KELLOGG CO
Form 10-Q
November 09, 2011
**Table of Contents**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM 10-Q

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended October 1, 2011**

**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 x No ¨

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

Yes x No ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

Yes ¨ No x

Common Stock outstanding as of October 29, 2011 359,150,227 shares

**Table of Contents**

KELLOGG COMPANY

INDEX


| | Page |
|---|---|
| PART I Financial Information | |
| Item 1:<br>Financial Statements | |
| Consolidated Balance Sheet October 1, 2011 and January 1, 2011 | 3 |
| Consolidated Statement of Income quarter and year-to-date periods ended October 1, 2011 and October 2, 2010 | 4 |
| Consolidated Statement of Equity year ended January 1, 2011 and year-to-date period ended October 1, 2011 | 5 |
| Consolidated Statement of Cash Flows year-to-date periods ended October 1, 2011 and October 2, 2010 | 6 |
| Notes to Consolidated Financial Statements | 7 |
| Item 2:<br>Management s Discussion and Analysis of Financial Condition and Results of Operations | 24 |
| Item 3:<br>Quantitative and Qualitative Disclosures about Market Risk | 33 |
| Item 4:<br>Controls and Procedures | 33 |
| PART II Other Information | |
| Item 1A:<br>Risk Factors | 34 |
| Item 2:<br>Unregistered Sales of Equity Securities and Use of Proceeds | 34 |
| Item 6:<br>Exhibits | 34 |
| Signatures | 35 |
| Exhibit Index | 36 |

Table of Contents

**Part I FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**Kellogg Company and Subsidiaries**

**CONSOLIDATED BALANCE SHEET**

(millions, except per share data)

| | October 1, 2011 (unaudited) | January 1, 2011 * |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **$ 582** | $ 444 |
| Accounts receivable, net | **1,302** | 1,190 |
| Inventories: | | |
| Raw materials and supplies | **252** | 224 |
| Finished goods and materials in process | **761** | 832 |
| Deferred income taxes | **159** | 110 |
| Other prepaid assets | **122** | 115 |
| **Total current assets** | **3,178** | 2,915 |
| Property, net of accumulated depreciation of $4,858 and $4,690 | **3,193** | 3,128 |
| Goodwill | **3,622** | 3,628 |
| Other intangibles, net of accumulated amortization of $48 and $47 | **1,455** | 1,456 |
| Pension | **480** | 333 |
| Other assets | **335** | 387 |
| **Total assets** | **$ 12,263** | $ 11,847 |
| **Current liabilities** | | |
| Current maturities of long-term debt | **$** | $ 952 |
| Notes payable | **737** | 44 |
| Accounts payable | **1,200** | 1,149 |
| Accrued advertising and promotion | **446** | 405 |
| Accrued income taxes | **18** | 60 |
| Accrued salaries and wages | **239** | 153 |
| Other current liabilities | **461** | 421 |
| **Total current liabilities** | **3,101** | 3,184 |
| Long-term debt | **5,300** | 4,908 |
| Deferred income taxes | **790** | 697 |
| Pension liability | **195** | 265 |
| Nonpension postretirement benefits | **191** | 214 |
| Other liabilities | **401** | 425 |
| **Commitments and contingencies** | | |

| **Equity** | | |
|---|---|---|
| Common stock, $.25 par value | **105** | 105 |
| Capital in excess of par value | **510** | 495 |
| Retained earnings | **6,644** | 6,122 |
| Treasury stock, at cost | **(3,050)** | (2,650) |
| Accumulated other comprehensive income (loss) | **(1,926)** | (1,914) |
| **Total Kellogg Company equity** | **2,283** | 2,158 |
| **Noncontrolling interests** | **2** | (4) |
| **Total equity** | **2,285** | 2,154 |
| **Total liabilities and equity** | **$ 12,263** | $ 11,847 |

* Condensed from audited financial statements.
Refer to Notes to Consolidated Financial Statements.

Table of Contents

**Kellogg Company and Subsidiaries**

**CONSOLIDATED STATEMENT OF INCOME**

(millions, except per share data)

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (Results are unaudited) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| **Net sales** | **$ 3,312** | $ 3,157 | **$10,183** | $9,537 |
| **Cost of goods sold** | **1,962** | 1,788 | **5,969** | 5,438 |
| **Selling, general and administrative expense** | **886** | 828 | **2,635** | 2,438 |
| **Operating profit** | **464** | 541 | **1,579** | 1,661 |
| **Interest expense** | **58** | 62 | **178** | 188 |
| **Other income (expense), net** | **(9)** | 1 | **(10)** | 9 |
| **Income before income taxes** | **397** | 480 | **1,391** | 1,482 |
| **Income taxes** | **107** | 143 | **394** | 427 |
| **Net income** | **$ 290** | $ 337 | **$997** | $1,055 |
| **Net income (loss) attributable to noncontrolling interests** | | (1) | **(2)** | (3) |
| **Net income attributable to Kellogg Company** | **$ 290** | $ 338 | **$999** | $1,058 |
| **Per share amounts:** | | | | |
| **Basic** | **$ 0.81** | $ 0.91 | **$2.75** | $2.80 |
| **Diluted** | **$ 0.80** | $ 0.90 | **$2.73** | $2.78 |
| **Dividends per share** | **$ 0.430** | $ 0.405 | **$1.240** | $1.155 |
| **Average shares outstanding:** | | | | |
| **Basic** | **360** | 373 | **363** | 378 |
| **Diluted** | **363** | 376 | **365** | 381 |
| **Actual shares outstanding at period end** | | | **359** | 368 |

Refer to Notes to Consolidated Financial Statements.

**Table of Contents**

**Kellogg Company and Subsidiaries**

**CONSOLIDATED STATEMENT OF EQUITY**

(millions)

| | Common stock | | Capital in excess of par value | Retained earnings | Treasury stock | | Accumulated other comprehensive income (loss) | Total Kellogg Company equity | Non-controlling interests | Total equity | Total comprehensive income (loss) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (unaudited) | shares | amount | | | shares | amount | | | | | |
| Balance, January 2, 2010 | 419 | $105 | $ 472 | $5,481 | 38 | $(1,820) | $ (1,966) | $ 2,272 | $ 3 | $ 2,275 | |
| Common stock repurchases | | | | | 21 | (1,057) | | (1,057) | | (1,057) | |
| Net income (loss) | | | | 1,247 | | | | 1,247 | (7) | 1,240 | $ 1,240 |
| Dividends | | | | (584) | | | | (584) | | (584) | |
| Other comprehensive income | | | | | | | 52 | 52 | | 52 | 52 |
| Stock compensation | | | 19 | | | | | 19 | | 19 | |
| Stock options exercised and other | | | 4 | (22) | (5) | 227 | | 209 | | 209 | |
| Balance, January 1, 2011 | 419 | $105 | $ 495 | $6,122 | 54 | $(2,650) | $ (1,914) | $ 2,158 | $ (4) | $ 2,154 | $ 1,292 |
| Common stock repurchases | | | | | 13 | (688) | | (688) | | (688) | |
| Acquisition of noncontrolling interest | | | (8) | | | | | (8) | 8 | | |
| Net income (loss) | | | | 999 | | | | 999 | (2) | 997 | 997 |
| Dividends | | | | (452) | | | | (452) | | (452) | |
| Other comprehensive income | | | | | | | (12) | (12) | | (12) | (12) |
| Stock compensation | | | 17 | | | | | 17 | | 17 | |
| Stock options exercised and other | | | 6 | (25) | (6) | 288 | | 269 | | 269 | |
| **Balance, October 1, 2011** | **419** | **$105** | **$ 510** | **$6,644** | **61** | **$(3,050)** | **$ (1,926)** | **$ 2,283** | **$ 2** | **$ 2,285** | **$ 985** |

Refer to Notes to Consolidated Financial Statements.

5

Table of Contents

**Kellogg Company and Subsidiaries**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

(millions)

| (unaudited) | Year-to-date period ended **October 1, 2011** | October 2, 2010 |
|---|---|---|
| **Operating activities** | | |
| Net income | **$997** | $1,055 |
| Adjustments to reconcile net income to operating cash flows: | | |
| Depreciation and amortization | **270** | 265 |
| Deferred income taxes | **(2)** | (53) |
| Other | **133** | 116 |
| Postretirement benefit plan contributions | **(187)** | (45) |
| Changes in operating assets and liabilities: | | |
| Trade receivables | **(224)** | (125) |
| Inventories | **43** | (43) |
| Accounts payable | **51** | 68 |
| Accrued income taxes | **85** | 63 |
| Accrued interest expense | **14** | (18) |
| Accrued and prepaid advertising, promotion and trade allowances | **25** | 33 |
| Accrued salaries and wages | **86** | (161) |
| All other current assets and liabilities | **(22)** | (76) |
| **Net cash provided by operating activities** | **1,269** | 1,079 |
| **Investing activities** | | |
| Additions to properties | **(392)** | (252) |
| Other | **11** | 2 |
| **Net cash used in investing activities** | **(381)** | (250) |
| **Financing activities** | | |
| Net issuances of notes payable | **689** | 547 |
| Issuances of long-term debt | **397** | |
| Reductions of long-term debt | **(946)** | (1) |
| Net issuances of common stock | **265** | 178 |
| Common stock repurchases | **(693)** | (907) |
| Cash dividends | **(452)** | (435) |
| Other | **10** | 7 |
| **Net cash used in financing activities** | **(730)** | (611) |
| Effect of exchange rate changes on cash and cash equivalents | **(20)** | 7 |
| Increase in cash and cash equivalents | **138** | 225 |
| Cash and cash equivalents at beginning of period | **444** | 334 |
| **Cash and cash equivalents at end of period** | **$582** | $559 |

Refer to Notes to Consolidated Financial Statements.

Table of Contents

**Notes to Consolidated Financial Statements**

**for the quarter ended October 1, 2011 (unaudited)**

**Note 1 Accounting Policies**

***Basis of presentation***

The unaudited interim financial information of Kellogg Company (the Company) included in this report reflects normal recurring adjustments that management believes are necessary for a fair statement of the results of operations, financial position, equity and cash flows for the periods presented. This interim information should be read in conjunction with the financial statements and accompanying notes contained on pages 27 to 57 of the Company s 2010 Annual Report on Form 10-K.

The condensed balance sheet data at January 1, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. The results of operations for the quarterly period ended October 1, 2011 are not necessarily indicative of the results to be expected for other interim periods or the full year.

***Accounting standards to be adopted in future periods***

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08, Testing Goodwill for Impairment, allowing entities the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under ASU No. 2011-08, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company will consider early adoption of ASU 2011-08 in connection with its annual goodwill impairment evaluation in the fourth quarter of 2011.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income, requiring most entities to present items of net income and other comprehensive income either in one continuous statement referred to as the statement of comprehensive income or in two separate, but consecutive, statements of net income and other comprehensive income. The update does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU No. 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted. The Company will be adopting ASU 2011-05 at the beginning of its 2012 fiscal year.

**Note 2 Goodwill and other intangible assets**

Changes in the carrying amount of goodwill for the quarter ended October 1, 2011 are presented in the following table.

***Carrying amount of goodwill***

| (millions) | North America | Europe | Latin America | Asia Pacific (a) | Consolidated |
|---|---|---|---|---|---|
| January 1, 2011 | $3,539 | $62 | $ | $27 | $3,628 |
| Currency translation adjustment | | (5) | | (1) | (6) |
| **October 1, 2011** | **$3,539** | **$57** | **$** | **$26** | **$3,622** |

(a) Includes Australia, Asia and South Africa.

***Intangible assets subject to amortization***

| | Gross carrying amount | | Accumulated amortization | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | January 1, 2011 | **October 1, 2011** | January 1, 2011 |
| Trademarks | **$19** | $19 | **$17** | $16 |
| Other | **41** | 41 | **31** | 31 |
| Total | **$60** | $60 | **$48** | $47 |

For intangible assets in the preceding table, amortization was less than $1 million for each of the current and prior year comparable quarters. The currently estimated aggregate annual amortization expense for full-year 2011 and each of the four succeeding fiscal years is approximately $2 million.

Table of Contents

***Intangible assets not subject to amortization***

| | Total carrying amount | |
|---|---|---|
| (millions) | **October 1, 2011** | January 1, 2011 |
| Trademarks | **$ 1,443** | $ 1,443 |

**Note 3 Exit or disposal activities**

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

***2011 activities***

During 2011, the Company incurred exit costs related to ongoing programs which will result in cost of goods sold (COGS) and selling, general and administrative (SGA) expense savings.

Total charges incurred during the quarter and year-to-date periods ended October 1, 2011 and October 2, 2010 were as follows:

| | **Quarter ended, October 1, 2011** | | | Quarter ended, October 2, 2010 | | |
|---|---|---|---|---|---|---|
| (millions) | **COGS program** | **SGA programs** | **Total** | COGS program | SGA programs | Total |
| Employee severance | **$1** | **$1** | **$2** | $ | $1 | $1 |
| Other cash costs (a) | **1** | | **1** | | 1 | 1 |
| Asset write-offs | **1** | | **1** | | | |
| Retirement benefits (b) | | **6** | **6** | | 5 | 5 |
| **Total** | **$3** | **$7** | **$10** | $ | $7 | $7 |

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

| | **Year-to-date period ended, October 1, 2011** | | | Year-to-date period ended, October 2, 2010 | | |
|---|---|---|---|---|---|---|
| (millions) | **COGS program** | **SGA programs** | **Total** | COGS program | SGA programs | Total |
| Employee severance | **$ 5** | **$ 1** | **$ 6** | $ 2 | $ 2 | $ 4 |
| Other cash costs (a) | **1** | | **1** | | 6 | 6 |
| Asset write-offs | **2** | | **2** | | | |
| Retirement benefits (b) | | **12** | **12** | 1 | 5 | 6 |
| **Total** | **$ 8** | **$13** | **$21** | $ 3 | $13 | $16 |

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

**Table of Contents**

Total program costs incurred through October 1, 2011 were as follows:

| | Total program costs through October 1, 2011 | | |
|---|---|---|---|
| (millions) | **COGS program** | **SGA programs** | **Total** |
| Employee severance | **$23** | **$21** | **$44** |
| Other cash costs (a) | **7** | **15** | **22** |
| Asset write-offs | **3** | | **3** |
| Retirement benefits (b) | **3** | **17** | **20** |
| Total | **$36** | **$53** | **$89** |

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

In 2009, the Company commenced various COGS related cost reduction programs. Refer to page 36 of the Company s 2010 Annual Report on Form 10-K for further information on these initiatives. Costs impacted the following operating segments during the quarter and year-to-date periods ended October 1, 2011 and October 2, 2010.

| | COGS program | | | |
|---|---|---|---|---|
| | Quarter ended | | Year-to-date period ended | |
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| North America | **$** | $ | **$** | $1 |
| Europe | **3** | | **8** | 2 |
| Total | **$ 3** | $ | **$ 8** | $3 |

These costs represent employee severance and other cash costs associated with the elimination of hourly and salaried positions, as well as non-cash asset write offs at various global manufacturing facilities. To date, we have incurred $36 million in total exit costs for this program. The costs have impacted our operating segments, as follows (in millions): North America-$14; Europe-$21; and Asia Pacific-$1. Based on forecasted exchange rates, the Company currently expects to incur an additional $7 million in exit costs for this program during 2011.

In 2009, the Company commenced various SGA programs which resulted in an improvement in the efficiency and effectiveness of various support functions. Refer to page 37 of the Company s 2010 Annual Report on Form 10-K for further information on these initiatives. Costs for these programs impacted the following operating segments during the quarter and year-to-date periods ended October 1, 2011 and October 2, 2010 as follows:

| | SGA programs | | | |
|---|---|---|---|---|
| | Quarter ended | | Year-to-date period ended | |
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| North America | **$7** | $6 | **$13** | $10 |
| Europe | | 1 | | 1 |
| Asia Pacific (a) | | | | 2 |
| Total | **$7** | $7 | **$13** | $13 |

(a) Includes Australia, Asia and South Africa.

These costs represent severance and other cash costs associated with the elimination of positions. To date, we have incurred $53 million in exit costs for these programs. The costs have impacted our operating segments as follows (in millions): North America-$34; Europe-$15; Asia Pacific-$3; and Latin America-$1. Based on forecasted exchange rates, the Company currently expects to incur an additional $1 million in exit costs for these programs during 2011.

Reserves for the COGS and SGA programs are primarily for employee severance and will be paid out by the end of 2011. The detail is as follows:

| (millions) | Balance January 1, 2011 | Accruals | Payments | **Balance October 1, 2011** |
|---|---|---|---|---|
| COGS program | $2 | $5 | $(6) | **$1** |
| SGA programs | 3 | 1 | (3) | **1** |
| Total | $5 | $6 | $(9) | **$2** |

**Note 4 Equity**

***Earnings per share***

Basic earnings per share is determined by dividing net income attributable to Kellogg Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is similarly determined, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued. Dilutive potential common shares consist principally of employee stock options issued by the Company, and to a lesser extent, certain contingently issuable performance shares. Basic earnings per share is reconciled to diluted earnings per share in the following table. The total number of anti-dilutive potential common shares excluded from the reconciliation were 5 million and 4 million for the quarter and year-to-date periods ended October 1, 2011, respectively, and 9 million and 4 million for the quarter and year-to-date periods ended October 2, 2010, respectively.

Quarters ended October 1, 2011 and October 2, 2010:

| (millions, except per share data) | **Net income attributable to Kellogg Company** | **Average shares outstanding** | **Earnings per share** |
|---|---|---|---|
| **2011** | | | |
| Basic | **$290** | **360** | **$0.81** |
| Dilutive potential common shares | | **3** | **(0.01)** |
| Diluted | **$290** | **363** | **$0.80** |
| **2010** | | | |
| Basic | $338 | 373 | $0.91 |
| Dilutive potential common shares | | 3 | (0.01) |
| Diluted | $338 | 376 | $0.90 |

Year-to-date period ended October 1, 2011 and October 2, 2010:

| (millions, except per share data) | **Net income attributable to Kellogg Company** | **Average shares outstanding** | **Earnings per share** |
|---|---|---|---|
| **2011** | | | |
| Basic | **$ 999** | **363** | **$2.75** |
| Dilutive potential common shares | | **2** | **(0.02)** |
| Diluted | **$ 999** | **365** | **$2.73** |
| **2010** | | | |
| Basic | $1,058 | 378 | $2.80 |
| Dilutive potential common shares | | 3 | (0.02) |
| Diluted | $1,058 | 381 | $2.78 |

During the year-to-date period ended October 1, 2011, the Company issued 0.4 million shares to employees and directors under various benefit plans and stock purchase programs. Equity-based compensation is discussed further in Note 6.

On April 23, 2010, the Company s board of directors authorized a $2.5 billion three-year share repurchase program for 2010 through 2012. During the year-to-date period ended October 1, 2011, the Company repurchased 13 million shares of common stock for a total of $688 million. During the year-to-date period ended October 2, 2010, the Company repurchased 18 million shares of common stock for a total of $907 million.

**Table of Contents**

***Comprehensive income***

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

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

Quarter ended October 1, 2011:

| (millions) | Pre-tax amount | Tax (expense) or benefit | After-tax amount |
|---|---|---|---|
| **2011** | | | |
| Net income | | | **$290** |
| Other comprehensive income: | | | |
| Foreign currency translation adjustments | **$(188)** | **$** | **(188)** |
| Cash flow hedges: | | | |
| Unrealized gain (loss) on cash flow hedges | **(1)** | | **(1)** |
| Reclassification to net earnings | **1** | | **1** |
| Postretirement and postemployment benefits: | | | |
| Amounts arising during the period: | | | |
| Net experience gain (loss) | **4** | **(2)** | **2** |
| Prior service credit (cost) | **1** | | **1** |
| Reclassification to net earnings: | | | |
| Net experience loss | **33** | **(12)** | **21** |
| Prior service cost | **4** | **(1)** | **3** |
| | **$(146)** | **$(15)** | **(161)** |
| Total comprehensive income | | | **$129** |

Quarter ended October 2, 2010:

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

**Table of Contents**

Year-to-date period ended October 1, 2011:

| (millions) | Pre-tax amount | Tax (expense) or benefit | After-tax amount |
|---|---|---|---|
| **2011** | | | |
| Net income | | | **$ 997** |
| Other comprehensive income: | | | |
| Foreign currency translation adjustments | **$(45)** | **$** | **(45)** |
| Cash flow hedges: | | | |
| Unrealized gain (loss) on cash flow hedges | **(36)** | **12** | **(24)** |
| Reclassification to net earnings | **(10)** | **4** | **(6)** |
| Postretirement and postemployment benefits: | | | |
| Amounts arising during the period: | | | |
| Net experience gain (loss) | **(9)** | **2** | **(7)** |
| Reclassification to net earnings: | | | |
| Net experience loss | **97** | **(34)** | **63** |
| Prior service cost | **10** | **(3)** | **7** |
| | **$7** | **$ (19)** | **(12)** |
| Total comprehensive income | | | **$985** |

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

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

Accumulated other comprehensive income (loss) as of October 1, 2011 and January 1, 2011 consisted of the following:

| (millions) | **October 1, 2011** | January 1, 2011 |
|---|---|---|
| Foreign currency translation adjustments | **$(834)** | $(789) |
| Cash flow hedges unrealized net gain (loss) | **(5)** | 25 |
| Postretirement and postemployment benefits: | | |
| Net experience loss | **(1,019)** | (1,075) |
| Prior service cost | **(68)** | (75) |

| | | |
|---|---|---|
| Total accumulated other comprehensive income (loss) | **$(1,926)** | $(1,914) |

Table of Contents

**Note 5 Debt**

The following table presents the components of notes payable at October 1, 2011 and January 1, 2011:

| (millions) | **October 1, 2011** | | January 1, 2011 | |
|---|---|---|---|---|
| | **Principal amount** | **Effective interest rate** | Principal amount | Effective interest rate |
| U.S. commercial paper | **$707** | **0.27%** | $ | % |
| Bank borrowings | **30** | | 44 | |
| Total | **$737** | | $44 | |

In August 2011, the Company terminated interest rate swaps with notional amounts totaling $1.5 billion, which were designated as fair value hedges for (a) $750 million of its 4.25% fixed rate U.S. Dollar Notes due 2013 and (b) $750 million of its 5.125% fixed rate U.S. Dollar Notes due 2012 (collectively, the Notes). The interest rate swaps effectively converted the interest rate on the Notes from fixed to variable and the unrealized gain upon termination of $24 million will be amortized to interest expense over the remaining term of the Notes.

In May 2011, the Company issued $400 million of seven-year 3.25% fixed rate U.S. Dollar Notes, using the proceeds from these Notes for general corporate purposes including repayment of commercial paper. The Notes contain customary covenants that limit the ability of the Company and its restricted subsidiaries (as defined) to incur certain liens or enter into certain sale and lease-back transactions, as well as a change of control provision.

During the first quarter of 2011, the Company repaid its $946 million, ten-year 6.6% U.S. Dollar Notes at maturity with U.S. commercial paper.

In March 2011, the Company entered into an unsecured Four-Year Credit Agreement to replace its existing unsecured Five-Year Credit Agreement, which would have expired in November 2011. The Four-Year Credit Agreement allows the Company to borrow, on a revolving credit basis, up to $2.0 billion, to obtain letters of credit in an aggregate amount up to $75 million, U.S. swingline loans in an aggregate amount up to $200 million and European swingline loans in an aggregate amount up to $400 million and to provide a procedure for lenders to bid on short-term debt of the Company. The agreement contains customary covenants and warranties, including specified restrictions on indebtedness, liens, sale and leaseback transactions, and a specified interest coverage ratio. If an event of default occurs, then, to the extent permitted, the administrative agent may terminate the commitments under the credit facility, accelerate any outstanding loans under the agreement, and demand the deposit of cash collateral equal to the lender s letter of credit exposure plus interest.

Table of Contents

**Note 6 Stock compensation**

The Company uses various equity-based compensation programs to provide long-term performance incentives for its global workforce. Currently, these incentives consist principally of stock options, and to a lesser extent, executive performance shares and restricted stock grants. Additionally, the Company awards restricted stock to its non-employee directors. The interim information below should be read in conjunction with the disclosures included on pages 41 to 44 of the Company s 2010 Annual Report on Form 10-K.

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

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| Pre-tax compensation expense | **$8** | $ 1 | **$30** | $24 |
| Related income tax benefit | **$3** | $ | **$11** | $ 8 |

As of October 1, 2011, total stock-based compensation cost related to non-vested awards not yet recognized was $53 million and the weighted-average period over which this amount is expected to be recognized was 2 years.

***Stock options***

During the year-to-date periods ended October 1, 2011 and October 2, 2010, the Company granted non-qualified stock options to eligible employees as presented in the following activity tables. Terms of these grants and the Company s methods for determining grant-date fair value of the awards were consistent with that described on pages 42 and 43 of the Company s 2010 Annual Report on Form 10-K.

Year-to-date period ended October 1, 2011:

| 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 | **26** | **$47** | | |
| Granted | **5** | **53** | | |
| Exercised | **(6)** | **45** | | |
| Forfeitures and expirations | **(1)** | **52** | | |
| Outstanding, end of period | **24** | **$48** | **6.5** | **$121** |
| Exercisable, end of period | **16** | **$46** | **5.2** | **$108** |

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

| 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 | 26 | $45 | | |
| Granted | 4 | 53 | | |
| Exercised | (4) | 44 | | |
| Forfeitures and expirations | | | | |
| Outstanding, end of period | 26 | $46 | 6.5 | $129 |
| Exercisable, end of period | 20 | $46 | 5.7 | $104 |

Table of Contents

The weighted-average fair value of options granted was $7.59 per share for the year-to-date period ended October 1, 2011 and $7.90 per share for the year-to-date period ended October 2, 2010. The fair value was estimated using the following assumptions:

| | Weighted-average expected volatility | Weighted-average expected term (years) | Weighted-average risk-free interest rate | Dividend yield |
|---|---|---|---|---|
| Grants within the year-to-date period ended October 1, 2011: | 17% | 6.98 | 3.07% | 3.10% |
| Grants within the year-to-date period ended October 2, 2010: | 20% | 4.94 | 2.54% | 2.80% |

The total intrinsic value of options exercised was $59 million for the year-to-date period ended October 1, 2011 and $40 million for the year-to-date period ended October 2, 2010.

***Performance shares***

In the first quarter of 2011, the Company granted performance shares to a limited number of senior executive-level employees, which entitle these employees to receive a specified number of shares of the Company s common stock on the vesting date, provided cumulative three-year operating profit and internal net sales growth targets are achieved.

The 2011 target grant currently corresponds to approximately 225,000 shares, with a grant-date fair value of $48 per share. The actual number of shares issued on the vesting date could range from 0 to 200% of target, depending on actual performance achieved. Based on the market price of the Company s common stock at October 1, 2011, the maximum future value that could be awarded to employees on the vesting date for all outstanding performance share awards was as follows:

| (millions) | **October 1, 2011** |
|---|---|
| 2009 Award | **$18** |
| 2010 Award | **$21** |
| 2011 Award | **$24** |

The 2008 performance share award, payable in stock, was settled at 69% of target in February 2011 for a total dollar

equivalent of $6 million.

15

Table of Contents

**Note 7 Employee benefits**

The Company sponsors a number of U.S. and foreign pension, other nonpension postretirement and postemployment plans to provide various benefits for its employees. These plans are described on pages 44 to 49 of the Company s 2010 Annual Report on Form 10-K. Components of Company plan benefit expense for the periods presented are included in the tables below.

***Pension***

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| Service cost | **$ 23** | $ 22 | **$ 72** | $ 66 |
| Interest cost | **52** | 52 | **157** | 151 |
| Expected return on plan assets | **(91)** | (82) | **(277)** | (238) |
| Amortization of unrecognized prior service cost | **4** | 4 | **11** | 11 |
| Recognized net loss | **27** | 20 | **79** | 60 |
| Settlement cost | **3** | | **7** | |
| Total pension expense | **$ 18** | $ 16 | **$ 49** | $ 50 |

***Other nonpension postretirement***

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| Service cost | **$ 6** | $ 5 | **$ 17** | $ 15 |
| Interest cost | **16** | 16 | **47** | 48 |
| Expected return on plan assets | **(22)** | (16) | **(66)** | (48) |
| Amortization of unrecognized prior service cost | **(1)** | (1) | **(2)** | (2) |
| Recognized net loss | **5** | 4 | **15** | 13 |
| Total postretirement benefit expense | **$ 4** | $ 8 | **$ 11** | $ 26 |

***Postemployment***

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| Service cost | **$ 2** | $ 1 | **$ 5** | $ 4 |
| Interest cost | **1** | 1 | **3** | 3 |
| Recognized net loss | **1** | 1 | **3** | 3 |
| Total postemployment benefit expense | **$ 4** | $ 3 | **$ 11** | $ 10 |

Company contributions to employee benefit plans are summarized as follows:

| (millions) | Pension | Total |
|---|---|---|

| | | Nonpension postretirement | |
|---|---|---|---|
| **Quarter ended:** | | | |
| October 1, 2011 | **$ 1** | **$ 3** | **$ 4** |
| October 2, 2010 | $ 6 | $ 3 | $ 9 |
| **Year-to-date period ended:** | | | |
| October 1, 2011 | **$176** | **$ 11** | **$187** |
| October 2, 2010 | $ 35 | $10 | $ 45 |
| **Full year:** | | | |
| Fiscal year 2011 (projected) | **$180** | **$15** | **$195** |
| Fiscal year 2010 (actual) | $350 | $293 | $643 |

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

Table of Contents

**Note 8 Income taxes**

The consolidated effective tax rate for the quarter ended October 1, 2011, of 27% was lower than the prior year s rate of 30%. The consolidated effective tax rate for the year-to-date period ended October 1, 2011 was 28%, compared to the prior year-to-date period ended October 2, 2010 rate of 29%. The effective rate for the third quarter of 2011 benefited from a write off of an investment in a Latin America subsidiary as well as a decrease in the United Kingdom s statutory income tax rate.

As of October 1, 2011, the Company classified $12 million of unrecognized tax positions as a net current liability, representing several income tax positions under examination in various jurisdictions. Management s estimate of reasonably possible changes in unrecognized tax benefits during the next twelve months consists of the current liability balance, expected to be settled within one year, offset by $8 million of projected additions. Management is currently unaware of any issues under review that could result in significant additional payments, accruals or other material deviation in this estimate.

Following is a reconciliation of the Company s total gross unrecognized tax benefits for the year-to-date period ended October 1, 2011; $50 million of this total represents the amount that, if recognized, would affect the Company s effective income tax rate in future periods.

| (millions) | |
|---|---|
| January 1, 2011 | **$ 104** |
| Tax positions related to current year: | |
| Additions | **7** |
| Tax positions related to prior years: | |
| Additions | **8** |
| Reductions | **(16)** |
| Settlements | **(34)** |
| **October 1, 2011** | **$ 69** |

The Company had the following amounts of income tax related interest accrued as of January 1, 2011 and October 1, 2011.

| (millions) | |
|---|---|
| Interest accrued at January 1, 2011 | $ 26 |
| Reduction of interest expense recognized for the year-to-date period ended October 1, 2011 | $ (2) |
| Interest accrued at October 1, 2011 | $ 18 |

**Note 9 Derivative instruments and fair value measurements**

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

The Company designates derivatives as cash flow hedges, fair value hedges, net investment hedges, and uses other contracts to reduce volatility in interest rates, foreign currency and commodities. As a matter of policy, the Company does not engage in trading or speculative hedging transactions.

**Table of Contents**

Total notional amounts of the Company s derivative instruments as of October 1, 2011 and January 1, 2011 were as follows:

| (millions) | **October 1, 2011** | January 1, 2011 |
|---|---|---|
| Foreign currency exchange contracts | **$1,011** | $1,075 |
| Interest rate contracts | **200** | 1,900 |
| Commodity contracts | **251** | 379 |
| Total | **$1,462** | $3,354 |

Following is a description of each category in the fair value hierarchy and the financial assets and liabilities of the Company that were included in each category at October 1, 2011 and January 1, 2011, measured on a recurring basis.

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

*Level 2* Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. For the Company, level 2 financial assets and liabilities consist of interest rate swaps and over-the-counter commodity and currency contracts.

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

*Level 3* Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the asset or liability. The Company did not have any level 3 financial assets or liabilities as of October 1, 2011 or January 1, 2011.

The following table presents assets and liabilities that were measured at fair value in the Consolidated Balance Sheet on a recurring basis as of October 1, 2011 and January 1, 2011:

| (millions) | Level 1 | | Level 2 | | Total | |
|---|---|---|---|---|---|---|
| | **October 1, 2011** | January 1, 2011 | **October 1, 2011** | January 1, 2011 | **October 1, 2011** | January 1, 2011 |
| **Derivatives designated as hedging instruments:** | | | | | | |
| **Assets:** | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other prepaid assets | **$** | $ | **$14** | $ 7 | **$ 14** | $ 7 |
| Interest rate contracts: | | | | | | |
| Other prepaid assets | | | | 5 | | 5 |
| Other assets | | | **16** | 69 | **16** | 69 |
| Commodity contracts: | | | | | | |
| Other prepaid assets | **2** | 23 | | | **2** | 23 |
| **Total assets** | **$ 2** | $ 23 | **$ 30** | $ 81 | **$ 32** | $ 104 |
| **Liabilities:** | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other current liabilities | **$** | $ | **$(15)** | $(27) | **$(15)** | $ (27) |
| Commodity contracts: | | | | | | |
| Other current liabilities | **(12)** | | **(10)** | (10) | **(22)** | (10) |
| Other liabilities | | | **(27)** | (29) | **(27)** | (29) |
| **Total liabilities** | **$(12)** | $ | **$(52)** | $(66) | **$(64)** | $ (66) |

The fair value of non designated hedging instruments as of October 1, 2011 and January 1, 2011 was immaterial.

Table of Contents

The effect of derivative instruments on the Consolidated Statement of Income for the quarters ended October 1, 2011 and October 2, 2010 was as follows:

| Derivatives in fair value hedging relationships (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|---|---|---|---|
| | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | Other income (expense), net | **$ (9)** | $ 26 |

| Derivatives in cash flow hedging relationships (millions) | Gain (loss) recognized in AOCI | | Location of gain (loss) reclassified from AOCI | Gain (loss) reclassified from AOCI into income | | Location of gain (loss) recognized in income (a) | Gain (loss) recognized in income(a) | |
|---|---|---|---|---|---|---|---|---|
| | **October 1, 2011** | October 2, 2010 | | **October 1, 2011** | October 2, 2010 | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | **$ 5** | $ 2 | COGS | **$ (1)** | $ (8) | Other income (expense), net | **$ (1)** | $ |
| Foreign currency exchange contracts | **2** | (2) | SGA expense | | (1) | Other income (expense), net | | |
| Interest rate contracts | | | Interest expense | **1** | (1) | N/A | | |
| Commodity contracts | **(8)** | (2) | COGS | **(1)** | 4 | Other income (expense), net | | |
| **Total** | **$ (1)** | $ (2) | | **$ (1)** | $ (6) | | **$ (1)** | $ |

| Derivatives not designated as hedging instruments (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|---|---|---|---|
| | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | Other income (expense), net | **$ (1)** | $ |
| Interest rate contracts | Interest expense | **$ 2** | $ |
| **Total** | | **$ 1** | $ |

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

**Table of Contents**

The effect of derivative instruments on the Consolidated Statement of Income for the year-to-date periods ended October 1, 2011 and October 2, 2010 were as follows:

| Derivatives in fair value hedging relationships (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|---|---|---|---|
| | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | Other income (expense), net | **$ 16** | $ (25) |

| Derivatives in cash flow hedging relationships (millions) | Gain (loss) recognized in AOCI | | Location of gain (loss) reclassified from AOCI | Gain (loss) reclassified from AOCI into income | | Location of gain (loss) recognized in income (a) | Gain (loss) recognized in income(a) | |
|---|---|---|---|---|---|---|---|---|
| | **October 1, 2011** | October 2, 2010 | | **October 1, 2011** | October 2, 2010 | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | **$ 2** | $ (10) | COGS | **$ (4)** | $ (21) | Other income (expense), net | **$ (2)** | $ |
| Foreign currency exchange contracts | | | SGA expense | | (1) | Other income (expense), net | | |
| Interest rate contracts | **(13)** | | Interest expense | **3** | (3) | N/A | | |
| Commodity contracts | **(25)** | (31) | COGS | **11** | (12) | Other income (expense), net | | (1) |
| **Total** | **$ (36)** | $ (41) | | **$ 10** | $ (37) | | **$ (2)** | $ (1) |

| Derivatives not designated as hedging instruments (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|---|---|---|---|
| | | **October 1, 2011** | October 2, 2010 |
| Foreign currency exchange contracts | Other income (expense), net | **$** | $ |
| Interest rate contracts | Interest expense | **$ (1)** | $ |
| **Total** | | **$ (1)** | $ |

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

Contracts with certain of the Company s counterparties contain provisions requiring the Company to post collateral if the derivative instruments held with that counterparty are in a net liability position and the Company s credit rating falls below BB+ (S&P), or Ba1 (Moody s). The fair value of all derivative instruments with credit-risk-related contingent features in a net liability position on October 1, 2011 was $27 million. If the credit-risk-related contingent features were triggered as of October 1, 2011, the Company would be required to post collateral of $27 million. In addition, certain derivative instruments contain provisions that would be triggered in the event the Company defaults on its debt agreements. There were no collateral posting requirements as of October 1, 2011 triggered by credit-risk-related contingent features.

***Financial instruments***

The carrying values of the Company s short-term items, including cash, cash equivalents, accounts receivable, accounts payable and notes payable approximate fair value. The fair value of the Company s long-term debt is calculated based on broker quotes and was as follows at October 1, 2011:

| (millions) | Fair Value | Carrying Value |
|---|---|---|
| Long-term debt | $ 6,134 | $ 5,300 |

***Counterparty credit risk concentration***

The Company is exposed to credit loss in the event of nonperformance by counterparties on derivative financial and commodity contracts. Management believes a concentration of credit risk with respect to derivative counterparties is limited due to the credit ratings and use of master netting and reciprocal collateralization agreements with the counterparties and the use of exchange-traded commodity contracts.

Master netting agreements apply in situations where the Company executes multiple contracts with the same counterparty. There were no counterparties representing a concentration of credit risk to the Company at October 1, 2011.

For certain derivative contracts, reciprocal collateralization agreements with counterparties call for the posting of collateral in the form of cash, treasury securities or letters of credit if a fair value liability position to the Company or our counterparties exceeds a certain amount. There were no collateral balance requirements at October 1, 2011.

Management believes concentrations of credit risk with respect to accounts receivable is limited due to the generally high credit quality of the Company s major customers, as well as the large number and geographic dispersion of smaller customers. However, the Company conducts a disproportionate amount of business with a small number of large multinational grocery retailers, with the five largest accounts encompassing approximately 28% of consolidated trade receivables at October 1, 2011.

**Note 10 Product recall**

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

Table of Contents

**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-flavored 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.

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| **Net sales** | | | | |
| North America | **$ 2,217** | $ 2,130 | **$ 6,812** | $ 6,469 |
| Europe | **585** | 564 | **1,840** | 1,730 |
| Latin America | **274** | 247 | **816** | 709 |
| Asia Pacific (a) | **236** | 216 | **715** | 629 |
| Consolidated | **$ 3,312** | $ 3,157 | **$ 10,183** | $ 9,537 |
| **Segment operating profit** | | | | |
| North America (b) | **$ 357** | $ 407 | **$ 1,203** | $ 1,269 |
| Europe | **84** | 102 | **287** | 307 |
| Latin America | **43** | 34 | **152** | 126 |
| Asia Pacific (a) | **23** | 25 | **79** | 82 |
| Corporate (b) | **(43)** | (27) | **(142)** | (123) |
| Consolidated | **$ 464** | $ 541 | **$ 1,579** | $ 1,661 |

(a) Includes Australia, Asia and South Africa.

(b) Research and Development expense totaling $3 million for the quarter ended October 2, 2010 and $8 million for the year-to-date period ended October 2, 2010 was reallocated to Corporate from North America.

23

Table of Contents

KELLOGG COMPANY

PART I FINANCIAL INFORMATION

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

**Results of operations**

***Overview***

For more than 100 years, consumers have counted on Kellogg for great-tasting, high-quality and nutritious foods. 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-flavored snacks, frozen waffles and veggie foods. Kellogg products are manufactured and marketed globally. We currently manage our operations in four geographic operating segments, consisting of North America and the three International operating segments of Europe, Latin America and Asia Pacific.

Our long term growth targets are 3 to 4% for internal net sales, mid single-digit (4 to 6%) for internal operating profit, and high single-digit (7 to 9%) for net earnings per diluted share (EPS) on a currency-neutral basis. Internal net sales and internal operating profit exclude the impact of foreign currency translation, acquisitions, dispositions and shipping day differences. See the Foreign currency translation section for an explanation of management s definition of currency neutral.

For the quarter ended October 1, 2011, our reported net sales increased 5% and internal net sales increased 3%. Consolidated operating profit decreased 14%, while internal operating profit decreased 16%. Diluted earnings per share (EPS) decreased 11% to $0.80, compared to $0.90 in the comparable prior year quarter. EPS on a currency-neutral basis was down 13%. Our performance was below our expectations for the quarter. While we experienced solid top-line growth, our operating profit was negatively impacted by the lapping of the significant reduction of incentive compensation costs in the third quarter of 2010 and the reinstatement of those costs in 2011 and our investments in our supply chain.

For the full year 2011, we still expect our internal net sales to increase by approximately 4 to 5%. We have lowered our outlook for internal operating profit and EPS on a currency-neutral basis to reflect the increased level of investment in our supply chain. We expect internal operating profit to be down 2 to 4%, with EPS on a currency-neutral basis to be approximately flat.

Preliminarily for 2012, we expect our internal net sales to be up 4 to 5%, above our long-term targets. We expect our operating profit to be flat to up slightly. This reflects investments to promote sustainable momentum for the long-term health of our business. The investments will focus on three key areas: increased brand-building, our supply chain, and the SAP reimplementation. EPS on a currency-neutral basis is expected to be up 2 to 4%.

Table of Contents

***Net sales and operating profit***

The following table provides an analysis of net sales and operating profit performance for the third quarter of 2011 versus 2010:

| (dollars in millions) | North America | Europe | Latin America | Asia Pacific (a) | Corporate | Consoli-dated |
|---|---|---|---|---|---|---|
| **2011 net sales** | **$ 2,217** | **$ 585** | **$ 274** | **$ 236** | **$** | **$ 3,312** |
| **2010 net sales** | **$ 2,130** | **$ 564** | **$ 247** | **$ 216** | **$** | **$ 3,157** |
| % change 2011 vs. 2010: | | | | | | |
| Volume (tonnage) (b) | (.7)% | (4.5)% | (3.0)% | (5.0)% | | (1.9)% |
| Pricing/mix | 4.4% | 2.9% | 12.3% | 7.0% | | 5.0% |
| **Subtotal internal business** | **3.7%** | **(1.6)%** | **9.3%** | **2.0%** | | **3.1%** |
| Foreign currency impact | .4% | 5.2% | 1.3% | 7.8% | | 1.8% |
| **Total change** | **4.1%** | **3.6%** | **10.6%** | **9.8%** | | **4.9%** |

| (dollars in millions) | North America (c) | Europe | Latin America | Asia Pacific (a) | Corporate (c) | Consoli-dated |
|---|---|---|---|---|---|---|
| **2011 operating profit** | **$ 357** | **$ 84** | **$ 43** | **$ 23** | **$ (43)** | **$ 464** |
| **2010 operating profit** | **$ 407** | **$ 102** | **$ 34** | **$ 25** | **$ (27)** | **$ 541** |
| % change 2011 vs. 2010: | | | | | | |
| **Internal business** | **(12.7)%** | **(20.9)%** | **19.0%** | **(13.6)%** | **(54.5)%** | **(15.7)%** |
| Foreign currency impact | .5% | 4.5% | 2.8% | 4.5% | % | 1.6% |
| **Total change** | **(12.2)%** | **(16.4)%** | **21.8%** | **(9.1)%** | **(54.5)%** | **(14.1)%** |

(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.

(c) Research and Development expense totaling $3 million for the quarter ended October 2, 2010 was reallocated to Corporate from North America.

Our reported consolidated net sales grew by 5%. Volume was down 2% in the quarter due to customer trade inventory reductions in the U.S., a challenging operating environment in the U.K. as well as volume declines in Russia and China due to our continued conversion to value-added formats in these markets. Pricing/mix increased net sales by 5%. Foreign exchange provided a favorable impact of almost 2%.

Our North America operating segment had internal net sales growth of 4%. North America has three product groups: retail cereal; retail snacks; and frozen and specialty channels. Internal net sales in retail cereal was flat. We believe our underlying consumption growth across all channels was 5%, in-line with data for measured channels. The gap between our sales and the consumption data was driven by swings in trade inventory. In the third quarter of 2010, trade inventory was being rebuilt following a product recall in the second quarter of 2010. In the third quarter of 2011, trade inventory declined. The trends in the cereal category continued to improve in the quarter driven by strong price realization.

The retail snack product group (cookies, crackers, toaster pastries, cereal bars and fruit-flavored snacks) grew 3% with growth in crackers, cookies and wholesome snacks driven by strong execution, especially during the back-to-school period. A trade inventory reduction in toaster pastries negatively impacted sales.

Internal net sales in the frozen and specialty channels (frozen foods, food service and vending) increased 12%, driven by growth in our frozen food business, particularly in our waffle business due to strong innovation and brand building. The veggie category remained strong and we saw growth in our foodservice business.

Internal net sales in our international operating segments increased 2%. Europe s internal net sales were down 2%, driven by the U.K. The U.K. continued to face a challenging operating environment a tough economy combined with a highly competitive retail landscape. As a result, our cereal consumption was down in the third quarter. To address these challenges, we are accelerating our rate of innovation in the $4^{th}$ quarter of 2011 and the beginning of 2012. The snacks business in the U.K. continued to struggle, as we have seen new products enter the category which have driven significant consumption declines for our products. We are going into 2012 with much stronger snack innovation plans. We saw some positive trends on the continent, with growth in France, Spain and Italy. Latin America s internal net sales grew by 9% with growth in Mexico,

Table of Contents

Venezuela and Colombia. Strong price realization helped offset high cost inflation and was used to fund a double-digit increase in brand-building. In Asia Pacific, internal net sales were up 2% as a result of continued strong sales in our Korea, South Africa and India businesses. Offsetting this growth was softness in Australia, Japan and China. In Australia, our sales declined compared to last year due to a recent customer issue.

Consolidated operating profit was down 14% on a reported basis, and 16% on an internal basis, driven primarily by input-cost inflation, investments in our supply chain, the adjustment we made in the third quarter of 2010 to significantly reduce incentive compensation expense and the reinstatement of those costs in 2011. The net incentive compensation adjustment decreased operating profit by 12%. Brand-building in the quarter was down compared to last year, resulting in a benefit to operating profit. While we anticipated the third quarter of 2011 would have the highest inflation of the year, we incurred more cost pressures than expected, resulting in less operating profit.

It takes time and consistency to develop sustainable momentum; we underestimated how much work is required in our supply chain. As a result, we have made additional investments. Our supply chain projects represent an important investment for our Company to improve reliability and capability. We have also made additional investments in our physical infrastructure across our network. We have selectively added people in our plants, added resources and intend to expand training and awareness programs. We have changed a number of suppliers and significantly increased our independent testing and auditing. These investments have resulted in additional labor costs, asset write-offs, and in some cases, temporarily increased logistics solutions and sourcing.

Internal operating profit in North America was down 13% in the quarter. While operating profit benefited from strong improvements in price/mix, this benefit was more than offset by increased cost pressures, including commodities, energy and fuel inflation, investments in our supply chain and the reinstatement of incentive compensation. Europe s internal operating profit declined by 21%, impacted by the difficult operating environment in the U.K. and input-cost inflation across the region. In Latin America, internal operating profit increased by 19% driven by strong sales growth, partially offset by a double-digit increase in brand-building investment. Asia Pacific s internal operating profit decreased by 14% primarily due to a customer trading issue in Australia.

Table of Contents

The following tables provide analysis of our net sales and operating performance for the year-to-date periods of 2011 as compared to 2010. Our net sales benefited from a slight increase in volume, improved pricing/mix due to price realization and foreign exchange. Internal operating profit was down on a year-to-date basis due to increased cost pressures, investments in our supply chain and the reinstatement of incentive compensation.

| (dollars in millions) | North America | Europe | Latin America | Asia Pacific (a) | Corporate | Consolidated |
|---|---|---|---|---|---|---|
| **2011 net sales** | **$ 6,812** | **$ 1,840** | **$ 816** | **$ 715** | **$** | **$ 10,183** |
| **2010 net sales** | **$ 6,469** | **$ 1,730** | **$ 709** | **$ 629** | **$** | **$ 9,537** |
| % change 2011 vs. 2010: | | | | | | |
| Volume (tonnage) (b) | 1.0% | (2.7)% | % | % | | .2% |
| Pricing/mix | 3.8% | 2.2% | 8.8% | 2.6% | | 3.8% |
| **Subtotal internal business** | **4.8%** | **(.5)%** | **8.8%** | **2.6%** | | **4.0%** |
| Foreign currency impact | .5% | 6.8% | 6.3% | 11.1% | | 2.8% |
| **Total change** | **5.3%** | **6.3%** | **15.1%** | **13.7%** | | **6.8%** |

| (dollars in millions) | North America (c) | Europe | Latin America | Asia Pacific (a) | Corporate (c) | Consolidated |
|---|---|---|---|---|---|---|
| **2011 operating profit** | **$ 1,203** | **$ 287** | **$ 152** | **$ 79** | **$ (142)** | **$ 1,579** |
| **2010 operating profit** | **$ 1,269** | **$ 307** | **$ 126** | **$ 82** | **$ (123)** | **$ 1,661** |
| % change 2011 vs. 2010: | | | | | | |
| **Internal business** | **(5.7)%** | **(12.8)%** | **12.6%** | **(13.7)%** | **(14.9)%** | **(7.6)%** |
| Foreign currency impact | .5% | 6.4% | 7.5% | 9.9% | % | 2.7 % |
| **Total change** | **(5.2)%** | **(6.4)%** | **20.1%** | **(3.8)%** | **(14.9)%** | **(4.9)%** |

(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.
(c) Research and Development expense totaling $8 million for the year-to-date period ended October 2, 2010 was reallocated to Corporate from North America.

***Margin performance***

Margin performance for the third quarter and year-to-date periods of 2011 versus 2010 is as follows:

| **Quarter** | **2011** | 2010 | *Change vs. prior year (pts.)* |
|---|---|---|---|
| Gross margin (a) | **40.7 %** | 43.4 % | **(2.7)** |
| SGA (b) | **(26.7)%** | (26.3)% | **(0.4)** |
| Operating margin | **14.0 %** | 17.1 % | **(3.1)** |
| **Year-to-date** | **2011** | 2010 | *Change* |
| Gross margin (a) | **41.4 %** | 43.0 % | **(1.6)** |
| SGA (b) | **(25.9)%** | (25.6)% | **(0.3)** |
| Operating margin | **15.5 %** | 17.4 % | **(1.9)** |

(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.

Our gross profit margin for the quarter was 270 basis points lower than in the same period in 2010. Our cost pressures (mainly commodities, energy and fuel) in the third quarter of 2011 were the highest of the year, slightly higher than anticipated. Our gross margin came under additional pressure due to the investments in our supply chain infrastructure across our U.S. network. These incremental investments resulted in increased logistic costs, and reduced operating leverage while production lines were down and represented approximately half of the decline in gross margin. Our selling, general and administrative (SGA) expense as a percentage of net sales increased by 40 basis points due to the reinstatement of incentive compensation. This increase offset the impact of reduced brand-building. As a result of lower gross margin and higher SGA as a percentage of net sales, our operating margin was down by 310 basis points.

Table of Contents

On a year-to-date basis, gross margin was down 160 basis points. The year-to-date performance was impacted by the increased cost pressures in the third quarter as well as the lag in price execution in the first quarter of 2011 to cover increased input costs. Our SGA expense as a percentage of net sales increased by 30 basis points primarily due to the reinstatement of incentive compensation. On a year-to-date basis, brand-building increased SGA expense as a percentage of net sales slightly. As a result of lower gross margin and higher SGA as a percentage of net sales, our operating margin was down by 190 basis points.

For the full year, we expect gross margin to remain under pressure and be down approximately 100 basis points compared to 2010.

***Foreign currency translation***

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

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

| | Quarter ended | | Year-to-date period ended | |
|---|---|---|---|---|
| Consolidated results | **October 1, 2011** | October 2, 2010 | **October 1, 2011** | October 2, 2010 |
| Diluted net earnings per share (EPS) | **$ 0.80** | $ 0.90 | **$ 2.73** | $ 2.78 |
| Translation impact (a) | **(0.02)** | 0.02 | **(0.08)** | 0.02 |
| Currency neutral EPS | **$ 0.78** | $ 0.92 | **$ 2.65** | $ 2.80 |
| Currency neutral EPS growth (b) | **(13)%** | | **(5)%** | |

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

***Product recall***

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

***Exit or disposal activities***

We view our continued spending on cost reduction initiatives as part of our ongoing operating principles to provide greater visibility in achieving our long-term profit growth targets. Initiatives undertaken are currently expected to recover cash implementation costs within a

five-year period of completion. Each cost reduction initiative is normally up to three years in duration. Upon completion (or as each major stage is completed in the case of multi-year programs), the project begins to deliver cash savings and/or reduced depreciation. Certain of these initiatives represent exit or disposal plans for which material charges will be incurred. We include these charges in our measure of operating segment profitability.

See Note 3 for the details of these activities.

Table of Contents

***Interest expense***

For the quarter and year-to-date periods ended October 1, 2011, interest expense was $58 million and $178 million, respectively, as compared to the quarter and year-to-date periods ended October 2, 2010 with interest expense of $62 million and $188 million, respectively. Year-to-date 2011 interest expense was lower than prior year expense due to the differential in interest rates on debt that matured in March 2011 versus debt that was issued in May 2011.

For the full year 2011, we expect gross interest expense to be approximately $235 to $245 million, compared to 2010 s full year amount of $248 million.

***Income taxes***

The consolidated effective income tax rate was 27% for the quarter ended October 1, 2011, as compared to 30% for the comparable quarter of 2010. Refer to Note 8 of the Consolidated Financial Statements for further discussion.

For the full year 2011, we currently expect the consolidated effective income tax rate to be approximately 29%. Fluctuations in foreign currency exchange rates could impact the expected effective income tax rate as it is dependent upon U.S. dollar earnings of foreign subsidiaries doing business in various countries with differing statutory rates. Additionally, the rate could be impacted if pending uncertain tax matters, including tax positions that could be affected by planning initiatives, are resolved more or less favorably than we currently expect.

**Liquidity and capital resources**

Our principal source of liquidity is operating cash flows supplemented by borrowings for major acquisitions and other significant transactions. Our cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating and investing needs.

The following table sets forth a summary of our cash flows:

| | Year-to-date period ended | |
|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 |
| Net cash provided by (used in): | | |
| Operating activities | **$ 1,269** | $ 1,079 |
| Investing activities | **(381)** | (250) |
| Financing activities | **(730)** | (611) |
| Effect of exchange rates on cash and cash equivalents | **(20)** | 7 |
| Net increase in cash and cash equivalents | **$ 138** | $ 225 |

***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.

Net cash provided by our operating activities for the year-to-date period ended October 1, 2011, amounted to $1,269 million, an increase of $190 million over the same period in 2010. The increase compared to the prior year is primarily due to lower incentive compensation payments during first quarter 2011 as well as a reduction in cash taxes paid.

Our cash conversion cycle (defined as days of inventory and trade receivables outstanding less days of trade payables outstanding, based on a trailing 12 month average) is relatively short, equating to approximately 24 days and 22 days for the 12 month periods ended October 1, 2011 and October 2, 2010, respectively. Compared with the 12 month period ended October 2, 2010, the unfavorable impact on the 2011 cash conversion cycle resulted from higher days of inventory, which was somewhat mitigated by an increase in trade payables outstanding.

Our pension and other postretirement benefit plan contributions amounted to $187 million and $45 million for the year-to-date periods ended October 1, 2011 and October 2, 2010, respectively. For the full year 2011, we currently expect that our contributions to pension and other postretirement plans will total approximately $200 million. Plan funding strategies may be modified in response to our evaluation of tax deductibility, market conditions and competing investment alternatives.

We measure cash flow 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 repurchases. Our cash flow metric is reconciled to the most comparable GAAP measure, as follows:

| | Year-to-date period ended | | *Change versus* |
|---|---|---|---|
| (millions) | **October 1, 2011** | October 2, 2010 | *prior year* |
| Net cash provided by operating activities | **$ 1,269** | $ 1,079 | **17.6%** |
| Additions to properties | **(392)** | (252) | |
| Cash flow | **$ 877** | $ 827 | **6.0%** |

For 2011, we are projecting cash flow (as defined) within a range of $1.1 billion to $1.2 billion. This projection reflects the impact of our expected pension and postretirement benefit plan contributions, net of tax.

***Investing activities***

Our net cash used in investing activities during the year-to-date period ended October 1, 2011 amounted to $381 million, an increase of $131 million compared with the same period in 2010. The year-over-year increase was primarily attributable to the addition of manufacturing capacity to support growth and innovation as well as investments in our supply chain infrastructure.

For full-year 2011, we project capital spending of approximately 4 to 5% of net sales. We are increasing our investment in manufacturing capacity as well as improving our information technology infrastructure.

***Financing activities***

Our net cash used in financing activities for the year-to-date period ended October 1, 2011 amounted to $730 million compared to $611 million for the same period in 2010. There were several drivers of the difference between the two years, resulting in the net use in cash of $119 million compared to 2010. There was an overall reduction in long-term debt compared to the prior year, resulting in an increase in cash used in financing activities. This increase was mitigated by the following items which decreased the cash used in financing activities: lower common stock repurchases; an increase in commercial paper borrowings; and higher proceeds from the issuance of common stock related to stock option exercises.

We used commercial paper to refinance $946 million of long-term debt that matured in the first quarter of 2011. In May 2011, we issued $400 million of seven-year 3.25% fixed rate U.S. Dollar Notes, and used proceeds of $397 million to pay down commercial paper.

We spent $693 million and $907 million to repurchase common stock during the year-to-date periods ended October 1, 2011 and October 2, 2010, respectively. To date, during 2011 we repurchased approximately 13 million shares of our common stock. Of the $693 million spent in 2011, $5 million related to shares purchased in 2010 that did not settle prior to the end of the 2010 reporting period. During the same period of 2010, we repurchased approximately 18 million shares of our common stock.

On April 23, 2010, our board of directors authorized a $2.5 billion, three-year share repurchase program for 2010 through 2012. As of October 1, 2011, total purchases under the repurchase authorization amounted to 33 million shares totaling $1.7 billion. During the remainder of 2011 and 2012, we plan to execute the remaining repurchases under the 2010 authorization. We project total purchases of $800 million in 2011, which includes the $693 million executed in the first nine months of 2011, with the balance in 2012. Actual repurchases could be different from our current projections, as influenced by factors such as the impact of changes in our stock price and other competing priorities.

We paid cash dividends of $452 million year-to-date 2011, compared to $435 million during the same period in 2010. In July 2011, the board of directors declared a dividend of $.43 per common share, payable December 15, 2011 to shareholders of record at close of business on December 1, 2011. The dividend is consistent with our current plan to maintain our dividend pay-out between 40% and 50% of reported net income.

In March 2011, we entered into an unsecured Four-Year Credit Agreement to replace our existing unsecured Five-Year Credit Agreement, which would have expired in November 2011. The Four-Year Credit Agreement allows us to borrow, on a revolving credit basis, up to $2.0 billion, although we do not plan to draw against it. (See Note 5 within Notes to Consolidated Financial Statements for additional information on the Four-Year Credit Agreement.)

We are in compliance with all debt covenants. 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. We expect our access to public debt and commercial paper markets, along with operating cash flows, will be adequate to meet future operating, investing and financing needs, including the pursuit of selected acquisitions.

Table of Contents

**Accounting standards to be adopted in future periods**

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08, Testing Goodwill for Impairment, allowing entities the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under ASU No. 2011-08, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We will consider early adoption of ASU 2011-08 in connection with our annual goodwill impairment evaluation in the fourth quarter of 2011.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income, requiring most entities to present items of net income and other comprehensive income either in one continuous statement referred to as the statement of comprehensive income or in two separate, but consecutive, statements of net income and other comprehensive income. The update does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU No. 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted. We will be adopting ASU 2011-05 at the beginning of our 2012 fiscal year.

Table of Contents

**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; 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, 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, can, anticipate, project, should, or words or phrases of similar meaning. Our actual results or activities may differ materially 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, renovation and new product introductions;
- the recoverability of the carrying value of goodwill and other intangibles;
- the success of productivity improvements and business transitions;
- commodity and energy prices;
- labor costs;
- disruptions or inefficiencies in supply chain;
- 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, statutory tax rates, currency conversion and availability;

- legal and regulatory factors including changes in advertising and labeling laws and regulations;
- the ultimate impact of product recalls;
- 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.

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

Our Company is exposed to certain market risks, which exist as a part of our ongoing business operations. We use derivative financial and commodity instruments, where appropriate, to manage these risks. Refer to Note 9 within Notes to Consolidated Financial Statements for further information on our derivative financial and commodity instruments.

Refer to disclosures contained on pages 25-26 of our 2010 Annual Report on Form 10-K. Other than changes noted here, there have been no material changes in the Company s market risk as of October 1, 2011.

During the quarter ended October 1, 2011, we terminated interest rate swaps with notional amounts totaling $2.5 billion, of which $1.5 billion was previously designated as fair value hedges of certain U.S. Dollar Notes. Refer to Note 5 within Notes to Consolidated Financial Statements. The total notional amount of interest rate swaps at October 1, 2011 was $200 million, representing a settlement receivable of $16 million. The total notional amount of interest rate swaps at January 1, 2011 was $1.9 billion, representing a settlement receivable of $74 million.

The total notional amount of commodity derivative instruments at October 1, 2011 was $251 million, representing a settlement obligation of approximately $47 million. The total notional amount of commodity derivative instruments at January 1, 2011 was $379 million, representing a settlement obligation of approximately $16 million. Assuming a 10% decrease in period-end commodity prices, the settlement obligation would have increased by approximately $20 million at October 1, 2011, and $36 million at January 1, 2011, generally offset by a reduction in the cost of the underlying commodity purchases.

## 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 October 1, 2011, 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.

Table of Contents

**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 January 1, 2011. 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 January 1, 2011, 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 |
|---|---|---|---|---|
| Month #1: | | | | |
| 7/3/11-7/30/11 | | $0.00 | | $930 |
| Month #2: | | | | |
| 7/31/11-8/27/11 | 3,264,034 | $52.67 | 3,264,034 | $758 |
| Month #3: | | | | |
| 8/28/11-10/1/11 | 61,997 | $51.98 | 61,997 | $755 |
| Total | 3,326,031 | $52.65 | 3,326,031 | |

On April 23, 2010, the board of directors authorized a $2.5 billion three-year share repurchase program for 2010 through 2012. This authorization replaced the previous share buyback program which authorized stock repurchases of up to $1,113 million for 2010.

**Item 6. Exhibits**

(a) Exhibits:

| | |
|---|---|
| 31.1 | Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant |
| 31.2 | Rule 13a-14(e)/15d-14(a) Certification from Ronald L. Dissinger |
| 32.1 | Section 1350 Certification from John A. Bryant |
| 32.2 | Section 1350 Certification from Ronald L. Dissinger |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |

| | |
|---|---|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

**Table of Contents**

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/ R. L. Dissinger
R. L. Dissinger
Principal Financial Officer;

Senior Vice President and Chief Financial Officer

/s/ A. R. Andrews
A. R. Andrews
Principal Accounting Officer;

Vice President     Corporate Controller

Date: November 9, 2011

**Table of Contents**

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 John A. Bryant | E |
| 31.2 | Rule 13a-14(e)/15d-14(a) Certification from Ronald L. Dissinger | E |
| 32.1 | Section 1350 Certification from John A. Bryant | E |
| 32.2 | Section 1350 Certification from Ronald L. Dissinger | E |
| 101.INS | XBRL Instance Document | E |
| 101.SCH | XBRL Taxonomy Extension Schema Document | E |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | E |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | E |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | E |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | E |