit plan-related charges. We expect these cash requirements to be funded by operating cash flow. These forecasted charges and cash requirements are incorporated in our communicated expectations for 2007 earnings and cash flow performance. Additional initiatives, which could be implemented in 2007 or 2008, are in the planning stages and will be announced as we commit to a course of action.

In 2006, we commenced a multi-year European manufacturing optimization plan to improve utilization of our facility in Manchester, England and to better align production in Europe. Based on forecasted foreign exchange rates, we currently expect to incur approximately \$60 million in total project costs (including those already incurred in 2006), largely comprised of voluntary early

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retirement and severance benefits to eliminate approximately 220 hourly and salaried employee positions from the Manchester facility by the end of 2008. For 2006, we incurred approximately \$28 million of total project costs and expect to incur approximately \$18 million in 2007, with the remainder incurred in 2008. (Refer to page 36 of our 2006 Annual Report on Form 10-K for further information on this initiative.)

All of the costs for the European manufacturing optimization plan have been recorded in cost of goods sold within our European operating segment. The following tables present total project costs to date and a reconciliation of employee severance reserves for this initiative. All other cash costs were paid in the period incurred.

Project costs to date (in millions)	Employee severance	Other cash costs (a)	Asset write- offs	Retirement benefits (b)	Total
Year ended December 30, 2006	\$12	\$2	\$5	\$9	\$28
Quarter ended March 31, 2007	3	1	1		5
Quarter ended June 30, 2007	4	1	2		7
Quarter ended September 29, 2007		2			2
<b>Total project to date</b>	<b>\$19</b>	<b>\$6</b>	<b>\$8</b>	<b>\$9</b>	<b>\$42</b>

(a) Primarily includes expenditures for equipment removal and relocation, and temporary contracted services to facilitate employee transactions.

(b) Pension plan curtailment losses and special termination benefits recognized under SFAS No. 88  
Accounting for Settlements and Curtailments of Defined Benefit Pension Plans

and for  
Termination  
Benefits.

Employee severance reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
Year ended December 30, 2006	\$	\$12	\$	\$12
Quarter ended March 31, 2007	12	3	(9)	6
Quarter ended June 30, 2007	6	4	(5)	5
Quarter ended September 29, 2007	5		(5)	
Total project to date		<b>\$19</b>	<b>\$(19)</b>	

Following the 2006 commencement of our multi-year European optimization in Manchester, England, in October 2007, we committed to reorganize certain production processes between our plants in Valls, Spain and Bremen, Germany. Commencement of this plan follows consultation with union representatives at the Bremen facility regarding the elimination of approximately 120 employee positions. This reorganization plan is specifically intended to improve manufacturing and distribution efficiency across our continental European operations, and is expected to be completed by mid 2008. Based on current foreign exchange rates, we expect to incur approximately \$23 million of total project costs, comprised approximately 50% of asset write-offs and 50% of employee separation benefits and other cash costs. Based on the current project timetable, virtually all of these costs are expected to be recognized in 2008.

In July 2007, we commenced a plan to reorganize our direct store-door delivery (DSD) operations in the southeastern United States. This DSD reorganization plan is intended to integrate our southeastern sales and distribution regions with the rest of our U.S. direct store-door operations, resulting in greater efficiency across the nationwide network. In preparation for this initiative, in June 2007, we began to extend offers to exit approximately 517 distribution route franchise agreements with independent contractors, which were substantially accepted as of July 2007. The plan is expected to result in the involuntary termination or relocation of approximately 300 employee positions. We expect to substantially complete this initiative by the end of 2007 and to incur approximately \$80 million of total project costs during that period, principally consisting of cash expenditures for route franchise settlements and to a lesser extent, for employee separation, relocation, and reorganization.

All of the costs for the U.S. DSD reorganization plan have been recorded in selling, general, and administrative expense within our North America operating segment. The following tables present total project costs to date and a reconciliation of reserves for route franchise settlements and employee severance.



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Project costs to date (in millions)	Route		Retirement		Total
	franchise settlements	Severance	benefits (a)	Asset write-offs	
Quarter ended June 30, 2007	\$ 38	\$	\$	\$	\$38
Quarter ended September 29, 2007	23	2	2	1	28
<b>Total project to date</b>	<b>\$ 61</b>	<b>\$ 2</b>	<b>\$ 2</b>	<b>\$ 1</b>	<b>\$66</b>

(a) Estimated multiemployer pension plan withdrawal liability.

Route franchise settlements reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
	Quarter ended June 30, 2007			
Quarter ended September 29, 2007	38	23	(51)	10
<b>Total project to date</b>		<b>\$61</b>	<b>\$(51)</b>	

Employee severance reserves to date (in millions)	Beginning of period	Accruals	Payments	End of period
	Quarter ended June 30, 2007			
Quarter ended September 29, 2007		2	(1)	1
<b>Total project to date</b>		<b>\$2</b>	<b>\$(1)</b>	

In summary, operating profit for the quarter ended September 29, 2007 included total exit plan-related charges of \$30 million, comprised of \$2 million recorded in cost of goods sold and \$28 million recorded in selling, general, and administrative expense. The operating segment impact of these costs was (in millions): North America-\$28; Europe-\$2. On a year-to-date basis, operating profit included total exit plan-related charges of \$80 million, comprised of \$14 million recorded in cost of goods sold and \$66 million recorded in selling, general, and administrative expense. The operating segment impact of these costs was (in millions): North America-\$66; Europe-\$14. Cost of goods sold for the quarter and year-to-date periods ended September 30, 2006, included total exit plan-related charges of approximately \$9 million and \$36 million, respectively. The total year-to-date amount for 2006 was comprised of \$15 million of asset write-offs, \$4 million attributable to a multiemployer pension plan withdrawal

liability, and \$17 million of cash expenditures, which consisted principally of severance, removals, and production relocation costs. For the quarter, the operating segment impact of these costs was (in millions): North America-\$5; Europe-\$4. For the year-to-date period, the operating segment impact was (in millions): North America-\$32; Europe-\$4. The North America costs related to a U.S. bakery consolidation initiative, which was completed in 2006. The details of this initiative are provided on page 37 of our 2006 Annual Report on Form 10-K. The European costs were incurred as part of a multi-year European manufacturing optimization plan described above and on page 36 of our 2006 Annual Report on Form 10-K.

***Interest expense***

Interest expense for the current year-to-date period was \$233 million and interest income (which is recorded within other income) was \$15 million, as compared to the prior-year period interest expense of \$227 million and interest income of \$7 million. Accordingly, interest expense, net of interest income, for the year-to-date period of 2007 was within \$3 million of the 2006 amount. For the full year of 2007, we currently expect interest expense, net of interest income, to approximate the 2006 level of \$296 million.

***Income taxes***

The consolidated effective income tax rate was approximately 27% for the quarter and 28% for the year-to-date period ended September 29, 2007, as compared to approximately 32% for both the comparable quarter and year-to-date periods of 2006. The third quarter 2007 effective income tax rate was lower than the prior-period rate due primarily to statutory rate reductions, as discussed in the following paragraph. The year-to-date 2007 effective income tax rate also benefited from the reversal of a foreign tax liability of \$40 million, which was triggered by our implementation of an international restructuring initiative in the first quarter of 2007.

In July 2007, the government of the United Kingdom enacted a statutory rate reduction of two percentage points, applicable from April 1, 2008. In August 2007, the government of Germany enacted a federal statutory income tax rate reduction of

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ten percentage points effective in 2008, partially offset by the effect of other German tax law changes. Accordingly, during the third quarter of 2007, we reduced our net deferred income tax liabilities in these jurisdictions to reflect the lower rates, resulting in a decrease to consolidated income tax expense of \$17 million.

In addition to these statutory rate reductions enacted in our fiscal third quarter, on October 1, 2007, the government of Mexico enacted a tax reform package. Beginning in 2008, corporate entities will pay the higher of traditional income tax (generally imposed at a rate of 28%) or a new corporate flat tax, which is phased in at a rate of 16.5% in 2008 to 17.5% by 2010. Under the new flat tax, allowable deductions, such as interest expense, are limited. We are currently studying the impact of the Mexican tax law reform on our Latin American operations; however, we believe this law change could result in a slight increase in our consolidated effective income tax rate, beginning in 2008.

Taking into account the cumulative amount of discrete tax benefits that have been recognized through September 29, 2007, we currently believe that our full-year 2007 consolidated effective income tax rate will be approximately 29%. Our projection of effective income tax rate for any period is highly influenced by country mix of earnings, changes in statutory tax rates, timing of implementation of tax planning initiatives, and developments which affect our evaluation of uncertain tax positions. For further information on our uncertain tax positions, refer to Note 10 within Notes to Consolidated Financial Statements.

**Liquidity and capital resources****Overview**

Our principal source of liquidity is operating cash flows, supplemented by borrowings for major acquisitions and other significant transactions. This cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating and investing needs. During 2007, we believe our Company's financial strength has been especially evident in the face of the recent U.S. sub-prime mortgage market crisis and its pervasive effect on general credit market liquidity. For the year-to-date period, we have continued to have unfettered access to the U.S. commercial paper market without significant increase in our effective short-term borrowing rate, our commercial paper and term debt credit ratings have not been affected, and we continue to expect our total interest expense for 2007 to remain consistent with our original forecast. We have not had any significant new borrowings under our Euro or Canadian commercial paper programs since June 2007, which has limited our exposure to non-U.S. credit market illiquidity during this turbulent period.

Although we presently observe a general recovery of liquidity within the commercial paper market and improved pricing in the corporate bond market, we cannot reasonably predict the extent and duration of the continuing sub-prime mortgage market crisis, nor the potential indirect effect on our sector. However, we continue to believe that we will be able to meet our interest and principal repayment obligations and maintain our debt covenants for the foreseeable future, while still meeting our operational needs, including the pursuit of selected bolt-on acquisitions, through our strong cash flow, our program of issuing short-term debt, and maintaining credit facilities on a global basis. Our significant long-term debt issues do not contain acceleration of maturity clauses that are dependent on credit ratings. A change in the Company's credit ratings could limit our access to the U.S. short-term debt market and/or increase the cost of refinancing long-term debt in the future. However, even under these circumstances, we would continue to have access to our aforementioned credit facilities, which represented in excess of 1.8 times our outstanding commercial paper balance of approximately \$1.8 billion at September 29, 2007. In addition, assuming continuation of the present market conditions, we believe it would be possible to term out certain short-term maturities or obtain additional credit facilities such that the Company could further extend its ability to meet its long-term borrowing obligations through 2008.

**Operating activities**

The principal source of our operating cash flow is net earnings, meaning cash receipts from the sale of our products, net of costs to manufacture and market our products. Our cash conversion cycle (*defined as days of inventory and trade receivables outstanding less days of trade payables outstanding*) is relatively short; equating to approximately 28 days for the trailing 365-day period ended September 29, 2007, which is similar to the comparable prior year period. The following table presents the major components of our operating cash flow during the current and prior year-to-date periods:



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(in millions)	Year-to-date period ended		<i>Change versus prior year</i>
	<b>September 29, 2007</b>	September 30, 2006	
<b>Operating activities</b>			
Net earnings	\$ 927	\$ 822	\$ 105
Items in net earnings not requiring (providing) cash:			
Depreciation and amortization	275	258	17
Deferred income taxes	(114)	2	(116)
Other (a)	138	140	(2)
Pension and other postretirement benefit plan contributions	(42)	(38)	(4)
Changes in operating assets and liabilities:			
Core working capital (b)	(118)	(194)	76
Other working capital	187	122	65
	69	(72)	141
<b>Net cash provided by operating activities</b>	<b>\$1,253</b>	\$ 1,112	\$ 141

(a) Consists principally of non-cash expense accruals for employee compensation and benefit obligations.

(b) Inventory and trade receivables less trade payables.

Our net cash provided by operating activities for the year-to-date period ended September 29, 2007 was \$141 million higher than the comparable period of 2006, due primarily to growth in cash-basis earnings and favorable working capital performance, as presented in the preceding schedule:

**Core working capital** In relation to the prior period, the favorable year-over-year variance was principally attributable to higher trade payables, which are due, in part, to increased payment terms in international locations.

**Other working capital** The favorable movement primarily represents year-over-year timing of various individually-insignificant business receipts and expenditures, including non-income tax refunds and hedging settlements.

Refer to Note 12 within Notes to Consolidated Financial Statements for additional information on changes in the components of working capital during the periods presented.

Total 2007 postretirement benefit plan contributions are currently estimated at approximately \$48 million, as compared to \$99 million in 2006. Actual 2007 contributions could exceed our current projections, as influenced by our decision to undertake discretionary funding of our benefit trusts versus other competing investment priorities, future changes in government requirements, renewals of union contracts, or higher-than-expected health care claims cost experience.

Our management measure of cash flow is defined as net cash provided by operating activities reduced by expenditures for property additions. We use this non-GAAP financial measure of cash flow to focus management and investors on the amount of cash available for debt repayment, dividend distributions, acquisition opportunities, and share repurchase. Our cash flow metric is reconciled to the most comparable GAAP measure, as follows:

(dollars in millions)	Year-to-date period ended		<i>Change versus prior year</i>
	<b>September 29, 2007</b>	September 30, 2006	
Net cash provided by operating activities	\$ <b>1,253</b>	\$ 1,112	12.7%
Additions to properties	<b>(292)</b>	(262)	
Cash flow	\$ <b>961</b>	\$ 850	13.1%

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For 2007, we are targeting cash flow (as defined) of approximately one billion dollars. In comparison to average quarterly cash flow of approximately \$320 million for the year-to-date period, the lower-than-average implied fourth quarter cash flow reflects our expectations regarding historical seasonality and incremental benefit plan funding patterns.

***Investing activities***

As discussed in Note 6 within Notes to Consolidated Financial Statements, our property additions for the year-to-date period of 2007 include approximately \$16 million for the purchase of a previously-leased snacks manufacturing facility in Chicago, Illinois. For the full-year of 2007, we currently expect property expenditures to remain at approximately 4% of net sales, which is consistent with our actual spending rate for 2006 and also our long-term target for capital spending.

On November 1, 2007, a subsidiary of the Company acquired Bear Naked, Inc., a leading seller of natural granola products. On November 5, 2007, the Company acquired certain assets and liabilities of the Wholesome & Hearty Foods Company, a U.S. manufacturer of veggie foods marketed under the *Gardenburger*® brand. The Company paid a total of approximately \$122 million in cash for these businesses. In addition, the Company or its subsidiaries have entered into agreements to purchase several businesses in various areas around the world. Pending receipt of regulatory approvals and satisfaction of other pre-closing conditions, we currently expect to complete these acquisitions as early as the fourth quarter of 2007, for a total cash purchase price of approximately \$120-\$150 million.

***Financing activities***

For 2007, our Board of Directors has currently authorized a stock repurchase program of up to \$650 million for general corporate purposes and to offset issuances under employee benefit programs. As of September 29, 2007, we had spent \$417 million of this authorization to purchase approximately 8 million shares. We currently expect to spend the entire 2007 stock repurchase authorization by year end. On October 26, 2007, our Board approved a similar stock repurchase authorization for 2008 of up to \$650 million.

On September 15, 2007, our Company paid a quarterly dividend to shareholders of \$.31 per common share, which represented a 6.5% increase from the previous level of \$.2910 per common share paid during the four preceding quarterly periods. This increase is consistent with our current plan to maintain our dividend pay-out ratio between 40% and 50% of reported net earnings. In October 2007, our Board of Directors declared another dividend of \$.31 per common share, payable December 14, 2007, to shareholders of record at the close of business on December 3, 2007. To utilize excess cash and reduce financing costs, on February 28, 2007, we redeemed Euro 550 million of floating rate notes otherwise due May 2007 (the Euro Notes), for \$728 million. To partially refinance this redemption, we established a program to issue euro-commercial paper notes up to a maximum aggregate amount outstanding at any time of \$750 million or its equivalent in alternative currencies. The notes may have maturities ranging up to 364 days and are senior unsecured obligations of the applicable issuer, with subsidiary issuances guaranteed by the Company. On June 13, 2007, we also increased the aggregate principal amount of notes that may be outstanding at any time under our U.S. commercial paper program from \$2.0 billion to \$2.5 billion.

In connection with these financing activities, we increased our short-term lines of credit from \$2.2 billion at December 30, 2006 to approximately \$3.3 billion at September 29, 2007. This increase was achieved via a \$400 million unsecured 364-Day Credit Agreement effective January 31, 2007 and a \$700 million 364-Day Credit Agreement effective June 13, 2007. These 364-Day Agreements contain customary covenants, warranties, and restrictions similar to those described for the Five-Year Credit Agreement on page 41 of our 2006 Annual Report on Form 10-K. Our credit facilities are available for general corporate purposes, including commercial paper back-up, although we do not currently anticipate any draw-down of the facilities.

As compared to our financial position as of December 30, 2006, our total cash at September 29, 2007 has increased \$165 million to \$576 million, while total debt has remained approximately at just under \$5 billion. Additionally, the domicile of approximately \$.8 billion of short-term debt (notes payable and current maturities of long-term debt) has shifted from international locations to the United States. These movements during the year-to-date period of 2007 are primarily associated with the settlement of certain intercompany transactions. Taking into account the aforementioned pending business acquisitions and other factors, we currently expect our total cash balance to decline and our net debt (*debt, net of cash*) level to increase modestly during the remainder of 2007.





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**Forward-looking statements**

This Management's Discussion and Analysis contains forward-looking statements with projections concerning, among other things, our strategy, financial principles, and plans; initiatives, improvements and growth; sales, gross margins, advertising, promotion, merchandising, brand building, operating profit, and earnings per share; innovation; investments in business acquisitions; capital expenditures; asset write-offs and expenditures and costs related to productivity or efficiency initiatives; the impact of accounting changes and significant accounting estimates; our ability to meet interest and debt principal repayment obligations; minimum contractual obligations; future common stock repurchases or debt reduction; effective income tax rate; cash flow and core working capital improvements; interest expense; commodity, fuel, and energy prices; and employee benefit plan costs and funding. Forward-looking statements include predictions of future results or activities and may contain the words expect, believe, will, will deliver, anticipate, project, should, or words or phrases of similar meaning. Our actual results or activities may differ materially from these predictions. Our future results could be affected by a variety of factors, including:

- the impact of competitive conditions;
- the effectiveness of pricing, advertising, and promotional programs;
- the success of innovation and new product introductions;
- the recoverability of the carrying value of goodwill and other intangibles;
- the success of productivity improvements and business transitions;
- fuel, energy and commodity (ingredient and packaging) prices;
- labor, wage and benefit costs;
- the availability of and interest rates on short-term and long-term financing;
- actual market performance of benefit plan trust investments;
- the levels of spending on systems initiatives, properties, business opportunities, integration of acquired businesses, and other general and administrative costs;
- changes in consumer behavior and preferences;
- the effect of U.S. and foreign economic conditions on items such as interest rates, taxes and tariffs, currency conversion and availability;
- legal and regulatory factors;
- business disruption or other losses from war, terrorist acts, or political unrest; and,
- the risks and uncertainties described herein under Part II, Item 1A.

Forward-looking statements speak only as of the date they were made, and we undertake no obligation to publicly update them.

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**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Refer to disclosures contained on pages 25-26 of our 2006 Annual Report on Form 10-K. There have been no material changes in our exposures, risk management strategies, or hedging positions since December 30, 2006.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure under Rules 13a-15(e) and 15d-15(e). Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurance of achieving the desired control objectives.

As of September 29, 2007, we carried out an evaluation under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

During the last fiscal quarter, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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KELLOGG COMPANY  
PART II OTHER INFORMATION

**Item 1A. Risk Factors**

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 30, 2006 other than as set forth below.

***Technology failures could disrupt our operations and negatively impact our business.***

We increasingly rely on information technology systems to process, transmit, and store electronic information. For example, our production and distribution facilities and inventory management utilize information technology to increase efficiencies and limit costs. Furthermore, a significant portion of the communications between our personnel, customers, and suppliers depends on information technology. Like other companies, our information technology systems may be vulnerable to a variety of interruptions due to events beyond our control, including, but not limited to, natural disasters, terrorist attacks, telecommunications failures, computer viruses, hackers, and other security issues. We have technology security initiatives and disaster recovery plans in place or in process to mitigate our risk to these vulnerabilities, but these measures may not be adequate.

The risk factors disclosed under this Part II, Item 1A and in Part I, Item 1A to our Annual report on Form 10-K for the fiscal year ended December 30, 2006, in addition to the other information set forth in this Report, could materially affect our business, financial condition, or results. Additional risks and uncertainties not currently known to us or that we deem to be immaterial could also materially adversely affect our business, financial condition, or results.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) Issuer Purchases of Equity Securities  
(millions, except per share data)

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Period #1: 7/1/07-7/28/07	0.1	\$ 51.93	0.1	\$ 386
Period #2: 7/29/07-8/25/07	1.2	53.55	1.2	326
Period #3: 8/26/07-9/29/07	1.8	55.26	1.8	233
Total (1)	3.1	\$ 54.47	3.1	

(1) Shares included in the table above were purchased as part of publicly

announced plans  
or programs, as  
follows:

- a. Approximately 2.8 million shares were purchased during the third quarter of 2007 under a program authorized by our Board of Directors to repurchase up to \$650 million of Kellogg common stock during 2007 for general corporate purposes and to offset issuances for employee benefit programs. This repurchase program was publicly announced in a press release on December 11, 2006. On October 26, 2007, our Board of Directors authorized a stock repurchase program of up to \$650 million for 2008, which was publicly announced in a press release October 29, 2007.
- b. Approximately .3 million shares were purchased during the third quarter of 2007 from employees and directors in stock swap and similar transactions pursuant to various shareholder-approved equity-based compensation plans described in Note 8 within Notes to Consolidated Financial Statements, which is included herein under Part I, Item 1.

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**Item 6. Exhibits**

(a) Exhibits:

31.1 Rule 13a-14(e)/15d-14(a) Certification from A.D. David Mackay

31.2 Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant

32.1 Section 1350 Certification from A.D. David Mackay

32.2 Section 1350 Certification from John A. Bryant

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KELLOGG COMPANY  
SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KELLOGG COMPANY

/s/ J.A. Bryant  
J.A. Bryant  
Principal Financial Officer;  
Executive Vice President, Chief Financial Officer,  
Kellogg Company and President, Kellogg North  
America

/s/ A.R. Andrews  
A.R. Andrews  
Principal Accounting Officer;  
Vice President Corporate Controller

Date: November 5, 2007

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KELLOGG COMPANY  
EXHIBIT INDEX

Exhibit No.	Description	Electronic (E) Paper (P) Incorp. By Ref. (IBRF)
31.1	Rule 13a-14(e)/15d-14(a) Certification from A.D. David Mackay	E
31.2	Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant	E
32.1	Section 1350 Certification from A.D. David Mackay	E
32.2	Section 1350 Certification from John A. Bryant	E