

KELLOGG CO
Form 10-Q
November 05, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 28, 2013

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

IRS Employer Identification No.38-0710690

Registrant's telephone number: 269-961-2000

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

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Yes No

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

Yes No

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

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

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

Yes No

Common Stock outstanding as of October 26, 2013 362,197,285 shares

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KELLOGG COMPANY

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

(millions, except per share data)

| | September 28, 2013 | December 29, 2012 |
|---|-----------------------|----------------------|
| | (unaudited) | * |
| Current assets | | |
| Cash and cash equivalents | \$ 300 | \$ 281 |
| Accounts receivable, net | 1,474 | 1,454 |
| Inventories: | | |
| Raw materials and supplies | 331 | 300 |
| Finished goods and materials in process | 981 | 1,065 |
| Deferred income taxes | 185 | 152 |
| Other prepaid assets | 163 | 128 |
| Total current assets | 3,434 | 3,380 |
| Property, net of accumulated depreciation of \$5,387 and \$5,209 | 3,777 | 3,782 |
| Goodwill ** | 5,052 | 5,038 |
| Other intangibles, net of accumulated amortization of \$59 and \$53 | 2,364 | 2,359 |
| Pension | 187 | 145 |
| Other assets | 406 | 465 |
| Total assets | \$ 15,220 | \$ 15,169 |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 298 | \$ 755 |
| Notes payable | 756 | 1,065 |
| Accounts payable | 1,399 | 1,402 |
| Accrued advertising and promotion | 512 | 517 |
| Accrued income taxes | 75 | 46 |
| Accrued salaries and wages | 257 | 266 |
| Other current liabilities | 537 | 472 |
| Total current liabilities | 3,834 | 4,523 |
| Long-term debt | 6,348 | 6,082 |
| Deferred income taxes | 560 | 523 |
| Pension liability | 886 | 886 |
| Nonpension postretirement benefits | 271 | 281 |
| Other liabilities | 425 | 409 |

Commitments and contingencies

Equity

| | | |
|--|------------------|-----------|
| Common stock, \$.25 par value | 105 | 105 |
| Capital in excess of par value | 620 | 573 |
| Retained earnings | 6,098 | 5,615 |
| Treasury stock, at cost | (3,025) | (2,943) |
| Accumulated other comprehensive income (loss) ** | (963) | (946) |
| Total Kellogg Company equity | 2,835 | 2,404 |
| Noncontrolling interests | 61 | 61 |
| Total equity | 2,896 | 2,465 |
| Total liabilities and equity | \$ 15,220 | \$ 15,169 |

* Condensed from audited financial statements.

** December 29, 2012 balances have been revised as discussed in Note 2 to the 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)

| (Results are unaudited) | Quarter ended September 28, 2013 | September 29, 2012 | Year-to-date period ended September 28, 2013 | September 29, 2012 |
|---|--|-----------------------|--|-----------------------|
| Net sales | \$ 3,716 | \$ 3,720 | \$ 11,291 | \$ 10,634 |
| Cost of goods sold | 2,266 | 2,254 | 6,971 | 6,376 |
| Selling, general and administrative expense | 946 | 953 | 2,743 | 2,699 |
| Operating profit | 504 | 513 | 1,577 | 1,559 |
| Interest expense | 56 | 73 | 177 | 195 |
| Other income (expense), net | 4 | 10 | (8) | 30 |
| Income before income taxes | 452 | 450 | 1,392 | 1,394 |
| Income taxes | 124 | 131 | 398 | 400 |
| Earnings (loss) from joint ventures | (2) | (1) | (5) | (1) |
| Net income | \$ 326 | \$ 318 | \$ 989 | \$ 993 |
| Net income (loss) attributable to noncontrolling interests | | | | |
| Net income attributable to Kellogg Company | \$ 326 | \$ 318 | \$ 989 | \$ 993 |
| Per share amounts: | | | | |
| Basic | \$ 0.90 | \$ 0.89 | \$ 2.72 | \$ 2.78 |
| Diluted | \$ 0.90 | \$ 0.89 | \$ 2.70 | \$ 2.77 |
| Dividends per share | \$ 0.460 | \$ 0.440 | \$ 1.340 | \$ 1.300 |
| Average shares outstanding: | | | | |
| Basic | 362 | 358 | 363 | 357 |
| Diluted | 364 | 359 | 366 | 359 |
| Actual shares outstanding at period end | | | 362 | 358 |

Refer to Notes to Consolidated Financial Statements.

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

(millions)

| | Quarter ended September 28, 2013 | | | Year-to-date period ended September 28, 2013 | | |
|---|-------------------------------------|--------------------------|---------------------|---|--------------------------|---------------------|
| | Pre-tax amount | Tax (expense) benefit | After-tax amount | Pre-tax amount | Tax (expense) benefit | After-tax amount |
| (Results are unaudited) | | | | | | |
| Net income | | | \$ 326 | | | \$ 989 |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments* | \$ 63 | \$ | 63 | \$ (28) | \$ | (28) |
| Cash flow hedges: | | | | | | |
| Unrealized gain (loss) on cash flow hedges | (7) | 3 | (4) | 5 | | 5 |
| Reclassification to net income | (2) | | (2) | (4) | | (4) |
| Postretirement and postemployment benefits: | | | | | | |
| Net experience gain (loss) | | | | | | |
| Prior service credit (cost) | (1) | | (1) | (1) | | (1) |
| Reclassification to net income: | | | | | | |
| Net experience loss | 1 | | 1 | 4 | | 4 |
| Prior service cost | 4 | (1) | 3 | 10 | (3) | 7 |
| Other comprehensive income (loss) | \$ 58 | \$ 2 | \$ 60 | \$ (14) | \$ (3) | \$ (17) |
| Comprehensive income | | | \$ 386 | | | \$ 972 |

| | Quarter ended September 29, 2012 | | | Year-to-date period ended September 29, 2012 | | |
|---|-------------------------------------|--------------------------|---------------------|---|--------------------------|---------------------|
| | Pre-tax amount | Tax (expense) benefit | After-tax amount | Pre-tax amount | Tax (expense) benefit | After-tax amount |
| (Results are unaudited) | | | | | | |
| Net income | | | \$ 318 | | | \$ 993 |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments* | \$ 101 | \$ | 101 | \$ 75 | \$ 2 | 77 |
| Cash flow hedges: | | | | | | |
| Unrealized gain (loss) on cash flow hedges | (1) | | (1) | (9) | 3 | (6) |
| Reclassification to net income | 3 | (1) | 2 | 12 | (4) | 8 |
| Postretirement and postemployment benefits: | | | | | | |
| Amounts arising during the period: | | | | | | |
| Net experience gain (loss)* | | | | (3) | 1 | (2) |
| Prior service credit (cost)* | | | | (10) | 3 | (7) |
| Reclassification to net income: | | | | | | |
| Net experience loss* | 2 | | 2 | 4 | | 4 |
| Prior service cost* | 2 | (1) | 1 | 9 | (3) | 6 |
| Other comprehensive income (loss) | \$ 107 | \$ (2) | \$ 105 | \$ 78 | \$ 2 | \$ 80 |
| Comprehensive income | | | \$ 423 | | | \$ 1,073 |

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* December 29, 2012 balances have been revised as discussed in Note 2 and Note 7 to the financial statements.

Refer to Notes to Consolidated Financial Statements.

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

(millions)

| (unaudited) | Common | | 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) |
|--|------------|---------------|---|----------------------|----------------|-------------------|---|------------------------------------|----------------------------------|-----------------|--|
| | shares | amount | | | shares | amount | | | | | |
| Balance, December 31, 2011 | 419 | \$ 105 | \$ 522 | \$ 5,305 | 62 | \$ (3,130) | \$ (1,006) | \$ 1,796 | \$ 2 | \$ 1,798 | |
| Common stock repurchases | | | | | 1 | (63) | | (63) | | (63) | |
| Acquisition of noncontrolling interest | | | | | | | | | 59 | 59 | |
| Net income | | | | 961 | | | | 961 | | 961 | \$ 961 |
| Dividends | | | | (622) | | | | (622) | | (622) | |
| Other comprehensive income* | | | | | | | 60 | 60 | | 60 | 60 |
| Stock compensation | | | 36 | | | | | 36 | | 36 | |
| Stock options exercised and other | 1 | | 15 | (29) | (5) | 250 | | 236 | | 236 | |
| Balance, December 29, 2012* | 420 | \$ 105 | \$ 573 | \$ 5,615 | 58 | \$ (2,943) | \$ (946) | \$ 2,404 | \$ 61 | \$ 2,465 | \$ 1,021 |
| Common stock repurchases | | | | | 9 | (544) | | (544) | | (544) | |
| Net income | | | | 989 | | | | 989 | | 989 | 989 |
| Dividends | | | | (486) | | | | (486) | | (486) | |
| Other comprehensive loss* | | | | | | | (17) | (17) | | (17) | (17) |
| Stock compensation | | | 24 | | | | | 24 | | 24 | |
| Stock options exercised and other | | | 23 | (20) | (9) | 462 | | 465 | | 465 | |
| Balance, September 28, 2013 | 420 | \$ 105 | \$ 620 | \$ 6,098 | 58 | \$ (3,025) | \$ (963) | \$ 2,835 | \$ 61 | \$ 2,896 | \$ 972 |

* December 29, 2012 balances have been revised as discussed in Note 2 to the financial statements. Refer to Notes to Consolidated Financial Statements.

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

(millions)

| (unaudited) | Year-to-date period ended | |
|---|---------------------------|-----------------------|
| | September 28, 2013 | September 29, 2012 |
| Operating activities | | |
| Net income | \$ 989 | \$ 993 |
| Adjustments to reconcile net income to operating cash flows: | | |
| Depreciation and amortization | 340 | 302 |
| Postretirement benefit plan expense (benefit) | (10) | (14) |
| Deferred income taxes | (27) | (20) |
| Other | 73 | (29) |
| Postretirement benefit plan contributions | (42) | (43) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Trade receivables | (113) | (95) |
| Inventories | 52 | (5) |
| Accounts payable | (2) | 145 |
| Accrued income taxes | 52 | 1 |
| Accrued interest expense | 33 | 43 |
| Accrued and prepaid advertising, promotion and trade allowances | (4) | 118 |
| Accrued salaries and wages | (9) | |
| All other current assets and liabilities | 57 | (21) |
| Net cash provided by (used in) operating activities | 1,389 | 1,375 |
| Investing activities | | |
| Additions to properties | (363) | (262) |
| Acquisitions, net of cash acquired | | (2,674) |
| Other | (1) | 8 |
| Net cash provided by (used in) investing activities | (364) | (2,928) |
| Financing activities | | |
| Net issuances (reductions) of notes payable | (309) | 112 |
| Issuances of long-term debt | 645 | 1,727 |
| Reductions of long-term debt | (761) | |
| Net issuances of common stock | 450 | 87 |
| Common stock repurchases | (544) | (63) |
| Cash dividends | (486) | (464) |
| Other | 23 | (2) |
| Net cash provided by (used in) financing activities | (982) | 1,397 |

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| | | |
|--|---------------|---------------|
| Effect of exchange rate changes on cash and cash equivalents | (24) | 1 |
| Increase (decrease) in cash and cash equivalents | 19 | (155) |
| Cash and cash equivalents at beginning of period | 281 | 460 |
| Cash and cash equivalents at end of period | \$ 300 | \$ 305 |

Refer to Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements

for the quarter ended September 28, 2013 (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, comprehensive income, financial position, equity and cash flows for the periods presented. This interim information should be read in conjunction with the financial statements and accompanying footnotes within the Company's 2012 Annual Report on Form 10-K.

The condensed balance sheet data at December 29, 2012 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 September 28, 2013 are not necessarily indicative of the results to be expected for other interim periods or the full year.

New accounting standards

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the Financial Accounting Standards Board (FASB) issued an updated accounting standard that includes a requirement to present reclassification adjustments out of accumulated other comprehensive income by component either on the face of the financial statements or as a separate disclosure in the notes to the financial statements. This updated standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012 and was adopted by the Company on a prospective basis at the beginning of its 2013 fiscal year. Refer to Note 4 for disclosures required under this standard.

Note 2 Goodwill and other intangible assets

On May 31, 2012, the Company completed its acquisition of the *Pringles*[®] business (Pringles) from The Procter & Gamble Company (P&G) for \$2.695 billion, or \$2.683 billion net of cash and cash equivalents, subject to certain purchase price adjustments. The net purchase price adjustments have resulted in a reduction of the purchase price by approximately \$15 million. The purchase price, net of cash and cash equivalents, totals \$2.668 billion. The acquisition was accounted for under the purchase method and was financed through a combination of cash on hand and short-term and long-term debt. The assets and liabilities of Pringles are included in the Consolidated Balance Sheet as of December 29, 2012 and September 28, 2013 and the results of the Pringles operations subsequent to the acquisition date are included in the Consolidated Statement of Income.

The purchase price allocation, including the allocation to reportable segments, was completed in the quarter ended June 29, 2013 when the valuations of fixed assets and intangible assets were finalized resulting in a reallocation of goodwill between the Company's reportable segments. Prior year amounts were revised to reflect these changes as of the date of the acquisition, resulting in reductions to goodwill and the foreign currency translation component of other comprehensive income (OCI) of \$15 million as of December 29, 2012 and no impact for the year-to-date period ended September 29, 2012.

During the quarter ended September 28, 2013, the Company recorded an immaterial correction of an error to the purchase price allocation for Pringles that was outside of the measurement period, which resulted in an increase to other non-current liabilities, goodwill and non-current deferred tax assets of \$15 million, \$13 million and \$2 million, respectively. The goodwill of \$13 million was allocated to our operating segments as follows: Europe, \$10 million and Asia Pacific, \$3 million.

As part of the Pringles acquisition, we incurred \$12 million of integration-related costs in the third quarter of 2013 of which \$7 million are recorded in selling, general and administrative (SGA) expense, \$3 million are recorded in cost of goods sold (COGS), and \$2 million are recorded in net sales. Integration-related costs in the year-to-date period ended September 28, 2013 were \$48 million of which \$34 million are recorded in SGA expense, \$9 million are recorded in COGS and \$5 million are recorded in net sales.

Pringles contributed net revenues of \$422 million and net earnings of \$49 million for the third quarter of 2013 and contributed net revenues of \$1,216 million and net earnings of \$97 million for the year-to-date period ended September 28, 2013, including the integration-related costs discussed above. The unaudited pro forma combined historical third quarter results, as if Pringles had been acquired at the beginning of fiscal 2011, are estimated to be:

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| (millions, except per share data) | Quarter ended September 29, 2012 | Year-to-date period ended September 29, 2012 |
|--|--|---|
| Net sales | \$ 3,720 | \$ 11,299 |
| Net income | \$ 318 | \$ 1,041 |
| Net income (loss) attributable to noncontrolling interests | | |
| Net income attributable to Kellogg Company | \$ 318 | \$ 1,041 |
| Net earnings per share | \$ 0.89 | \$ 2.90 |

The pro forma results include interest expense on the debt issued to finance the acquisition, amortization of the definite lived intangible assets, and depreciation based on estimated fair value and useful lives. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of 2011, nor are they necessarily indicative of future consolidated results.

Changes in the carrying amount of goodwill for the year-to-date period ended September 28, 2013, are presented in the following table.

Carrying amount of goodwill

| (millions) | U.S. Morning Foods | U.S. Snacks | U.S. Specialty | North America Other | Europe | Latin America | Asia Pacific | Consoli- dated |
|---------------------------------|--------------------------|-----------------|-------------------|---------------------------|---------------|------------------|-----------------|-------------------|
| December 29, 2012 | \$ 133 | \$ 3,767 | \$ 82 | \$ 280 | \$ 438 | \$ 92 | \$ 246 | \$ 5,038 |
| Additions | | 11 | | | 10 | | 3 | 24 |
| Currency translation adjustment | | | | (1) | 1 | (2) | (8) | (10) |
| September 28, 2013 | \$ 133 | \$ 3,778 | \$ 82 | \$ 279 | \$ 449 | \$ 90 | \$ 241 | \$ 5,052 |

Intangible assets subject to amortization

(millions)

| | U.S. Morning Foods | U.S. Snacks | U.S. Specialty | North America Other | Europe | Latin America | Asia Pacific | Consoli- dated |
|---------------------------------|--------------------------|----------------|-------------------|---------------------------|--------------|------------------|-----------------|-------------------|
| Gross carrying amount | | | | | | | | |
| December 29, 2012 | \$ 28 | \$ 70 | \$ | \$ 5 | \$ 43 | \$ 7 | \$ 10 | \$ 163 |
| Currency translation adjustment | | | | | | | | |
| September 28, 2013 | \$ 28 | \$ 70 | \$ | \$ 5 | \$ 43 | \$ 7 | \$ 10 | \$ 163 |

Accumulated Amortization

| | | | | | | | | |
|---------------------------|--------------|--------------|-----------|-------------|-------------|-------------|-------------|--------------|
| December 29, 2012 | \$ 28 | \$ 12 | \$ | \$ 3 | \$ 3 | \$ 7 | \$ | \$ 53 |
| Amortization | | 3 | | | 2 | | 1 | 6 |
| September 28, 2013 | \$ 28 | \$ 15 | \$ | \$ 3 | \$ 5 | \$ 7 | \$ 1 | \$ 59 |

Intangible assets subject to amortization, net

| | | | | | | | | |
|---------------------------------|-----------|--------------|-----------|-------------|--------------|-----------|-------------|---------------|
| December 29, 2012 | \$ | \$ 58 | \$ | \$ 2 | \$ 40 | \$ | \$ 10 | \$ 110 |
| Currency translation adjustment | | | | | | | | |
| Amortization | | (3) | | (2) | | (1) | (6) | |
| September 28, 2013 | \$ | \$ 55 | \$ | \$ 2 | \$ 38 | \$ | \$ 9 | \$ 104 |

For intangible assets in the preceding table, amortization was \$6 million for the current year-to-date period ended September 28, 2013, compared to \$1 million for the prior year-to-date period ended September 29, 2012. The currently estimated aggregate annual amortization expense for full-year 2013 and each of the four succeeding fiscal years is approximately \$9 million.

Table of Contents**Intangible assets not subject to amortization**

| (millions) | U.S. Morning Foods | U.S. Snacks | U.S. Specialty | North America Other | Europe | Latin America | Asia Pacific | Consoli- dated |
|---------------------------------|--------------------------|-----------------|-------------------|---------------------------|---------------|------------------|-----------------|-------------------|
| December 29, 2012 | \$ 63 | \$ 1,625 | \$ | \$ 95 | \$ 466 | \$ | \$ | \$ 2,249 |
| Currency translation adjustment | | | | | 11 | | | 11 |
| September 28, 2013 | \$ 63 | \$ 1,625 | \$ | \$ 95 | \$ 477 | \$ | \$ | \$ 2,260 |

Note 3 Exit or disposal activities

The Company views its continued spending on cost-reduction initiatives as part of its on-going operating principles to provide greater visibility in achieving long-term profit growth targets. Initiatives undertaken are 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 is expected to deliver cash savings and/or reduced depreciation.

Costs summary**On-going initiatives**

Prior to the beginning of the quarter ended September 28, 2013, the Company had commenced various COGS and SGA initiatives. The COGS initiatives are intended to optimize the Company's global manufacturing network, reduce waste, and develop best practices on a global basis. The SGA initiatives focus on improvements in the efficiency and effectiveness of various global support functions. These initiatives are expected to be substantially complete by the end of 2013.

During the quarter ended September 28, 2013, the Company recorded a \$1 million reduction in expense resulting from adjustments to severance reserves related to one of these on-going initiatives which impacted the U.S. Morning Foods reportable segment. During the year-to-date period ended September 28, 2013, the Company recorded \$9 million of charges associated with exit or disposal activities for on-going initiatives. The tables below provide the details for the charges incurred for currently active on-going initiatives during the quarter and year-to-date periods ended September 28, 2013 and September 29, 2012:

| (millions) | Quarter ended September 28, 2013 | September 29, 2012 | Year-to-date period ended September 28, 2013 | September 29, 2012 | Program costs to date September 28, 2013 |
|------------------------|--|-----------------------|--|-----------------------|--|
| Employee related costs | \$ (1) | \$ | \$ 3 | \$ 3 | \$ 6 |
| Asset related costs | | 1 | 4 | 2 | 21 |
| Other costs | | | 2 | | 2 |
| Total | \$ (1) | \$ 1 | \$ 9 | \$ 5 | \$ 29 |

| (millions) | Quarter ended September 28, 2013 | September 29, 2012 | Year-to-date period ended September 28, 2013 | September 29, 2012 | Program costs to date September 28, 2013 |
|--------------------|--|--------------------------|--|--------------------------|--|
| U.S. Morning Foods | \$ (1) | \$ | \$ 2 | \$ 1 | \$ 3 |
| U.S. Snacks | | 1 | 1 | 3 | 3 |

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| | | | | | |
|--------------|---------------|-------------|-------------|-------------|--------------|
| Europe | | | | 1 | |
| Asia Pacific | | | 6 | | 23 |
| Total | \$ (1) | \$ 1 | \$ 9 | \$ 5 | \$ 29 |

Other costs include incremental charges for equipment removal and relocation of assets and employees that are directly related to exit or disposal activities.

At September 28, 2013, there were no exit cost reserves for severance for these initiatives. Based on forecasted exchange rates, the Company currently expects to incur an additional \$2 million in exit costs for these initiatives in 2013.

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New initiatives

Europe Supply Chain

During the quarter ended September 28, 2013, the Company commenced two new initiatives that are designed to improve operational effectiveness in Europe. Total costs for these initiatives are expected to be \$6 million, consisting primarily of severance costs and asset write-offs. The Company recorded a charge of \$2 million associated with exit or disposal activities for these initiatives which consisted primarily of severance costs. At September 28, 2013 exit cost reserves for severance for these initiatives were \$2 million. Based on forecasted exchange rates, the Company currently expects to incur an additional \$4 million in exit costs for these initiatives in 2013. These initiatives are expected to be substantially complete by the end of 2013.

Project K

On November 4, 2013, the Company announced Project K, a global four-year efficiency and effectiveness program. The program is expected to generate a significant amount of savings, once all phases are approved and implemented, that will be invested in key strategic areas of focus for the business. The Company expects that this investment will drive future growth in revenues, gross margin, operating profit, and cash flow.

The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.

The Company currently anticipates that the program will result in total pre-tax charges, once all phases are approved and implemented, of \$1.2 to \$1.4 billion, with cash costs estimated to be \$900 million to \$1.1 billion. The Company currently expects the charges will consist of asset-related costs totaling \$450 to \$500 million which will consist primarily of asset impairments and other exit-related costs; employee-related costs totaling \$425 to \$475 million which will include severance, pension and other termination benefits; and other costs totaling \$325 to \$425 million which will consist primarily of charges related to the design and implementation of global business capabilities. A significant portion of other costs are the result of the implementation of global business service centers which are intended to simplify and standardize business support processes.

The Company currently expects that total pre-tax charges will impact reportable segments as follows: U.S. Morning Foods (approximately 18%), U.S. Snacks (approximately 10%), U.S. Specialty (approximately 2%) North America Other (approximately 3%), Europe (approximately 8%), Latin America (approximately 5%), Asia-Pacific (approximately 7%), and Corporate (approximately 47%). A majority of the costs impacting Corporate relate to additional initiatives to be executed after 2014 that are currently not fully defined. As the development of these initiatives is completed, the Company will update its estimated costs by reportable segment as needed.

In the third quarter, the Company recognized charges of \$17 million that have been attributed to the program. The tables below outline the details of these charges:

Table of Contents**Project K**

| (millions) | Quarter ended September 28, 2013 | Year-to-date period ended September 28, 2013 |
|------------------------|--|---|
| Employee related costs | \$ 8 | \$ 8 |
| Asset related costs | | |
| Other costs | 9 | 9 |
| Total | \$ 17 | \$ 17 |

| (millions) | Quarter ended September 28, 2013 | Year-to-date period ended September 28, 2013 |
|--------------------|---|--|
| U.S. Morning Foods | \$ 5 | \$ 5 |
| U.S. Snacks | 1 | 1 |
| U.S. Specialty | 1 | 1 |
| Latin America | 3 | 3 |
| Asia Pacific | 1 | 1 |
| Center | 6 | 6 |
| Total | \$ 17 | \$ 17 |

Other costs incurred during the quarter ended September 28, 2013 consist primarily of third-party incremental costs related to the development and implementation of global business capabilities.

At September 28, 2013 exit cost reserves for Project K were \$6 million. The following table provides details for Project K exit cost reserves.

| (millions) | Balance December 29, 2012 | Costs Incurred | Cash Payments | Balance September 28, 2013 |
|------------|---------------------------------|-------------------|------------------|----------------------------------|
| Project K | \$ | \$ 17 | \$ (11) | \$ 6 |

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. There were anti-dilutive potential common shares excluded from the reconciliation for the quarter and year-to-date periods ended September 28, 2013 of 6 million and 5 million, respectively. The total number of anti-dilutive potential common shares excluded from the reconciliation were 16 million and 17 million, respectively, for the quarter and year-to-date periods ended September 29, 2012.

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Quarters ended September 28, 2013 and September 29, 2012:

| (millions, except per share data) | Net income attributable to Kellogg Company* | Average shares outstanding | Earnings per share* |
|-----------------------------------|---|----------------------------------|------------------------|
| 2013 | | | |
| Basic | \$326 | 362 | \$0.90 |
| Dilutive potential common shares | | 2 | |
| Diluted | \$326 | 364 | \$0.90 |
| 2012 | | | |
| Basic | \$318 | 358 | \$0.89 |
| Dilutive potential common shares | | 1 | |
| Diluted | \$318 | 359 | \$0.89 |

* 2012 amounts have been revised as discussed in Note 7 to the financial statements.
Year-to-date periods ended September 28, 2013 and September 29, 2012:

| (millions, except per share data) | Net income attributable to Kellogg Company* | Average shares outstanding | Earnings per share* |
|-----------------------------------|---|----------------------------------|------------------------|
| 2013 | | | |
| Basic | \$989 | 363 | \$2.72 |
| Dilutive potential common shares | | 3 | (0.02) |
| Diluted | \$989 | 366 | \$2.70 |
| 2012 | | | |
| Basic | \$993 | 357 | \$2.78 |
| Dilutive potential common shares | | 2 | (0.01) |
| Diluted | \$993 | 359 | \$2.77 |

* 2012 amounts have been revised as discussed in Note 7 to the financial statements.

In December 2012, the Company's board of directors approved a \$300 million share repurchase program for 2013, which was superseded in April 2013 by an authorization to repurchase shares up to \$1 billion through April 2014. In May 2013, the Company entered into an Accelerated Share Repurchase (ASR) Agreement with a financial institution counterparty and paid \$355 million for the repurchase of shares during the term of the Agreement which extended through August 2013. During the second quarter of 2013, 4.9 million shares were initially delivered to the Company and accounted for as a reduction to Kellogg Company equity. The transaction was completed during the third quarter, at which time the Company received 0.6 million additional shares. The total number of shares delivered upon settlement of the ASR was based upon the volume weighted average price of the Company's stock over the term of the agreement.

During the year-to-date period ended September 28, 2013, the Company repurchased approximately 9 million shares of common stock for a total of \$544 million, including shares delivered under the ASR. During the year-to-date period ended September 29, 2012, the Company repurchased slightly more than 1 million shares of common stock for a total of \$63 million.

Comprehensive income

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Comprehensive income includes net income and all other changes in equity during a period except those resulting from investments by or distributions to shareholders. OCI 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.

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| (millions) | Quarter ended September 28, 2013 | | | Year-to-date period ended September 28, 2013 | | |
|---|----------------------------------|--------------------------|------------------|--|--------------------------|------------------|
| | Pre-tax amount | Tax (expense) or benefit | After-tax amount | Pre-tax amount | Tax (expense) or benefit | After-tax amount |
| Net income | | | \$ 326 | | | \$ 989 |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments | \$ 63 | \$ | 63 | \$(28) | \$ | (28) |
| Cash flow hedges: | | | | | | |
| Unrealized gain (loss) on cash flow hedges | (7) | 3 | (4) | 5 | | 5 |
| Reclassification to net earnings | (2) | | (2) | (4) | | (4) |
| Postretirement and postemployment benefits: | | | | | | |
| Amounts arising during the period: | | | | | | |
| Net experience gain (loss) | | | | | | |
| Prior service credit (cost) | (1) | | (1) | (1) | | (1) |
| Reclassification to net income: | | | | | | |
| Net experience loss | 1 | | 1 | 4 | | 4 |
| Prior service cost | 4 | (1) | 3 | 10 | (3) | 7 |
| Other comprehensive income (loss) | \$ 58 | \$ 2 | 60 | \$(14) | \$ (3) | (17) |
| Comprehensive income | | | \$ 386 | | | \$ 972 |

Reclassifications out of Accumulated Other Comprehensive Income (AOCI) for the quarter and year-to-date periods ended September 28, 2013 consisted of the following:

| (millions) | Amount reclassified from AOCI | | Year-to-date period ended | Line item impacted within Income Statement |
|---|----------------------------------|--------------------|---------------------------|--|
| Details about AOCI components | Quarter ended September 28, 2013 | September 28, 2013 | September 28, 2013 | |
| Gains and losses on cash flow hedges: | | | | |
| Foreign currency exchange contracts | \$ (2) | \$ (7) | | COGS |
| Foreign currency exchange contracts | (1) | (1) | | SGA |
| Interest rate contracts | (1) | (3) | | Interest expense |
| Commodity contracts | 2 | 7 | | COGS |
| | \$ (2) | \$ (4) | | Total before tax |
| | | | | Tax (expense) benefit |
| | \$ (2) | \$ (4) | | Net of tax |
| Amortization of postretirement and postemployment benefits: | | | | |
| Net experience loss | \$ 1 | \$ 4 | | See Note 7 for further details |
| Prior service cost | 4 | 10 | | See Note 7 for further details |
| | \$ 5 | \$ 14 | | Total before tax |

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| | (1) | (3) | Tax (expense) benefit |
|-------------------------|------|-------|-----------------------|
| | \$ 4 | \$ 11 | Net of tax |
| Total reclassifications | \$ 2 | \$ 7 | Net of tax |

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Accumulated other comprehensive income (loss) as of September 28, 2013 and December 29, 2012 consisted of the following:

| (millions) | September 28, 2013 | December 29, 2012 |
|--|-----------------------|----------------------|
| Foreign currency translation adjustments | \$ (860) | \$ (832) |
| Cash flow hedges unrealized net gain (loss) | (2) | (3) |
| Postretirement and postemployment benefits: | | |
| Net experience loss | (25) | (29) |
| Prior service cost | (76) | (82) |
| Total accumulated other comprehensive income (loss) | \$ (963) | \$ (946) |

Note 5 Debt

The following table presents the components of notes payable at September 28, 2013 and December 29, 2012:

| (millions) | September 28, 2013 | | December 29, 2012 | |
|-------------------------|---------------------|----------------------------|---------------------|----------------------------|
| | Principal amount | Effective interest rate | Principal amount | Effective interest rate |
| U.S. commercial paper | \$573 | 0.21% | \$853 | 0.26% |
| Europe commercial paper | 142 | 0.20 | 159 | 0.18 |
| Bank borrowings | 41 | | 53 | |
| Total | \$756 | | \$1,065 | |

In the first quarter of 2013, the Company terminated interest rate swaps with notional amounts totaling \$250 million, which were designated as fair value hedges of its 3.25% fixed rate U.S. Dollar Notes due 2018. The interest rate swaps effectively converted the interest rate on the Notes from fixed to variable and the unrealized gain upon termination of \$12 million will be amortized to interest expense over the remaining term of the notes.

In the second quarter of 2013, the Company terminated interest rate swaps with notional amounts totaling \$1.4 billion, which were designated as fair value hedges for (a) \$750 million of its 4.45% fixed rate U.S. Dollar Notes due 2016, (b) \$500 million of its 1.875% fixed rate U.S. Dollar Notes due 2016 and (c) \$150 million of its 3.25% fixed rate U.S. Dollar Notes due 2018 (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 \$41 million will be amortized to interest expense over the remaining term of the Notes.

In February 2013, the Company issued \$250 million of floating rate U.S. Dollar Notes bearing interest at LIBOR plus 0.23% due February 2015 and \$400 million of ten-year 2.75% U.S. Dollar Notes, resulting in aggregate net proceeds after debt discount and commissions of \$645 million. The proceeds from these Notes were used for general corporate purposes, including, together with cash on hand, the repayment of \$749 million aggregate principal amount of the Company's 4.25% U.S. Dollar Notes that matured on March 6, 2013. 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.

In the first half of 2013, the Company entered into interest rate swaps with notional amounts totaling \$1.9 billion, which effectively converted a portion of the associated U.S. Dollar Notes from fixed rate to floating rate obligations. These derivative instruments were designated as fair value hedges. The effective interest rates on debt obligations resulting from the Company's interest rate swaps as of September 28, 2013 were as follows: (a) seven-year 4.45% U.S. Dollar Notes due 2016 3.46%; (b) five-year 1.875% U.S. Dollar Notes due 2016 1.01%; (c) five-year 1.75% U.S. Dollar Notes due 2017 1.35%; (d) seven-year 3.25% U.S. Dollar Notes due 2018 1.89%; (e) ten-year 4.15% U.S. Dollar Notes due 2019 2.74%; (f) ten-year 4.00% U.S. Dollar Notes due 2020 2.91%; (g) ten-year 3.125% U.S. Dollar Notes due 2022 2.74%.

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, restricted stock units and restricted stock grants. The Company also sponsors a discounted stock purchase plan in the United States and matching-grant programs in several international locations. Additionally, the Company awards restricted stock to its outside directors. The interim information below should be read in conjunction with the disclosures included within the stock compensation footnote of the Company's 2012 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:

| (millions) | Quarter ended | | Year-to-date period ended | |
|------------------------------|--------------------|--------------------|---------------------------|--------------------|
| | September 28, 2013 | September 29, 2012 | September 28, 2013 | September 29, 2012 |
| Pre-tax compensation expense | \$ 10 | \$ 10 | \$ 31 | \$ 32 |
| Related income tax benefit | \$ 4 | \$ 4 | \$ 12 | \$ 12 |

As of September 28, 2013, total stock-based compensation cost related to non-vested awards not yet recognized was \$56 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 period ended September 28, 2013 and September 29, 2012, 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 within the stock compensation footnote in the Company's 2012 Annual Report on Form 10-K.

Year-to-date period ended September 28, 2013:

| | Shares (millions) | Weighted-average exercise price | Weighted-average remaining contractual term (yrs.) | Aggregate intrinsic value (millions) |
|-------------------------------------|-------------------|---------------------------------|--|--------------------------------------|
| Employee and director stock options | | | | |
| Outstanding, beginning of period | 25 | \$50 | | |
| Granted | 6 | 60 | | |
| Exercised | (10) | 48 | | |
| Forfeitures and expirations | (1) | 55 | | |
| Outstanding, end of period | 20 | \$53 | 7.2 | \$111 |
| Exercisable, end of period | 10 | \$50 | 5.5 | \$88 |

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Year-to-date period ended September 29, 2012:

| | Shares (millions) | Weighted- average exercise price | Weighted- average remaining contractual term (yrs.) | Aggregate intrinsic value (millions) |
|-------------------------------------|----------------------|---|--|---|
| Employee and director stock options | | | | |
| Outstanding, beginning of period | 24 | \$48 | | |
| Granted | 6 | 52 | | |
| Exercised | (2) | 43 | | |
| Forfeitures and expirations | (1) | 53 | | |
| Outstanding, end of period | 27 | \$49 | 6.4 | \$78 |
| Exercisable, end of period | 17 | \$48 | 5.1 | \$78 |

The weighted-average fair value of options granted was \$5.92 per share and \$5.23 per share for the year-to-date periods ended September 28, 2013 and September 29, 2012, respectively. 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 September 28, 2013: | 15% | 7.44 | 1.49% | 2.90% |
| Grants within the year-to-date period ended September 29, 2012: | 16% | 7.53 | 1.60% | 3.30% |

The total intrinsic value of options exercised was \$133 million and \$16 million for the year-to-date periods ended September 28, 2013 and September 29, 2012, respectively.

Performance shares

In the first quarter of 2013, 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 2013 target grant currently corresponds to approximately 210,000 shares, with a grant-date fair value of \$54 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 September 28, 2013, the maximum future value that could be awarded to employees on the vesting date for all outstanding performance share awards was as follows:

| | September 28, 2013 |
|------------|-----------------------|
| (millions) | |
| 2011 Award | \$22 |
| 2012 Award | \$22 |
| 2013 Award | \$25 |

The 2010 performance share award, payable in stock, was settled at 40% of target in February 2013 for a total dollar equivalent of \$4 million.

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 within the footnotes to the Consolidated Financial Statements included in the Company's 2012 Annual Report on Form 10-K. During the fourth quarter of 2012 the Company changed its policy for recognizing expense for its pension

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and postretirement benefit plans. Components of Company plan benefit expense for the periods presented are included in the tables below. Prior year amounts have been revised to reflect the new policy.

Table of Contents**Pension**

| (millions) | Quarter ended | | Year-to-date period ended | |
|---|--------------------|--------------------|---------------------------|--------------------|
| | September 28, 2013 | September 29, 2012 | September 28, 2013 | September 29, 2012 |
| Service cost | \$ 33 | \$ 28 | \$ 101 | \$ 82 |
| Interest cost | 51 | 53 | 151 | 156 |
| Expected return on plan assets | (90) | (86) | (269) | (257) |
| Amortization of unrecognized prior service cost | 4 | 3 | 12 | 10 |
| Total pension expense (income) | \$ (2) | \$ (2) | \$ (5) | \$ (9) |

Other nonpension postretirement

| (millions) | Quarter ended | | Year-to-date period ended | |
|---|--------------------|--------------------|---------------------------|--------------------|
| | September 28, 2013 | September 29, 2012 | September 28, 2013 | September 29, 2012 |
| Service cost | \$ 8 | \$ 7 | \$ 25 | \$ 20 |
| Interest cost | 13 | 13 | 37 | 39 |
| Expected return on plan assets | (21) | (21) | (65) | (63) |
| Amortization of unrecognized prior service cost | | (1) | (2) | (1) |
| Total postretirement benefit expense (income) | \$ | \$ (2) | \$ (5) | \$ (5) |

Postemployment

| (millions) | Quarter ended | | Year-to-date period ended | |
|--------------------------------------|--------------------|--------------------|---------------------------|--------------------|
| | September 28, 2013 | September 29, 2012 | September 28, 2013 | September 29, 2012 |
| Service cost | \$ 2 | \$ 2 | \$ 5 | \$ 6 |
| Interest cost | 1 | 1 | 3 | 3 |
| Recognized net loss | 1 | 1 | 4 | 3 |
| Total postemployment benefit expense | \$ 4 | \$ 4 | \$ 12 | \$ 12 |

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Company contributions to employee benefit plans are summarized as follows:

| (millions) | Pension | Nonpension postretirement | Total |
|-----------------------------------|---------|------------------------------|-------|
| Quarter ended: | | | |
| September 28, 2013 | \$ 2 | \$ 4 | \$ 6 |
| September 29, 2012 | \$ 7 | \$ 3 | \$ 10 |
| Year-to-date period ended: | | | |
| September 28, 2013 | \$ 30 | \$ 12 | \$ 42 |
| September 29, 2012 | \$ 31 | \$ 12 | \$ 43 |
| Full year: | | | |
| Fiscal year 2013 (projected) | \$ 45 | \$ 17 | \$ 62 |
| Fiscal year 2012 (actual) | \$ 38 | \$ 13 | \$ 51 |

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

Note 8 Income taxes

The consolidated effective tax rate for the quarter ended September 28, 2013 was 27% as compared to the prior year's rate of 29%. The lower effective rate in the current quarter was primarily due to a rate reduction and the elimination of a tax liability in international jurisdictions. The consolidated effective tax rate for the year-to-date periods ended September 28, 2013 and September 29, 2012 was 29%.

As of September 28, 2013, the Company classified \$19 million related to uncertain 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 \$10 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 September 28, 2013; \$60 million of this total represents the amount that, if recognized, would affect the Company's effective income tax rate in future periods.

| | |
|--|--------------|
| (millions) | |
| December 29, 2012 | \$ 80 |
| Tax positions related to current year: | |
| Additions | 8 |
| Reductions | |
| Tax positions related to prior years: | |
| Additions | 11 |
| Reductions | (5) |
| Settlements | (11) |
| September 28, 2013 | \$ 83 |

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For the year-to-date period ended September 28, 2013, the Company recognized expense of \$4 million for tax-related interest and cash settlements of \$5 million, resulting in an accrual balance of \$18 million at September 28, 2013.

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.

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.

Total notional amounts of the Company's derivative instruments as of September 28, 2013 and December 29, 2012 were as follows:

| (millions) | September 28, 2013 | December 29, 2012 |
|-------------------------------------|-----------------------|----------------------|
| Foreign currency exchange contracts | \$ 645 | \$ 570 |
| Interest rate contracts | 2,400 | 2,150 |
| Commodity contracts | 383 | 320 |
| Total | \$3,428 | \$ 3,040 |

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 September 28, 2013 and December 29, 2012, 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 September 28, 2013 or December 29, 2012.

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The following table presents assets and liabilities that were measured at fair value in the Consolidated Balance Sheet on a recurring basis as of September 28, 2013 and December 29, 2012:

Derivatives designated as hedging instruments

| (millions) | September 28, 2013 | | | December 29, 2012 | | |
|--------------------------------------|--------------------|----------------|----------------|-------------------|----------------|----------------|
| | Level 1 | Level 2 | Total | Level 1 | Level 2 | Total |
| Assets: | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other prepaid assets | \$ | \$ 4 | \$ 4 | \$ | \$ 4 | \$ 4 |
| Interest rate contracts (a): | | | | | | |
| Other assets | | | | | 64 | 64 |
| Total assets | \$ | \$ 4 | \$ 4 | \$ | \$ 68 | \$ 68 |
| Liabilities: | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other current liabilities | \$ | \$ (8) | \$ (8) | \$ | \$ (3) | \$ (3) |
| Interest rate contracts: | | | | | | |
| Other liabilities | | (43) | (43) | | | |
| Commodity contracts: | | | | | | |
| Other current liabilities | | (10) | (10) | | (11) | (11) |
| Other liabilities | | (21) | (21) | | (27) | (27) |
| Total liabilities | \$ | \$ (82) | \$ (82) | \$ | \$ (41) | \$ (41) |

(a) The fair value of the related hedged portion of the Company's long-term debt, a level 2 liability, was \$2.5 billion as of September 28, 2013 and \$2.3 billion as of December 29, 2012.

Derivatives not designated as hedging instruments

| (millions) | September 28, 2013 | | | December 29, 2012 | | |
|--------------------------------------|--------------------|---------------|----------------|-------------------|-----------|---------------|
| | Level 1 | Level 2 | Total | Level 1 | Level 2 | Total |
| Assets: | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other prepaid assets | \$ | \$ 1 | \$ 1 | \$ | \$ | \$ |
| Commodity contracts: | | | | | | |
| Other prepaid assets | 5 | | 5 | 5 | | 5 |
| Total assets | \$ 5 | \$ 1 | \$ 6 | \$ 5 | \$ | \$ 5 |
| Liabilities: | | | | | | |
| Foreign currency exchange contracts: | | | | | | |
| Other current liabilities | \$ | \$ (1) | \$ (1) | \$ | \$ | \$ |
| Commodity contracts: | | | | | | |
| Other current liabilities | (9) | | (9) | (3) | | (3) |
| Total liabilities | \$ (9) | \$ (1) | \$ (10) | \$ (3) | \$ | \$ (3) |

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The effect of derivative instruments on the Consolidated Statements of Income and Comprehensive Income for the quarters ended September 28, 2013 and September 29, 2012 was as follows:

Derivatives in fair value hedging relationships

| (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income (a) | |
|-------------------------------------|---|---|---------------------|
| | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | Other income (expense), net | \$ (1) | \$ 2 |
| Interest rate contracts | Interest expense | (3) | 4 |
| Total | | \$ (4) | \$ 6 |

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

Derivatives in cash flow hedging relationships

| (millions) | Gain (loss) | | Location of gain (loss) reclassified from AOCI | Gain (loss) | | Location of gain (loss) recognized in income (a) | Gain (loss) | |
|-------------------------------------|-----------------------|------------------|--|---------------------------------------|------------------|---|-----------------------------|------------------|
| | recognized in AOCI | | | reclassified from AOCI into income | | | recognized in income (a) | |
| | Sep. 28, 2013 | Sep. 29, 2012 | | Sep. 28, 2013 | Sep. 29, 2012 | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | \$ (4) | \$ (4) | COGS | \$ 2 | \$ (1) | Other income (expense), net | \$ | \$ |
| Foreign currency exchange contracts | (3) | | SGA expense | 1 | 1 | Other income (expense), net | | |
| Interest rate contracts | | | Interest expense | 1 | 1 | N/A | | |
| Commodity contracts | | 3 | COGS | (2) | (4) | Other income (expense), net | | |
| Total | \$ (7) | \$ (1) | | \$ 2 | \$ (3) | | \$ | \$ |

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

Derivatives in net investment hedging relationships

| (millions) | Gain (loss) recognized in AOCI | |
|-------------------------------------|--------------------------------------|------------------|
| | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | \$ | \$ (1) |
| Total | \$ | \$ (1) |

Derivatives not designated as hedging instruments

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| (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|-------------------------------------|--|-------------------------------------|------------------|
| | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | Other income (expense), net | \$ 1 | \$ |
| Commodity contracts | COGS | (2) | (3) |
| Total | | \$ (1) | \$ (3) |

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The effect of derivative instruments on the Consolidated Statements of Income and Comprehensive Income for the year-to-date periods ended September 28, 2013 and September 29, 2012 were as follows:

Derivatives in fair value hedging relationships

| (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income(a) | |
|-------------------------------------|---|--|---------------------|
| | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | Other income (expense), net | \$ 2 | \$ 1 |
| Interest rate contracts | Interest expense | (2) | 4 |
| Total | | \$ | \$ 5 |

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

Derivatives in cash flow hedging relationships

| (millions) | Gain (loss) | | Location of gain (loss) | | Gain (loss) | | Gain (loss) | |
|-------------------------------------|------------------|------------------|------------------------------|---------------------------------------|--------------------------|-----------------------------|------------------|------------------|
| | recognized in | | gain (loss) | Gain (loss) | | Location of gain (loss) | | recognized in |
| | Sep. 28, 2013 | Sep. 29, 2012 | reclassified from AOCI | reclassified from AOCI into income | recognized in income (a) | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | \$ 8 | \$ (5) | COGS | \$ 7 | \$ (1) | Other income (expense), net | \$ | \$ |
| Foreign currency exchange contracts | (2) | 1 | SGA expense | 1 | 2 | Other income (expense), net | | |
| Interest rate contracts | | | Interest expense | 3 | 3 | N/A | | |
| Commodity contracts | (1) | (5) | COGS | (7) | (16) | Other income (expense), net | | |
| Total | \$ 5 | \$ (9) | | \$ 4 | \$ (12) | | \$ | \$ |

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

Derivatives in net investment hedging relationships

| (millions) | Gain (loss) recognized in AOCI | |
|-------------------------------------|--------------------------------------|------------------|
| | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | \$ | \$ 5 |
| Total | \$ | \$ 5 |

Derivatives not designated as hedging instruments

| (millions) | Location of gain (loss) recognized in income | Gain (loss) recognized in income | |
|-------------------------------------|--|-------------------------------------|------------------|
| | | Sep. 28, 2013 | Sep. 29, 2012 |
| Foreign currency exchange contracts | COGS | \$ 2 | \$ |
| Interest rate contracts | Interest expense | | (1) |
| Commodity contracts | COGS | (26) | (3) |
| Total | | \$ (24) | \$ (4) |

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During the next 12 months, the Company expects \$8.0 million of net deferred losses reported in AOCI at September 28, 2013 to be reclassified to income, assuming market rates remain constant through contract maturities.

Certain of the Company's derivative instruments contain provisions requiring the Company to post collateral on those derivative instruments that are in a liability position if the Company's credit rating is at or below BB+ (S&P), or Ba1 (Moody's). The fair value of all derivative instruments with credit-risk-related contingent features in a liability position on September 28, 2013 was \$59 million. If the credit-risk-related contingent features were triggered as of September 28, 2013, the Company would be required to post additional collateral of \$54 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 September 28, 2013 triggered by credit-risk-related contingent features, however, there was \$5 million of collateral posted under the reciprocal agreements as discussed under counterparty credit risk concentration below.

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, which are level 2 liabilities, is calculated based on broker quotes and was as follows at September 28, 2013:

| (millions) | Fair Value | Carrying Value |
|--------------------------------------|-----------------|-----------------|
| Current maturities of long-term debt | \$ 298 | \$ 298 |
| Long-term debt | 6,794 | 6,348 |
| Total | \$ 7,092 | \$ 6,646 |

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. Certain counterparties represent a concentration of credit risk to the Company. If those counterparties fail to perform according to the terms of derivative contracts, this would result in a loss to the Company. As of September 28, 2013, the Company was not in a significant net asset position with any counterparties with which a master netting agreement would apply.

For certain derivative contracts, reciprocal collateralization agreements with counterparties call for the posting of collateral in the form of cash, treasury securities or letters of credit if a fair value loss position to the Company or its counterparties exceeds a certain amount. As of September 28, 2013 the Company had posted collateral of \$5 million in the form of cash, which was reflected as an increase in accounts receivable, net on the Consolidated Balance Sheet.

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 27% of consolidated trade receivables at September 28, 2013.

Note 10 Reportable segments

Kellogg Company is the world's leading producer of cereal, second largest producer of cookies and crackers, and a leading producer of savory snacks and frozen foods. Additional product offerings include toaster pastries, cereal bars, fruit-flavored snacks 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 through eight operating segments that are based on product category or geographic location. These operating segments are evaluated for similarity with regards to economic characteristics, products, production processes, types or classes

of customers, distribution methods and regulatory environments to

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determine if they can be aggregated into reportable segments. Beginning in the first quarter of 2013, the Kashi operating segment, which was formerly aggregated with the U.S. Morning Foods operating segment and reported as U.S. Morning Foods and Kashi, was eliminated due to a reorganization of the business. Kashi operating segment results of prior periods were recast between U.S. Morning Foods and U.S. Snacks to conform to the current presentation. The reportable segments are discussed in greater detail below.

U.S. Morning Foods includes cereal, toaster pastries, health and wellness bars, and beverages generally marketed under the Kellogg's name.

U.S. Snacks includes products such as cookies, crackers, cereal bars, savory snacks and fruit-flavored snacks.

U.S. Specialty primarily represents the food service, convenience and Girl Scouts businesses. The food service business is mostly non-commercial, servicing institutions such as schools and hospitals.

North America Other represents the U.S. Frozen and Canada operating segments. As these operating segments are not considered economically similar enough to aggregate with other operating segments and are immaterial for separate disclosure, they have been grouped together as a single reportable segment.

The three remaining reportable segments are based on geographic location – Europe which consists principally of European countries; Latin America which is comprised of Central and South America and includes Mexico; and Asia Pacific which is comprised of South Africa, Australia and other Asian and Pacific markets.

The measurement of reportable segment results is based on segment operating profit which is generally consistent with the presentation of operating profit in the Consolidated Statement of Income. Intercompany transactions between operating segments were insignificant in all periods presented. Segment operating profit excludes unrealized gains and losses on certain commodity hedging activities, certain components of our postemployment benefit plans, and general corporate expenses. Once realized, the gains and losses on certain commodity hedging activities are recognized within the segment results in the same period in which the underlying transaction being economically hedged is included in earnings. We exclude certain components of our postemployment benefit plans from segment operating profit because we centrally manage postemployment benefit plan funding decisions as well as the determination of discount rate, expected rate of return on plan assets and other actuarial assumptions. We also manage market-based impacts to these benefit plans centrally. Therefore we allocate only the service cost and amortization of prior service cost components of our pension and nonpension postretirement plan expense to segment operating profit.

| | Quarter ended | | Year-to-date period ended | |
|---------------------------|---------------|---------------|---------------------------|---------------|
| | September 28, | September 29, | September 28, | September 29, |
| (millions) | 2013 | 2012 | 2013 | 2012 |
| Net sales | | | | |
| U.S. Morning Foods | \$ 883 | \$ 903 | \$ 2,657 | \$ 2,692 |
| U.S. Snacks | 886 | 908 | 2,704 | 2,544 |
| U.S. Specialty | 281 | 264 | 932 | 864 |
| North America Other | 382 | 388 | 1,173 | 1,125 |
| Europe | 729 | 685 | 2,144 | 1,836 |
| Latin America | 302 | 292 | 914 | 836 |
| Asia Pacific | 253 | 280 | 767 | 737 |
| Consolidated | \$ 3,716 | \$ 3,720 | \$ 11,291 | \$ 10,634 |
| Operating profit | | | | |
| U.S. Morning Foods | \$ 132 | \$ 134 | \$ 475 | \$ 465 |
| U.S. Snacks | 105 | 117 | 341 | 361 |
| U.S. Specialty | 70 | 62 | 210 | 189 |
| North America Other | 70 | 67 | 223 | 207 |
| Europe | 74 | 76 | 220 | 210 |
| Latin America | 39 | 36 | 129 | 135 |
| Asia Pacific | 25 | 29 | 63 | 79 |
| Total Reportable Segments | 515 | 521 | 1,661 | 1,646 |

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| | | | | |
|--------------|--------|--------|----------|----------|
| Corporate | (11) | (8) | (84) | (87) |
| Consolidated | \$ 504 | \$ 513 | \$ 1,577 | \$ 1,559 |

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KELLOGG COMPANY

PART I FINANCIAL INFORMATION

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

Results of operations

Overview

For more than 100 years, consumers have counted on Kellogg for great-tasting, high-quality and nutritious foods. Kellogg is the world's leading producer of cereal, second largest producer of cookies and crackers, and a leading producer of savory snacks and frozen foods. Additional product offerings include toaster pastries, cereal bars, fruit-flavored snacks and veggie foods. Kellogg products are manufactured and marketed globally.

We manage our operations through eight operating segments that are based on product category or geographic location. These operating segments are evaluated for similarity with regards to economic characteristics, products, production processes, types or classes of customers, distribution methods and regulatory environments to determine if they can be aggregated into reportable segments. We report results of operations in the following reportable segments: U.S. Morning Foods; U.S. Snacks; U.S. Specialty; North America Other; Europe; Latin America; and Asia Pacific.

We manage our Company for sustainable performance defined by our long-term annual growth targets. These targets are 3 to 4% for internal net sales, mid-single-digit (4 to 6%) for underlying internal operating profit, and high-single-digit (7 to 9%) for currency-neutral underlying diluted net earnings per share.

Internal net sales and internal operating profit growth of our reportable segments exclude the impact of foreign currency translation and, if applicable, acquisitions, dispositions and integration costs associated with the acquisition of the *Pringles*[®] business (Pringles). In addition to these items, internal operating profit growth also includes the benefit of allocating a portion of costs related to our support functions that are now being leveraged to provide support to the Pringles business.

On November 4, 2013, we announced Project K, a global four-year efficiency and effectiveness program. The program is expected to generate a significant amount of savings, once all phases are approved and implemented, that will be invested in key strategic areas of focus for the business. We expect that this investment will drive future growth in revenues, gross margin, operating profit, and cash flow. See the Exit or disposal activities section for more information.

Comparability of certain financial measures is impacted significantly by two types of charges: 1) Mark-to-market adjustments that are recorded for pensions and commodity derivative contracts; and 2) Charges related to Project K. To provide increased transparency and assist in understanding our underlying operating performance we use non-GAAP financial measures within the MD&A that exclude the impact of these charges. These non-GAAP financial measures include underlying gross margin, underlying gross profit, underlying SGA%, underlying operating margin, underlying operating profit, underlying internal operating profit growth, underlying income taxes, underlying net income attributable to Kellogg Company, underlying basic earnings per share (EPS), underlying diluted EPS, and underlying diluted EPS growth. Underlying internal operating profit growth excludes the following impacts, if applicable: foreign currency translation, mark-to-market adjustments, acquisitions, dispositions, integration costs associated with the acquisition of the Pringles business, and charges related to Project K.

For the quarter ended September 28, 2013, our reported net sales declined slightly while internal net sales increased by 0.5%. We experienced solid increases in internal net sales in Europe, Latin America and Asia-Pacific, while internal net sales in U.S. Morning Foods and U.S. Snacks declined. Reported operating profit declined by 2%, and underlying internal operating profit increased by 1%. This result includes the impact of cost containment in overhead and consumer promotion investments which was partially offset by increased advertising investment and the anticipated negative impact of inflation, net of cost savings.

Diluted EPS of \$.90 for the quarter was up 1% compared to prior year diluted EPS of \$.89. Underlying diluted EPS for the quarter of \$.93 was up 4% compared to the prior year underlying diluted EPS of \$.89, ahead of our expectations due to better than expected cost containment and a lower tax rate.

Table of Contents**Reconciliation of certain non-GAAP Financial Measures**

| | Quarter ended | | Year-to-date period ended | |
|---|-----------------------|-----------------------|---------------------------|-----------------------|
| | September 28, 2013 | September 29, 2012 | September 28, 2013 | September 29, 2012 |
| Consolidated results | | | | |
| (dollars in millions, except per share data) | | | | |
| Reported operating profit | \$ 504 | \$ 513 | \$ 1,577 | \$ 1,559 |
| Mark-to-market (a) | 2 | | (59) | (50) |
| Project K (b) | (17) | | (17) | |
| Underlying operating profit (c), (d) | \$ 519 | \$ 513 | \$ 1,653 | \$ 1,609 |
| Reported income taxes | \$ 124 | \$ 131 | \$ 398 | \$ 400 |
| Mark-to-market (a) | | | (19) | (15) |
| Project K (b) | (5) | | (5) | |
| Underlying income taxes (c) | \$ 129 | \$ 131 | \$ 422 | \$ 415 |
| Reported net income attributable to Kellogg Company | \$ 326 | \$ 318 | \$ 989 | \$ 993 |
| Mark-to-market (a) | 2 | | (40) | (35) |
| Project K (b) | (12) | | (12) | |
| Underlying net income attributable to Kellogg Company (c), (d) | \$ 336 | \$ 318 | \$ 1,041 | \$ 1,028 |
| Reported basic EPS | \$ 0.90 | \$ 0.89 | \$ 2.72 | \$ 2.78 |
| Mark-to-market (a) | | | (0.12) | (0.10) |
| Project K (b) | (0.03) | | (0.03) | |
| Underlying basic EPS (c) | \$ 0.93 | \$ 0.89 | \$ 2.87 | \$ 2.88 |
| Underlying basic EPS growth (c) | 4.5% | 4.7% | (0.3)% | (2.0)% |
| Reported diluted EPS | \$ 0.90 | \$ 0.89 | \$ 2.70 | \$ 2.77 |
| Mark-to-market (a) | | | (0.12) | (0.10) |
| Project K (b) | (0.03) | | (0.03) | |
| Underlying diluted EPS (c) | \$ 0.93 | \$ 0.89 | \$ 2.85 | \$ 2.87 |
| Underlying diluted EPS growth (c) | 4.5% | 6.0% | (0.7)% | (1.4)% |

- (a) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, actual asset returns exceeded expectations by \$211 million but discount rates fell almost 100 basis points for pension plans resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2012. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the first quarter of 2013. During the second and third quarters of 2013 and 2012, there were no pension mark-to-market adjustments recorded to earnings. In 2011, actual asset returns were lower than expected by \$471 million and discount rates declined resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2011. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

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- (b) Costs incurred attributed to Project K, a global four-year efficiency and effectiveness program. The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.
- (c) Underlying operating profit, underlying income taxes, underlying net income attributable to Kellogg Company, underlying basic EPS, underlying basic EPS growth, underlying diluted EPS, and underlying diluted EPS growth are non-GAAP measures that exclude the impact of mark-to-market adjustments for pension plans and commodity contracts and Project K. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance. These non-GAAP measures are reconciled to the directly comparable measures in accordance with U.S. GAAP within this table.
- (d) Underlying operating profit for the quarters ended September 28, 2013 and September 29, 2012 includes postretirement benefit plan income of \$2 million and \$4 million, respectively. Underlying operating profit for the year-to-date periods ended September 28, 2013 and September 29, 2012 includes postretirement benefit plan income of \$10 million and \$14 million, respectively.

Underlying net income attributable to Kellogg Company for the quarters ended September 28, 2013 and September 29, 2012 includes postretirement benefit plan income of \$2 million and \$3 million, respectively. Underlying net income attributable to Kellogg Company for the year-to-date periods ended September 28, 2013 and September 29, 2012 includes postretirement benefit plan income of \$7 million and \$10 million, respectively.

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 2013 versus 2012:

| (dollars in millions) | U.S. Morning Foods | U.S. Snacks | U.S. Specialty | North America Other | Europe | Latin America | Asia Pacific | Corpor- orate | Consol- idated |
|--------------------------------|-----------------------|----------------|-------------------|---------------------------|---------------|------------------|-----------------|------------------|-------------------|
| 2013 net sales | \$ 883 | \$ 886 | \$ 281 | \$ 382 | \$ 729 | \$ 302 | \$ 253 | \$ | \$ 3,716 |
| 2012 net sales | \$ 903 | \$ 908 | \$ 264 | \$ 388 | \$ 685 | \$ 292 | \$ 280 | \$ | \$ 3,720 |
| % change 2013 vs. 2012: | | | | | | | | | |
| As reported | (2.2)% | (2.5)% | 6.2% | (1.5)% | 6.4% | 3.4% | (9.4)% | % | (.1)% |
| Acquisitions/Divestitures | % | .8% | % | % | % | % | (1.4)% | % | % |
| Integration (a) | % | % | % | % | % | % | (.6)% | % | % |
| Foreign currency impact | % | % | % | (1.8)% | 3.1% | (3.3)% | (10.3)% | % | (.6)% |
| Internal business (b) | (2.2)% | (3.3)% | 6.2% | .3% | 3.3% | 6.7% | 2.9% | % | .5% |

| (dollars in millions) | U.S. Morning Foods | U.S. Snacks | U.S. Specialty | North America Other | Europe | Latin America | Asia Pacific | Corpor- orate | Consol- idated |
|--------------------------------|--------------------------|----------------|-------------------|---------------------------|---------------|------------------|-----------------|------------------|-------------------|
| 2013 operating profit | \$ 132 | \$ 105 | \$ 70 | \$ 70 | \$ 74 | \$ 39 | \$ 25 | \$ (11) | \$ 504 |
| 2012 operating profit | \$ 134 | \$ 117 | \$ 62 | \$ 67 | \$ 76 | \$ 36 | \$ 29 | \$ (8) | \$ 513 |
| % change 2013 vs. 2012: | | | | | | | | | |
| As Reported | (1.7)% | (10.3)% | 11.9% | 6.7% | (3.1)% | 8.4% | (15.1)% | (28.9)% | (1.7)% |
| Acquisitions / Divestitures | % | 1.3% | % | % | % | % | .2% | % | .3% |
| Integration (a) | % | 5.3% | % | (.3)% | (.1)% | % | (5.3)% | 67.9% | 1.5% |
| Foreign currency impact | % | % | % | (2.5)% | .8% | (6.0)% | (9.9)% | 3.0% | (1.1)% |
| Internal business (b) | (1.7)% | (16.9)% | 11.9% | 9.5% | (3.8)% | 14.4% | (.1)% | (99.8)% | (2.4)% |
| Mark-to-market (c) | % | % | % | % | % | % | % | 21.3% | .2% |
| Project K (d) | (3.7)% | (1.0)% | (.6)% | (.4)% | % | (9.5)% | (2.4)% | (119.9)% | (3.2)% |
| Underlying internal (e) | 2.0% | (15.9)% | 12.5% | 9.9% | (3.8)% | 23.9% | 2.3% | (1.2)% | .6% |

(a) Includes impact of integration costs associated with the Pringles acquisition.

(b) Internal net sales and operating profit growth for 2013 exclude the impact of acquisitions, divestitures, integration costs and impact of foreign currency translation. Internal net sales and operating profit growth are non-GAAP financial measures which are reconciled to the directly comparable measures in accordance with U.S. GAAP within these tables.

(c) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. During the third quarter of 2013 and 2012, there were no pension mark-to-market adjustments recorded in earnings. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

(d)

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Costs incurred attributed to Project K, a global four-year efficiency and effectiveness program. The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.

- (e) Underlying internal operating profit growth excludes the impact of foreign currency translation, pension plans and commodity contracts mark-to-market adjustments, Project K and, if applicable, acquisitions, dispositions, and integration costs associated with the acquisition of Pringles. The Company believes the use of this non-GAAP measure provides increased transparency and assists in understanding underlying operating performance. This non-GAAP measure is reconciled to the directly comparable measure in accordance with U.S. GAAP within this table.

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Internal net sales for U.S. Morning Foods declined 2% as a result of decreased volume and pricing/mix. This segment consists of cereal, toaster pastries, health and wellness bars, and beverages. Cereal category growth has been challenging, as expected, due to the timing of innovation scheduled for launch mid-year. Despite this category performance, *Froot Loops*® and *Raisin Bran*® posted solid consumption increases during the quarter. Toaster pastries reported solid consumption growth and share gains. Beverages continued to report increased consumption resulting from expanded distribution.

Internal net sales in U.S. Snacks declined 3% as a result of unfavorable volume, partially offset by improved pricing/mix. This segment consists of crackers, cereal bars, cookies, salty snacks, and fruit-flavored snacks. Crackers posted a decline as a result of lower in-market support and the impact of the difficult comparisons for *Special K Cracker Chips*® due to the launch of Popcorn Chips in the prior year. *Cheez-It*® and *Townhouse*® both continued to report strong consumption and share gains in the cracker segment behind the performance of innovations. The bars business was flat for the quarter as softness in existing products was offset by continued positive results from *Special K Pastry Crisps*® and *Nutri-grain Fruit Crunch*® innovations. The cookies business declined in the quarter as several brands underperformed while *Keebler*® cookies reported increased consumption for the quarter behind improved in-store execution with key customers. Salty snacks reported a decline for the quarter due to trade inventory reductions while consumption continued to grow during the quarter against a strong year-ago growth comparison.

Internal net sales in U.S. Specialty increased by 6% as a result of increased volume and pricing/mix. Sales growth was driven by good results in the convenience business due to innovation and distribution gains.

Internal net sales in North America Other (U.S. Frozen and Canada) increased slightly due to favorable pricing/mix being partially offset by decreased volume. Sales performance was driven by solid growth in the Canada business resulting from both volume and pricing improvements. The U.S. Frozen business reported a slight decline as a result of volume reduction against double-digit internal net sales growth in the prior year.

Internal net sales for Europe increased 3% as a result of increased volume and improved pricing/mix. Salty snacks reported strong double-digit growth in this segment. Latin America's internal net sales growth was 7% due to improved pricing/mix and increased volume. Sales growth was reported in a majority of the markets in the segment, with Venezuela and Brazil posting double-digit gains. The salty snacks business also posted double-digit growth in Latin America. Internal net sales in Asia Pacific increased 3% as a result of increased volume and improved pricing/mix. India, Southeast Asia, and the salty snacks business all reported double-digit growth.

Underlying internal operating profit in U.S. Morning Foods improved by 2% due to improved gross margin and favorable timing of overhead investments more than offsetting a mid-single-digit increase in advertising investment. U.S. Snacks declined by 16% due to the impact from reduced sales, inflation, unfavorable timing of overhead investment, and a double-digit increase in advertising investment being partially offset by favorable timing of consumer promotion investments. U.S. Specialty improved by 12% as a result of the impact of sales growth, improved gross margin, and favorable timing of brand-building investments, which was partially offset by the unfavorable timing of overhead investment. North America Other improved by 10% due to improved gross margin and favorable timing of overhead investment being partially offset by a mid-single-digit increase in advertising investment. Europe declined by 4% due to the impact of a double-digit increase in advertising investment and an investment in several productivity initiatives during the quarter being partially offset by the impact of sales growth and favorable timing of overhead investments. Latin America improved by 24% due to the impact of sales growth and favorable timing of brand-building investment being partially offset by the impact of inflation and unfavorable timing of overhead investments. Asia Pacific improved by 2% for the quarter as the favorable impact from sales growth and timing of brand-building investment was partially offset by the impact of inflation.

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The following table provides an analysis of net sales and operating profit performance for the year-to-date periods of 2013 as compared to 2012.

| (dollars in millions) | U.S. | | | North | | | | Corporate | Consolidated |
|--------------------------------|-----------------|-----------------|----------------|-----------------|-----------------|---------------|---------------|-----------|------------------|
| | Morning Foods | U.S. Snacks | U.S. Specialty | America Other | Europe | Latin America | Asia Pacific | | |
| 2013 net sales | \$ 2,657 | \$ 2,704 | \$ 932 | \$ 1,173 | \$ 2,144 | \$ 914 | \$ 767 | \$ | \$ 11,291 |
| 2012 net sales | \$ 2,692 | \$ 2,544 | \$ 864 | \$ 1,125 | \$ 1,836 | \$ 836 | \$ 737 | \$ | \$ 10,634 |
| % change 2013 vs. 2012: | | | | | | | | | |
| As Reported | (1.3)% | 6.3 % | 7.8 % | 4.3 % | 16.8 % | 9.3 % | 4.1 % | % | 6.2 % |
| Acquisitions/Divestitures (a) | % | 9.1 % | 4.0 % | 1.7 % | 14.2 % | 4.9 % | 9.4 % | % | 6.1 % |
| Integration impact (b) | % | % | % | (.1)% | % | % | (.5)% | % | % |
| Foreign currency impact | % | % | % | (1.1)% | .7 % | (2.0)% | (7.3)% | % | (.6)% |
| Internal business (c) | (1.3)% | (2.8)% | 3.8 % | 3.8 % | 1.9 % | 6.4 % | 2.5 % | % | .7 % |

| (dollars in millions) | U.S. | | | North | | | | Corporate | Consolidated |
|--------------------------------|---------------|----------------|----------------|---------------|---------------|---------------|----------------|----------------|-----------------|
| | Morning Foods | U.S. Snacks | U.S. Specialty | America Other | Europe | Latin America | Asia Pacific | | |
| 2013 operating profit | \$ 475 | \$ 341 | \$ 210 | \$ 223 | \$ 220 | \$ 129 | \$ 63 | (84) | \$ 1,577 |
| 2012 operating profit | \$ 465 | \$ 361 | \$ 189 | \$ 207 | \$ 210 | \$ 135 | \$ 79 | (87) | \$ 1,559 |
| % change 2013 vs. 2012: | | | | | | | | | |
| As Reported | 2.2 % | (5.5)% | 11.1 % | 8.2 % | 4.8 % | (4.1)% | (20.4)% | 1.5 % | 1.1 % |
| Acquisitions/Divestitures (a) | % | 9.5 % | 4.1 % | 1.5 % | 8.0 % | 5.0 % | 6.7 % | (4.3)% | 4.5 % |
| Integration impact (b) | % | (.8)% | % | (.6)% | (1.6)% | (.2)% | (10.3)% | 31.3 % | .2 % |
| Foreign currency impact | % | % | % | (1.5)% | (.8)% | (7.7)% | (7.2)% | (.9)% | (1.3)% |
| Internal business (c) | 2.2 % | (14.2)% | 7.0 % | 8.8 % | (.8)% | (1.2)% | (9.6)% | (24.6)% | (2.3)% |
| Mark-to-market (d) | % | % | % | % | % | % | % | (14.7)% | (.5)% |
| Project K (e) | (1.1)% | (.4)% | (.2)% | (.1)% | % | (2.5)% | (.9)% | (9.8)% | (1.1)% |
| Underlying internal (f) | 3.3 % | (13.8)% | 7.2 % | 8.9 % | (.8)% | 1.3 % | (8.7)% | (.1)% | (.7)% |

- (a) Impact of results for the year-to-date periods ended September 28, 2013 and September 29, 2012 from the acquisition of Pringles and the divestiture of Navigable Foods.
- (b) Includes impact of integration costs associated with the Pringles acquisition.
- (c) Internal net sales and operating profit growth for 2013 exclude the impact of acquisitions, divestitures, integration costs and impact of foreign currency translation. Internal net sales and operating profit growth are non-GAAP financial measures which are reconciled to the directly comparable measures in accordance with U.S. GAAP within these tables.
- (d) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations by \$211 million but discount rates fell almost 100 basis points for pension plans resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2012. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the first quarter of 2013. During the third quarter of 2013 there were no pension mark-to-market adjustments recorded to earnings. In 2011, asset returns were lower than expected by \$471 million and discount rates declined resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2011. A portion of the 2011 pension

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mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. During the third quarter of 2012, there were no pension mark-to-market adjustments recorded in earnings. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

- (e) Costs incurred attributed to Project K, a global four-year efficiency and effectiveness program. The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.

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- (f) Underlying internal operating profit growth excludes the impact of foreign currency translation, pension plan and commodity contracts mark-to-market adjustments, Project K and, if applicable, acquisitions, dispositions, and integration costs associated with the acquisition of Pringles. The Company believes the use of this non-GAAP measure provides increased transparency and assists in understanding underlying operating performance. This non-GAAP measure is reconciled to the directly comparable measure in accordance with U.S. GAAP within this table.

Year-to-date internal net sales for U.S. Morning Foods declined 1% due to the cereal category growing slower than anticipated. This performance has been partially offset by continued growth in toaster pastries behind consumption growth and share gains.

U.S. Snacks year-to-date internal net sales declined approximately 3% due to the competitive environment. Plans are being executed to stabilize under-performing brands and improve in-store execution.

U.S. Specialty year-to-date internal net sales improved 4% due to strong innovation performance. This was partially offset by a reduction in trade inventory levels in the first half of the year. North America Other year-to-date internal net sales increased by 4% due to solid U.S. Frozen growth resulting from increased brand-building support behind innovation activity.

Europe's year-to-date internal net sales improved by 2% due to strong performance in the salty snacks and improved performance in the UK being partially offset by the continued difficult operating environment in Continental Europe. Latin America's year-to-date internal net sales improved by 6% due to significant improvements in pricing/mix and strong performance in Venezuela, Brazil, and salty snacks. Year-to-date internal net sales for Asia Pacific improved 2% resulting from good performance in India, Southeast Asia, Australia, and salty snacks.

Year-to-date underlying internal operating profit has improved in the majority of our segments as sales growth and cost containment have been able to offset the negative impact of significant inflation realized in the first three quarters of the year. Most of our businesses have been impacted by a majority of the anticipated full-year net inflation in the first three quarters of the year. We expect net deflation in the remainder of the year combined with lower SG&A spend resulting in improved profitability.

U.S. Snacks, Europe, and Asia Pacific reported year-to-date declines in underlying internal operating profit. The U.S. Snacks decline is primarily due to reduced sales and increased inflation. These impacts have been partially offset by reduced brand-building and overhead investments. Europe's decline is primarily due to significant inflation realized during the year and investment in several productivity initiatives during the third quarter. The decline in Asia Pacific is primarily due to charges in the first quarter related to the closure of a plant in Australia.

Table of Contents**Margin performance**

Margin performance for the third quarter of 2013 versus 2012 is as follows:

| Quarter | 2013 | 2012 | Change vs. prior year (pts.) |
|---------------------------------|----------------|---------|------------------------------|
| Reported gross margin (a) | 39.0% | 39.4% | (.4) |
| Project K (COGS) (c) | (0.2)% | % | (.2) |
| Underlying gross margin (d) | 39.2% | 39.4% | (0.2) |
| Reported SGA% | (25.4)% | (25.6)% | .2 |
| Project K (SGA) (c) | (0.2)% | % | (.2) |
| Underlying SGA% (d) | (25.2)% | (25.6)% | .4 |
| Reported operating margin | 13.6% | 13.8% | (.2) |
| Project K (c) | (0.4)% | % | (.4) |
| Underlying operating margin (d) | 14.0% | 13.8% | .2 |
| Year-to-date | 2013 | 2012 | |
| Reported gross margin (a) | 38.3% | 40.0% | (1.7) |
| Mark-to-market (COGS) (e) | (0.5)% | (0.5)% | |
| Underlying gross margin (d) | 38.8% | 40.5% | (1.7) |
| Reported SGA% | (24.3)% | (25.3)% | 1.0 |
| Project K (SGA) (c) | (0.1)% | % | (.1) |
| Underlying SGA% (d) | (24.2)% | (25.3)% | 1.1 |
| Reported operating margin | 14.0% | 14.7% | (.7) |
| Mark-to-market (e) | (0.5)% | (0.5)% | |
| Project K (c) | (0.1)% | % | (.1) |
| Underlying operating margin (d) | 14.6% | 15.2% | (.6) |

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

(b) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. During the third quarter of 2013 and 2012, there were no pension mark-to-market adjustments recorded to earnings. Mark-to-market adjustments for

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commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

- (c) Costs incurred attributed to Project K, a global four-year efficiency and effectiveness program. The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.
- (d) Underlying gross margin, underlying SGA%, and underlying operating margin are non-GAAP measures that exclude the impact of pension and commodity mark-to-market adjustments and Project K. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance.

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- (e) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations by \$211 million but discount rates fell almost 100 basis points for pension plans resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2012. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the first quarter of 2013. During the third quarter of 2013, there were no pension mark-to-market adjustments recorded to earnings. In 2011, asset returns were lower than expected by \$471 million and discount rates declined resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2011. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. During the third quarter of 2012, there were no pension mark-to-market adjustments recorded to earnings. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

Underlying gross margin for the quarter, which excludes the impact of mark-to-market adjustments and the impact of the Project K, declined by 20 basis points due to the impact of inflation, net of cost savings. Underlying SG&A %, which excludes the impact of mark-to-market adjustments and the impact of the Project K, improved by 40 basis points as a result of reduced integration costs, as well as cost containment across overhead and consumer promotion.

On a year-to-date basis, underlying gross margin declined 170 basis points due to the impact of inflation, net of cost savings, and the impact of the lower margin structure of the Pringles business. Underlying SG&A% improved by 110 basis points as a result of favorable overhead leverage and synergies resulting from the Pringles acquisition, as well as brand-building investment that increased at a rate lower than sales growth.

Our underlying gross profit, underlying SG&A, and underlying operating profit measures are reconciled to the most comparable GAAP measure as follows:

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| Quarter (dollars in millions) | 2013 | 2012 |
|---------------------------------------|----------|----------|
| Reported gross profit (a) | \$ 1,450 | \$ 1,466 |
| Mark-to-market (COGS) (b) | 2 | |
| Project K (COGS) (c) | (6) | |
| Underlying gross profit (d) | \$ 1,454 | \$ 1,466 |
| Reported SGA | \$ 946 | \$ 953 |
| Project K (SGA) (c) | 11 | |
| Underlying SGA (d) | \$ 935 | \$ 953 |
| Reported operating profit | \$ 504 | \$ 513 |
| Mark-to-market (b) | 2 | |
| Project K (c) | (17) | |
| Underlying operating profit (d) | \$ 519 | \$ 513 |
| Year-to-date (dollars in millions) | 2013 | 2012 |
| Reported gross profit (a) | \$ 4,320 | \$ 4,258 |
| Mark-to-market (COGS) (e) | (59) | (50) |
| Project K (COGS) (c) | (6) | |
| Underlying gross profit (d) | \$ 4,385 | \$ 4,308 |
| Reported SGA | \$ 2,743 | \$ 2,699 |
| Project K (SGA) (c) | 11 | |
| Underlying SGA (d) | \$ 2,732 | \$ 2,699 |
| Reported operating profit | \$ 1,577 | \$ 1,559 |
| Mark-to-market (e) | (59) | (50) |
| Project K (c) | (17) | |
| Underlying operating profit (d) | \$ 1,653 | \$ 1,609 |

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

(b) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. During the third quarter of 2013 and 2012, there were no pension mark-to-market adjustments recorded to earnings. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

(c) Costs incurred attributed to Project K, a global four-year efficiency and effectiveness program. The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the

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- implementation of global business services, and a new global focus on categories.
- (d) Underlying gross profit, underlying SGA, and underlying operating profit are non-GAAP measures that exclude the impact of pension and commodity mark-to-market adjustments and Project K. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance.

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- (e) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations by \$211 million but discount rates fell almost 100 basis points for pension plans resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2012. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the first quarter of 2013. During the third quarter of 2013 there were no pension mark-to-market adjustments recorded to earnings. In 2011, asset returns were lower than expected by \$471 million and discount rates declined resulting in an unfavorable mark-to-market adjustment recorded in earnings in the fourth quarter of 2011. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. During the third quarter of 2012, there were no pension mark-to-market adjustments recorded in earnings. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

For the full year, we expect underlying gross margin to remain under pressure and decline approximately 50 basis points compared to 2012 including the full-year impact of Pringles.

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.

Exit or disposal activities

We view our continued spending on cost-reduction initiatives as part of our on-going operating principles to provide greater visibility in achieving our long-term profit growth targets. Initiatives undertaken are 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 is expected to deliver cash savings and/or reduced depreciation.

Project K

On November 4, 2013, we announced Project K, a global four-year efficiency and effectiveness program. The program is expected to generate a significant amount of savings, once all phases are approved and implemented, that will be invested in key strategic areas of focus for the business. We expect that this investment will drive future growth in revenues, gross margin, operating profit, and cash flow.

The focus of the program will be to strengthen existing businesses in core markets, increase growth in developing and emerging markets, and drive an increased level of value-added innovation. The program is expected to provide a number of benefits, including an optimized supply chain infrastructure, the implementation of global business services, and a new global focus on categories.

We currently anticipate that the program will result in total pre-tax charges, once all phases are approved and implemented, of \$1.2 to \$1.4 billion, with cash costs estimated to be \$900 million to \$1.1 billion. Cash expenditures are estimated to be approximately \$15 million in 2013, approximately \$250 million in 2014, and the balance of \$650-\$850 million thereafter. We expect the charges will consist of asset-related costs totaling \$450 to \$500 million which will consist primarily of asset impairments and other exit-related costs; employee-related costs totaling \$425 to \$475 million which will include severance, pension and other termination benefits; and other costs totaling \$325 to \$425 million which will consist primarily of charges related to the design and implementation of global business capabilities. A significant portion of other costs are the result of the implementation of global business service centers which are intended to simplify and standardize business support processes.

We currently expect that total pre-tax charges will impact reportable segments as follows: U.S. Morning Foods (approximately 18%), U.S. Snacks (approximately 10%), U.S. Specialty (approximately 2%),

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North America Other (approximately 3%), Europe (approximately 8%), Latin America (approximately 5%), Asia-Pacific (approximately 7%), and Corporate (approximately 47%). A majority of the costs impacting Corporate relate to additional initiatives to be executed after 2014 that are currently not fully defined. As the development of these initiatives is completed, we will update our estimated costs by reportable segment as needed.

As a result of Project K, we anticipate that capital spending will be impacted for at least the next two years. Our current business model assumes capital spending to be approximately 3-4% of net sales annually. For the next two years, capital spending is expected to be approximately 4-5% as a result of Project K activities.

Due to the difference in timing between expected cash costs for the project and expected future cash savings, we anticipate funding the project through a combination of cash on hand and short-term debt.

We also expect that the project will have an impact on our consolidated effective income tax rate during the execution of the project due to the timing of charges being taken in different tax jurisdictions. The impact of this project on our consolidated effective income tax rate will be excluded from the underlying income tax rate that will be disclosed on a quarterly basis.

In the third quarter, we recognized charges of \$17 million that have been attributed to the program. The tables below outline the details of these charges:

Project K

| (millions) | Quarter ended September 28, 2013 | Year-to-date period ended September 28, 2013 |
|------------------------|--|---|
| Employee related costs | \$ 8 | \$ 8 |
| Asset related costs | | |
| Other costs | 9 | 9 |
| Total | \$ 17 | \$ 17 |

| (millions) | Quarter ended September 28, 2013 | Year-to-date period ended September 28, 2013 |
|--------------------|---|--|
| U.S. Morning Foods | \$ 5 | \$ 5 |
| U.S. Snacks | 1 | 1 |
| U.S. Specialty | 1 | 1 |
| Latin America | 3 | 3 |
| Asia Pacific | 1 | 1 |
| Center | 6 | 6 |
| Total | \$ 17 | \$ 17 |

Other costs incurred during the quarter ended September 28, 2013 consist primarily of third-party incremental costs related to the development and implementation of global business capabilities.

At September 28, 2013 exit cost reserves for Project K were \$6 million. The following table provides details for Project K exit cost reserves.

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| (millions) | Balance December 29, 2012 | Costs Incurred | Cash Payments | Balance September 28, 2013 |
|------------|---------------------------------|-------------------|------------------|----------------------------------|
| Project K | \$ | \$ 17 | \$ (11) | \$ 6 |

During 2013, total charges of \$175 to \$200 million are expected to be incurred. Savings are expected to be minimal in 2013, increasing each subsequent year, and ultimately reaching \$425 to \$475 million annually in 2018. The majority of these savings are expected to be cash savings.

Table of Contents**Interest expense**

For the quarter and year-to-date periods ended September 28, 2013, interest expense was \$56 million and \$177 million, respectively, as compared to the quarter and year-to-date periods ended September 29, 2012 with interest expense of \$73 million and \$195 million, respectively. The decrease in interest expense from the prior year is due primarily to the payoff of debt replaced by a combination of lower yield debt and commercial paper.

For the full year 2013, we expect gross interest expense to be approximately \$230-\$240 million, compared to 2012's full year interest expense of \$261 million.

Income taxes

The consolidated effective income tax rate was 27% for the quarter ended September 28, 2013, as compared to 29% for the comparable quarter of 2012. Excluding the impact of the mark-to-market adjustments for pension plans and commodity contracts as well as the impact of costs incurred attributed to Project K, underlying effective tax rates were 28% for the quarter ended September 28, 2013 and 29% for the comparable quarter of 2012. Refer to Note 8 of the Consolidated Financial Statements for further discussion.

For the full year 2013, 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:

| (millions) | Year-to-date period ended | |
|---|---------------------------|-----------------------|
| | September 28, 2013 | September 29, 2012 |
| Net cash provided by (used in): | | |
| Operating activities | \$ 1,389 | \$ 1,375 |
| Investing activities | (364) | (2,928) |
| Financing activities | (982) | 1,397 |
| Effect of exchange rates on cash and cash equivalents | (24) | 1 |
| Net increase (decrease) in cash and cash equivalents | \$ 19 | \$ (155) |

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 September 28, 2013 amounted to \$1.389 billion, an increase of \$14 million over the same period in 2012. The increase compared to the prior year is primarily due to increased cash flow from inventory, taxes and other non-working capital assets and liabilities. This was partially offset by unfavorable cash flow impacts to accounts payable and accrued advertising and promotion which was directly related to the one-time benefit received in 2012 from the acquisition of Pringles.

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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 30 days for each of the 12 month periods ended September 28, 2013 and September 29, 2012. Compared with the 12 month period ended September 29, 2012, the 2013 cash conversion cycle was relatively consistent for inventory, trade receivables and trade payables.

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Our pension and other postretirement benefit plan contributions amounted to \$42 million and \$43 million for the year-to-date periods ended September 28, 2013 and September 29, 2012, respectively. For the full year 2013, we currently expect that our contributions to pension and other postretirement plans will total approximately \$60 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:

| (millions) | Year-to-date period ended | | Change versus prior year |
|---|---------------------------|-----------------------|-----------------------------|
| | September 28, 2013 | September 29, 2012 | |
| Net cash provided by operating activities | \$ 1,389 | \$ 1,375 | 1.0 % |
| Additions to properties | (363) | (262) | |
| Cash flow | \$ 1,026 | \$ 1,113 | (7.8)% |

For the full-year 2013, we are projecting cash flow (as defined) to be approximately \$1.1 billion to \$1.2 billion.

Investing activities

Our net cash used in investing activities for the year-to-date period ended September 28, 2013 amounted to \$364 million compared to \$2.928 billion in the same period of 2012. The year-over-year decrease was primarily attributable to the \$2.674 billion acquisition of Pringles in 2012. For the full-year 2013, we project capital spending to be slightly higher than 4% of net sales.

Financing activities

Our net cash used in financing activities for the year-to-date period ended September 28, 2013 amounted to \$982 million compared to net cash provided by financing activities of \$1.397 billion in the same period of 2012. The decrease compared to the prior year is primarily due to the borrowings in 2012 for the Pringles acquisition. The cash used in financing activities for the year-to-date period ended September 28, 2013 was primarily a result of net retirements of long-term debt, payment of dividends and common stock repurchases, partially offset by the issuance of common stock.

In February 2013, we issued long-term debt for net proceeds of approximately \$645 million and in March 2013, retired \$749 million of long-term debt at maturity.

In April 2010, our board of directors approved a \$2.5 billion, three-year share repurchase program for 2010 through 2012. As of September 29, 2012, total purchases under the repurchase authorization amounted to 37 million shares totaling \$1.9 billion, with \$63 million repurchased in 2012. In December 2012, our board of directors approved a \$300 million share repurchase program for 2013. In April 2013, the board of directors approved a \$1 billion share repurchase program expiring in April 2014. This authorization supersedes the December 2012 authorization and is intended to allow us to repurchase shares to offset the impact of proceeds from the exercise of options through the end of 2013, and to begin our 2014 purchase plan. Actual repurchases could be different from our current expectations, as influenced by factors such as the impact of changes in our stock price and other competing priorities. In May 2013, we entered into an Accelerated Share Repurchase (ASR) Agreement with a financial institution counterparty and paid \$355 million for the repurchase of shares during the term of the Agreement which extended through August 2013. The total number of shares delivered upon settlement of the ASR was based upon the volume weighted average price of the Company's stock over the term of the agreement. Total purchases in 2013, including shares delivered under the ASR, amounted to approximately 9 million shares totaling \$544 million.

We paid cash dividends of \$486 million in the year-to-date period ended September 28, 2013, compared to \$464 million during the same period in 2012. In October 2013, the board of directors declared a dividend of \$.46 per common share, payable on December 16, 2013 to shareholders of record at the close of business on December 2, 2013. The dividend is consistent with our current plan to maintain our dividend pay-out between 40% and 50% of reported net income.

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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.

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Forward-looking statements

This Report contains forward-looking statements with projections concerning, among other things, the Company's global growth and efficiency program (Project K), the integration of the *Pringles*[®] business, 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; costs, charges, rates of return, asset write-offs and expenditures and costs related to productivity or efficiency initiatives; workforce reductions, savings, 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 *expects*, *believes*, *will*, *can*, *anticipates*, *projects*, *should*, *estimates*, *implies*, or words or phrases of similar meaning. For example, forward-looking statements are in 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 ability to implement Project K as planned, whether the expected amount of costs associated with Project K will exceed forecasts, whether the Company will be able to realize the anticipated benefits from Project K in the amounts and times expected;

the ability to realize the anticipated benefits and synergies from the Pringles acquisition in the amounts and at the times expected;

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;

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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 food safety, advertising and labeling laws and regulations;

the ultimate impact of product recalls;

business disruption or other losses from natural disasters, war, terrorist acts, or political unrest; and,

the risks and uncertainties described herein under Part II, Item 1A.

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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

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 within Item 7A of our 2012 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 September 28, 2013.

During the year-to-date period ended September 28, 2013 we terminated interest rate swaps with notional amounts totaling \$1.7 billion which were previously designated as fair value hedges of certain U.S. Dollar Notes. Additionally during the year-to-date period ended September 28, 2013 we entered into new interest rate swaps with notional amounts totaling \$1.9 billion that are 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 September 28, 2013 was \$2.4 billion, representing a net settlement obligation of \$43 million. The total notional amount of interest rate swaps at December 29, 2012 was \$2.2 billion, representing a settlement receivable of \$64 million. Assuming average variable rate debt levels during the year, a one percentage point increase in interest rates would have increased annual interest expense by approximately \$36 million at September 28, 2013 and \$24 million at year-end December 29, 2012.

Venezuela was designated as a highly inflationary economy as of the beginning of our 2010 fiscal year. Gains and losses resulting from the translation of the financial statements of subsidiaries operating in highly inflationary economies are recorded in earnings. In February 2013, the Venezuelan government announced a 46.5% devaluation of the official exchange rate. Additionally, the Transaction System for Foreign Currency Denominated Securities (SITME) was eliminated. Accordingly, in 2013 we began using the official exchange rate to translate our Venezuelan subsidiary's financial statements to U.S. dollar. For the year-to-date period ended September 28, 2013, we recognized a \$14 million charge as a result of the devaluation of the official Venezuelan exchange rate. Our Venezuelan subsidiary represents 1% of total net sales and 2% of total operating profit for the Company on a year-to-date basis.

Item 4. Controls and Procedures

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

As of September 28, 2013, 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 first quarter of 2012, we initiated the implementation of an upgrade to our existing enterprise resource planning (ERP) system within North America. This implementation has resulted in the modification of certain business processes and internal controls impacting financial reporting. During the implementation, which is expected to continue into 2014, we have taken the necessary steps to monitor and maintain appropriate internal controls impacting financial reporting. It is anticipated that, upon completion, implementation of this new ERP will enhance internal controls due to increased automation and further integration of related processes.

There have been no other changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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KELLOGG COMPANY

PART II OTHER INFORMATION

Item 1A. Risk Factors

Other than noted below, there have been no material changes in our risk factors from those disclosed in Part I, Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 29, 2012. The risk factors disclosed under this Part II, Item 1A and in Part I, Item 1A to our Annual report on Form 10-K for the fiscal year ended December 29, 2012, 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.

We may not realize the benefits that we expect from our global four-year efficiency and effectiveness program (Project K).

In November 2013, the Company announced a global four-year efficiency and effectiveness program (Project K). The successful implementation of Project K presents significant organizational design and infrastructure challenges and in many cases will require successful negotiations with third parties, including labor organizations, suppliers, business partners, and other stakeholders. In addition, the project may not advance our business strategy as expected. As a result, we may not be able to implement Project K as planned, including realizing, in full or in part, the anticipated benefits from our program. Events and circumstances, such as financial or strategic difficulties, delays and unexpected costs may occur that could result in our not realizing all or any of the anticipated benefits or our not realizing the anticipated benefits on our expected timetable. If we are unable to realize the anticipated savings of the program, our ability to fund other initiatives may be adversely affected. Any failure to implement Project K in accordance with our expectations could adversely affect our financial condition, results of operations and cash flows.

In addition, the complexity of Project K will require a substantial amount of management and operational resources. Our management team must successfully implement administrative and operational changes necessary to achieve the anticipated benefits of Project K. These and related demands on our resources may divert the organization's attention from existing core businesses, integrating or separating personnel and financial or other systems, have adverse effects on existing business relationships with suppliers and customers, and impact employee morale. As a result our financial condition, results of operations or cash flows may be adversely affected.

Table of Contents**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: 6/30/13-7/27/13 | | | | \$ 492 |
| Month #2: (+) 7/28/13-8/24/13 | 0.6 | \$ 58.08 | 0.6 | \$ 456 |
| Month #3: 8/25/13-9/28/13 | | | | \$ 456 |
| Total | 0.6 | \$ 58.08 | 0.6 | |

In December 2012, our board of directors approved a share repurchase program authorizing us to repurchase shares of our common stock amounting to \$300 million during 2013. On April 26, 2013, the board of directors approved a new authorization to repurchase up to \$1 billion in shares through April 2014. This authorization supersedes the December 2012 authorization and is intended to allow us to repurchase shares to offset the impact of proceeds from the exercise of options through the end of 2013, and to begin our 2014 purchase plan.

(+) In May 2013, the Company entered into an Accelerated Share Repurchase (ASR) Agreement with a financial institution counterparty and paid \$355 for the repurchase of shares during the term of the Agreement, which extended through August 2013. The Company received 0.6 million of these shares in August upon settlement of the ASR at an average cost of \$58.08 per share.

Item 6. Exhibits

(a) Exhibits:

10.1 Agreement between us and Brad Davidson, dated August 21, 2013

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| | |
|---------|---|
| 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 |

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KELLOGG COMPANY

SIGNATURES

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

KELLOGG COMPANY

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

Senior Vice President and Chief Financial

Officer

/s/ M. A. Dangel
M. A. Dangel
Principal Accounting Officer;

Vice President Corporate Controller

Date: November 5, 2013

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KELLOGG COMPANY

EXHIBIT INDEX

| Exhibit No. | Description | Electronic (E) Paper (P) Incorp. By Ref. (IBRF) |
|-------------|---|--|
| 10.1 | Agreement between us and Brad Davidson, dated August 21, 2013 | E |
| 31.1 | Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant | E |
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