

KELLOGG CO
Form 10-K
February 23, 2007

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

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

For the Fiscal Year Ended December 30, 2006

Commission file number 1-4171

Kellogg Company

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State of Incorporation)

38-0710690
(I.R.S. Employer Identification No.)

**One Kellogg Square
Battle Creek, Michigan 49016-3599**

(Address of Principal Executive Offices)

Registrant's telephone number: (269) 961-2000

Securities registered pursuant to Section 12(b) of the Securities Act:

Title of each class:
Common Stock, \$.25 par value per share

Name of each exchange on which registered:
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Securities Act: None

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Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Securities Exchange Act of 1934. (Check one)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant (assuming only for purposes of this computation that the W.K. Kellogg Foundation Trust, directors and executive officers may be affiliates) was approximately \$14.5 billion, as determined by the June 30, 2006, closing price of \$48.43 for one share of common stock, as reported for the New York Stock Exchange Composite Transactions.

As of January 26, 2007, 397,969,170 shares of the common stock of the registrant were issued and outstanding.

Parts of the registrant's Proxy Statement for the Annual Meeting of Shareowners to be held on April 27, 2007 are incorporated by reference into Part III of this Report.

TABLE OF CONTENTS

PART I

Item 1. Business

Item 1A. Risk Factors

Item 1B. Unresolved Staff Comments

Item 2. Properties

Item 3. Legal Proceedings

Item 4. Submission of Matters to a Vote of Security Holders

PART II

Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities

Item 6. Selected Financial Data

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Data

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Item 9A. Controls and Procedures

Item 9B. Other Information

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions, and Director Independence

Item 14. Principal Accounting Fees and Services

PART IV

Item 15. Exhibits, Financial Statement Schedules

SIGNATURES

EXHIBIT INDEX

Amended and Restated Five-Year Credit Agreement dated as of November 10, 2006

364-Day Credit Agreement dated as of January 31, 2007

Form of Multicurrency Global Note related to Euro-Commercial Paper Program

2003 Long-Term Incentive Plan, as amended and restated as of December 8, 2006

Domestic and Foreign Subsidiaries

Consent of Independent Registered Public Accounting Firm

Powers of Attorney

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

Rule 13a-14(a)/15d-14(a) Certification by John A. Bryant

Section 1350 Certification of A.D. David Mackay

Section 1350 Certification of John A. Bryant

Table of Contents

PART I

Item 1. Business

The Company. Kellogg Company, founded in 1906 and incorporated in Delaware in 1922, and its subsidiaries are engaged in the manufacture and marketing of ready-to-eat cereal and convenience foods.

The address of the principal business office of Kellogg Company is One Kellogg Square, P.O. Box 3599, Battle Creek, Michigan 49016-3599. Unless otherwise specified or indicated by the context, Kellogg, we, us and our refer to Kellogg Company, its divisions and subsidiaries.

Financial Information About Segments. Information on segments is located in Note 14 within Notes to the Consolidated Financial Statements which are included herein under Part II, Item 8.

Principal Products. Our principal products are ready-to-eat cereals and convenience foods, such as cookies, crackers, toaster pastries, cereal bars, fruit snacks, frozen waffles and veggie foods. These products were, as of December 30, 2006, manufactured by us in 17 countries and marketed in more than 180 countries. Our cereal products are generally marketed under the **Kellogg** s name and are sold principally to the grocery trade through direct sales forces for resale to consumers. We use broker and distribution arrangements for certain products. We also generally use these, or similar arrangements, in less-developed market areas or in those market areas outside of our focus.

We also market cookies, crackers, and other convenience foods, under brands such as **Kellogg** s, **Keebler**, **Cheez-It**, **Murray**, **Austin** and **Famous Amos**, to supermarkets in the United States through a direct store-door (DSD) delivery system, although other distribution methods are also used.

Additional information pertaining to the relative sales of our products for the years 2004 through 2006 is located in Note 14 within Notes to the Consolidated Financial Statements, which are included herein under Part II, Item 8.

Raw Materials. Agricultural commodities are the principal raw materials used in our products. Cartonboard, corrugated, and plastic are the principal packaging materials used by us. World supplies and prices of such commodities (which include such packaging materials) are constantly monitored, as are government trade policies. The cost of such commodities may fluctuate widely due to government policy and regulation, weather conditions, or other unforeseen circumstances. Continuous efforts are made to maintain and improve the quality and supply of such commodities for purposes of our short-term and long-term requirements.

The principal ingredients in the products produced by us in the United States include corn grits, wheat and wheat derivatives, oats, rice, cocoa and chocolate, soybeans and soybean derivatives, various fruits, sweeteners, flour, shortening, dairy products, eggs, and other filling ingredients, which are obtained from various sources. Most of these commodities are purchased principally from sources in the United States.

We enter into long-term contracts for the commodities described in this section and purchase these items on the open market, depending on our view of possible price fluctuations, supply levels, and our relative negotiating power. While the cost of some of these commodities has, and may continue to, increase over time, we believe that we will be able to purchase an adequate supply of these items as needed. As further discussed herein under Part II, Item 7A, we also use commodity futures and options to hedge some of our costs.

Raw materials and packaging needed for internationally based operations are available in adequate supply and are sometimes imported from countries other than those where used in manufacturing.

Cereal processing ovens at major domestic and international facilities are regularly fueled by natural gas or propane, which are obtained from local utilities or other local suppliers. Short-term standby propane storage exists at several plants for use in the event of an interruption in natural gas supplies. Oil may also be used to fuel certain operations at various plants in the event of natural gas shortages or when its use presents economic advantages. In addition, considerable amounts of diesel fuel are used in connection with the distribution of our products. As further discussed herein under Part II, Item 7A, beginning in 2006, we have used over-the-counter commodity price swaps to hedge some of our natural gas costs.

Trademarks and Technology. Generally, our products are marketed under trademarks we own. Our principal trademarks are our housemarks, brand names, slogans, and designs related to cereals and convenience foods manufactured and marketed by us, and we also grant licenses to third parties to use these marks on various goods. These trademarks include **Kellogg** s for cereals, convenience foods and our other products, and the brand

Table of Contents

names of certain ready-to-eat cereals, including *All-Bran*, *Apple Jacks*, *Bran Buds*, *Complete* Bran Flakes, *Complete* Wheat Flakes, *Cocoa Krispies*, *Cinnamon Crunch Crispix*, *Corn Pops*, *Cruncheroos*, *Kellogg's* *Corn Flakes*, *Cracklin Oat Bran*, *Crispix*, *Froot Loops*, *Kellogg's* *Frosted Flakes*, *Frosted Mini-Wheats*, *Frosted Krispies*, *Just Right*, *Kellogg's* Low Fat Granola, *Mueslix*, *Nutri-Grain*, *Pops*, *Product 19*, *Kellogg's* *Raisin Bran*, *Rice Krispies*, *Raisin Bran Crunch*, *Smacks*, *Smart Start*, *Special K* and *Special K* Red Berries in the United States and elsewhere; *Zucaritas*, *Choco Zucaritas*, *Crusli Sucrilhos*, *Sucrilhos* Chocolate, *Sucrilhos* Banana, *Vector*, *Musli*, *Nutridia*, and *Choco Krispis* for cereals in Latin America; *Vive* and *Vector* in Canada; *Choco Pops*, *Chocos*, *Frosties*, *Muslix*, *Fruit n Fibre*, *Kellogg's* *Crunchy Nut Corn Flakes*, *Kellogg's* *Crunchy Nut Red Corn Flakes*, *Honey Loops*, *Kellogg's* *Extra*, *Sustain*, *Mueslix*, *Country Store*, *Ricicles*, *Smacks*, *Start*, *Smacks Choco Tresor*, *Pops*, and *Optima* for cereals in Europe; and *Cerola*, *Sultana Bran*, *Supercharged*, *Chex*, *Frosties*, *Goldies*, *Rice Bubbles*, *Nutri-Grain*, *Kellogg's* *Iron Man Food*, and *BeBig* for cereals in Asia and Australia. Additional Company trademarks are the names of certain combinations of *Kellogg's* ready-to-eat cereals, including *Fun Pak*, *Jumbo*, and *Variety*. Other Company brand names include *Kellogg's* Corn Flake Crumbs; *Croutettes* for herb season stuffing mix; *All-Bran*, *Choco Krispis*, *Froot Loops*, *Nutridia*, *Kuadri-Krispis*, *Zucaritas*, *Special K*, and *Crusli* for cereal bars, *Keloketas* for cookies, *Komplete* for biscuits; and *Kaos* for snacks in Mexico and elsewhere in Latin America; *Pop-Tarts Pastry Swirls* for toaster danish; *Pop-Tarts* and *Pop-Tarts Snak-Stix* for toaster pastries; *Eggo*, *Special K*, *Froot Loops* and *Nutri-Grain* for frozen waffles and pancakes; *Rice Krispies Treats* for baked snacks and convenience foods; *Nutri-Grain* cereal bars, *Nutri-Grain* yogurt bars, *All-Bran* bars, *Smart Start* bars and *Kellogg's* *Crunch* bars for convenience foods in the United States and elsewhere; *K-Time*, *Rice Bubbles*, *Day Dawn*, *Be Natural*, *Sunibrite* and *LCMs* for convenience foods in Asia and Australia; *Nutri-Grain* Squares, *Nutri-Grain Elevenses*, and *Rice Krispies Squares* for convenience foods in Europe; *Fruit Winders* for fruit snacks in the United Kingdom; *Kashi* and *GoLean* for certain cereals, nutrition bars, and mixes; *TLC* for crackers; *Vector* for meal replacement products; and *Morningstar Farms*, *Loma Linda*, *Natural Touch*, and *Worthington* for certain meat and egg alternatives.

We also market convenience foods under trademarks and tradenames which include *Keebler*, *Cheez-It*, *E. L. Fudge*, *Murray*, *Famous Amos*, *Austin*, *Ready Crust*, *Chips Deluxe*, *Club*, *Fudge Shoppe*, *Hi-Ho*, *Sunshine*, *Munch Ems*, *Right Bites*, *Sandies*, *Soft Batch*, *Toasteds*, *Town House*, *Vienna Fingers*, *Wheatables*, and *Zesta*. One of our subsidiaries is also the exclusive licensee of the *Carr's* brand name in the United States.

Our trademarks also include logos and depictions of certain animated characters in conjunction with our products, including *Snap!Crackle!Pop!* for *Cocoa Krispies* and *Rice Krispies* cereals and *Rice Krispies Treats* convenience foods; *Tony the Tiger* for *Kellogg's* *Frosted Flakes*, *Zucaritas*, *Sucrilhos* and *Frosties* cereals and convenience foods; *Ernie Keebler* for cookies, convenience foods and other products; the *Hollow Tree* logo for certain convenience foods; *Toucan Sam* for *Froot Loops*; *Dig Em* for *Smacks*; *Coco the Monkey* for *Coco Pops*; *Cornelius* for *Kellogg's* *Corn Flakes*; *Melvin* the elephant for certain cereal and convenience foods; *Chocos* the Bear and *Kobi* the Bear for certain cereal products.

The slogans *The Best To You Each Morning*, *The Original and Best* and *They're Gr-r-reat!*, used in connection with our ready-to-eat cereals, along with *L Eggo my Eggo*, used in connection with our frozen waffles and pancakes, and *Elfin Magic* used in connection with convenience food products are also important Kellogg trademarks.

The trademarks listed above, among others, when taken as a whole, are important to our business. Certain individual trademarks are also important to our business. Depending on the jurisdiction, trademarks are generally valid as long as they are in use and/or their registrations are properly maintained and they have not been found to have become generic. Registrations of trademarks can also generally be renewed indefinitely as long as the trademarks are in use.

We consider that, taken as a whole, the rights under our various patents, which expire from time to time, are a valuable asset, but we do not believe that our businesses are materially dependent on any single patent or group of

related patents. Our activities under licenses or other franchises or concessions which we hold are similarly a valuable asset, but are not believed to be material.

Seasonality. Demand for our products has generally been approximately level throughout the year, although some of our convenience foods have a bias for stronger demand in the second half of the year due to events and holidays. We also custom-bake cookies for the Girl Scouts of the U.S.A., which are principally sold in the first quarter of the year.

Working Capital. Although terms vary around the world and by business types, in the United States we generally have required payment for goods sold eleven or sixteen days subsequent to the date of invoice as 2% 10/net 11 or 1% 15/net 16. Receipts from goods sold, supplemented as

Table of Contents

required by borrowings, provide for our payment of dividends, capital expansion, and for other operating expenses and working capital needs.

Customers. Our largest customer, Wal-Mart Stores, Inc. and its affiliates, accounted for approximately 18% of consolidated net sales during 2006, comprised principally of sales within the United States. At December 30, 2006, approximately 14% of our consolidated receivables balance and 22% of our U.S. receivables balance was comprised of amounts owed by Wal-Mart Stores, Inc. and its affiliates. During 2006, our top five customers, collectively, accounted for approximately 33% of our consolidated net sales and approximately 42% of U.S. net sales. There has been significant worldwide consolidation in the grocery industry in recent years and we believe that this trend is likely to continue. Although the loss of any large customer for an extended length of time could negatively impact our sales and profits, we do not anticipate that this will occur to a significant extent due to the consumer demand for our products and our relationships with our customers. Our products have been generally sold through our own sales forces and through broker and distributor arrangements, and have been generally resold to consumers in retail stores, restaurants, and other food service establishments.

Backlog. For the most part, orders are filled within a few days of receipt and are subject to cancellation at any time prior to shipment. The backlog of any unfilled orders at December 30, 2006 and December 31, 2005, was not material to us.

Competition. We have experienced, and expect to continue to experience, intense competition for sales of all of our principal products in our major product categories, both domestically and internationally. Our products compete with advertised and branded products of a similar nature as well as unadvertised and private label products, which are typically distributed at lower prices, and generally with other food products. Principal methods and factors of competition include new product introductions, product quality, taste, convenience, nutritional value, price, advertising, and promotion.

Research and Development. Research to support and expand the use of our existing products and to develop new food products is carried on at the W.K. Kellogg Institute for Food and Nutrition Research in Battle Creek, Michigan, and at other locations around the world. Our expenditures for research and development were approximately \$190.6 million in 2006, \$181.0 million in 2005 and \$148.9 million in 2004.

Regulation. Our activities in the United States are subject to regulation by various government agencies, including the Food and Drug Administration, Federal Trade Commission and the Departments of Agriculture, Commerce and Labor, as well as voluntary regulation by other bodies. Various state and local agencies also regulate our activities. Other agencies and bodies outside of the United States, including those of the European Union and various countries, states and municipalities, also regulate our activities.

Environmental Matters. Our facilities are subject to various U.S. and foreign federal, state, and local laws and regulations regarding the discharge of material into the environment and the protection of the environment in other ways. We are not a party to any material proceedings arising under these regulations. We believe that compliance with existing environmental laws and regulations will not materially affect our consolidated financial condition or our competitive position.

Employees. At December 30, 2006, we had approximately 26,000 employees.

Financial Information About Geographic Areas. Information on geographic areas is located in Note 14 within Notes to the Consolidated Financial Statements, which are included herein under Part II, Item 8.

Executive Officers. The names, ages, and positions of our executive officers (as of February 15, 2007) are listed below together with their business experience. Executive officers are generally elected annually by the Board of Directors at the meeting immediately prior to the Annual Meeting of Shareowners.

James M. Jenness

Chairman of the Board 60

Mr. Jenness has been our Chairman since February 2005 and has served as a Kellogg director since 2000. From February 2005 until December 2006, he also served as our Chief Executive Officer. He was Chief Executive Officer of Integrated Merchandising Systems, LLC, a leader in outsource management of retail promotion and branded merchandising from 1997 to December 2004. He is also a director of Kimberly-Clark Corporation.

A. D. David Mackay

President and Chief Executive Officer 51

Mr. Mackay became our President and Chief Executive Officer on December 31, 2006 and has served as a Kellogg director since February 2005. Mr. Mackay joined Kellogg Australia in 1985 and held several positions with Kellogg USA, Kellogg Australia and Kellogg New Zealand before leaving Kellogg in 1992. He rejoined Kellogg Australia in 1998 as managing

3

Table of Contents

director and was appointed managing director of Kellogg United Kingdom and Republic of Ireland later in 1998. He was named Senior Vice President and President, Kellogg USA in July 2000, Executive Vice President in November 2000, and President and Chief Operating Officer in September 2003. He is also a director of Fortune Brands, Inc.

John A. Bryant
Executive Vice President,
Chief Financial Officer, Kellogg Company and
President, Kellogg International 41

Mr. Bryant joined Kellogg in March 1998, working in support of the global strategic planning process. He was appointed Senior Vice President and Chief Financial Officer, Kellogg USA, in August 2000, was appointed as our Chief Financial Officer in February 2002 and was appointed Executive Vice President later in 2002. He also assumed responsibility for the Natural and Frozen Foods Division, Kellogg USA, in September 2003. He was appointed Executive Vice President and President, Kellogg International in June 2004 and was appointed to his current position in December 2006.

Jeffrey W. Montie
Executive Vice President and President,
Kellogg North America 45

Mr. Montie joined Kellogg Company in 1987 as a brand manager in the U.S. ready-to-eat cereal (RTEC) business and held assignments in Canada, South Africa and Germany, and then served as Vice President, Global Innovation for Kellogg Europe before being promoted. In December 2000, Mr. Montie was promoted to President, Morning Foods Division of Kellogg USA and, in August 2002, to Senior Vice President, Kellogg Company. Mr. Montie has been Executive Vice President of Kellogg Company, President of the Morning Foods Division of Kellogg North America since September 2003 and President of Kellogg North America since June 2004.

Donna J. Banks
Senior Vice President, Global Supply Chain 50

Dr. Banks joined Kellogg in 1983. She was appointed to Senior Vice President, Research and Development in 1997, to Senior Vice President, Global Innovation in 1999 and to Senior Vice President, Research, Quality and Technology in 2000. She was appointed to her current position in June 2004.

Celeste Clark
Senior Vice President, Global Nutrition and
Corporate Affairs 53

Dr. Clark has been Kellogg's Senior Vice President of Global Nutrition and Corporate Affairs since June 2006. She joined Kellogg in 1977 and served in several roles of increasing responsibility before being appointed to Vice President, Worldwide Nutrition Marketing in 1996 and then to Senior Vice President, Nutrition and Marketing Communications, Kellogg USA in 1999. She was appointed to Vice President, Corporate and Scientific Affairs in October 2002, and to Senior Vice President, Corporate Affairs in August 2003.

Gary H. Pilnick
Senior Vice President, General Counsel,
Corporate Development and Secretary 42

Mr. Pilnick was appointed Senior Vice President, General Counsel and Secretary in August 2003 and assumed responsibility for Corporate Development in June 2004. He joined Kellogg as Vice President Deputy General Counsel and Assistant Secretary in September 2000 and served in that position until August 2003. Before joining Kellogg, he served as Vice President and Chief Counsel of Sara Lee Branded Apparel and as Vice President and Chief Counsel, Corporate Development and Finance at Sara Lee Corporation.

Kathleen Wilson-Thompson

Senior Vice President, Global Human Resources 49

Kathleen Wilson-Thompson has been Kellogg Company's Senior Vice President, Global Human Resources since July 2005. She served in various legal roles until 1995, when she assumed the role of Human Resources Manager for one of our plants. In 1998, she returned to the legal department as Corporate Counsel, and was promoted to Chief Counsel, Labor and Employment in November 2001, a position she held until October 2003, when she was promoted to Vice President, Chief Counsel, U.S. Businesses, Labor and Employment.

Alan R. Andrews

Vice President and Corporate Controller 51

Mr. Andrews joined Kellogg Company in 1982. He served in various financial roles before relocating to China as general manager of Kellogg China in 1993. He subsequently served in several leadership innovation and finance roles before being promoted to Vice President, International Finance, Kellogg International in 2000. In 2002, he was appointed to Assistant Corporate Controller and assumed his current position in June 2004.

Availability of Reports; Website Access; Other Information. Our internet address is <http://www.kelloggcompany.com>.

Through Investor Relations Financials SEC Filings on our home page, we make available free of charge our proxy statements, our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, SEC Forms 3, 4 and 5 and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically

Table of Contents

file such material with, or furnish it to, the Securities and Exchange Commission. Our reports filed with the Securities and Exchange Commission are also made available to read and copy at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information about the Public Reference Room by contacting the SEC at 1-800-SEC-0330. Reports filed with the SEC are also made available on its website at www.sec.gov.

Copies of the Corporate Governance Guidelines, the Charters of the Audit, Compensation and Nominating and Governance Committees of the Board of Directors, the Code of Conduct for Kellogg Company directors and Global Code of Ethics for Kellogg Company employees (including the chief executive officer, chief financial officer and corporate controller) can also be found on the Kellogg Company website. Amendments or waivers to the Global Code of Ethics applicable to the chief executive officer, chief financial officer and corporate controller can also be found in the Investor Relations section of the Kellogg Company website. We will provide copies of any of these documents to any Shareowner upon request.

Forward-Looking Statements. This Report 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 expenditure; 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, will deliver, anticipate, project, words or phrases of similar meaning. For example, forward-looking statements are found in this Item 1 and in several sections of Management's Discussion and Analysis. Our actual results or activities may differ materially from these predictions. Our future results could be affected by a variety of factors, including the impact of competitive conditions; the effectiveness of pricing, advertising, and promotional programs; the success of innovation and new product introductions; the recoverability of the carrying value of goodwill and other intangibles; the success of productivity improvements and business transitions; commodity and energy prices, and labor costs; the availability of and interest rates on short-term and long-term financing; actual market performance of benefit plan trust investments; the levels of spending on systems initiatives, properties, business opportunities, integration of acquired businesses, and other general and administrative costs; changes in consumer behavior and preferences; the effect of U.S. and foreign economic conditions on items such as interest rates, statutory tax rates, currency conversion and availability; legal and regulatory factors; business disruption or other losses from war, terrorist acts, or political unrest and the risks and uncertainties described in Item 1A below. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to publicly update them.

Item 1A. Risk Factors

In addition to the factors discussed elsewhere in this Report, the following risks and uncertainties could materially adversely affect our business, financial condition and results of operations. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations and financial condition.

Our performance is affected by general economic and political conditions and taxation policies.

Our results in the past have been, and in the future may continue to be, materially affected by changes in general economic and political conditions in the United States and other countries, including the interest rate environment in which we conduct business, the financial markets through which we access capital and currency, political unrest and

terrorist acts in the United States or other countries in which we carry on business.

The enactment of or increases in tariffs, including value added tax, or other changes in the application of existing taxes, in markets in which we are currently active or may be active in the future, or on specific products that we sell or with which our products compete, may have an adverse effect on our business or on our results of operations.

We operate in the highly competitive food industry.

We face competition across our product lines, including ready-to-eat cereals and convenience foods, from other companies which have varying abilities to withstand changes in market conditions. Some of our competitors have substantial financial, marketing and other resources, and competition with them in our various markets and

5

Table of Contents

product lines could cause us to reduce prices, increase capital, marketing or other expenditures, or lose category share, any of which could have a material adverse effect on our business and financial results. Category share and growth could also be adversely impacted if we are not successful in introducing new products.

Our consolidated financial results and demand for our products are dependent on the successful development of new products and processes.

There are a number of trends in consumer preferences which may impact us and the industry as a whole. These include changing consumer dietary trends and the availability of substitute products.

Our success is dependent on anticipating changes in consumer preferences and on successful new product and process development and product relaunches in response to such changes. We aim to introduce products or new or improved production processes on a timely basis in order to counteract obsolescence and decreases in sales of existing products. While we devote significant focus to the development of new products and to the research, development and technology process functions of our business, we may not be successful in developing new products or our new products may not be commercially successful. Our future results and our ability to maintain or improve our competitive position will depend on our capacity to gauge the direction of our key markets and upon our ability to successfully identify, develop, manufacture, market and sell new or improved products in these changing markets.

An impairment in the carrying value of goodwill or other acquired intangible could negatively affect our consolidated operating results and net worth.

The carrying value of goodwill represents the fair value of acquired businesses in excess of identifiable assets and liabilities as of the acquisition date. The carrying value of other intangibles represents the fair value of trademarks, trade names, and other acquired intangibles as of the acquisition date. Goodwill and other acquired intangibles expected to contribute indefinitely to our cash flows are not amortized, but must be evaluated by management at least annually for impairment. If carrying value exceeds current fair value, the intangible is considered impaired and is reduced to fair value via a charge to earnings. Events and conditions which could result in an impairment include changes in the industries in which we operate, including competition and advances in technology; a significant product liability or intellectual property claim; or other factors leading to reduction in expected sales or profitability. Should the value of one or more of the acquired intangibles become impaired, our consolidated earnings and net worth may be materially adversely affected.

As of December 30, 2006, the carrying value of intangible assets totaled approximately \$4.87 billion, of which \$3.45 billion was goodwill and \$1.42 billion represented trademarks, tradenames, and other acquired intangibles compared to total assets of \$10.71 billion and shareholders' equity of \$2.07 billion.

We may not achieve our targeted cost savings from cost reduction initiatives.

Our success depends in part on our ability to be an efficient producer in a highly competitive industry. We have invested a significant amount in capital expenditures to improve our operational facilities. Ongoing operational issues are likely to occur when carrying out major production, procurement, or logistical changes and these, as well as any failure by us to achieve our planned cost savings, could have a material adverse effect on our business and consolidated financial position and on the consolidated results of our operations and profitability.

We have a substantial amount of indebtedness.

We have indebtedness that is substantial in relation to our shareholders' equity. As of December 30, 2006, we had total debt of approximately \$5.04 billion and shareholders' equity of \$2.07 billion.

Our substantial indebtedness could have important consequences, including:

the ability to obtain additional financing for working capital, capital expenditure or general corporate purposes may be impaired, particularly if the ratings assigned to our debt securities by rating organizations were revised downward;

restricting our flexibility in responding to changing market conditions or making us more vulnerable in the event of a general downturn in economic conditions or our business;

a substantial portion of the cash flow from operations must be dedicated to the payment of principal and interest on our debt, reducing the funds available to us for other purposes including expansion through acquisitions, marketing spending and expansion of our product offerings; and

we may be more leveraged than some of our competitors, which may place us at a competitive disadvantage.

Our ability to make scheduled payments or to refinance our obligations with respect to indebtedness will depend on our financial and operating performance, which in turn, is subject

Table of Contents

to prevailing economic conditions, the availability of, and interest rates on, short-term financing, and to financial, business and other factors beyond our control.

Our results may be materially and adversely impacted as a result of increases in the price of raw materials, including agricultural commodities, fuel and labor.

Agricultural commodities, including corn, wheat, soybean oil, sugar and cocoa, are the principal raw materials used in our products. Cartonboard, corrugated, and plastic are the principal packaging materials used by us. The cost of such commodities may fluctuate widely due to government policy and regulation, weather conditions, or other unforeseen circumstances. To the extent that any of the foregoing factors affect the prices of such commodities and we are unable to increase our prices or adequately hedge against such changes in prices in a manner that offsets such changes, the results of our operations could be materially and adversely affected.

Cereal processing ovens at major domestic and international facilities are regularly fuelled by natural gas or propane, which are obtained from local utilities or other local suppliers. Short-term stand-by propane storage exists at several plants for use in case of interruption in natural gas supplies. Oil may also be used to fuel certain operations at various plants. In addition, considerable amounts of diesel fuel are used in connection with the distribution of our products. The cost of fuel may fluctuate widely due to economic and political conditions, government policy and regulation, war, or other unforeseen circumstances which could have a material adverse effect on our consolidated operating results or financial condition.

A shortage in the labor pool or other general inflationary pressures or changes in applicable laws and regulations could increase labor cost, which could have a material adverse effect on our consolidated operating results or financial conditions.

Additionally, our labor costs include the cost of providing benefits for employees. We sponsor a number of defined benefit plans for employees in the United States and various foreign locations, including pension, retiree health and welfare, active health care, severance and other postemployment benefits. We also participate in a number of multiemployer pension plans for certain of our manufacturing locations. Our major pension plans and U.S. retiree health and welfare plans are funded with trust assets invested in a globally diversified portfolio of equity securities with smaller holdings of bonds, real estate and other investments. The annual cost of benefits can vary significantly from year to year and is materially affected by such factors as changes in the assumed or actual rate of return on major plan assets, a change in the weighted-average discount rate used to measure obligations, the rate or trend of health care cost inflation, and the outcome of collectively-bargained wage and benefit agreements.

We may be unable to maintain our profit margins in the face of a consolidating retail environment. In addition, the loss of one of our largest customers could negatively impact our sales and profits.

Our largest customer, Wal-Mart Stores, Inc. and its affiliates, accounted for approximately 18% of consolidated net sales during 2006, comprised principally of sales within the United States. At December 30, 2006, approximately 14% of our consolidated receivables balance and 22% of our U.S. receivables balance was comprised of amounts owed by Wal-Mart Stores, Inc. and its affiliates. During 2006, our top five customers, collectively, accounted for approximately 33% of our consolidated net sales and approximately 42% of U.S. net sales. As the retail grocery trade continues to consolidate and mass marketers become larger, our large retail customers may seek to use their position to improve their profitability through improved efficiency, lower pricing and increased promotional programs. If we are unable to use our scale, marketing expertise, product innovation and category leadership positions to respond, our profitability or volume growth could be negatively affected. The loss of any large customer for an extended length of time could negatively impact our sales and profits.

Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products and brands.

We consider our intellectual property rights, including particularly and most notably our trademarks, but also including patents, trade secrets, copyrights and licensing agreements, to be a significant and valuable aspect of our business. We attempt to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws, as well as licensing agreements, third party nondisclosure and assignment agreements and policing of third party misuses of our intellectual property. Our failure to obtain or adequately protect our trademarks, products, new features of our products, or our technology, or any change in law or other changes that serve to lessen or remove the current legal protections of our intellectual property, may diminish our competitiveness and could materially harm our business.

We may be unaware of intellectual property rights of others that may cover some of our technology, brands or products.

7

Table of Contents

Any litigation regarding patents or other intellectual property could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. Third party claims of intellectual property infringement might also require us to enter into costly license agreements. We also may be subject to significant damages or injunctions against development and sale of certain products.

Changes in tax, environmental or other regulations or failure to comply with existing licensing, trade and other regulations and laws could have a material adverse effect on our consolidated financial condition.

Our activities, both in and outside of the United States, are subject to regulation by various federal, state, provincial and local laws, regulations and government agencies, including the U.S. Food and Drug Administration, U.S. Federal Trade Commission, the U.S. Departments of Agriculture, Commerce and Labor, as well as similar and other authorities of the European Union and various state, provincial and local governments, as well as voluntary regulation by other bodies. Various state and local agencies also regulate our activities.

The manufacturing, marketing and distribution of food products is subject to governmental regulation that is becoming increasingly onerous. Those regulations control such matters as ingredients, advertising, relations with distributors and retailers, health and safety and the environment. We are also regulated with respect to matters such as licensing requirements, trade and pricing practices, tax and environmental matters. The need to comply with new or revised tax, environmental or other laws or regulations, or new or changed interpretations or enforcement of existing laws or regulations, may have a material adverse effect on our business and results of operations.

Our operations face significant foreign currency exchange rate exposure which could negatively impact our operating results.

We hold assets and incur liabilities, earn revenue and pay expenses in a variety of currencies other than the U.S. dollar, primarily the British Pound, Euro, Australian dollar, Canadian dollar and Mexican peso. Because our consolidated financial statements are presented in U.S. dollars, we must translate our assets, liabilities, revenue and expenses into U.S. dollars at then-applicable exchange rates. Consequently, increases and decreases in the value of the U.S. dollar may negatively affect the value of these items in our consolidated financial statements, even if their value has not changed in their original currency. To the extent we fail to manage our foreign currency exposure adequately, our consolidated results of operations may be negatively affected.

If our food products become adulterated or misbranded, we might need to recall those items and may experience product liability if consumers are injured as a result.

We may need to recall some of our products if they become adulterated or misbranded. We may also be liable if the consumption of any of our products causes injury. A widespread product recall could result in significant losses due to the costs of a recall, the destruction of product inventory, and lost sales due to the unavailability of product for a period of time. We could also suffer losses from a significant product liability judgment against us. A significant product recall or product liability case could also result in a loss of consumer confidence in our food products, which could have a material adverse effect on our business results and the value of our brands.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

Our corporate headquarters and principal research and development facilities are located in Battle Creek, Michigan.

We operated, as of December 30, 2006, manufacturing plants and distribution and warehousing facilities totaling more than 28 million square feet of building area in the United States and other countries. Our plants have been designed and constructed to meet our specific production requirements, and we periodically invest money for capital and technological improvements. At the time of its selection, each location was considered to be favorable, based on the location of markets, sources of raw materials, availability of suitable labor, transportation facilities, location of our other plants producing similar products, and other factors. Our manufacturing facilities in the United States include four cereal plants and warehouses located in Battle Creek, Michigan; Lancaster, Pennsylvania; Memphis, Tennessee; and Omaha, Nebraska and other plants in San Jose, California; Atlanta, Augusta, Columbus, and Rome, Georgia; Chicago, Illinois; Kansas City, Kansas; Florence, Louisville, and Pikeville, Kentucky; Grand Rapids, Michigan; Blue Anchor, New Jersey; Cary and Charlotte, North Carolina; Cincinnati, Fremont, and Zanesville, Ohio; Muncy, Pennsylvania; Rossville, Tennessee and Allyn, Washington.

Outside the United States, we had, as of December 30, 2006, additional manufacturing locations, some with warehousing facilities, in Australia, Brazil, Canada, Colombia, Ecuador,

Table of Contents

Germany, Great Britain, Guatemala, India, Japan, Mexico, South Africa, South Korea, Spain, Thailand, and Venezuela.

We generally own our principal properties, including our major office facilities, although some manufacturing facilities are leased, and no owned property is subject to any major lien or other encumbrance. Distribution facilities (including related warehousing facilities) and offices of non-plant locations typically are leased. In general, we consider our facilities, taken as a whole, to be suitable, adequate, and of sufficient capacity for our current operations.

Item 3. Legal Proceedings

We are not a party to any pending legal proceedings which could reasonably be expected to have a material adverse effect on us and our subsidiaries, considered on a consolidated basis, nor are any of our properties or subsidiaries subject to any such proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II**Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Information on the market for our common stock, number of shareowners and dividends is located in Note 13 within Notes to the Consolidated Financial Statements, which are included herein under Part II, Item 8.

The following table provides information with respect to acquisitions by us of our shares of common stock during the quarter ended December 30, 2006.

ISSUER PURCHASES OF EQUITY SECURITIES

(millions, except per share data)	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Approximate dollar value of shares that may yet be purchased under the plans or programs
Period				
Month #1: 10/1/06-10/28/06	.1	\$ 49.27	.1	\$ 70.1
Month #2: 10/29/06-11/25/06	2.1	\$ 49.80	2.1	\$ 14.4
Month #3: 11/26/06-12/30/06	.9	\$ 50.21	.9	
Total (1)	3.1	\$ 49.91	3.1	

- (1) Shares included in the preceding table were purchased as part of publicly announced plans or programs, as follows:
- a) Approximately 1.4 million shares were purchased during the fourth quarter of 2006 under a program authorized by our Board of Directors to repurchase up to \$650 million of Kellogg common stock during 2006 for general corporate purposes and to offset issuances for employee benefit programs. This repurchase program was publicly announced in a press release on October 31, 2005. On December 8, 2006, our Board of Directors authorized a stock repurchase program of up to \$650 million for 2007, which was publicly announced in a press release on December 11, 2006.
 - b) Approximately 1.7 million shares were purchased during the fourth quarter of 2006 from employees and directors in stock swap and similar transactions pursuant to various shareholder-approved equity-based compensation plans described in Note 8 within Notes to the Consolidated Financial Statements, which are included herein under Part II, Item 8.

Table of Contents**Item 6. Selected Financial Data**

Kellogg Company and Subsidiaries

Selected Financial Data

(Millions, except per share data and number of employees)	2006	2005	2004	2003	2002
Operating trends					
Sales	\$ 10,906.7	\$ 10,177.2	\$ 9,613.9	\$ 8,811.5	\$ 8,304.1
Operating profit as a % of net sales	44.2%	44.9%	44.9%	44.4%	45.0%
Depreciation	351.2	390.3	399.0	359.8	346.9
Amortization	1.5	1.5	11.0	13.0	3.0
Advertising expense	915.9	857.7	806.2	698.9	588.7
Research and development expense	190.6	181.0	148.9	126.7	106.4
Operating profit	1,765.8	1,750.3	1,681.1	1,544.1	1,508.1
Operating profit as a % of net sales	16.2%	17.2%	17.5%	17.5%	18.2%
Interest expense	307.4	300.3	308.6	371.4	391.2
Earnings	1,004.1	980.4	890.6	787.1	720.9
Weighted average shares outstanding:					
Basic	397.0	412.0	412.0	407.9	408.4
Diluted	400.4	415.6	416.4	410.5	411.5
Earnings per share:					
Basic	2.53	2.38	2.16	1.93	1.77
Diluted	2.51	2.36	2.14	1.92	1.75
Flow trends					
Cash provided by operating activities	\$ 1,410.5	\$ 1,143.3	\$ 1,229.0	\$ 1,171.0	\$ 999.9
Capital expenditures	453.1	374.2	278.6	247.2	253.5
Cash provided by operating activities reduced by capital expenditures (a)	\$ 957.4	\$ 769.1	\$ 950.4	\$ 923.8	\$ 746.4
Cash used in investing activities	(445.4)	(415.0)	(270.4)	(219.0)	(188.8)
Cash used in financing activities	(789.0)	(905.3)	(716.3)	(939.4)	(944.4)
Debt coverage ratio (b)	6.9	7.1	6.8	5.1	4.8
Capital structure trends					
Total assets (c)	\$ 10,714.0	\$ 10,574.5	\$ 10,561.9	\$ 9,914.2	\$ 9,990.8
Property, net	2,815.6	2,648.4	2,715.1	2,780.2	2,840.2
Short-term debt	1,991.3	1,194.7	1,029.2	898.9	1,197.3
Long-term debt	3,053.0	3,702.6	3,892.6	4,265.4	4,519.4
Shareholders' equity (c)	2,069.0	2,283.7	2,257.2	1,443.2	895.1

Stock price trends

Stock price range	\$ 42-51	\$ 42-47	\$ 37-45	\$ 28-38	\$ 29-37
Dividends per common share	1.137	1.060	1.010	1.010	1.010

Number of employees

25,856	25,606	25,171	25,250	25,676
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- (a) The Company uses this non-GAAP financial measure to focus management and investors on the amount of cash available for debt repayment, dividend distribution, acquisition opportunities, and share repurchase, which is reconciled above.
- (b) Interest coverage ratio is calculated based on earnings before interest expense, income taxes, depreciation, and amortization, divided by interest expense.
- (c) The Company adopted SFAS No. 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* as of the end of its 2006 fiscal year. The standard generally requires company plan sponsors to reflect the net over- or under-funded position of a defined postretirement benefit plan as an asset or liability on the balance sheet. Accordingly, the 2006 balances associated with the identified captions within this summary were materially affected by the adoption of this standard. Refer to Note 1 for further information.

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Kellogg Company and Subsidiaries****Results Of Operations****Overview**

Kellogg Company is the world's leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, fruit snacks, frozen waffles, and veggie foods. Kellogg products are manufactured and marketed globally. We currently manage our operations in four geographic operating segments, comprised of North America and the three International operating segments of Europe, Latin America, and Asia Pacific. For the periods presented, the Asia Pacific operating segment included Australia and Asian markets. Beginning in 2007, this segment will also include South Africa, which was formerly a part of Europe.

We manage our Company for sustainable performance defined by our long-term annual growth targets. During the periods presented, these targets were low single-digit for internal net sales, mid single-digit for internal operating profit, and high single-digit for net earnings per share, which we met or exceeded in each of 2004, 2005, and 2006:

Consolidated results (dollars in millions)		2006	2005	2004
Net sales		\$ 10,906.7	\$ 10,177.2	\$ 9,613.9
Net sales growth:	As reported	7.2%	5.9%	9.1%
	Internal (a)	6.8%	6.4%	5.0%
Operating profit		\$ 1,765.8	\$ 1,750.3	\$ 1,681.1
Operating profit growth:	As reported (b)	.9%	4.1%	8.9%
	Internal (a)	4.3%	5.2%	4.5%
Diluted net earnings per share (EPS)		\$ 2.51	\$ 2.36	\$ 2.14
EPS growth (b)		6%	10%	11%

- (a) Our measure of internal growth excludes the impact of currency and, if applicable, acquisitions, dispositions, and shipping day differences. Specifically, internal net sales and operating profit growth for 2005 and 2004 exclude the impact of a 53rd shipping week in 2004. Internal operating profit growth for 2006 also excludes the impact of adopting SFAS No. 123(R) Share-Based Payment. Accordingly, internal operating profit growth for 2006 is a non-GAAP financial measure, which is further discussed and reconciled to GAAP-basis growth on pages 11 and 12.
- (b) At the beginning of 2006, we adopted SFAS No. 123(R) Share-Based Payment, which reduced our fiscal 2006 operating profit by \$65.4 million (\$42.4 million after tax or \$.11 per share), due primarily to recognition of compensation expense associated with employee and director stock option grants. Correspondingly, our reported operating profit and net earnings growth for 2006 was reduced by approximately 4%. Diluted net earnings per share growth was reduced by approximately 5%. Refer to the section beginning on page 21 entitled *Stock compensation* for further information on the Company's adoption of SFAS No. 123(R).

In combination with an attractive dividend yield, we believe this profitable growth has and will continue to provide a strong total return to our shareholders. We plan to continue to achieve this sustainability through a strategy focused on growing our cereal business, expanding our snacks business, and pursuing selected growth opportunities. We support our business strategy with operating principles that emphasize profit-rich, sustainable sales growth, as well as cash flow and return on invested capital. We believe our steady earnings growth, strong cash flow, and continued investment during a multi-year period of significant commodity and energy-driven cost inflation demonstrates the strength and flexibility of our business model.

Net sales and operating profit

2006 compared to 2005

The following tables provide an analysis of net sales and operating profit performance for 2006 versus 2005:

(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consoli- dated
2006 net sales	\$ 7,348.8	\$ 2,143.8	\$ 890.8	\$ 523.3	\$	\$ 10,906.7
2005 net sales	\$ 6,807.8	\$ 2,013.6	\$ 822.2	\$ 533.6	\$	\$ 10,177.2
<i>% change 2006 vs. 2005:</i>						
Volume (tonnage) (b)	3.5%	1.4%	4.5%	-1.2%		3.1%
Pricing/mix	4.0%	4.0%	4.0%	.9%		3.7%
Subtotal internal business	7.5%	5.4%	8.5%	-.3%		6.8%
Foreign currency impact	.4%	1.1%	-.2%	-1.6%		.4%

Total change	7.9%	6.5%	8.3%	-1.9%		7.2%
(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consolidated
2006 operating profit	\$ 1,340.5	\$ 334.1	\$ 220.1	\$ 76.9	\$ (205.8)	\$ 1,765.8
2005 operating profit	\$ 1,251.5	\$ 330.7	\$ 202.8	\$ 86.0	\$ (120.7)	\$ 1,750.3
<i>% change 2006 vs. 2005:</i>						
Internal business	6.5%	.7%	9.3%	-8.7%	-16.2%	4.3%
SFAS No. 123(R) adoption impact					-54.1%	-3.7%
Foreign currency impact	.6%	.3%	-.8%	-1.9%		.3%
Total change	7.1%	1.0%	8.5%	-10.6%	-70.3%	.9%

(a) Includes Australia and Asia.

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

During 2006, our consolidated net sales increased 7%, with strong results in both North America and the total of our International segments. Internal net sales also grew 7%, building on a 6% rate of internal growth during 2005. Successful innovation, brand-building (advertising and consumer promotion) investment, and in-store execution continued to drive broad-based sales growth across each

Table of Contents

of our enterprise-wide product groups. In fact, we achieved growth in retail cereal sales within each of our operating segments.

For 2006, our North America operating segment reported a net sales increase of 8%. Internal net sales growth was also 8%, with each major product group contributing as follows: retail cereal +3%; retail snacks (cookies, crackers, toaster pastries, cereal bars, fruit snacks) +11%; frozen and specialty (food service, vending, convenience, drug stores, custom manufacturing) channels +8%. The significant growth achieved by our North America snacks business represented nearly one-half of the total dollar increase in consolidated internal net sales for 2006. The 2006 growth in North America retail cereal sales was on top of 8% growth in 2005 and represented the 6th consecutive year in which we've increased our dollar share of category sales. Although North America consumer retail cereal consumption remained steady throughout 2006, our shipment revenues declined in the fourth quarter of 2006 by approximately 2% versus the prior-year period. We believe this decline was largely attributable to year-end retail trade inventory adjustments, which brought inventories in line with year-end 2005 levels after several successive quarters of slight inclines.

Our International operating segments collectively achieved net sales growth of approximately 6% or 5% on an internal basis, with leading dollar contributions from our UK, France, Mexico, and Venezuela business units. Internal sales of our Asia Pacific operating segment (which represents less than 5% of our consolidated results) were approximately even with the prior year, as solid growth in Australia cereal and Asian markets was offset by weak performance in our Australia snack business.

Consolidated operating profit for 2006 grew 1%, with internal operating profit up 4% versus 2005. As discussed on page 11, our measure of internal operating profit growth is consistent with our measure of internal sales growth, except that during 2006, internal operating profit growth also excluded the impact of incremental stock compensation expense associated with our adoption of SFAS No. 123(R). We used this non-GAAP financial measure during our first year of adopting this FASB standard in order to assist management and investors in assessing the Company's financial operating performance against comparative periods, which did not include stock option-related compensation expense. Accordingly, corporate selling, general, and administrative (SGA) expense was higher and operating profit was lower by \$65.4 million for 2006, reducing consolidated operating profit growth by approximately four percentage points. Refer to the section beginning on page 21 entitled *Stock compensation* for further information on the Company's adoption of SFAS No. 123(R).

As further discussed beginning on page 14, our measure of internal operating profit growth includes up-front costs related to cost-reduction initiatives. Although total 2006 up-front costs of \$82 million were not significantly changed from the 2005 amount of \$90 million, a year-over-year shift in operating segment allocation of such costs affected relative segment performance. The 2006 versus 2005 change in project cost allocation was a \$44 million decline in North America (improving 2006 segment operating profit performance by approximately 4%) and a \$28 million increase in Europe (reducing 2006 segment operating profit performance by approximately 8%).

Our current-year operating profit growth was affected by significant cost pressures as discussed in the *Margin performance* section beginning on page 13. Expenditures for brand-building activities increased at a low single-digit rate; this rate of growth incorporates savings reinvestment from our recent focus on media buying efficiencies and global leverage of promotional campaigns. Within our total brand-building metric, advertising expenditures grew at a high single-digit rate for 2006, which is a dynamic that we expect to continue through 2007 due to a relatively heavier focus on promotional efficiencies. Consistent with our long-term commitment, we expect to return to higher rates of growth for total brand-building expenditures, beginning in 2008.

2005 compared to 2004

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The following tables provide an analysis of net sales and operating profit performance for 2005 versus 2004:

(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consolidated
2005 net sales	\$ 6,807.8	\$ 2,013.6	\$ 822.2	\$ 533.6	\$	\$ 10,177.2
2004 net sales	\$ 6,369.3	\$ 2,007.3	\$ 718.0	\$ 519.3	\$	\$ 9,613.9
% change 2005 vs. 2004:						
Volume (tonnage) (b)	5.6%	-.2%	7.5%	.8%		4.5%
Pricing/mix	2.2%	2.0%	3.2%	.4%		1.9%
Subtotal internal business	7.8%	1.8%	10.7%	1.2%		6.4%
Shipping day differences (c)	-1.4%	-.9%		-1.0%		-1.1%
Foreign currency impact	.5%	-.6%	3.8%	2.6%		.6%
Total change	6.9%	.3%	14.5%	2.8%		5.9%

(a) Includes Australia and Asia.

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

(c) Impact of 53rd week in 2004. Refer to Note 1 within Notes to Consolidated Financial Statements for further information on our fiscal year end.

Table of Contents

(dollars in millions)	North America	Europe	Latin America	Asia Pacific (a)	Corporate	Consoli- dated
2005 operating profit	\$ 1,251.5	\$ 330.7	\$ 202.8	\$ 86.0	\$ (120.7)	\$ 1,750.3
2004 operating profit	\$ 1,240.4	\$ 292.3	\$ 185.4	\$ 79.5	\$ (116.5)	\$ 1,681.1
<i>% change 2005 vs. 2004:</i>						
Internal business	2.4%	14.9%	6.6%	7.4%	-4.1%	5.2%
Shipping day differences (c)	-2.1%	-1.0%		-2.2%	.4%	-1.8%
Foreign currency impact	.6%	-.8%	2.8%	3.0%		.7%
Total change	.9%	13.1%	9.4%	8.2%		