Net Sales (millions)
Net sales increased again in 2004, the fourth consecutive year of growth.

Operating Profit (millions)
Operating profit increased despite significant investment in future growth.

Cash Flow (a) (millions)
Cash Flow, defined as operating cash flow less capital expenditure, grew to $950 million in 2004.

Net Earnings Per Share (diluted)
Earnings per share of $2.14 were 11% higher than in 2003.

Total Share Owner Return
For the fourth consecutive year, Kellogg Company’s total return to share owners has exceeded that of the S&P Packaged Foods Index.

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Financial Highlights

<table>
<thead>
<tr>
<th>(dollars in millions, except per share data)</th>
<th>2004</th>
<th>Change</th>
<th>2003</th>
<th>Change</th>
<th>2002</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales</td>
<td>$9,613.9</td>
<td>9%</td>
<td>$8,811.5</td>
<td>6%</td>
<td>$8,304.1</td>
<td>10%</td>
</tr>
<tr>
<td>Gross profit as a % of net sales</td>
<td>44.9%</td>
<td>.5 pts</td>
<td>44.4%</td>
<td>-6 pts</td>
<td>45.0%</td>
<td>.8 pts</td>
</tr>
<tr>
<td>Operating profit</td>
<td>1,681.1</td>
<td>9%</td>
<td>1,544.1</td>
<td>2%</td>
<td>1,508.1</td>
<td>29%</td>
</tr>
<tr>
<td>Net earnings</td>
<td>890.6</td>
<td>13%</td>
<td>787.1</td>
<td>9%</td>
<td>720.9</td>
<td>52%</td>
</tr>
<tr>
<td>Net earnings per share</td>
<td></td>
<td></td>
<td>2.16</td>
<td>12%</td>
<td>1.93</td>
<td>9%</td>
</tr>
<tr>
<td>Basic</td>
<td></td>
<td></td>
<td>2.14</td>
<td>11%</td>
<td>1.92</td>
<td>10%</td>
</tr>
<tr>
<td>Diluted</td>
<td></td>
<td></td>
<td>2.14</td>
<td>11%</td>
<td>1.92</td>
<td>10%</td>
</tr>
<tr>
<td>Cash flow (a)</td>
<td>950.4</td>
<td>3%</td>
<td>923.8</td>
<td>24%</td>
<td>746.4</td>
<td>-13%</td>
</tr>
<tr>
<td>Dividends per share</td>
<td>$1.01</td>
<td>–</td>
<td>$1.01</td>
<td>–</td>
<td>$1.01</td>
<td>–</td>
</tr>
</tbody>
</table>

(a) Cash flow is defined as net cash provided by operating activities, reduced by capital expenditure. The Company uses this non-GAAP financial measure to focus management and investors on the amount of cash available for debt repayment, dividend distributions, acquisition opportunities, and share repurchase. Refer to Management’s Discussion and Analysis on page 28 for reconciliation to the comparable GAAP measure.
Kellogg Company had another successful year in 2004. We continued our strategy of growing our cereal business, expanding our snacks business, and pursuing selected growth opportunities. We managed our business using our Volume to Value and Manage for Cash operating principles, and we exceeded our targets. We are committed to remaining dependable and providing sustainable growth into the future. We really are Staying On Track.

2004 Annual Report

With 2004 net sales of nearly $10 billion, Kellogg Company is the world’s leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, frozen waffles, and meat alternatives. The Company’s brands include Kellogg’s®, Keebler®, Pop-Tarts®, Eggo®, Cheez-It®, Nutri-Grain®, Rice Krispies®, Murray®, Austin®, Morningstar Farms®, Famous Amos®, and Kashi®. Kellogg products are manufactured in 17 countries and are marketed in over 180 countries around the world.
Kellogg Company is broadly divided into two divisions: Kellogg North America and Kellogg International. Kellogg North America includes retail cereal, retail snacks, and frozen and specialty channels businesses in both the United States and Canada. Kellogg International is divided into businesses in Europe, Latin America, and Asia and Australia (Asia Pacific).

The North American Retail Cereal business includes many of the Company’s popular brands such as Special K, Kellogg’s Frosted Flakes, and Kashi, our natural brand. The North American Retail Snacks business includes Keebler cookies and crackers, such as Chips Deluxe and Cheez-It, wholesome snacks, such as Fruit Twistables fruit snacks and Nutri-Grain bars, and our popular toaster pastry brand, Pop-Tarts. The Frozen and Specialty Channels business includes brands such as Eggo, Morningstar Farms, and Worthington, and the food service, convenience store, vending, and drug store businesses.

The Kellogg International business focuses almost exclusively on the cereal and wholesome snack categories within the respective regions. The European business includes cereal brands such as Special K and Crunchy Nut Cornflakes and wholesome snacks such as Special K bars. The Latin American business also focuses predominantly on cereal, including brands such as Zucaritas and Kellogg’s Cornflakes, and wholesome snacks such as All-Bran bars. The Asia Pacific business includes cereals such as Kellogg’s Bran Flakes and All-Bran in Japan and Nutri-Grain in Australia. Our snack brands in Asia Pacific include Special K bars, Nutri-Grain bars, and Muesli bars.
Kellogg International is comprised of our cereal and convenience foods businesses outside of North America. Our primary regions include Europe, Latin America, and Asia Pacific.
To Our Share Owners

I must begin by recognizing the vision and legacy of our former chairman and CEO, Carlos Gutierrez. We are proud of him and wish him all the best as Secretary of Commerce of the United States. I must also say that I am honored, after 30 years of deep involvement with the Kellogg Company, to become its chairman and CEO. I have a strong affection for, and belief in, this wonderful company; I have every confidence that our 25,000 employees and our Board of Directors will stay on track, continue our success, and deliver dependable, sustainable growth.

Exceeding Expectations

Our Company had another very good year in 2004. We exceeded our targets and achieved excellent results while maintaining our discipline and following our proven strategy of growing our cereal business, expanding our snacks business, and pursuing selected growth opportunities. While we have achieved a great deal over the last few years, we are never satisfied. Our recent success has been aimed at positioning us for a strong future and we have built an excellent foundation upon which to grow. In fact, we constantly look for ways to shape our future and focus all our efforts on continuing to execute a plan that will deliver strong, dependable growth for years to come.

One of the strengths of our Company is the philosophy of setting realistic targets for all our financial goals. In 2004, our results again exceeded almost all of these targets.

Revenues. Revenue growth for the full year was nine percent, significantly greater than the low single-digit growth rate that we target. Even internal growth, which excludes the effect of acquisitions and divestitures, the effect of currency exchange, and differences in the number of shipping days, was five percent. This is an encouraging result, one that highlights the strength of our Volume to Value operating principle. In fact, much of 2004’s growth in revenues came from improvements in mix. This, in turn, was made possible by the effective innovation and brand-building programs we executed this year.
**Operating Profit.** Revenue growth without regard for increases in expenses will not result in operating profit growth. The Company’s internal operating profit increased by four percent in 2004, as we remained very focused on containing cost inflation and driving increased productivity. This result was in line with our long-term target of mid single-digit growth in operating profit. That we achieved this while making significant investments for the future, absorbing increased commodity costs, and increasing our investment in brand building, is a testament to our strategy and the ability of our employees.

**Earnings.** Diluted earnings per share increased by 11 percent in 2004; this was also greater than our long-term target of high single-digit growth. Earnings growth resulted primarily from the strong revenue growth we achieved during the year. In addition, lower interest expense as a result of debt repayment, and the effect of foreign exchange, also contributed to the growth.

**Cash Flow.** Ultimately, the value of a company represents its ability to generate cash flow. That is why our organization is so focused on this important metric. In 2004 we generated $950 million of cash flow*, which exceeded earnings by $59 million. All our employees are aware of how they can affect cash flow and all have a strong incentive to focus on improvement. Cash flow provides the Company with the financial flexibility to reduce debt, repurchase shares, pay dividends, and consider making small, complementary acquisitions. We will continue to focus on reducing our debt, and we will also continue to repurchase shares of our Company. The way we used our cash was balanced between the repurchase of shares and the reduction of debt in 2004, and we will continue this trend in 2005.

**Share Owner Return.** Each of these results is reflected in our Company’s share price and annual total return. In 2004, our stock provided share owners with a total return of 20 percent, which compares favorably with the industry average of 18 percent and the S&P500 index’s return of 10 percent. In fact, over the last three years, our stock has averaged an annual return of 17 percent.

**Shaping Our Organization**

A company is only as good as its people. That is why we are so committed to developing our employees throughout their careers. In 2004, we conducted another K Values Culture Survey. This survey was sent to all 25,000 of our employees and was translated into 50 languages. It provided the opportunity to voice concerns and effect change in the organization. For example, the last survey led to the establishment of

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*Cash flow is defined as cash from operating activities less capital expenditures. Refer to Management’s Discussion and Analysis on page 28 for reconciliation to the comparable GAAP measure.*

In 2004, our stock provided share owners with a total return of 20 percent, which compares favorably with the industry average of 18 percent and the S&P500 index’s return of 10 percent. In fact, over the last three years, our stock has averaged an annual return of 17 percent.
Diversity involves everyone and everything, excluding no one.

Inclusion is the way we encourage all employees to help build, and be part of, our culture.

We constantly aim to expand the diversity of thought, background, experience, ethnicity, and gender of our employees in total. The simple fact is that it is good business for our organization to reflect the composition of our customer base.

The Talent Management Worldwide program was designed to improve the process of managing people and stresses communication between the manager and the employee. It is imperative that we do all we can to nurture the career of each of our employees. Equally as important, we want our Company to build a long-lasting relationship with our employees.

For that reason, diversity and inclusion remain very important issues for the Company. We constantly aim to expand the diversity of thought, background, experience, ethnicity, and gender of our employees in total. The simple fact is that it is good business for our organization to reflect the composition of our customer base.

- Our Ethnic Marketing Group is doing an excellent job reaching out to a diverse consumer base. In fact, we have earned a third of the ethnic market for U.S. cereal sales.

- Our Supplier Diversity Program focuses the organization on sourcing materials from alternate vendors. Like the broader diversity program, this initiative makes good business sense and it helps our Company mirror the composition of the communities in which we do business.

- We support and encourage various employee affinity groups within the organization. The Kellogg African American Resource Group, Women of Kellogg, and the Young Professionals group are all examples of resources available to our employees. These groups are open to all employees and promote the individual’s development through the provision of information, informal mentoring opportunities, and the chance to develop a network of contacts.

We also made a series of moves designed to strengthen our management team, broaden their experience, and help their personal development.

David Mackay continues in his position as president and chief operating officer and was named to the Board of Directors. David has been instrumental in the success of the Company in recent years and this appointment reflects his significant contributions. We are confident that David will bring a unique perspective to the governance issues and broader strategic initiatives that are addressed by the Board.

John Bryant was promoted to president, Kellogg International. John has made notable contributions to our Company over the last few years, most recently as chief financial officer. John led our finance organization through a time of significant change and left the group in a far stronger position. Last year he added responsibility for the management of our U.S. natural and frozen businesses. John brings great insight to our entire international business and will continue to build and position it for future success.
Jeff Montie was promoted to president, Kellogg North America. Jeff led the great success enjoyed by our U.S. Morning Foods business in recent years and, last year, added responsibility for management of the Canadian operations. Jeff has managed many of our domestic and international businesses over the years and will now bring his expertise to the entire North American organization.

Jeff Boromisa was promoted to chief financial officer. Jeff is a 23-year veteran of the Kellogg Company, who has served in leadership positions in our procurement group, internal auditing group, corporate finance and treasury operations, and North American and corporate planning; most recently he served as corporate controller and chief financial officer of Kellogg International. Jeff has been instrumental in the execution of our Volume to Value and Manage for Cash principles and his transition to CFO has been seamless.

The largest change undergone by our organization in 2004 was the announcement of the departure of our chairman and chief executive officer, Carlos Gutierrez. Carlos had a truly remarkable career with the Company, and he has left an indelible mark on this organization. Fortunately, one of Carlos’ many strengths was his ability to motivate people and build a strong organization. As a result of his foresight, the Company and our management team remain well positioned for the future.

Staying On Track

We have dramatically changed our Company over the last four years and really have shaped our future. We are committed to delivering sustainable, dependable performance and we have concentrated our efforts on growing our cereal business, expanding our snacks business, and pursuing selected growth opportunities. The remarkable revenue and profit growth that we have enjoyed has been a direct result of successful execution throughout the organization, including the introduction of innovative new products and brand-building programs.

We also recognize that health issues are becoming increasingly important to consumers. We have always been concerned that our products be part of a healthy diet; in fact, the very beginning of our Company stems from a search for a healthy food. We have never forgotten this and continue to introduce products that provide the nutritional benefits consumers want in each of the categories in which we compete.

Staying On Track

Value-added products are an integral part of our Volume to Value operating principle and we constantly strive for new, and better, ideas. Research into, and development of, differentiated new products is essential to our innovation process. Some of the people responsible for our innovation team’s success in 2004 are (front row) Joseph George, D’Anne Hayman, Christine Wentworth, Gloria Cagampang, (back row) Lisa Elander, Ken Patterson, and John Kepplinger.
Innovation. We introduced a significant number of new products in 2004 after a similarly strong program in 2003. These products resonated with consumers and generated excitement in their respective categories. This was demonstrated by the contribution that mix played in our revenue growth; mix improvement is simply the sale of a higher-priced, value-added product in place of a lower-priced, less value-added product. We continue to focus on meeting the needs and demands of consumers and providing them with a wide range of choices.

We also recognize that health issues are becoming increasingly important to consumers. We have always been concerned that our products be part of a healthy diet; in fact, the very beginning of our Company stems from a search for a healthy food. We have never forgotten this and continue to introduce products that provide the nutritional benefits that consumers want in each of the categories in which we compete. For example, we introduced Smart Start Soy Protein and All-Bran bars in the U.S. in 2004 and have many more products planned for introduction around the world in 2005.

Brand Building. Our Company produces some of the world’s best loved and most trusted brands. These brands are also a competitive advantage for us as they provide a point of differentiation and immediate credibility for our new products. Consequently, we devote a meaningful amount of time and resources to the development of our brand-building programs, such as advertising and consumer promotion. In 2004, we increased our spending on brand building at a double-digit rate and created programs that resonated with consumers. For example, most businesses ran a localized version of the two-week Special K challenge campaign. This program has been successful around the world and has helped build Special K into our largest global brand. We will continue to focus on this important part of our Volume to Value principle in 2005 and beyond.

Focus. Most of our products, from Special K cereal, to Fruit Twistables fruit snacks, to Rice Krispies Treats, are sold in one or perhaps two adjacent aisles in the store. This focus gives us the advantage of concentrating on related businesses without the distraction of being involved in unrelated businesses in different categories. This focus extends into our international businesses, where we sell only cereal and wholesome snacks. Our share owners do not need us to diversify for them, but they do want us to focus on what we know and on those businesses where we can add value. Scale within categories adds value and that is where we will continue to concentrate our efforts.

International Infrastructure. Our international infrastructure is another of our competitive advantages. We are fortunate that our founder, W.K. Kellogg, had the foresight to invest in many markets around the world early in the last century. Today, our products are produced in 17 countries and are enjoyed in more than 180 countries around the world. Despite this scale,
our products remain very similar in each of these regions. This has allowed us to spread ideas across our businesses: We encourage our employees to take proven ideas from another country and adapt them to local tastes. For example, the idea for our new All-Bran bars originated in Mexico. From there it was adapted and the bars have already been introduced into both the U.S. and Canada.

**Realistic Targets.** Perhaps as important has been the adoption of challenging but realistic performance targets. We were one of the first companies in the industry to take this step and it has been a significant competitive advantage for us. We believe that maintaining these targets is the right thing for the long-term health of our business. Our strategy is not to force our managers into actions that might drive good results in the near-term, but that might have a lasting, negative result in the long-term.

**Investment.** In 2004, we implemented many initiatives designed to improve our operational effectiveness and position our Company for future growth. Since 2002, we have absorbed the cost of these projects in our performance, because we believe it is the right thing to do. We do not report corporate restructurings and ask our investors to exclude them from our performance. These projects, and the up-front costs associated with them, are simply a cost of doing business and should be a part of reported performance. It is important to note that these high-return initiatives help provide us with embedded earnings power and visibility. They really are investments for the future and are the right thing to do for our Company.

We have done a significant amount of work over recent years to position our Company for future growth: We have implemented a straightforward, simple business model that focuses our Company on revenue growth and the generation of cash flow; we have redirected our resources to our core markets and invested for growth; we have adopted realistic targets that drive better decisions for the long-term health of the business; and we have made significant investment in initiatives designed to improve the efficiency of the business and provide increased financial flexibility. All of these things leave our Company in a much stronger position; a position from which we can grow. The transition was not easy, but our 25,000 employees have performed remarkably and we are confident that they will achieve even more in the years to come. We are staying on track; we have a plan that has worked and that will continue to work. Continuity of our strategy is important for our employees, our investors, and the long-term potential of our business. We hope that you agree that our Company is well positioned and thank you for your continued confidence.

We have done a significant amount of work over recent years to position our Company for future growth.

We have a plan that has worked and that will continue to work. Continuity of our strategy is important for our employees, our investors, and the long-term potential of our business.

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James M. Jenness  
Chairman of the Board  
Chief Executive Officer
Delivering Another Strong Year

We delivered another year of strong results in 2004. Each of our businesses around the world posted these results in the face of significant cost pressures and competitive activity. This year’s excellent performance was also the direct result of the continued execution of our proven strategy. Equally important, though, was the investment we made for the future. Over the past few years we have laid a strong foundation for consistent growth; a foundation upon which we will grow in the years to come.

North American Retail Cereal

The North American Retail Cereal business had another excellent year in 2004. Internal revenues increased by two percent, which met our long-term goals. It is notable that this growth builds on six percent growth in 2003 and came across the portfolio of brands and across segments. Importantly, the business again benefited from excellent innovation and brand-building programs. In fact, we gained 0.4 points of U.S. retail cereal category share during 2004; this was our fifth consecutive year of category share gains.*

Innovation. Various cereals introduced over the last year and a half contributed to sales growth in 2004, including Special K Vanilla Almond and a new version of Smart Start to add to the Smart Start Antioxidants version already on the market. The new Smart Start includes soy protein, which reduces the risk of heart disease and is rich in fiber, calcium, and iron. These cereals, targeted at health-conscious adults, have been well received and we have additional versions, with differing nutritional profiles, planned for introduction.

In addition, we introduced a new Banana Berry flavor of Fruit Harvest. The Fruit Harvest cereals, which contain real fruit, have also been a great success and are an excellent example of the way in which we can provide additional value to the consumer and excitement to the category.

We also introduced one-third less sugar versions of Kellogg’s Frosted Flakes and Froot Loops in 2004. Importantly, neither of these products includes any artificial

sweeteners. We recognize that health and obesity concerns are becoming ever more important to consumers. These products are intended to provide choice and have helped increase the overall sales growth of both brands.

**Advertising/Brand Building.** Our brands are a significant competitive advantage for us. Built over the course of decades, they are instantly recognizable to consumers, provide a platform upon which we can advertise, and allow for the efficient introduction of new products and technology to the category. We believe that investment in brand building includes only advertising and consumer promotion. It does not include coupons, trade spending, or any other activity which reduces the price of our products.

In 2004, we benefited from the introduction of Maple & Brown Sugar Mini-Wheats and a very successful advertising campaign for the entire Mini-Wheats line, which centered on the nutritional advantages that result from a high-fiber diet. This combination of brand building and innovation highlights the effect that these activities can have on revenue growth. While the new Maple & Brown Sugar flavor has done very well, revenues for the entire range of Mini-Wheats have also increased. Not surprisingly, we have new flavors of Mini-Wheats planned that will help us further capitalize on consumers’ increased awareness of the benefits of a diet high in fiber.

Our ability to execute consumer promotions across categories and across businesses is also a significant competitive advantage for us; it is one that we are increasingly benefiting from and one that we will utilize even more in 2005 and beyond.

For example, our Canadian business ran a pedometer promotion in conjunction with the Special K brand. This enormously successful program gave consumers a free pedometer in each specially marked box of Special K. They could

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**Staying On Track**

*Sales of Special K have grown very quickly in recent years. The brand is now our single largest around the world and accounts for a significant proportion of our business in some regions. This growth is due to very successful brand-building programs such as the “lose up to 6 pounds in two weeks” promotion in the U.S. In addition, an active innovation program has spurred sales and has led to new products such as Special K bars and new and exciting types of cereal. Tiziana Castiglioni is the director of Global Brands and coordinates Special K marketing on a global scale. Pictured: (front row) Angel Murphy, Tiziana Castiglioni, Leslie Lee, (back row) Marisa Thompson, Tim Borne, Terah Farness, and Theresa Flack.*
then measure the distance they walked or ran each day and could tailor their exercise programs accordingly. Special K has become a trusted brand worldwide and its image and positioning are truly unique. Our North American cereal business also ran successful tie-ins with various entertainment properties during 2004, including Disney, Spiderman, the Olympics, Cartoon Network, SpongeBob Squarepants, NASCAR, and The Incredibles.

**Focused Strategy.** We maintain a focused strategy across all our businesses. This is evident in our North American cereal business where we provide consumers with choice without straying from our competencies. Ideas for new products and brand-building campaigns travel easily within the business unit and between business units. The similarity of our products and brands, across categories and regions, facilitates this process.

**2005.** We were very pleased with the growth seen in the North American Retail Cereal business in 2004. In 2005, we expect this business to deliver low single-digit sales growth, in line with our long-term goals.

### North American Retail Snacks

The North American Retail Snacks business also had a very good year in 2004, after a challenging 2003. Internal revenues in 2004 increased by eight percent. This result is notable as it significantly exceeded our long-term growth targets. In fact, the cracker, toaster pastry, and wholesome snack businesses all posted growth in each of the quarters and for the whole year. We saw growth where we invested, and we focused our efforts on increasing the intensity of our innovation and brand-building efforts.


**Staying On Track**

Pop-Tarts toaster pastries is our single largest brand in the U.S. Impressively, the brand posted double-digit sales growth in 2004 as a result of innovation, excellent advertising programs, and growth of the core business. Pop-Tarts holds an 84 percent* share of the toaster pastry category and truly is a unique brand. During 2004 we introduced a successful French Toast flavor; pictured is the team that worked on the introduction: (back row) Chris Noble, Chris Gambino, Charlie Gambino, Ron Jansen, Doug Edmonson, Dave Isaacs, (front row) Nancy Esterline, Jim Kincaid, Katie Gyekis, and Carolina Arana.
Innovation. One of the most successful products launched in 2004, by any of our businesses, was the Cheez-It Twisterz line of crackers. Twisterz is a true product innovation: a twisted cracker that incorporates two delicious flavors. We launched two varieties of Twisterz early in the year, Hot Wings & Cheesy Blue, and Cheddar & More Cheddar. Due to the success of the brand, we have additional product and packaging innovation planned for the near future. We also introduced other new crackers during the year including new flavors of our original Cheez-It cracker, SpongeBob Cheez-It crackers, and the very successful Scooby-Doo Graham Cracker Sticks.

We also introduced a number of new cookies in 2004. We launched two flavors of Sandies Fruit Delights, which have been very well received by consumers. Also well received was the introduction of SpongeBob Squarepants animal cookies. These cookies tied in with the broader SpongeBob Squarepants-themed promotions, which we ran across the businesses. This promotion demonstrates the flexibility of our focused strategy, in that it allows for the use of a promotional theme across our entire portfolio of products. The success of these products and ideas shows that we can generate growth where we concentrate our efforts and where we invest. We expect additional activity in 2005 and anticipate continuing 2004’s good results.

We were also very active in the wholesome snacks business in 2004. The most significant innovation during the year was the introduction of our new fruit snacks in both the U.S. and Canada. Fruit snacks was a logical category for us to enter: Kellogg is a trusted brand name; we have experience using fruit in our products; and a majority of fruit snacks are sold in the same aisle as many of our other products. In the U.S., we introduced Disney fruit snacks, which are shaped like popular Disney characters, and Fruit Twistables, a unique innovation with an...
intertwined combination of fruit flavors; in Canada we introduced a *Froot Loops* branded *Fruit Twistables* product. Each contains real fruit and has been a great success: In less than a year, we have attained the number two position in the U.S. category. We see great potential for growth in this category and will continue to innovate in the future.

We also introduced various packaging innovations across our snacks business in 2004 that addressed consumers’ desire for additional convenience. The introduction of higher-count caddy packs, which are twelve-packs of single-serve packages of cookies and crackers, has been well received. Also well received was the new On-the-Go, single-serve packaging introduced across various cookie and cracker brands in 2004.

*DSD Execution.* Another of our competitive advantages is the direct-store-door, or DSD, delivery capability utilized by our retail snacks business. Through DSD, Kellogg employees deliver, stock, and display our products on retail shelves. While this method of distribution is more expensive than traditional warehouse delivery, it is efficient for fast-selling, high-impulse items and provides us with faster delivery and additional control of our products. For example, our DSD representatives are able to monitor levels of stock and ensure that our product is always available. They can also work with the retailer to build off-shelf displays that highlight specific products or combinations of products. This cooperation is good for both the retailer and our DSD business and helps drive increased revenue growth.

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**Staying On Track**

We ran our first truly global promotion in the summer of 2004. The program, tied to the release of the *Spiderman II* movie, ran almost simultaneously in 42 countries. It included the introduction of limited-edition products and new packaging designed specifically for the event. The campaign was a huge success and we look forward to running additional global promotions in the future. A large team of people around the world made the program a success. Pictured: (front row) Sandy Uridge, Kristin Wesolowski, Sara Atchu, (back row) Rob Grainger, Julie Suehr, and Greg Miller.
North American Frozen and Specialty Channels

In 2004, the North American Frozen and Specialty Channels businesses continued their recent success. Internal revenues increased by four percent in 2004, after increasing by three percent in 2003. The Food-Away-From-Home business posted mid single-digit revenue growth for the year; the Eggo brand increased revenues at a double-digit rate for the year.

**Specialty Channels.** In an effort to improve the focus of Kellogg Company’s business in non-traditional retail channels, the Kellogg Specialty Channel Division was formed in 2004. This improved focus has enhanced our ability to innovate specifically for these customers, while improving the efficiency of our operations. In addition, we can also better leverage the similarities that exist across these channels and improve our sales and marketing execution.

**Innovation.** Many industry participants have experienced weakness in their food-away-from-home businesses in recent years. Our business, however, was able to navigate through this difficult environment and actually increase its revenues. Innovation has been the main catalyst for this growth. In fact, over recent years, the percentage of sales generated by products introduced during the previous three years has grown substantially. We did not slow our innovation activity in 2004 either; we continued to expand our line of cereal-in-a-cup products and we introduced a wellness cereal pack, channel specific packages of our new Cheez-It Twisterz, and fruit snacks. Our Club store business has gained share in both the ready-to-eat-cereal and wholesome snack categories and our Convenience and Drug businesses launched successful 99¢ packages of Keebler snacks. Finally, the Food-Away-From-Home team worked closely with the military to provide products and packaging specifically designed for this important customer.

**Frozen Foods.** Our Frozen Foods business had a good year in 2004. The Eggo brand expanded its leadership in the Frozen Breakfast category by 0.5 points and its share of the Frozen Waffles category by 0.7 points.* Eggo now holds 65 percent share of the Frozen Waffles category. This gain was the result of both innovation and continued investment in brand building. Eggo French Toaster Sticks continued their strong performance throughout the year in both the U.S. and Canada and we have more innovation planned for 2005. Morningstar Farms, our frozen meat-alternatives business, also posted good results in 2004 as it expanded its share in core categories.

**2005.** We anticipate that our North American Frozen and Specialty Channels businesses will post low single-digit internal sales growth in 2005 as a result of continued strength from new products and successful brand-building programs.

International

Our international infrastructure is also a significant competitive advantage for our Company and would be very difficult and expensive to recreate. Fortunately, our founder, W.K. Kellogg, had the foresight to invest in many international markets almost 100 years ago. Consequently, many consumers in international regions feel an affinity for our brands and consider them to be of local origin. Our longevity in these regions also provides insight into the respective markets and the ability to take proven ideas from one region and tailor them to another. In fact, we encourage our employees to share ideas with each other whenever possible. For example, many cereal and snack products, including several versions of Special K and our new All-Bran bars, were introduced in one market and have subsequently spread around the world. This process also provides the added benefit of keeping the products in our portfolio very similar across regions; this improves the efficiency of global promotions and eases the transfer of additional proven ideas.

These similar portfolios of products provide us with another benefit: They allow us to effectively spread advertising and promotional ideas from business to business. For example, in the summer of 2004 we ran a Spiderman-themed promotion, almost simultaneously, in 42 countries. This is something that few other companies could achieve and we gained significant benefits of scale from the similarity of the products in all those regions: Kellogg’s Frosted Flakes in the U.S., Frosties in the United Kingdom, and Zucaritas in Mexico all ran similar promotions, which included inserts such as toys in the box. Some of our businesses in smaller countries, which might not have been able to do so before, were also able to participate. The purchasing power generated by the participation of businesses in 42 countries greatly improved the economics of the Spiderman program.

Europe

The European business posted strong internal revenue growth of four percent in 2004, which was its highest internal growth for a decade and which built on similarly good growth of three percent in 2003. Europe implemented the Volume to Value process later than did the U.S. business, but the principle is now showing excellent results across the region. In fact, the U.K., our single largest business in Europe, posted increased local-currency revenues of two percent in 2004. The U.K. business maintained its category-leading share during the year, despite an aggressive competitive environment. The remaining businesses, which account for approximately half of sales in the region, posted aggregate internal revenue growth of four percent for the year. This resulted primarily from exposure to high growth markets, such as Italy and Spain.
Innovation. The innovation program in Europe also produced many new products during 2004. In the U.K., products such as Special K Lite Bites, Frosties Light, and yogurt-coated varieties of Special K and All-Bran have helped spur this growth. We also introduced Rice Krispies Muddles in the U.K. This unique, great tasting cereal contains a prebiotic that actually helps children’s digestion and health. Again, some ideas that have made their way around the globe also added to growth in Europe. Sales of Special K bars continued to grow and a new version, Apple and Pear, contributed to that brand’s very strong double-digit growth in 2004. We also introduced yogurt varieties of Nutri-Grain bars and Extra bars in four flavors. Finally, our European business also adapted Mexico’s All-Bran bar to local tastes and introduced it during 2004.

Advertising/Brand Building. Brand-building activity is one of the primary drivers of the success of Volume to Value, and Europe is no exception. In 2004, Europe participated in the very successful, global Spiderman-themed promotion through the introduction of new products and the marketing of existing brands. This included toys in the box and packaging designs unique to the program. In addition, we ran a number of challenge campaigns for Special K in most of the countries in Europe. These promotions, timed to run early in the year and immediately before summer, were a great success. They challenged consumers to eat Special K, and in the U.K., Crunchy Nut Cornflakes, twice a day for two weeks. Each of the flavors of Special K cereal benefited from this excellent brand-building program, as did products in different categories such as Special K bars. The European business has also extended the challenge idea into the area of general health with an All-Bran challenge. Not coincidently, this was an idea first conceived in Mexico and was adapted for the European market.

2005. We expect low single-digit internal sales growth in the European business in 2005. We anticipate that this growth will be driven by a strong promotional calendar and good new product introductions, despite a competitive environment that has been increasingly difficult.
Latin America

Internal revenue growth in Latin America was 11 percent in 2004. This exceeded our goal of low single-digit growth and built on strong 13 percent growth in 2003. Mexico accounts for the majority of this business, although we have growth businesses throughout the region. The Latin American business has effectively leveraged corporate-wide ideas in ways specific to that region. It is also a significant source of ideas and talent that find their way to other regions.

Innovation. We made a considerable amount of investment in innovation in Latin America during 2004. For instance, we introduced Zucaritas Turbo Mix, in Mexico. This product builds on the brand equity of Tony the Tiger, but with a high-energy, sports-oriented positioning. This is an example of the way in which we can energize an existing brand and bring excitement to the category.

We continued to see very strong growth in our snacks business in Mexico, even after this business almost doubled in size in 2003. In fact, in 2004 we began the construction of a manufacturing facility in Mexico which will produce cereal and snacks for that market. In addition, we further increased the scale of our direct-store-door delivery system, which when combined with a solid innovation program and good execution, contributed significantly to overall sales growth. There are numerous examples of how innovation and brand building drove sales growth in 2004. Nutri-Grain, All-Bran, and Choco Krispies bars all saw excellent growth as a result of increased focus and activity.

We also took a great idea from the North American business and introduced it into Mexico. Pop-Tarts is an approximately $500 million business in the U.S. and holds a share of 84 percent of the toaster pastry category. It is still early, but we are encouraged by the initial success of Pop-Tarts in Mexico.

Advertising/Brand Building. Around the world, our products provide the excitement and taste enjoyed by children combined with the nutritional benefits desired by parents. In 2004, we continued our Defensa K marketing campaign in Latin America. This program has been very successful as it highlights the nutritional content of our products, particularly the iron content, which is important in a region with a relatively high incidence of anemia.

In addition, we ran many other promotional campaigns during the year. Mexico was a participant in the global Spiderman promotion, the SpongeBob Squarepants promotion, a Disney package inserts program, and also introduced a popular Yu-Gi-Oh! version of Choco Krispies. All are additional examples of the ways in which we can leverage our global scale, excite consumers, and drive category growth.

2005. For 2005, we again expect low-to-mid single-digit internal growth from our Latin American business as the categories continue to grow and we maintain leading category shares in most of the region.
Asia Pacific

In Asia Pacific, internal revenue growth was two percent in 2004. This built on growth of three percent in 2003. We are pleased with this result as we faced an increasingly competitive environment in Australia in 2004 and weakness in the South Korean cereal category.

**Innovation.** *Nutri-Grain* cereal is one of our strongest brands in Australia. The brand has a healthy, youthful image and sports orientation, which is very popular with teens. In 2004, we introduced a new berry variety, a distinctly different flavor that was marketed using the same message as the original. We also introduced *Nutri-Grain* bars in Australia in 2004. It is early, but we are very encouraged by the initial success of these products. In addition we introduced a very successful new Apple and Cinnamon flavor of *Special K* in Australia. This, and a new Peach and Apricot *Special K* bar, added to the significant growth of the brand in 2004. We also introduced a one-third less sugar version of *Frosties* in South Korea to offer choice to consumers.

**Advertising/Brand Building.** The Asia Pacific region was also very active with brand-building programs in 2004. A very effective initiative was built around our *Nutri-Grain* brand in Australia. This was a program which challenged consumers to eat the cereal for six weeks in order to improve their fitness and increase their levels of energy. The program was a derivation of the challenge programs which ran elsewhere in 2004 and is another example of how a good idea can be tailored to specific products and regions.

In addition, the Australian business, which developed the pedometer idea, used it again during the fourth quarter. This promotion was designed to coincide with the Australian summer and has been well received by consumers.

In Asia, we ran successful health-oriented programs on *Cornflakes* in India and on *All-Bran* in Japan. In addition, *Frosties* promotions, including *Spiderman* and mini discs in the box helped increase sales of the brand in Japan in 2004.

**2005.** We expect low single-digit sales growth in our Asia Pacific business in 2005, despite a more challenging competitive environment in Australia.
Volume to Value is the primary piece of our broader operating principle as it ensures that we remain focused on profitable revenue growth rather than volume growth.

We again executed the Volume to Value principle across our businesses in 2004. New products that consumers value and the successful support from effective advertising and consumer promotion drive mix improvement. This provides revenue growth and higher margins, as consumers value the added benefit from innovation. This, in turn, provides additional profit that we can invest in continued innovation and brand building. Continuing the successful innovation and brand-building programs is the key to sustaining the momentum of the business.

In 2004, we again increased our investment in brand building at a double-digit rate; we also invested significantly in innovation. In fact, products introduced in the last three years accounted for more than 15 percent of sales in 2004. This is a dramatic increase from the low double-digit rate of only a few years ago. Consequently, price increases and mix improvement added three percent to revenue growth in 2004 while internal net sales increased by five percent. Gross profit margin expanded by 50 basis points, despite continued high commodity costs and significant investment in efficiency initiatives. This was made possible by the improvement in price/mix, improved productivity, and cost savings. All of which combined to produce increased earnings, which can be reinvested in brand building and innovation for growth in 2005 and beyond.

In addition, the organization remained focused on Manage for Cash, the second part of our operating principle. We are constantly trying to decrease the amount of cash we have committed to working capital. By decreasing the amount of inventories we have, by increasing the speed with which we collect receivables, and by better managing our payables, we use less cash. In addition, we are committed to prioritizing the amount of cash we will spend in any year on capital expenditure. Ours is not a capital-intensive business and we have been successful at eliminating unnecessary expenditures. This vigilance, and increasing earnings, provides cash that we can use for debt repayment, the repurchase of shares, payment of dividends, or to make small, complementary acquisitions.

We believe that the earnings and cash flow accumulated over time using our strategy will far exceed the results achieved by chasing unreasonable goals.
In 2004, core working capital decreased to 7.3 percent of sales; a dramatic decrease from 11.3 percent of sales in mid 2001; this decrease represents four consecutive years of improvement. Capital expenditure in 2004 was three percent of sales, also a dramatic decrease from the six percent level of 1998. This year’s spending was in line with our long-term target; our capital discipline ensures that we invest in only the projects with the highest returns. We constantly focus on ways in which we can produce new products with existing capacity and how we can improve current procedures. Our supply chain managers have done an excellent job evolving our production capabilities as our product portfolio has evolved.

Total cash flow for the year was $950 million. This compares favorably with the $924 million generated last year, especially considering that we made $20 million more in total contributions to benefit plans this year than last.

We used nearly $300 million of cash flow to repay debt and increase our financial flexibility. We also repurchased approximately $300 million of our own shares in 2004. In 2005, we expect to continue to repay debt, but also to continue our share repurchase program, much as we did in 2004. Accordingly, the Board of Directors has authorized a $400 million share repurchase program for 2005.

Realistic Targets. The final piece of our operating principle involves setting realistic long-term targets. Only a few years ago, the packaged food industry as a whole had unrealistic targets for revenue and earnings growth. Our Company was one of the first to recognize that unrealistically high targets were unsustainable and attempting to achieve them, even in the short-term, could lead to disastrous decisions. Consequently, in 2000, we adopted the low single-digit internal revenue growth and high single-digit earnings growth targets that we have used since. Importantly, these are the same targets given to our managers. Our business model can support these growth rates without us having to mortgage future results to achieve short-term targets that are too high.

We believe that consistent, dependable results are far preferable to a couple of years of excellent, but unsustainable growth, followed by a period of dramatic under performance and restructuring charges. We believe that the earnings and cash flow accumulated over time using our strategy will far exceed the results achieved by chasing unreasonable goals.

Staying On Track

In 2004 we introduced Fruit Twistables fruit snacks, a unique product which combines fruit flavors. Fruit Twistables contain real fruit juice and the brand’s introduction was a great success. From the formation of the idea to production, the introduction of a new product is a complicated process. Integral to the introduction of Fruit Twistables were (front row) Steve Richey, Dave Emenhiser, Mary Steele, Becky Thompson, (back row) Rafael Corral, Jim Melluish, and Dace Dixon.
We have done a lot of work over the last four years improving our Company. We have dramatically changed the ways in which we conduct our business. We have changed our strategy, the way in which we measure success, and even our long-term goals. We also changed the way in which we communicate our performance and the way we measure the ongoing health of the business.

We do not believe in taking periodic, large charges and then asking our share owners to disregard the cost. Rather, we believe, these charges are an ongoing cost of business and we absorb them into our performance as they occur. For example, if we close a plant or write-off an asset, it will impact the results of the period during which the event occurs. We have completed many such projects over the past two years. In fact, we absorbed up-front costs associated with cost-reduction projects of $71 million in 2003 and $109 million in 2004.

We target a very high rate of return on the projects and typically expect a less than five-year payback period. These projects are necessary to maintain the ongoing health of the Company and we are already benefiting from the projects that were completed in 2003 and 2004.
• In 2004 we converted to the SAP information system throughout Europe. This was a major undertaking by our Information Technologies group and business unit personnel and it is a testament to their hard work and technical competencies that systems in the entire region were converted on time, with essentially no disruption to the business.

• We completed the relocation of our European headquarters from Manchester to Dublin. This plan was designed to improve the coordination and integration of the pan-European business. A majority of our European staff has elected to move to Dublin and we expect no disruption to operations as a result of the transition.

• We moved our Snacks business from Elmhurst, Illinois, to our headquarters in Battle Creek this year. This move was designed to increase the efficiency of the business through better coordination of activities. For example, coordination between the marketing departments for Special K cereal and Special K bars is now far easier. As with the European move, many of our employees elected to make the move to Battle Creek. Again, we saw very little disruption to the business, as this year’s results demonstrate.

• We closed our Worthington, Ohio, veggie-foods plant and consolidated the production in Zanesville. The capacity rationalization will significantly improve our cost structure and operating efficiency.

The investment that we have made in our business in 2004 has been extensive. We undertook some significant projects designed to improve our efficiency and we invested in brand building and innovation in all of our businesses. These actions were all designed to add to the foundation we built over the past few years.
Values

Our Company has many competitive advantages that have been developed over the years, but our people are by far the most important. We constantly strive to engage, motivate, and develop our employees. Consequently, we have 25,000 business people all focused on the Company’s future. We have a set of values, which encompass the way we run our business and build relationships with our employees.

We Act With Integrity And Show Respect

- Demonstrate a commitment to integrity and ethics
- Show respect for and value all individuals for their diverse backgrounds, experience, styles, approaches, and ideas
- Speak positively and supportively about team members when apart
- Listen to others for understanding
- Assume positive intent

We Are All Accountable

- Accept personal accountability for our own actions and results
- Focus on finding solutions and achieving results, rather than making excuses or placing blame
- Actively engage in discussions and support decisions once they are made
- Involve others in decisions and plans that affect them
- Keep promises and commitments made to others
- Personally commit to the success and well being of teammates
- Improve safety and health for employees and embrace the belief that all injuries are preventable

We Are Passionate About Our Business, Our Brands, And Our Food

- Show pride in our brands and heritage
- Promote a positive, energizing, optimistic, and fun environment
- Serve our customers and delight our consumers through the quality of our products and services
- Promote and implement creative and innovative ideas and solutions
- Aggressively promote and protect our reputation

We Have The Humility And Hunger To Learn

- Display openness and curiosity to learn from anyone, anywhere
- Solicit and provide honest feedback without regard to position
- Personally commit to continuous improvement and be willing to change
- Admit our mistakes and learn from them
- Never underestimate our competition

We Strive For Simplicity

- Stop processes, procedures, and activities that slow us down or do not add value
- Work across organizational boundaries/levels and break down internal barriers
- Deal with people and issues directly and avoid hidden agendas
- Prize results over form

We Love Success

- Achieve results and celebrate when we do
- Help people to be their best by providing coaching and feedback
- Work with others as a team to accomplish results and win
- Have a “can-do” attitude and drive to get the job done
- Make people feel valued and appreciated
- Make the tough calls
RESULTS OF OPERATIONS

Overview

Kellogg Company is the world’s leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, frozen waffles, and meat alternatives. Kellogg products are manufactured and marketed globally. We currently manage our operations based on the geographic regions of North America, Europe, Latin America, and Asia Pacific. This organizational structure is the basis of the operating segment data presented in this report.

In late 2004, our chief executive officer, Carlos Gutierrez, accepted the invitation of the President of the United States to serve as U.S. Secretary of Commerce, subject to Senate confirmation. In early 2005, Carlos assumed his cabinet post and James Jenness was appointed the new CEO of Kellogg Company. David Mackay continues to serve as president of our Company and has been appointed to the Board of Directors.

Despite these leadership changes, we will continue to manage our Company for steady, consistent growth and an attractive dividend yield, which together should provide strong total return for shareholders. We plan to continue to achieve this sustainability through a strategy focused on growing our cereal business, expanding our snacks business, and pursuing selective growth opportunities. We support our business strategy with operating principles that emphasize sales dollars over shipment volume (Volume to Value), as well as cash flow and return on invested capital (Manage for Cash). We believe the success of our strategy and operating principles are reflected in our steady growth in earnings and cash flow over the past several years. This growth has been achieved despite significant challenges such as rising commodity and benefit costs and increased investment in brand building, innovation, and cost-reduction initiatives.

For the fiscal year ended January 1, 2005, the Company reported diluted net earnings per share of $2.14, an 11% increase over fiscal 2003 results. Consolidated net sales and operating profit each grew approximately 9%, with net earnings up 13%. For the year ended December 27, 2003, net earnings per share were $1.92, a 10% increase over fiscal 2002 net earnings per share of $1.75. For 2004, net cash provided from operating activities was $1,229.0 million, a 5% increase over the 2003 amount of $1,171.0 million.

Net sales and operating profit

2004 compared to 2003

The following tables provide an analysis of net sales and operating profit performance for 2004 versus 2003:

<table>
<thead>
<tr>
<th>(dollars in millions)</th>
<th>North America</th>
<th>Europe</th>
<th>Latin America</th>
<th>Asia Pacific (a)</th>
<th>Corporate dated</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004 net sales</td>
<td>$6,369.3</td>
<td>$2,007.3</td>
<td>$718.0</td>
<td>$519.3</td>
<td>$—</td>
<td>$9,612.9</td>
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<tr>
<td>2003 net sales</td>
<td>$5,954.3</td>
<td>$1,734.2</td>
<td>$666.7</td>
<td>$456.3</td>
<td>$—</td>
<td>$8,811.5</td>
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<tr>
<td>% change - 2004 vs. 2003:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volume (tonnage) (b)</td>
<td>2.4%</td>
<td>-1.1%</td>
<td>6.1%</td>
<td>-4%</td>
<td>2.1%</td>
<td></td>
</tr>
<tr>
<td>Pricing/mix</td>
<td>2.6%</td>
<td>3.7%</td>
<td>-5.0%</td>
<td>2.7%</td>
<td>2.9%</td>
<td></td>
</tr>
<tr>
<td>Subtotal - internal business</td>
<td>5.0%</td>
<td>3.0%</td>
<td>11.1%</td>
<td>2.3%</td>
<td>5.0%</td>
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</tr>
<tr>
<td>Shipping day differences (c)</td>
<td>1.5%</td>
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<td>1.2%</td>
<td>1.3%</td>
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</tr>
<tr>
<td>Foreign currency impact</td>
<td>5%</td>
<td>11.1%</td>
<td>-3.4%</td>
<td>10.3%</td>
<td>-2.8%</td>
<td></td>
</tr>
<tr>
<td>Total change</td>
<td>7.0%</td>
<td>13.7%</td>
<td>13.8%</td>
<td>-</td>
<td>9.1%</td>
<td></td>
</tr>
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</table>

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<tbody>
<tr>
<td>2004 operating profit</td>
<td>$1,240.4</td>
<td>$292.3</td>
<td>$105.4</td>
<td>$79.5</td>
<td>($116.5)</td>
<td>$1,681.1</td>
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<td>2003 operating profit</td>
<td>$1,134.2</td>
<td>$279.8</td>
<td>$168.9</td>
<td>$66.1</td>
<td>($99.9)</td>
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<td>% change - 2004 vs. 2003:</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal business</td>
<td>6.5%</td>
<td>-7.4%</td>
<td>14.1%</td>
<td>13.8%</td>
<td>-16.1%</td>
<td>4.5%</td>
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<tr>
<td>Shipping day differences (c)</td>
<td>2.4%</td>
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<td>2.8%</td>
<td>-5%</td>
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<td>5%</td>
<td>10.8%</td>
<td>-4.3%</td>
<td>13.4%</td>
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<tr>
<td>Total change</td>
<td>9.4%</td>
<td>4.5%</td>
<td>9.8%</td>
<td>30.0%</td>
<td>-16.6%</td>
<td>8.9%</td>
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</table>

(a) Includes Australia and Asia.
(b) We measure the volume impact (tonnage) on revenues based on the stated weight of our product shipments.
(c) Impact of 53rd week in 2004. Refer to Note 1 within Notes to Consolidated Financial Statements for further information.

During 2004, consolidated net sales increased approximately 9 percent. Internal net sales (which excludes the impact of currency and, if applicable, acquisitions, dispositions, and shipping day differences) grew 5%, which was on top of approximately 4% growth in the prior year. During 2004, successful innovation and brand-building investment continued to drive growth in most of our businesses.

North America reported net sales growth of approximately 7%, with internal growth across all major product groups. Internal net sales of our North America retail cereal business increased approximately 2%, with successful innovation and consumer promotion activities supporting sales growth and category share gains in both the United States and Canada. Internal net sales of our North America retail snacks business increased 8%, with the wholesome snacks, crackers, and toaster pastries components of our snacks portfolio all contributing to that growth. While our cookie sales were essentially unchanged from the prior year, we were pleased with this performance, in light of a category decline in measured channels of approximately 4%. We believe the recovery of our snacks business this year was due primarily to successful product and packaging innovation, combined with effective execution in our direct store-door (DSD) delivery system. Internal net sales of our North America frozen and specialty channel (which includes food service, vending, convenience, drug stores, and custom manufacturing) businesses collectively increased approximately 4 percent.
Net sales in our European operating segment increased approximately 16%, with internal sales growth of nearly 4%. Both our U.K. business unit and pan-European cereal business achieved internal net sales growth for the year of approximately 2%. Sales of our snack products within the region grew at a strong double-digit rate.

Strong performance in Latin America resulted in net sales growth of approximately 8%, with internal net sales growth of 11% more than offsetting unfavorable foreign currency movements. Most of this growth was due to very strong price/mix and tonnage improvements in both cereal and snack sales by our Mexican business unit.

Net sales in our Asia Pacific operating segment increased approximately 14% due primarily to favorable foreign currency movements, with internal net sales growth at 2%. Strong internal net sales performance in Australia was partially offset by a sales decline in Asia, due primarily to the effect of negative publicity regarding sugar-containing products in Korea throughout most of the year.

Consolidated operating profit increased approximately 9% during 2004, with internal growth of more than 4%. This internal growth was achieved despite increased brand-building expenditures and significantly higher commodity costs. Furthermore, corporate operating profit for 2004 includes a charge of $9.5 million related to CEO transition expenses. Lastly, as discussed in the "Cost-reduction initiatives" section beginning on page 25, we absorbed in operating profit significant up-front costs in both 2003 and 2004, with 2004 charges exceeding 2003 charges by approximately $38 million.

The CEO transition expenses arise from the aforementioned departure of Carlos Gutierrez related to his appointment as U.S. Secretary of Commerce. The total charge (net of forfeitures) of $9.5 million is comprised principally of $3.7 million for special pension termination benefits and $5.5 million for accelerated vesting of 606,250 stock options.

Operating profit for each of fiscal 2003 and 2004 includes intangibles impairment losses of approximately $10 million. The 2003 loss was to reduce the carrying value of a contract-based intangible asset and was included in North American operating profit. The 2004 loss was comprised of $7.9 million to write off the remaining value of this same contract-based intangible asset in North America and $2.5 million to write off goodwill in Latin America.

2003 compared to 2002
The following tables provide an analysis of net sales and operating profit performance for 2003 versus 2002. These results have been restated to conform to the 2004 operating segment presentation as follows: 1) 2003 and 2002 Canadian results were combined into North America, 2) certain 2003 and 2002 U.S. export operations were moved from U.S. to Latin America, and 3) certain 2003 SGA expenditures were reallocated between Corporate and North America.

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<td>$456.3</td>
<td></td>
<td>$8,213.5</td>
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<td>2002 net sales</td>
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<td>$385.3</td>
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<td>$8,304.1</td>
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<td>% change - 2003 vs. 2002:</td>
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<td></td>
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<tr>
<td>Volume (tonnage) (b)</td>
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<td>-6%</td>
<td>71%</td>
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<td>-3.8%</td>
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<tr>
<td>Dispositions (c)</td>
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<td>Total change</td>
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<th>North America</th>
<th>Europe</th>
<th>Latin America</th>
<th>Asia Pacific (a)</th>
<th>Corporate</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003 operating profit</td>
<td>$1,134.2</td>
<td>$279.8</td>
<td>$168.9</td>
<td>$61.1</td>
<td>($99.9)</td>
<td>$1,544.1</td>
</tr>
<tr>
<td>2002 operating profit</td>
<td>$1,138.0</td>
<td>$252.5</td>
<td>$170.6</td>
<td>$38.5</td>
<td>($91.5)</td>
<td>$1,508.1</td>
</tr>
<tr>
<td>% change - 2003 vs. 2002:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal business</td>
<td>-3%</td>
<td>-2.1%</td>
<td>12.2%</td>
<td>38.1%</td>
<td>-9.2%</td>
<td>11%</td>
</tr>
<tr>
<td>Dispositions (c)</td>
<td>-8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-6%</td>
</tr>
<tr>
<td>Foreign currency impact</td>
<td>8%</td>
<td>12.9%</td>
<td>-12.2%</td>
<td>20.7%</td>
<td></td>
<td>1.9%</td>
</tr>
<tr>
<td>Total change</td>
<td>-3%</td>
<td>10.8%</td>
<td>-10.0%</td>
<td>58.8%</td>
<td>-9.2%</td>
<td>2.4%</td>
</tr>
</tbody>
</table>

(a) Includes Australia and Asia.
(b) We measure the volume impact (tonnage) on revenues based on the stated weight of our product shipments.
(c) Impact of results for the comparable 2002 period prior to divestiture of various U.S. private label operations.

During 2003, we achieved consolidated internal net sales growth of nearly 4%, against a similar year-ago growth rate. North American net sales in the retail cereal channel increased approximately 6%, as the combination of brand-building activities and innovation drove higher tonnage and improved mix. A modest U.S. cereal price increase taken early in 2003 also contributed to the sales increase. Internal net sales of our North American snacks business were approximately even with the prior year. The 2003 sales performance of our North American snacks business was negatively impacted by our strategic decisions to discontinue a low-margin contract manufacturing relationship in May 2003 and to accelerate stock-keeping unit (SKU) rationalization, beginning in the second quarter of 2003. In addition to these strategic factors, our North American snacks business experienced a decline in cookie sales, which we believe was a result of aggressive price promotion by competitors, a relative lack of innovation and brand-building activities, and current trends in consumer preferences. Internal net sales of our North American frozen and specialty channel businesses collectively increased approximately 3 percent.

Total international net sales increased over 5% in local currencies, with growth in all geographic segments. Our European operating segment exhibited strong sales and category share performance throughout 2003, benefiting from increased brand-building investment and innovation activities across the region. Internal net sales growth in Latin America was driven by a strong performance by our Mexican business unit in both cereal and snacks. Our Asia Pacific operating segment delivered solid internal net sales growth, as significant pricing and mix improvements offset the tonnage impact of discontinuing product lines in Australia and Asia in late 2002.
Consolidated internal operating profit increased only 1% during 2003, as significant charges related to cost-reduction initiatives (refer to discussion below) partially offset solid underlying business growth. North America internal operating profit declined slightly, absorbing the majority of the charges, as well as higher commodity, energy, and employee benefit costs, and a $10 million intangibles impairment charge. International operating profit increased over 6% on a local currency basis. Brand-building expenditures increased significantly in all core markets, reaching a double-digit growth rate on a consolidated basis.

For 2002, the Company recorded in cost of goods sold an impairment loss of $5 million related to the Company's manufacturing facility in China, representing a decline in real estate market value subsequent to an original impairment loss recognized for this property in 1997. The Company completed a sale of this facility in late 2003, and the carrying value of the property approximated the net sales proceeds.

### Margin performance

Margin performance is presented in the following table.

<table>
<thead>
<tr>
<th></th>
<th>Change vs. prior year (pts.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross margin</td>
<td>44.9</td>
</tr>
<tr>
<td>SGA% (a)</td>
<td>-27.4%</td>
</tr>
<tr>
<td>Operating margin</td>
<td>17.5%</td>
</tr>
</tbody>
</table>

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

For 2004, our consolidated gross margin increased 50 basis points over the prior-year results. Our strong sales growth continued to produce significant operating leverage. This factor, combined with mix improvements and productivity savings, offset the unfavorable impact of higher commodity costs, as well as charges associated with our cost-reduction initiatives (refer to discussion below). The 2003 gross margin reflects similar dynamics, except that unfavorable cost pressures (commodities, energy, employee benefits) more than offset the favorable factors such as operating leverage and mix, resulting in a 60 basis point decline versus 2002. Our investment in package-related promotions and cost-reduction initiatives also dampened gross margin performance.

The SGA% remained fairly steady from 2002 to 2004, as significant increases in brand-building and innovation expenditures over this time period were offset by overhead savings.

For 2005, we expect continuing modest improvement in our gross margin, with reinvestment in brand building and innovation, so as to maintain a relatively steady operating margin.

### Cost-reduction initiatives

We view our continued spending on cost-reduction initiatives as part of our ongoing financial strategy to reinvest earnings so as to provide greater reliability in meeting long-term growth targets. Initiatives undertaken must meet certain pay-back and internal rate of return (IRR) targets. We currently require each project to recover total cash implementation costs within a five-year period or to achieve an IRR of at least 20 percent. Each cost-reduction initiative is of relatively short duration (normally one year or less), and begins to deliver cash savings and/or reduced depreciation during the first year of implementation, which is then used to fund new initiatives. To implement these programs, the Company has incurred various up-front costs, including asset write-offs, exit charges, and other project expenditures, which we include in our measure and discussion of operating segment profitability within the “Net sales and operating profit” section beginning on page 23.

Major initiatives commenced in 2004 were the global rollout of the SAP information technology system, reorganization of pan-European operations, consolidation of U.S. meat alternatives manufacturing operations, and relocation of our U.S. snacks business unit to Battle Creek, Michigan. Major actions implemented in 2003 included a wholesome snack plant consolidation in Australia, manufacturing capacity rationalization in the Mercosur region of Latin America, and a plant workforce reduction in Great Britain. Additionally, during all periods presented, we have undertaken various manufacturing capacity rationalization and efficiency initiatives primarily in our North American and European operating segments, as well as the 2003 disposal of a manufacturing facility in China. Future initiatives are still in the planning stages and individual actions are being announced as plans are finalized. The cost-saving initiatives that we are planning could potentially result in a yet-undetermined amount of asset write-offs and other costs during 2005.

For 2004, total program-related charges were approximately $109 million, comprised of $41 million in asset write-offs, $1 million for special pension termination benefits, $15 million in severance and other exit costs, and $52 million in other cash expenditures such as relocation and consulting. Approximately 40% of the 2004 charges were recorded in cost of goods sold, with the balance recorded in selling, general, and administrative (SGA) expense. The 2004 charges impacted our operating segments as follows (in millions): North America-$44, Europe-$65.

For 2003, total program-related charges were approximately $71 million, comprised of $40 million in asset write-offs, $8 million for special pension termination benefits, and $23 million in severance and other cash exit costs. These charges were recorded principally in cost of goods sold and impacted our operating segments as follows (in millions): North America-$36, Europe-$21, Latin America-$8, Asia Pacific-$6.

At year-end 2003, the exit cost reserve balance totaled approximately $19 million. These reserves were principally comprised of severance obligations recorded in 2003, which were paid out during the first half of 2004. At year-end 2004, the exit cost reserve balance totaled approximately $11 million, representing severance costs to be paid out in 2005.
2004 initiatives

During 2004, our global rollout of the SAP information technology system resulted in accelerated depreciation of legacy software assets to be abandoned in 2005, as well as related consulting and other implementation expenses. Total incremental costs for 2004 were approximately $30 million. In close association with this SAP rollout, we undertook a major initiative to improve the organizational design and effectiveness of pan-European operations. Specific benefits of this initiative are expected to include improved marketing and promotional coordination across Europe, supply chain network savings, overhead cost reductions, and tax savings. To achieve these benefits, we implemented, at the beginning of 2005, a new European legal and operating structure headquartered in Ireland, with strengthened pan-European management authority and coordination. During 2004, we incurred various up-front costs, including relocation, severance, and consulting, of approximately $30 million. Additional relocation and other costs to complete this business transformation during the next several years are expected to be insignificant.

To improve operations and provide for future growth, during 2004, we substantially completed our plan to close a meat alternatives manufacturing facility in Worthington, Ohio. The plan included the out-sourcing of certain operations and consolidation of remaining production at the Zanesville, Ohio facility by early 2005. The Worthington facility originally employed approximately 300 employees, of which approximately 250 have separated from the Company as a result of the plant closure. Total asset write-offs, severance, and other up-front costs of the project are expected to be approximately $30 million, of which approximately $20 million was recognized during 2004. Management expects to complete a sale of the Worthington facility in 2005.

In order to integrate it with the rest of our U.S. operations, during 2004, we completed the relocation of our U.S. snacks business unit from Elmhurst, Illinois (the former headquarters of Keebler Foods Company) to Battle Creek, Michigan. About one-third of the approximately 300 employees affected by this initiative accepted relocation/reassignment offers. The recruiting effort to fill the remaining open positions was substantially completed by year-end 2004. Attributable to this initiative, we incurred approximately $15 million in relocation, recruiting, and severance costs during 2004. Subject to achieving certain employment levels and other regulatory requirements, we expect to defray a significant portion of these up-front costs through various multi-year tax incentives, beginning in 2005. The Elmhurst office building was sold in late 2004, and the net sales proceeds approximated carrying value.

We also undertook a manufacturing capacity rationalization in the Mercosur region of Latin America, which involved the closure of an owned facility in Argentina and separation of approximately 85 plant and administrative employees during 2003. We recorded an impairment loss of approximately $6 million to reduce the carrying value of the manufacturing facility to estimated fair value, and incurred approximately $2 million of severance and closure costs during 2003 to complete this initiative. In 2004, we began importing our products for sale in Argentina from other Latin America facilities.

In Great Britain, we initiated changes in plant crewing to better match the work pattern to the demand cycle, which resulted in voluntary workforce reductions of approximately 130 hourly and salaried employee positions. During 2003, we incurred approximately $18 million in separation benefit costs related to this initiative.

Interest expense

Since the acquisition of Keebler Foods Company in early 2001, our Company has paid down nearly $2.0 billion of debt, even early-retiring debt in each of December 2003 and 2004. Early-retirement premiums, which primarily represent accelerated interest, are recorded in interest expense and were $4.3 million in 2004 and $16.5 million in 2003. After peaking in 2002, annual interest expense has declined steadily for the past two years, due primarily to continuing pay-down of our debt balances and lower interest rates on refinancings.

<table>
<thead>
<tr>
<th>(dollars in millions)</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
<th>Change vs. prior year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported interest expense</td>
<td>$308.6</td>
<td>$371.4</td>
<td>$391.2</td>
<td>$308.6 - $371.4 = -5.3%</td>
</tr>
<tr>
<td>Amounts capitalized</td>
<td>.9</td>
<td>.9</td>
<td>1.0</td>
<td>.9 - 1.0 = -16.7%</td>
</tr>
<tr>
<td>Gross interest expense</td>
<td>$309.5</td>
<td>$371.4</td>
<td>$392.2</td>
<td>$309.5 - $371.4 = -5.3%</td>
</tr>
</tbody>
</table>

We currently expect total-year 2005 interest expense to be slightly less than $300 million, representing a decline of 3-4% from the 2004 level. While we expect net debt reduction in 2005 to be consistent with the 2004 reduction of nearly $300 million, our interest expense projection takes into account a forecasted increase in short-term interest rates and minimal benefit from refinancing of higher-coupon long-term debt.

Other income (expense), net

Other income (expense), net includes non-operating items such as interest income, foreign exchange gains and losses, charitable donations, and gains on asset sales. Other income (expense), net for 2004 includes charges of approximately $9 million for contributions to the Kellogg’s Corporate Citizenship Fund, a private trust established for charitable giving. Other income (expense), net for 2003 includes credits of approximately $17 million related to favorable legal settlements, a charge of $8 million for a contribution to the Kellogg’s Corporate Citizenship Fund, and a charge of $6.5 million to recognize the impairment of a cost-basis investment in an e-commerce business venture. Other income (expense), net for 2002 consists primarily of $24.7 million in credits related to legal settlements.

2003 initiatives

During 2003, we implemented a wholesome snack plant consolidation in Australia, which involved the exit of a leased facility and separation of approximately 140 employees. We incurred approximately $6 million in exit costs and asset write-offs during 2003 related to this initiative.
Income taxes

Our consolidated effective income tax rate has benefited from tax planning initiatives over the past several years, declining from 37% in 2002 to slightly less than 35% in 2004. The 2003 rate was even lower at less than 33%, as it included over 200 basis points of discrete benefits, such as favorable audit closures and revaluation of deferred state tax liabilities. The resulting tax savings have been reinvested, in part, in cost-reduction initiatives, brand-building expenditures, and other growth initiatives.

On October 22, 2004, the American Jobs Creation Act (“AJCA”) became law. The AJCA creates a temporary incentive for U.S. multinationals to repatriate foreign earnings by providing an 85 percent dividend received deduction for qualified dividends. Our Company may elect to claim this deduction for qualified dividends received in either our fiscal 2004 or 2005 years, and we currently plan to elect this deduction for 2005. We cannot fully evaluate the effects of this repatriation provision until the Treasury Department issues clarifying regulations. Furthermore, pending technical corrections legislation is needed to clarify that the dividend received deduction applies to both the cash and “section 78 gross-up” portions of qualifying dividend repatriations. While we believe the technical corrections legislation will pass in 2005, we have currently developed our repatriation plan based on the less favorable AJCA provisions in force as of year-end 2004. Under these assumptions, we currently intend to repatriate during 2005 approximately $70 million of foreign earnings under the AJCA and an additional $550 million of foreign earnings under regular rules. Prior to 2004, it was our intention to indefinitely reinvest substantially all of our undistributed foreign earnings. Accordingly, no deferred tax liability had been recorded in connection with the future repatriation of these earnings. Now that repatriation is foreseeable for up to $620 million of these earnings, we provided approximately $29 million. Should the technical corrections legislation pass during 2005, we currently believe that we would most likely repatriate a higher amount of earnings up to $1.1 billion under AJCA for a similar amount of net tax cost.

The AJCA also provides an ongoing deduction from taxable income equal to a stipulated percentage of qualified production income (“QPI”). The percentage deduction is phased in over five years, beginning in our 2005 fiscal year. While the Treasury Department has not issued detailed regulations on what constitutes QPI, we believe that this provision will result in a moderate reduction in our consolidated effective income tax rate, beginning in 2005. In combination with tax benefits expected from the reorganization of our European operations (refer to page 26 within the “Cost-reduction initiatives” section for additional information on this initiative), we expect our 2005 consolidated effective income tax rate to decline to approximately 33 percent.

LIQUIDITY AND CAPITAL RESOURCES

Our principal source of liquidity is operating cash flows, supplemented by borrowings for major acquisitions and other significant transactions. This cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating and investing needs. The principal source of our operating cash flow is net earnings, meaning cash receipts from the sale of our products, net of costs to manufacture and market our products. Our cash conversion cycle is relatively short; although receivable collection patterns vary around the world, in the United States, our days sales outstanding (DSO) averages 18-19 days. As a result, the growth in our operating cash flow should generally reflect the growth in our net earnings over time. As presented in the schedule below, operating cash flow performance over the 2002 to 2004 time frame generally reflects this principle, except for the level of benefit plan contributions and working capital movements (operating assets and liabilities).

<table>
<thead>
<tr>
<th>Operating activities</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating activities</td>
<td>$890.6</td>
<td>$787.1</td>
<td>$720.9</td>
</tr>
<tr>
<td>Net earnings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>depreciation and amortization</td>
<td>410.0</td>
<td>372.8</td>
<td>349.9</td>
</tr>
<tr>
<td>deferred income taxes</td>
<td>57.7</td>
<td>74.8</td>
<td>111.2</td>
</tr>
<tr>
<td>other</td>
<td>104.5</td>
<td>76.1</td>
<td>67.0</td>
</tr>
<tr>
<td>net earnings after non-cash items</td>
<td>1,462.8</td>
<td>1,336.8</td>
<td>1,291.0</td>
</tr>
<tr>
<td>pension and other postretirement benefit plan contributions</td>
<td>(204.0)</td>
<td>(184.2)</td>
<td>(446.6)</td>
</tr>
<tr>
<td>changes in operating assets and liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>core working capital (a)</td>
<td>46.0</td>
<td>1.3</td>
<td>29.5</td>
</tr>
<tr>
<td>other working capital</td>
<td>75.8</td>
<td>44.5</td>
<td>168.0</td>
</tr>
<tr>
<td>total</td>
<td>129.8</td>
<td>44.4</td>
<td>197.5</td>
</tr>
<tr>
<td>net cash provided by operating activities</td>
<td>$1,229.0</td>
<td>$1,171.0</td>
<td>$999.9</td>
</tr>
<tr>
<td>year-over-year change</td>
<td>5.0%</td>
<td>17.1%</td>
<td></td>
</tr>
</tbody>
</table>

(a) inventory and trade receivables less trade payables

The varying level of benefit plan contributions from year to year primarily reflects our decision to voluntarily fund several of our major pension and retiree health care plans, as influenced by tax strategies and market factors. Total minimum benefit plan contributions for 2005 are expected to be approximately $89 million. Actual contributions could exceed this amount, as influenced by our decision to voluntarily pre-fund our obligations during 2005 versus other competing investment priorities.

With respect to movements in operating assets and liabilities, since 2001, our Company has been successful in steadily reducing the level of core working capital (inventory and trade receivables less trade payables) as a percentage of net sales. This effort has involved logistics improvements to reduce inventory on hand while continuing to meet customer requirements, faster collection of accounts receivable, and extension of terms on trade payables. For the year ended January 1, 2005, average core working capital as a percentage of sales was 7.3%, compared to 8.2% for 2003 and 8.8% for 2002. This continual reduction contributed positively to cash flow in 2002.
and 2004, and had a neutral effect in 2003. For 2005, we expect additional modest improvements in our core working capital position. The unfavorable movements in other working capital for 2004, as presented in the table on page 27, relate largely to higher income tax payments and faster payment of customer promotional incentives, as compared to prior years. This unfavorable trend resulted in operating cash flow growth for 2004 trailing the growth in net earnings.

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

<table>
<thead>
<tr>
<th>(dollars in millions)</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
<th>Change vs. prior year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash provided by operating activities</td>
<td>$1227.0</td>
<td>$1,171.0</td>
<td>$998.9</td>
<td>5.0%</td>
</tr>
<tr>
<td>Additions to properties</td>
<td>(278.6)</td>
<td>(242.2)</td>
<td>(251.5)</td>
<td></td>
</tr>
<tr>
<td>Cash flow</td>
<td>$948.4</td>
<td>$928.8</td>
<td>$746.4</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

Our 2004 cash flow increased approximately 3% versus the prior year. Expenditures for property additions represented 2.9% of 2004 net sales, compared with 2.8% in 2003 and 3.1% in 2002. For 2005, expenditures for property additions are currently expected to remain at approximately 3% of net sales and cash flow (as defined) is expected to exceed the amount of net earnings.

Our Board of Directors authorized management to repurchase up to $300 million of Kellogg common stock during 2004, up to $250 million in 2003, and up to $150 million in 2002. Under these authorizations, we paid $298 million during 2004 for approximately 7.3 million shares, approximately $90 million during 2003 for approximately 2.9 million shares, and $101 million during 2002 for approximately 3.1 million shares. We funded this repurchase program principally by proceeds from employee stock option exercises. For 2005, our Board of Directors has authorized stock repurchases for general corporate purposes and to offset issuances for employee benefit programs of up to $400 million.

Since the acquisition of Keebler Foods Company in early 2001, our Company has paid down nearly $2.0 billion of debt, reducing our total debt balance from approximately $6.8 billion at March 2001 to $4.9 billion at year-end 2004. Some of the long-term debt has been redeemed prior to its maturity date. In September 2002, we redeemed $300.7 million of Notes due 2003, and in December 2003, we redeemed $172.9 million of Notes due 2006. In December 2004, we redeemed $103.7 million of Notes due 2006. In January 2004, we repaid $500 million of maturing seven-year Notes, replacing these Notes with short-term debt. During 2005, we intend to reduce our debt balances by approximately $300 million.

Citing lower debt levels and strong operating performance, both Standard & Poor's (S&P) and Moody's Investor Services have raised their credit ratings on our Company's senior unsecured long-term debt. In August 2004, S&P upgraded its rating from BBB to BBB+, and in October 2004, Moody's upgraded from Baa2 to Baa1. Within these organizations' systems, these credit ratings generally indicate medium-grade obligations, currently exhibiting adequate protection parameters. Our investors should be aware that a security rating is not a recommendation to buy, sell, or hold securities; that it may be subject to revision or withdrawal at any time by the assigning rating organization; and that each rating should be evaluated independently of any other rating.

In November 2004, we entered into an unsecured Five-Year Credit Agreement with 23 lenders to borrow, on a revolving credit basis, up to $2.0 billion, to obtain letters of credit in an aggregate amount up to $75 million, and to provide a procedure for the lenders to bid on short-term debt of our Company. This Credit Agreement replaces a $1.15 billion five-year agreement expiring in January 2006 and a $650 million 364-day agreement expiring in January 2005. The new Credit Agreement contains customary covenants and warranties, including specified restrictions on indebtedness, liens, sale and leaseback transactions, and a specified interest expense coverage ratio. If an event of default occurs, then, to the extent permitted, the administrative agent may terminate the commitments under the new credit facility, accelerate any outstanding loans, and demand the deposit of cash collateral equal to the lender's letter of credit exposure plus interest. As of year-end 2004, there were no borrowings outstanding under this facility and we currently believe it is remote that our Company would violate any of the stated covenants and warranties.

We believe that we will be able to meet our interest and principal repayment obligations and maintain our debt covenants for the foreseeable future, while still meeting our operational needs, including the pursuit of selective growth opportunities, through our strong cash flow, our program of issuing short-term debt, and maintaining credit facilities on a global basis. Our significant long-term debt issues do not contain acceleration of maturity clauses that are dependent on credit ratings. A change in the Company's credit ratings could limit its access to the U.S. short-term debt market and/or increase the cost of refinancing long-term debt in the future. However, even under these circumstances, we would continue to have access to our credit facilities, which are in amounts sufficient to cover the outstanding short-term debt balance and debt principal repayments through 2006.

**MARKET RISKS**

Our Company is exposed to certain market risks, which exist as a part of our ongoing business operations and we use derivative financial and commodity instruments, where appropriate, to manage these risks. Our Company, as a matter of policy, does not engage in trading or speculative transactions. Refer to Note 12 within Notes to Consolidated Financial Statements for further information on accounting policies related to derivative financial and commodity instruments.
**Foreign exchange risk**

Our Company is exposed to fluctuations in foreign currency cash flows related to third-party purchases, intercompany loans and product shipments, and nonfunctional currency denominated third-party debt. Our Company is also exposed to fluctuations in the value of foreign currency investments in subsidiaries and cash flows related to repatriation of these investments. Additionally, our Company is exposed to volatility in the translation of foreign currency earnings to U.S. Dollars. Primary exposures include the U.S. Dollar versus the British Pound, Euro, Australian Dollar, Canadian Dollar, and Mexican Peso, and in the case of inter-subsidiary transactions, the British Pound versus the Euro. We assess foreign currency risk based on transactional cash flows and translational positions and enter into forward contracts, options, and currency swaps to reduce fluctuations in net long or short currency positions. Forward contracts and options are generally less than 18 months duration. Currency swap agreements are established in conjunction with the term of underlying debt issuances.

The total notional amount of foreign currency derivative instruments at year-end 2004 was $375.5 million, representing a settlement obligation of $60.3 million. The total notional amount of foreign currency derivative instruments at year-end 2003 was $749.2 million, representing a settlement obligation of $67.8 million. All of these derivatives were hedges of anticipated transactions, translational exposure, or existing assets or liabilities, and mature within 18 months, except for one currency swap transaction outstanding at year-end 2004 that matures in 2006. Assuming an unfavorable 10% change in year-end exchange rates, the settlement obligation would have increased by approximately $37.5 million at year-end 2004 and $74.9 million at year-end 2003. These unfavorable changes would generally have been offset by favorable changes in the values of the underlying exposures.

**Interest rate risk**

Our Company is exposed to interest rate volatility with regard to future issuances of fixed rate debt and existing and future issuances of variable rate debt. Primary exposures include movements in U.S. Treasury rates, London Interbank Offered Rates (LIBOR), and commercial paper rates. We currently use interest rate swaps and forward interest rate contracts to reduce interest rate volatility and funding costs associated with certain debt issues, and to achieve a desired proportion of variable versus fixed rate debt, based on current and projected market conditions.

Note 7 within Notes to Consolidated Financial Statements provides information on our Company’s significant debt issues. There were no interest rate derivatives outstanding at year-end 2004. The total notional amount of interest rate derivative instruments at year-end 2003 was $1.91 billion, representing a settlement obligation of $2.1 million. Assuming average variable rate debt levels and issuances of fixed rate debt during the year, a one percentage point increase in interest rates would have increased interest expense by approximately $2.3 million in 2004 and $3.8 million in 2003.

**Price risk**

Our Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials and energy. Primary exposures include corn, wheat, soybean oil, sugar, cocoa, paperboard, natural gas, and diesel fuel. We use the combination of long cash positions with suppliers, and exchange-traded futures and option contracts to reduce price fluctuations in a desired percentage of forecasted purchases over a duration of generally less than one year. The total notional amount of commodity derivative instruments at year-end 2004 was $61.3 million, representing a settlement obligation of $4.8 million. Assuming a 10% decrease in year-end commodity prices, this settlement obligation would have increased by approximately $5.6 million, generally offset by a reduction in the cost of the underlying material purchases. The total notional amount of commodity derivative instruments at year-end 2003 was $26.5 million, representing a settlement receivable of $.2 million. Assuming a 10% decrease in year-end commodity prices, this settlement receivable would have converted to a settlement obligation of approximately $2.7 million, generally offset by a reduction in the cost of the underlying material purchases.

In addition to the derivative commodity instruments discussed above, we use long cash positions with suppliers to manage a portion of our price exposure. It should be noted that the exclusion of these positions from the analysis above could be a limitation in assessing the net market risk of our Company.

**OFF-BALANCE SHEET ARRANGEMENTS AND OTHER OBLIGATIONS**

**Off-balance sheet arrangements**

Our off-balance sheet arrangements are generally limited to residual value guarantees and secondary liabilities on operating leases of approximately $14 million and guarantees on loans to independent contractors for their purchase of DSD route franchises up to $17 million. We record the estimated fair value of these loan guarantees on our balance sheet, which we currently estimate to be insignificant. Refer to Note 6 within Notes to Consolidated Financial Statements for further information.

**Contractual obligations**

The following table summarizes future estimated cash payments to be made under existing contractual obligations. Further information on debt obligations is contained in Note 7 of Notes to Consolidated Financial Statements. Further information on lease obligations is contained in Note 6.
Our significant accounting policies, as well as recently adopted and issued pronouncements, are discussed in Note 1 of Notes to Consolidated Financial Statements. None of the pronouncements adopted in fiscal 2003 or 2004 have had or are expected to have a significant impact on our Company's financial statements.

In 2005, we expect to adopt SFAS No. 123(Revised) "Share-Based Payment," which generally requires public companies to recognize the fair value of equity-based awards to employees as compensation expense within reported results. Because we have historically used the intrinsic value method to account for employee stock options, we have generally not recognized expense for these types of awards. Once this standard is adopted, we currently expect full-year 2005 net earnings per share to be reduced by approximately $0.08. Application of this pronouncement requires significant judgment regarding the inputs to an option pricing model, including stock price volatility and employee exercise behavior. Most of these inputs are either highly dependent on the current economic environment at the date of grant or forward-looking over the expected term of the award. As a result, the actual impact of adoption on 2005 and future years' earnings could differ significantly from our current estimate. We are presently considering one of the modified retrospective methods of transition, which would be first effective for our 2005 fiscal third quarter, with retrospective restatement to the beginning of 2005.

Our critical accounting estimates, which require significant judgments and assumptions likely to have a material impact on our financial statements, are currently limited to those governing the amount and timing of recognition of consumer promotional expenditures, the assessment of the carrying value of goodwill and other intangible assets, valuation of our pension and other postretirement benefit obligations, and determination of our income tax expense and liabilities.

**SIGNIFICANT ACCOUNTING ESTIMATES**

Promotional expenditures

Our promotional activities are conducted either through the retail trade or directly with consumers and involve in-store displays; feature price discounts on our products; consumer coupons, contests, and loyalty programs; and similar activities. The costs of these activities are generally recognized at the time the related revenue is recorded, which normally precedes the actual cash expenditure. The recognition of these costs therefore requires management judgment regarding the volume of promotional offers that will be redeemed by either the retail trade or consumer. These estimates are made using various techniques including historical data on performance of similar promotional programs. Differences between estimated expense and actual redemptions are normally insignificant and recognized as a change in management estimate in a subsequent period. On a full-year basis, these subsequent period adjustments have rarely represented in excess of 3% (.003) of our Company's net sales. However, as our Company's total promotional expenditure represented over 35% of 2004 net sales, the likelihood exists of materially different reported results if different assumptions or conditions were to prevail.

**Intangibles**

We follow SFAS No. 142 "Goodwill and Other Intangible Assets" in evaluating impairment of intangibles. Under this standard, goodwill impairment testing first requires a comparison between the carrying value and fair value of a reporting unit with associated goodwill. Carrying value is based on the assets and liabilities associated with the operations of that reporting unit, which often requires allocation of shared or corporate items among reporting units. The fair value of a reporting unit is based primarily on our assessment of profitability multiples likely to be achieved in a theoretical sale transaction. Similarly, impairment testing of other intangible assets requires a comparison of carrying value to fair value of that particular asset. Fair values of non-goodwill intangible assets are based primarily on projections of future cash flows to be generated from that asset. For instance, cash flows related to a particular trademark would be based on a projected royalty stream attributable to branded product sales. These estimates are made using various inputs including historical data, current and anticipated market conditions, management plans, and market comparables. We periodically engage third party valuation consultants to assist in this process. At January 1, 2005, intangible assets, net, were $5.1 billion, consisting primarily of goodwill, trademarks, and DSD delivery system associated with the Keebler acquisition. While we currently believe that the fair value of all of our intangibles exceeds carrying value, materially different assumptions regarding future performance of our North American snacks business or the weighted average cost of capital used in the valuations could result in significant impairment losses.
Retirement benefits

Our Company sponsors a number of U.S. and foreign defined benefit employee pension plans and also provides retiree health care and other welfare benefits in the United States and Canada. Plan funding strategies are influenced by tax regulations. A substantial majority of plan assets are invested in a globally diversified portfolio of equity securities with smaller holdings of bonds, real estate, and other investments. We follow SFAS No. 87 "Employers’ Accounting for Pensions" and SFAS No. 106 "Employers’ Accounting for Postretirement Benefits Other Than Pensions" for the measurement and recognition of obligations and expense related to our retiree benefit plans. Embodied in both of these standards is the concept that the cost of benefits provided during retirement should be recognized over the employees’ active working life. Inherent in this concept, therefore, is the requirement to use various actuarial assumptions to predict and measure costs and obligations many years prior to the settlement date. Major actuarial assumptions that require significant management judgment and have a material impact on the measurement of our consolidated benefits expense and accumulated obligation include the long-term rates of return on plan assets, the health care cost trend rates, and the interest rates used to discount the obligations for our major plans, which cover employees in the United States, United Kingdom, and Canada. In addition, administrative ambiguities concerning the Medicare Prescription Drug Improvement and Modernization Act of 2003, presently result in uncertainty regarding the eventual financial impact of this legislative change on our Company.

To conduct our annual review of the long-term rate of return on plan assets, we work with third party financial consultants to model expected returns over a 20-year investment horizon with respect to the specific investment mix of our major plans. The return assumptions used reflect a combination of rigorous historical performance analysis and forward-looking views of the financial markets including consideration of current yields on long-term bonds, price-earnings ratios of the major stock market indices, and long-term inflation. Our U.S. plan model, corresponding to approximately 70% of our trust assets globally, currently incorporates a long-term inflation assumption of 2.7% and an active management premium of 1% (net of fees) validated by historical analysis. Although we review our expected long-term rates of return annually, our benefit trust investment performance and accumulated obligation include the long-term rates of return on plan assets, the health care cost trend rates, and the interest rates used to discount the obligations for our major plans, which cover employees in the United States, United Kingdom, and Canada. In addition, administrative ambiguities concerning the Medicare Prescription Drug Improvement and Modernization Act of 2003, presently result in uncertainty regarding the eventual financial impact of this legislative change on our Company.

To conduct our annual review of discount rates, we use several published market indices with appropriate duration weighting to assess prevailing rates on high quality debt securities. We also use third-party financial consultants to model specific AA-rated (or the equivalent in foreign jurisdictions) bond issues against the expected settlement cash flows of our plans. The measurement dates for our benefit plans are generally consistent with our Company’s fiscal year end. Thus, we select discount rates to measure our benefit obligations that are consistent with market indices during December of each year.

Despite the above-described rigorous policies for selecting major actuarial assumptions, we periodically experience differences between assumed and actual experience. For 2005, we currently expect incremental amortization of experience losses of approximately $24 million, arising largely from a decline in discount rates at year-end 2004, and to a lesser extent, the continuation of our health care trend rate at 8.5%. Assuming actual future experience is consistent with our current assumptions, annual amortization of accumulated experience losses during each of the next several years would remain approximately level with the 2005 amount.
In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) became law. The Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy (beginning in 2006) to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. While detailed regulations necessary to implement the Act have only recently been issued, we believe that certain health care benefit plans covering a significant portion of our workforce will qualify for the Medicare Part D subsidy, resulting in a reduction in our Company's expense related to providing prescription drug benefits under these plans. We have estimated the reduction in our benefit obligation attributable to past service cost at approximately $73 million and we recognized a reduction in benefit cost for 2004 of approximately $10 million. Significant management judgment was required to assess the eligibility of our plans as well as to estimate the underlying prescription drug costs to which the Act applies. Future differences between assumed and actual experience, including the eligibility of certain covered employee groups for which we have not yet claimed a benefit, would be amortized as an experience gain or loss, as described above.

**Income taxes**

Our consolidated effective income tax rate is influenced by tax planning opportunities available to us in the various jurisdictions in which we operate. Significant judgement is required in determining our effective tax rate and in evaluating our tax positions. We establish reserves when, despite our belief that our tax return positions are supportable, we believe that certain positions are likely to be challenged and that we may not succeed. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit. Our effective income tax rate includes the impact of reserve provisions and changes to reserves that we consider appropriate. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our reserves reflect the probable outcome of known tax contingencies. Favorable resolution would be recognized as a reduction to our effective tax rate in the year of resolution. Our tax reserves are presented in the balance sheet principally within accrued income taxes. Significant tax reserve adjustments impacting our effective tax rate would be separately presented in the rate reconciliation table of Note 11 within Notes to Consolidated Financial Statements. Historically, tax reserve adjustments for individual issues have rarely exceeded 1% of earnings before income taxes annually.

**FUTURE OUTLOOK AND FORWARD-LOOKING STATEMENTS**

Our long-term annual growth targets are low single-digit for internal net sales and high single-digit for net earnings per share. In addition, we remain committed to growing our brand-building investment faster than the rate of sales growth. In general, we expect 2005 results to be consistent with these targets and we will continue to reinvest in cost-reduction initiatives and other growth opportunities.
Kellogg Company and Subsidiaries

Selected Financial Data

(millions, except per share data and number of employees)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Operating trends</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net sales</td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$8,304.1</td>
<td>$7,548.4</td>
<td>$6,086.7</td>
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<td>Gross profit as a % of net sales</td>
<td>44.9%</td>
<td>44.4%</td>
<td>45.0%</td>
<td>44.2%</td>
<td>44.1%</td>
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<td>Depreciation</td>
<td>399.0</td>
<td>359.8</td>
<td>346.9</td>
<td>331.0</td>
<td>275.6</td>
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<td>Amortization</td>
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<td>13.0</td>
<td>3.0</td>
<td>1076</td>
<td>15.0</td>
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<td>Advertising expense</td>
<td>806.2</td>
<td>698.9</td>
<td>588.7</td>
<td>519.2</td>
<td>604.2</td>
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<td>Research and development expense</td>
<td>148.9</td>
<td>126.7</td>
<td>106.4</td>
<td>110.2</td>
<td>118.4</td>
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<tr>
<td>Operating profit (a)</td>
<td>1,681.1</td>
<td>1,544.1</td>
<td>1,508.1</td>
<td>1,167.9</td>
<td>989.8</td>
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<tr>
<td>Operating profit as a % of net sales</td>
<td>17.5%</td>
<td>17.5%</td>
<td>18.2%</td>
<td>15.5%</td>
<td>16.3%</td>
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<td>Interest expense</td>
<td>308.6</td>
<td>371.4</td>
<td>391.2</td>
<td>351.5</td>
<td>1375</td>
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<tr>
<td>Earnings before cumulative effect of accounting change (a) (b)</td>
<td>890.6</td>
<td>787.1</td>
<td>720.9</td>
<td>474.6</td>
<td>5877</td>
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<td>Average shares outstanding:</td>
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<td></td>
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<td>Basic</td>
<td>412.0</td>
<td>407.9</td>
<td>408.4</td>
<td>406.1</td>
<td>405.6</td>
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<tr>
<td>Diluted</td>
<td>416.4</td>
<td>410.5</td>
<td>411.5</td>
<td>407.2</td>
<td>405.6</td>
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<tr>
<td>Earnings per share before cumulative effect of accounting change (a) (b):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Basic</td>
<td>2.16</td>
<td>1.93</td>
<td>1.77</td>
<td>1.17</td>
<td>1.45</td>
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<tr>
<td>Diluted</td>
<td>2.14</td>
<td>1.92</td>
<td>1.75</td>
<td>1.16</td>
<td>1.45</td>
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<td><strong>Cash flow trends</strong></td>
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<tr>
<td>Net cash provided from operating activities</td>
<td>$1,229.0</td>
<td>$1,171.0</td>
<td>$999.9</td>
<td>$1,132.0</td>
<td>$880.9</td>
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<td>Capital expenditures</td>
<td>278.6</td>
<td>2472</td>
<td>253.5</td>
<td>276.5</td>
<td>230.9</td>
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<tr>
<td>Net cash provided from operating activities</td>
<td>950.4</td>
<td>923.8</td>
<td>746.4</td>
<td>855.5</td>
<td>650.0</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(270.4)</td>
<td>(219.0)</td>
<td>(188.8)</td>
<td>(4,143.8)</td>
<td>(379.3)</td>
</tr>
<tr>
<td>Net cash provided from (used in) financing activities</td>
<td>(716.3)</td>
<td>(939.4)</td>
<td>(944.4)</td>
<td>3,040.2</td>
<td>(441.8)</td>
</tr>
<tr>
<td>Interest coverage ratio (c)</td>
<td>6.8</td>
<td>5.1</td>
<td>4.8</td>
<td>4.5</td>
<td>9.4</td>
</tr>
<tr>
<td><strong>Capital structure trends</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>$10,790.4</td>
<td>$10,142.7</td>
<td>$10,219.3</td>
<td>$10,368.6</td>
<td>$4,886.0</td>
</tr>
<tr>
<td>Property, net</td>
<td>2,715.1</td>
<td>2,780.2</td>
<td>2,840.2</td>
<td>2,952.8</td>
<td>2,526.9</td>
</tr>
<tr>
<td>Short-term debt</td>
<td>988.3</td>
<td>898.9</td>
<td>1,197.3</td>
<td>595.6</td>
<td>1,386.3</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>3,892.6</td>
<td>4,265.4</td>
<td>4,519.4</td>
<td>5,619.0</td>
<td>709.2</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td>2,257.2</td>
<td>1,443.2</td>
<td>895.1</td>
<td>871.5</td>
<td>897.5</td>
</tr>
<tr>
<td><strong>Share price trends</strong></td>
<td></td>
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</tr>
<tr>
<td>Stock price range</td>
<td>$37-45</td>
<td>$28-38</td>
<td>$29-37</td>
<td>$25-34</td>
<td>$21-32</td>
</tr>
<tr>
<td>Cash dividends per common share</td>
<td>1.010</td>
<td>1.010</td>
<td>1.010</td>
<td>1.010</td>
<td>0.995</td>
</tr>
<tr>
<td>Number of employees</td>
<td>25,171</td>
<td>25,250</td>
<td>25,676</td>
<td>26,424</td>
<td>15,196</td>
</tr>
</tbody>
</table>

(a) Operating profit for 2001 includes restructuring charges, net of credits, of $33.3 ($20.5 after tax or $.05 per share). Operating profit for 2000 includes restructuring charges of $86.5 ($64.2 after tax or $.16 per share).

(b) Earnings before cumulative effect of accounting change for 2001 exclude the effect of a charge of $1.0 after tax to adopt SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities.

(c) Interest coverage ratio is calculated based on earnings before interest expense, income taxes, depreciation, and amortization, divided by interest expense.

(d) The Company uses this non-GAAP financial measure to focus management and investors on the amount of cash available for debt repayment, dividend distribution, acquisition opportunities, and share repurchase.
## Kellogg Company and Subsidiaries

### Consolidated Statement of Earnings

(millions, except per share data)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net sales</strong></td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$8,304.1</td>
</tr>
<tr>
<td><strong>Cost of goods sold</strong></td>
<td>5,298.7</td>
<td>4,898.9</td>
<td>4,569.0</td>
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<tr>
<td><strong>Selling, general, and administrative expense</strong></td>
<td>2,634.1</td>
<td>2,368.5</td>
<td>2,227.0</td>
</tr>
<tr>
<td><strong>Operating profit</strong></td>
<td>$1,681.1</td>
<td>$1,544.1</td>
<td>$1,508.1</td>
</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>308.6</td>
<td>371.4</td>
<td>391.2</td>
</tr>
<tr>
<td><strong>Other income (expense), net</strong></td>
<td>(6.6)</td>
<td>(3.2)</td>
<td>274</td>
</tr>
<tr>
<td><strong>Earnings before income taxes</strong></td>
<td>$1,365.9</td>
<td>$1,169.5</td>
<td>$1,144.3</td>
</tr>
<tr>
<td><strong>Income taxes</strong></td>
<td>475.3</td>
<td>382.4</td>
<td>423.4</td>
</tr>
<tr>
<td><strong>Net earnings</strong></td>
<td>$890.6</td>
<td>$787.1</td>
<td>$720.9</td>
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</table>

**Net earnings per share:**

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>$2.16</td>
<td>$1.93</td>
<td>$1.77</td>
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<tr>
<td>Diluted</td>
<td>2.14</td>
<td>1.92</td>
<td>1.75</td>
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</table>

Refer to Notes to Consolidated Financial Statements.

### Consolidated Statement of Shareholders’ Equity

(millions)

<table>
<thead>
<tr>
<th></th>
<th>Common stock</th>
<th>Capital in excess of par value</th>
<th>Retained earnings</th>
<th>Treasury stock</th>
<th>Accumulated other comprehensive income</th>
<th>Total shareholders' equity</th>
<th>Total comprehensive income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>shares</td>
<td>amount</td>
<td></td>
<td>shares</td>
<td>amount</td>
<td></td>
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</tr>
<tr>
<td><strong>Balance, January 1, 2002</strong></td>
<td>415.5</td>
<td>$103.8</td>
<td>$91.5</td>
<td>8.8</td>
<td>($337.1)</td>
<td>$871.5</td>
<td>$357.5</td>
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<td>Common stock repurchases</td>
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<td></td>
<td></td>
<td>3.1</td>
<td>(101.0)</td>
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<td></td>
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<tr>
<td>Net earnings</td>
<td>720.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>(412.6)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock options exercised and other</td>
<td>(41.6)</td>
<td>(4.3)</td>
<td>159.9</td>
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<td><strong>Balance, December 28, 2002</strong></td>
<td>415.5</td>
<td>$103.8</td>
<td>$49.9</td>
<td>76</td>
<td>($278.2)</td>
<td>$895.1</td>
<td>$418.9</td>
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<td>Common stock repurchases</td>
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<td></td>
<td>2.9</td>
<td>(90.0)</td>
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</tr>
<tr>
<td>Net earnings</td>
<td>787.1</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Dividends</td>
<td>(412.4)</td>
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<td></td>
<td></td>
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<tr>
<td>Other comprehensive income</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock options exercised and other</td>
<td>(25.4)</td>
<td>(4.7)</td>
<td>164.6</td>
<td></td>
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<td><strong>Balance, December 27, 2003</strong></td>
<td>415.5</td>
<td>$103.8</td>
<td>$24.5</td>
<td>5.8</td>
<td>($203.6)</td>
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<td>$911.3</td>
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<td>Common stock repurchases</td>
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<td></td>
<td>7.3</td>
<td>(297.5)</td>
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<tr>
<td>Net earnings</td>
<td>890.6</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>(417.6)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock options exercised and other</td>
<td>(24.5)</td>
<td>(19.4)</td>
<td>(10.7)</td>
<td>393.1</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Balance, January 1, 2005</strong></td>
<td>415.5</td>
<td>$103.8</td>
<td>–</td>
<td>2.4</td>
<td>($108.0)</td>
<td>($439.9)</td>
<td>$2,257.2</td>
</tr>
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</table>

Refer to Notes to Consolidated Financial Statements.
Kellogg Company and Subsidiaries

Consolidated Balance Sheet

(millions, except share data)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
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<td><strong>Current assets</strong></td>
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<td>Cash and cash equivalents</td>
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<td>Accounts receivable, net</td>
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<tr>
<td>Inventories</td>
<td>681.0</td>
<td>649.8</td>
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<tr>
<td>Other current assets</td>
<td>247.0</td>
<td>242.1</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$2,121.8</td>
<td>$1,787.9</td>
</tr>
<tr>
<td><strong>Property, net</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,715.1</td>
<td>2,780.2</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$10,790.4</td>
<td>$10,142.7</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current maturities of long-term debt</td>
<td>$278.6</td>
<td>$578.1</td>
</tr>
<tr>
<td>Notes payable</td>
<td>709.7</td>
<td>320.8</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>767.2</td>
<td>703.8</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>1,090.5</td>
<td>1,163.3</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>$2,846.0</td>
<td>$2,766.0</td>
</tr>
<tr>
<td><strong>Long-term debt</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,892.6</td>
<td>4,265.4</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$10,790.4</td>
<td>$10,142.7</td>
</tr>
<tr>
<td><strong>Shareholders’ equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $.25 par value, 1,000,000,000 shares authorized</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued: 415,451,198 shares in 2004 and 2003</td>
<td>103.8</td>
<td>103.8</td>
</tr>
<tr>
<td>Capital in excess of par value</td>
<td>–</td>
<td>24.5</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>2,701.3</td>
<td>2,247.7</td>
</tr>
<tr>
<td>Treasury stock at cost:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2,428,824 shares in 2004 and 5,751,578 shares in 2003</td>
<td>(108.0)</td>
<td>(203.6)</td>
</tr>
<tr>
<td>Accumulated other comprehensive income (loss)</td>
<td>(439.9)</td>
<td>(729.2)</td>
</tr>
<tr>
<td><strong>Total shareholders’ equity</strong></td>
<td>$2,257.2</td>
<td>$1,443.2</td>
</tr>
<tr>
<td><strong>Total liabilities and shareholders’ equity</strong></td>
<td>$10,790.4</td>
<td>$10,142.7</td>
</tr>
</tbody>
</table>

Refer to Notes to Consolidated Financial Statements. In particular, refer to Note 15 for supplemental information on various balance sheet captions.
## Kellogg Company and Subsidiaries

### Consolidated Statement of Cash Flows

<table>
<thead>
<tr>
<th>(millions)</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net earnings</td>
<td>$890.6</td>
<td>$787.1</td>
<td>$720.9</td>
</tr>
<tr>
<td>Adjustments to reconcile net earnings to operating cash flows:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>410.0</td>
<td>372.8</td>
<td>349.9</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>57.7</td>
<td>74.8</td>
<td>111.2</td>
</tr>
<tr>
<td>Other</td>
<td>104.5</td>
<td>76.1</td>
<td>67.0</td>
</tr>
<tr>
<td>Pension and other postretirement benefit plan contributions</td>
<td>(204.0)</td>
<td>(184.2)</td>
<td>(446.6)</td>
</tr>
<tr>
<td>Changes in operating assets and liabilities</td>
<td>(29.8)</td>
<td>44.4</td>
<td>197.5</td>
</tr>
<tr>
<td><strong>Net cash provided from operating activities</strong></td>
<td>$1,229.0</td>
<td>$1,171.0</td>
<td>$999.9</td>
</tr>
<tr>
<td><strong>Investing activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions to properties</td>
<td>($278.6)</td>
<td>($247.2)</td>
<td>($253.5)</td>
</tr>
<tr>
<td>Acquisitions of businesses</td>
<td>—</td>
<td>—</td>
<td>(2.2)</td>
</tr>
<tr>
<td>Dispositions of businesses</td>
<td>—</td>
<td>14.0</td>
<td>60.9</td>
</tr>
<tr>
<td>Property disposals</td>
<td>7.9</td>
<td>13.8</td>
<td>6.0</td>
</tr>
<tr>
<td>Other</td>
<td>.3</td>
<td>4</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net cash used in investing activities</strong></td>
<td>($270.4)</td>
<td>($219.0)</td>
<td>($188.8)</td>
</tr>
<tr>
<td><strong>Financing activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net increase (reduction) of notes payable, with maturities less than or equal to 90 days</td>
<td>$388.3</td>
<td>$208.5</td>
<td>($226.2)</td>
</tr>
<tr>
<td>Issuances of notes payable, with maturities greater than 90 days</td>
<td>142.3</td>
<td>67.0</td>
<td>354.9</td>
</tr>
<tr>
<td>Reductions of notes payable, with maturities greater than 90 days</td>
<td>(141.7)</td>
<td>(375.6)</td>
<td>(221.1)</td>
</tr>
<tr>
<td>Issuances of long-term debt</td>
<td>7.0</td>
<td>498.1</td>
<td>—</td>
</tr>
<tr>
<td>Reductions of long-term debt</td>
<td>(682.2)</td>
<td>(956.0)</td>
<td>(439.3)</td>
</tr>
<tr>
<td>Net issuances of common stock</td>
<td>291.8</td>
<td>121.6</td>
<td>100.9</td>
</tr>
<tr>
<td>Common stock repurchases</td>
<td>(297.5)</td>
<td>(90.0)</td>
<td>(101.0)</td>
</tr>
<tr>
<td>Cash dividends</td>
<td>(417.6)</td>
<td>(412.4)</td>
<td>(412.6)</td>
</tr>
<tr>
<td>Other</td>
<td>(6.7)</td>
<td>(.6)</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net cash used in financing activities</strong></td>
<td>($716.3)</td>
<td>($939.4)</td>
<td>($944.4)</td>
</tr>
<tr>
<td>Effect of exchange rate changes on cash</td>
<td>33.9</td>
<td>28.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Increase (decrease) in cash and cash equivalents</td>
<td>$276.2</td>
<td>$40.6</td>
<td>($131.2)</td>
</tr>
<tr>
<td>Cash and cash equivalents at beginning of year</td>
<td>181.2</td>
<td>100.6</td>
<td>231.8</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at end of year</strong></td>
<td>$417.4</td>
<td>$141.2</td>
<td>$100.6</td>
</tr>
</tbody>
</table>

Refer to Notes to Consolidated Financial Statements.
NOTE 1 ACCOUNTING POLICIES

Basis of presentation
The consolidated financial statements include the accounts of Kellogg Company and its majority-owned subsidiaries. Intercompany balances and transactions are eliminated. Certain amounts in the prior-year financial statements have been reclassified to conform to the current-year presentation.

The Company's fiscal year normally ends on the last Saturday of December and as a result, a 53rd week is added every fifth or sixth year. The Company's 2002 and 2003 fiscal years ended on December 28 and 27, respectively. The Company's 2004 fiscal year ended on January 1, 2005, and included a 53rd week.

Cash and cash equivalents
Highly liquid temporary investments with original maturities of less than three months are considered to be cash equivalents. The carrying amount approximates fair value.

Inventories
Inventories are valued at the lower of cost (principally average) or market.

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 151 “Inventory Costs,” to converge U.S. GAAP principles with International Accounting Standards on inventory valuation. SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and spoilage should be recognized as period charges, rather than as inventory value. This standard also provides that fixed production overheads should be allocated to units of production based on the normal capacity of production facilities, with excess overheads being recognized as period charges. The provisions of this standard are effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted. The Company plans to adopt this standard for its 2006 fiscal year. Management currently believes its accounting policy for inventory valuation is generally consistent with this guidance and does not, therefore, expect the adoption of SFAS No. 151 to have a significant impact on financial results.

Property
The Company's property consists mainly of plant and equipment used for manufacturing activities. These assets are recorded at cost and depreciated over estimated useful lives using straight-line methods for financial reporting and accelerated methods, where permitted, for tax reporting. Cost includes an amount of interest associated with significant capital projects. Plant and equipment are reviewed for impairment when conditions indicate that the carrying value may not be recoverable. Such conditions include an extended period of idleness or a plan of disposal. Assets to be abandoned at a future date are depreciated over the remaining period of use. Assets to be sold are written down to realizable value at the time the assets are being actively marketed for sale and the disposal is expected to occur within one year. As of year-end 2003 and 2004, the carrying value of assets held for sale was insignificant.

Goodwill and other intangible assets
The Company’s intangible assets consist primarily of goodwill, trademarks, and direct store-door (DSD) delivery system arising from the 2001 acquisition of Keebler Foods Company (“Keebler”). Management expects the Keebler trademarks and DSD system to contribute indefinitely to the cash flows of the Company. Accordingly, these assets have been classified as “indefinite-lived” intangibles pursuant to SFAS No. 142 “Goodwill and Other Intangible Assets.” Under this standard, goodwill and indefinite-lived intangibles are not amortized, but are tested at least annually for impairment. Goodwill impairment testing first requires a comparison between the carrying value and fair value of a “reporting unit,” which for the Company is generally equivalent to a North American product group or International country market. If carrying value exceeds fair value, goodwill is considered impaired and is reduced to the implied fair value. Impairment testing for non-amortized intangibles requires a comparison between the fair value and carrying value of the intangible asset. If carrying value exceeds fair value, the intangible is considered impaired and is reduced to fair value. The Company uses various market valuation techniques to determine the fair value of goodwill and other intangible assets and periodically engages third party valuation consultants for this purpose. Refer to Note 2 for further information on goodwill and other intangible assets.

Revenue recognition and measurement
The Company recognizes sales upon delivery of its products to customers net of applicable provisions for discounts, returns, and allowances. The Company classifies promotional payments to its customers, the cost of consumer coupons, and other cash redemption offers in net sales. The cost of promotional package inserts are recorded in cost of goods sold. Other types of consumer promotional expenditures are normally recorded in selling, general, and administrative (SGA) expense.

Advertising
The costs of advertising are generally expensed as incurred and are classified within SGA.

Stock compensation
The Company currently uses the intrinsic value method prescribed by Accounting Principles Board Opinion (APB) No. 25 “Accounting for Stock Issued to Employees,” to account for its employee stock options and other stock-based compensation. Under this method, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized. The table on page 38 presents the pro forma results for the current and prior years, as if the Company had used the alternate fair value method of accounting for stock-based compensation, prescribed by SFAS.
No. 123 “Accounting for Stock-Based Compensation” (as amended by SFAS No. 148). Under this pro forma method, the fair value of each option grant (net of estimated unvested forfeitures) was estimated at the date of grant using an option-pricing model and was recognized over the vesting period, generally two years. Prior to 2004, the Company used the Black-Scholes option pricing model. For 2004, the Company converted to a lattice-based or binomial model, which management believes to be a superior method for valuing the impact of different employee option exercise patterns under various economic and market conditions. This change in methodology did not have a significant impact on pro forma results for 2004. Pricing model assumptions are presented below. Refer to Note 8 for further information on the Company’s stock compensation programs.

### Weighted average pricing model assumptions

<table>
<thead>
<tr>
<th>2004(a)</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>As reported</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk-free interest rate</td>
<td>2.73%</td>
<td>1.89%</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>2.60%</td>
<td>2.70%</td>
</tr>
<tr>
<td>Volatility</td>
<td>23.00%</td>
<td>25.75%</td>
</tr>
<tr>
<td>Average expected term (years)</td>
<td>3.69</td>
<td>3.00</td>
</tr>
<tr>
<td>Fair value of options granted</td>
<td>$6.39</td>
<td>$4.75</td>
</tr>
</tbody>
</table>

(a) As reported stock-based compensation expense for 2004 includes a pre-tax charge of $5.5 ($3.6 after tax) related to the accelerated vesting of 17,484 stock options pursuant to a separation agreement between the Company and its former CEO. This modification to the terms of the original awards was treated as a renewal under FASB Interpretation No. 44 “Accounting for Certain Transactions Involving Stock Compensation.” Accordingly, the Company recognized the intrinsic value of the awards at the modification date. The pricing assumptions for this renewal are excluded from the table above and were: risk-free interest rate-1.32%; dividend yield-2.6%; volatility-23%; expected term-33 years, resulting in a per-option fair value of $9.66.

In December 2004, the FASB issued SFAS No. 123(Revised) “Share-Based Payment,” which generally requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value and to recognize this cost over the requisite service period. The standard also provides that any corporate tax benefit realized upon exercise of an award in excess of that previously recognized in earnings will be presented in the Statement of Cash Flows as a financing (rather than an operating) cash flow.

This standard is effective for public companies for interim or annual periods beginning after June 15, 2005, and may be adopted using either the “modified prospective” or “modified retrospective” method. If adopted retrospectively, companies may restate results using the fair value of awards as determined under original SFAS No. 123 either 1) for all years beginning after December 15, 1994, or 2) from the beginning of the fiscal year that includes the interim period of adoption. Early adoption is encouraged. The Company plans to adopt SFAS No. 123(Revised) as of the beginning of its 2005 fiscal third quarter and is currently considering retrospective restatement to the beginning of its 2005 fiscal year. Once this standard is adopted, management believes full-year fiscal 2005 net earnings per share will be reduced by approximately $.08.

### Recently adopted pronouncements

#### Exit activities

The Company adopted SFAS No. 146 “Accounting for Costs Associated with Exit or Disposal Activities,” with respect to exit or disposal activities initiated after December 31, 2002. This statement is intended to achieve consistency in timing of recognition between exit costs, such as one-time employee separation benefits and contract termination payments, and all other costs. Under pre-existing literature, certain costs associated with exit activities were recognized when management committed to a plan. Under SFAS No. 146, costs are recognized when a liability has been incurred under general concepts. Adoption of this standard did not have a significant impact on the Company’s 2003 and 2004 financial results. Refer to Note 3 for further information on the Company’s exit activities during the periods presented.

#### Leasing

In May 2003, the Emerging Issues Task Force of the FASB reached consensus on Issue No. 01-8 “Determining Whether an Arrangement Contains a Lease.” This consensus provides criteria for identifying “in-substance” leases of plant, property, and equipment within supply agreements, service contracts, and other arrangements not historically accounted for as leases. This guidance is generally applicable to arrangements entered into or modified in interim periods beginning after May 28, 2003. The Company has applied this consensus prospectively beginning in its fiscal third quarter of 2003. Management believes this guidance could apply to certain future agreements with contract manufacturers that produce or pack the Company’s products, potentially resulting in capital lease recognition within the balance sheet. However, the impact of this consensus during 2003 and 2004 was insignificant.

### Medicare prescription benefits

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) became law. The Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy (beginning in 2006) to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In January 2004, the Company elected, pursuant to FASB Staff Position (FSP) FAS 106-1, to defer accounting recognition of the effects of the Act until authoritative FASB guidance was issued.
In May 2004, the FASB issued FSP FAS 106-2, which applies to sponsors of single-employer defined benefit postretirement health care plans that are impacted by the Act. In general, the FSP concludes that plan sponsors should follow SFAS No. 106 “Employers’ Accounting for Postretirement Benefits Other Than Pensions,” in accounting for the effects of the Act, with benefits attributable to past service cost accounted for as an actuarial experience gain. The FSP is generally effective for the first interim period beginning after June 15, 2004, with earlier application encouraged. For employers such as Kellogg that elected deferral under FSP FAS 106-1, this guidance may be adopted retroactively to the date of Act enactment or prospectively from the date of adoption.

While detailed regulations necessary to implement the Act have only recently been issued, management believes that certain health care benefit plans covering a significant portion of the Company’s U.S. workforce will qualify for the Medicare Part D subsidy, resulting in a reduction in the Company’s expense related to providing prescription drug benefits under these plans. Accordingly, the Company adopted FSP FAS 106-2 as of its 2004 fiscal second quarter reporting period and has performed a remeasurement of its plan assets and obligations as of the end of its 2003 fiscal year. The reduction in the benefit obligation attributable to past service cost was approximately $73 million and the total reduction in benefit cost for full-year 2004 was approximately $10 million.

Use of estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 GOODWILL AND OTHER INTANGIBLE ASSETS
For 2004, the Company recorded in selling, general, and administrative (SGA) expense impairment losses of $10.4 million to write off the remaining carrying value of certain intangible assets. As presented in the following tables, the total amount consisted of $7.9 million attributable to a long-term licensing agreement in North America and $2.5 million of goodwill in Latin America.

For 2003, the Company recorded in SGA expense an impairment loss of $10.0 million to reduce the carrying value of a contract-based intangible asset. The asset is associated with a long-term licensing agreement principally in North America and the decline in value was based on the proportionate decline in estimated future cash flows to be derived from the contract versus original projections.

NOTE 3 COST-REDUCTION INITIATIVES
To position the Company for sustained reliable growth in earnings and cash flow for the long term, management is undertaking a series of cost-reduction initiatives. Major initiatives commenced in 2004 were the global rollout of the SAP information technology system, reorganization of pan-European operations, consolidation of U.S. meat alternatives manufacturing operations, and relocation of the Company’s U.S. snacks business unit to Battle Creek, Michigan. Major actions implemented in 2003 included a wholesome snack plant consolidation in Australia, manufacturing capacity rationalization in the Mercosur region of Latin America, and a plant workforce reduction in Great Britain. Additionally, during all periods presented, the Company has undertaken various manufacturing capacity rationalization and efficiency initiatives primarily in its North American and European operating segments, as well as the 2003 disposal of a manufacturing facility in China. Future initiatives are still in the planning stages and individual actions are being announced as plans are finalized.
Cost summary
To implement all of these programs, the Company has incurred various up-front costs, including asset write-offs, exit charges, and other project expenditures.

For 2004, the Company recorded total program-related charges of approximately $109 million, comprised of $41 million in asset write-offs, $1 million for special pension termination benefits, $15 million in severance and other exit costs, and $52 million in other cash expenditures such as relocation and consulting. Approximately 40% of the 2004 charges were recorded in cost of goods sold, with the balance recorded in selling, general, and administrative (SGA) expense. The 2004 charges impacted the Company’s operating segments as follows (in millions): North America-$44, Europe-$65.

For 2003, the Company recorded total program-related charges of approximately $71 million, comprised of $40 million in asset write-offs, $8 million for special pension termination benefits, and $23 million in severance and other cash costs. These charges were recorded principally in cost of goods sold and impacted the Company’s operating segments as follows (in millions): North America-$36, Europe-$21, Latin America-$8, Asia Pacific-$6.

For 2002, the Company recorded in cost of goods sold an impairment loss of $5 million related to the Company’s manufacturing facility in China, representing a decline in real estate market value subsequent to an original impairment loss recognized for this property in 1997. The Company completed a sale of this facility in late 2003, and the carrying value of the property approximated the net sales proceeds.

At year-end 2003, the exit cost reserve balance totaled approximately $19 million. These reserves were principally comprised of severance obligations recorded in 2003, which were paid out during the first half of 2004. At year-end 2004, the exit cost reserve balance totaled approximately $11 million, representing severance costs to be paid out in 2005.

2004 initiatives
During 2004, the Company’s global rollout of its SAP information technology system resulted in accelerated depreciation of legacy software assets to be abandoned in 2005, as well as related consulting and other implementation expenses. Total incremental costs for 2004 were approximately $30 million. In close association with this SAP rollout, management undertook a major initiative to improve the organizational design and effectiveness of pan-European operations. Specific benefits of this initiative are expected to include improved marketing and promotional coordination across Europe, supply chain network savings, overhead cost reductions, and tax savings. To achieve these benefits, management implemented, at the beginning of 2005, a new European legal and operating structure headquartered in Ireland, with strengthened pan-European management authority and coordination. During 2004, the Company incurred various up-front costs, including relocation, severance, and consulting, of approximately $30 million. Additional relocation and other costs to complete this business transformation during the next several years are expected to be insignificant.

To improve operations and provide for future growth, during 2004, the Company substantially completed its plan to close its meat alternatives manufacturing facility in Worthington, Ohio. The plan included the out-sourcing of certain operations and consolidation of remaining production at the Zanesville, Ohio facility by early 2005. The Worthington facility originally employed approximately 300 employees, of which approximately 250 have separated from the Company as a result of the plant closure. Total asset write-offs, severance, and other up-front costs of the project are expected to be approximately $30 million, of which approximately $20 million was recognized during 2004. Management expects to complete a sale of the Worthington facility in 2005.

In order to integrate it with the rest of our U.S. operations, during 2004, the Company completed the relocation of its U.S. snacks business unit from Elmhurst, Illinois (the former headquarters of Keebler Foods Company) to Battle Creek, Michigan. About one-third of the approximately 300 employees affected by this initiative accepted relocation/reassignment offers. The recruiting effort to fill the remaining open positions was substantially completed by year-end 2004. Attributable to this initiative, the Company incurred approximately $15 million in relocation, recruiting, and severance costs during 2004. Subject to achieving certain employment levels and other regulatory requirements, management expects to defray a significant portion of these up-front costs through various multi-year tax incentives, beginning in 2005. The Elmhurst office building was sold in late 2004, and the net sales proceeds approximated carrying value.

2003 initiatives
During 2003, the Company implemented a wholesome snack plant consolidation in Australia, which involved the exit of a leased facility and separation of approximately 140 employees. The Company incurred approximately $6 million in exit costs and asset write-offs during 2003 related to this initiative. The Company also undertook a manufacturing capacity rationalization in the Mercosur region of Latin America, which involved the closure of an owned facility in Argentina and separation of approximately 85 plant and administrative employees during 2003. The Company recorded an impairment loss of approximately $6 million to reduce the carrying value of the manufacturing facility to estimated fair value, and incurred approximately $2 million of severance and closure costs during 2003 to complete this initiative. In 2004, the Company began importing its products for sale in Argentina from other Latin America facilities.

In Great Britain, management initiated changes in plant crewing to better match the work pattern to the demand cycle, which resulted in voluntary workforce reductions of approximately 130 hourly and
salaried employee positions. During 2003, the Company incurred approximately $18 million in separation benefit costs related to this initiative.

NOTE 4 OTHER INCOME (EXPENSE), NET

Other income (expense), net includes non-operating items such as interest income, foreign exchange gains and losses, charitable donations, and gains on asset sales. Other income (expense), net for 2004 includes charges of approximately $9 million for contributions to the Kellogg’s Corporate Citizenship Fund, a private trust established for charitable giving. Other income (expense), net for 2003 includes credits of approximately $17 million related to favorable legal settlements, a charge of $8 million for a contribution to the Kellogg's Corporate Citizenship Fund, and a charge of $6.5 million to recognize the impairment of a cost-basis investment in an e-commerce business venture. Other income (expense), net for 2002 consists primarily of $24.7 million in credits related to legal settlements.

NOTE 5 EQUITY

Earnings per share

Basic net earnings per share is determined by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share is similarly determined, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued. Dilutive potential common shares are comprised principally of employee stock options issued by the Company. Basic net earnings per share is reconciled to diluted net earnings per share as follows:

<table>
<thead>
<tr>
<th>(millions, except per share data)</th>
<th>Net earnings</th>
<th>Average shares outstanding</th>
<th>Per share</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2004</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$890.6</td>
<td>422.0</td>
<td>$2.16</td>
</tr>
<tr>
<td>Dilutive potential common shares</td>
<td>—</td>
<td>4.4</td>
<td>(.02)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$890.6</td>
<td>416.4</td>
<td>$2.14</td>
</tr>
<tr>
<td><strong>2003</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$787.1</td>
<td>407.9</td>
<td>$1.93</td>
</tr>
<tr>
<td>Dilutive potential common shares</td>
<td>—</td>
<td>2.6</td>
<td>(.01)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$787.1</td>
<td>410.5</td>
<td>$1.92</td>
</tr>
<tr>
<td><strong>2002</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$720.9</td>
<td>408.4</td>
<td>$1.77</td>
</tr>
<tr>
<td>Dilutive potential common shares</td>
<td>—</td>
<td>3.1</td>
<td>(.02)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$720.9</td>
<td>411.5</td>
<td>$1.75</td>
</tr>
</tbody>
</table>

Comprehensive Income

Comprehensive income includes all changes in equity during a period except those resulting from investments by or distributions to shareholders. Comprehensive income for the periods presented consists of net earnings, minimum pension liability adjustments (refer to Note 9), unrealized gains and losses on cash flow hedges pursuant to SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities,” and foreign currency translation adjustments pursuant to SFAS No. 52 “Foreign Currency Translation” as follows:

<table>
<thead>
<tr>
<th>(millions)</th>
<th>Pretax amount</th>
<th>Tax expense benefit</th>
<th>After-tax amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2004</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net earnings</td>
<td>$890.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency translation adjustments</td>
<td>$71.7</td>
<td>—</td>
<td>71.7</td>
</tr>
<tr>
<td>Cash flow hedges:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss) on cash flow hedges</td>
<td>(10.2)</td>
<td>3.1</td>
<td>(7.1)</td>
</tr>
<tr>
<td>Reclassification to net earnings</td>
<td>19.3</td>
<td>(6.9)</td>
<td>12.4</td>
</tr>
<tr>
<td>Minimum pension liability adjustments</td>
<td>308.9</td>
<td>(96.6)</td>
<td>212.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$389.7</td>
<td>($100.4)</td>
<td>289.3</td>
</tr>
<tr>
<td><strong>2003</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net earnings</td>
<td>$787.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency translation adjustments</td>
<td>$81.6</td>
<td>—</td>
<td>81.6</td>
</tr>
<tr>
<td>Cash flow hedges:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss) on cash flow hedges</td>
<td>(18.7)</td>
<td>6.6</td>
<td>(12.1)</td>
</tr>
<tr>
<td>Reclassification to net earnings</td>
<td>10.3</td>
<td>(3.8)</td>
<td>6.5</td>
</tr>
<tr>
<td>Minimum pension liability adjustments</td>
<td>75.7</td>
<td>(27.5)</td>
<td>48.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$148.9</td>
<td>($24.7)</td>
<td>124.2</td>
</tr>
<tr>
<td><strong>2002</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net earnings</td>
<td>$720.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency translation adjustments</td>
<td>$1.6</td>
<td>—</td>
<td>1.6</td>
</tr>
<tr>
<td>Cash flow hedges:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss) on cash flow hedges</td>
<td>(2.9)</td>
<td>1.3</td>
<td>(1.6)</td>
</tr>
<tr>
<td>Reclassification to net earnings</td>
<td>6.9</td>
<td>(2.7)</td>
<td>4.2</td>
</tr>
<tr>
<td>Minimum pension liability adjustments</td>
<td>(453.5)</td>
<td>147.3</td>
<td>(306.2)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>($447.9)</td>
<td>$145.9</td>
<td>(302.0)</td>
</tr>
</tbody>
</table>

Accumulated other comprehensive income (loss) at year end consisted of the following:

<table>
<thead>
<tr>
<th>(millions)</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign currency translation adjustments</td>
<td>($334.3)</td>
<td>($406.0)</td>
</tr>
<tr>
<td>Cash flow hedges - unrealized net loss</td>
<td>(46.6)</td>
<td>(51.9)</td>
</tr>
<tr>
<td>Minimum pension liability adjustments</td>
<td>(59.0)</td>
<td>(271.3)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>($439.9)</td>
<td>($729.2)</td>
</tr>
</tbody>
</table>

NOTE 6 LEASES AND OTHER COMMITMENTS

The Company's leases are generally for equipment and warehouse space. Rent expense on all operating leases was $87.3 million in 2004, $80.5 million in 2003, and $89.5 million in 2002. Additionally, the Company is subject to residual value guarantees and secondary liabilities on operating leases totaling approximately $14 million, for which liabilities of $1.1 million had been recorded at January 1, 2005.
At January 1, 2005, future minimum annual lease commitments under noncancelable capital and operating leases were as follows:

<table>
<thead>
<tr>
<th>(millions)</th>
<th>Operating leases</th>
<th>Capital leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$812</td>
<td>$3.3</td>
</tr>
<tr>
<td>2006</td>
<td>72.5</td>
<td>1.2</td>
</tr>
<tr>
<td>2007</td>
<td>57.0</td>
<td>0.7</td>
</tr>
<tr>
<td>2008</td>
<td>44.9</td>
<td>—</td>
</tr>
<tr>
<td>2009</td>
<td>76.7</td>
<td>—</td>
</tr>
<tr>
<td>2010 and beyond</td>
<td>65.9</td>
<td>—</td>
</tr>
<tr>
<td>Total minimum payments</td>
<td>$404.2</td>
<td>$3.2</td>
</tr>
</tbody>
</table>

The table above reflects the remaining principal amounts outstanding as of year-end 2004 and 2003. The effective interest rates on these Notes, reflecting issuance discount and swap settlement, are as follows: due 2006-6.39%; due 2007-6.354%. These Notes were repaid in January 2004.

One of the Company’s subsidiaries is guarantor on loans to independent contractors for the purchase of DSD route franchises. At year-end 2004, there were total loans outstanding of $16.1 million to 559 franchisees. All loans are variable rate with a term of 10 years. Related to this arrangement, the Company has established with a financial institution a one-year renewable loan facility up to $17.0 million with a five-year term-out and servicing arrangement. The Company has the right to revoke and resell the route franchises in the event of default or any other breach of contract by franchisees. Revocations are infrequent. The Company’s maximum potential future payments under these guarantees are limited to the outstanding loan principal balance plus unpaid interest. The fair value of these guarantees is recorded in the Consolidated Balance Sheet and is currently estimated to be insignificant.

The Company has provided various standard indemnifications in agreements to sell business assets and lease facilities over the past several years, related primarily to pre-existing tax, environmental, and employee benefit obligations. Certain of these indemnifications are limited by agreement in either amount and/or term and others are unlimited. The Company has also provided various “hold harmless” provisions within certain service type agreements. Because the Company is not currently aware of any actual exposures associated with these indemnifications, management is unable to estimate the maximum potential future payments to be made. At January 1, 2005, the Company had not recorded any liability related to these indemnifications.

### NOTE 7 DEBT

Notes payable at year end consisted of commercial paper borrowings in the United States and to a lesser extent, bank loans and commercial paper of foreign subsidiaries at competitive market rates, as follows:

<table>
<thead>
<tr>
<th>(dollars in millions)</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal amount</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective interest rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. commercial paper</td>
<td>$690.2</td>
<td>2.5%</td>
</tr>
<tr>
<td>Canadian commercial paper</td>
<td>12.1</td>
<td>2.7%</td>
</tr>
<tr>
<td>Other</td>
<td>7.4</td>
<td>9.5</td>
</tr>
<tr>
<td>Total</td>
<td>$709.7</td>
<td>$320.8</td>
</tr>
</tbody>
</table>

Long-term debt at year end consisted primarily of fixed rate issuances of U.S. Dollar Notes, as follows:

<table>
<thead>
<tr>
<th>(millions)</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) 4.875% U.S. Dollar Notes due 2005</td>
<td>$199.8</td>
<td>$200.0</td>
</tr>
<tr>
<td>(b) 6.625% Euro Dollar Notes due 2004</td>
<td>—</td>
<td>500.0</td>
</tr>
<tr>
<td>(c) 6.0% U.S. Dollar Notes due 2006</td>
<td>722.2</td>
<td>824.2</td>
</tr>
<tr>
<td>(d) 6.6% U.S. Dollar Notes due 2011</td>
<td>1,494.5</td>
<td>1,493.6</td>
</tr>
<tr>
<td>(e) 745% U.S. Dollar Debentures due 2031</td>
<td>1,086.8</td>
<td>1,086.3</td>
</tr>
<tr>
<td>(f) 4.49% U.S. Dollar Notes due 2006</td>
<td>150.0</td>
<td>225.0</td>
</tr>
<tr>
<td>(g) 2.875% U.S. Dollar Notes due 2008</td>
<td>499.9</td>
<td>499.9</td>
</tr>
<tr>
<td>Other</td>
<td>18.0</td>
<td>14.5</td>
</tr>
<tr>
<td>Less current maturities</td>
<td>4,271.2</td>
<td>4,843.5</td>
</tr>
<tr>
<td>Balance at year end</td>
<td>$3,892.6</td>
<td>$4,265.4</td>
</tr>
</tbody>
</table>

(a) In October 1998, the Company issued $200 of seven-year 4.875% fixed rate U.S. Dollar Notes to replace maturing long-term debt. In conjunction with this issuance, the Company settled $200 national amount of interest rate swap agreements, which, when combined with original issue discount, effectively fixed the interest rate on the debt at 6.07%.

(b) In January 2001, the Company issued $500 of seven-year 6.625% fixed rate Euro Dollar Notes. In conjunction with this issuance, the Company settled $500 national amount of interest rate swap agreements, which effectively fixed the interest rate on the debt at 6.314%. These Notes were repaid in January 2004.

(c) In March 2001, the Company issued $4,600 of long-term debt instruments, primarily to finance the acquisition of Keebler Foods Company. The table above reflects the remaining principal amounts outstanding as of year-end 2004 and 2003. The effective interest rates on these Notes, reflecting issuance discount and swap settlement, are as follows: due 2006-6.39%; due 2011-7.08%; due 2031-6.22%. Initially, these instruments were privately placed, or sold outside the United States, in reliance on exemptions from registration under the Securities Act of 1933, as amended (the “1933 Act”). The Company then exchanged new debt securities for these initial debt instruments, with the new debt securities being substantially identical in all respects to the initial debt instruments, except for being registered under the 1933 Act. These debt securities contain standard events of default and covenants. The Notes due 2006 and 2011, and the Debentures due 2031 may be redeemed in whole or part by the Company at any time at prices determined under a formula (but not less than 100% of the principal amount plus unpaid interest to the redemption date). In December 2004, the Company redeemed $150.7 of the Notes due 2006. In December 2003, the Company redeemed $672.9 of the Notes due 2006.

(d) In November 2001, a subsidiary of the Company issued $375 of five-year 4.49% fixed rate U.S. Dollar Notes to replace other maturing debt. These Notes are guaranteed by the Company and mature $75 per year over the five-year term. These Notes, which were privately placed, contain standard warranties, events of default, and covenants. They also require the maintenance of a specified consolidated interest expense coverage ratio, and limit capital lease obligations and subsidiary debt. In conjunction with this issuance, the subsidiary of the Company entered into a $375 notional US$ / Pound Sterling currency swap, which effectively converted this debt into a 5.302% fixed rate Pound Sterling obligation for the duration of the five-year term.

(e) In June 2003, the Company issued $500 of five-year 2.875% fixed rate U.S. Dollar Notes, using the proceeds from these Notes to replace maturing long-term debt. These Notes were issued under an existing shelf registration statement. In conjunction with this issuance, the Company settled $500 notional amount of interest rate forward swap agreements, which effectively fixed the interest rate on the debt at 6.314%.

At January 1, 2005, the Company had $2.1 billion of short-term lines of credit, virtually all of which were unused and available for borrowing on an unsecured basis. These lines were comprised principally of an unsecured Five-Year Credit Agreement, expiring November 2009. The agreement allows the Company to borrow, on a revolving credit basis, up to $2.0 billion, to obtain letters of credit in an aggregate amount up to $75 million, and to provide a procedure for the lenders to bid on short-term debt of the Company. This Credit Agreement replaced a $1.15 billion five-year agreement expiring in January 2006 and a $650 million 364-day agreement expiring in January 2005. The new Credit Agreement

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NOTE 8  STOCK COMPENSATION

The Company uses various equity-based compensation programs to provide long-term performance incentives for its global workforce. Currently, these incentives are administered through several plans, as described below.

The 2003 Long-Term Incentive Plan ("2003 Plan"), approved by shareholders in 2003, permits benefits to be awarded to employees and officers in the form of incentive and non-qualified stock options, performance shares or performance share units, restricted stock or restricted stock units, and stock appreciation rights. The 2003 Plan authorizes the issuance of a total of (a) 25 million shares plus (b) shares not issued under the 2001 Long-Term Incentive Plan (the "2001 Plan"), with no more than 5 million shares to be issued in satisfaction of performance units, performance-based restricted shares and other awards (excluding stock options and stock appreciation rights), and with additional annual limitations on awards or payments to individual participants. Options granted under the 2003 Plan and 2001 Plan generally vest over two years, subject to earlier vesting if a change of control occurs. Restricted stock and performance share grants under the 2003 Plan and the 2001 Plan generally vest in three years, subject to earlier vesting and payment if a change in control occurs.

The Non-Employee Director Stock Plan ("Director Plan") was approved by shareholders in 2000 and allows each eligible non-employee director to receive 1,700 shares of the Company's common stock annually and annual grants of options to purchase 5,000 shares of the Company's common stock. Shares other than options are placed in the Kellogg Company Grantor Trust for Non-Employee Directors (the "Grantor Trust"). Under the terms of the Grantor Trust, shares are available to a director only upon termination of service on the Board. Under this plan, awards were as follows: 2004-55,000 options and 18,700 shares; 2003-55,000 options and 18,700 shares; 2002-50,850 options and 18,700 shares.

Options under all plans described above are granted with exercise prices equal to the fair market value of the Company's common stock at the time of the grant and have a term of no more than ten years, if they are incentive stock options, or no more than ten years and one day, if they are non-qualified stock options. These plans permit stock option grants to contain an accelerated ownership feature ("AOF"). An AOF option is generally granted when Company stock is used to pay the exercise price of a stock option or any taxes owed. The holder of the option is generally granted an AOF option for the number of shares so used with the exercise price equal to the then fair market value of the Company's stock. For all AOF options, the original expiration date is not changed but the options vest immediately. Subsequent to 2003, the terms of options granted to employees and directors have not contained an AOF feature.

In addition to employee stock option grants presented in the tables on page 44, under its long-term incentive plans, the Company made restricted stock grants to eligible employees as follows (approximate number of shares): 2004-140,000; 2003-209,000; 2002-132,000. Additionally, performance units were awarded to a limited number of senior executive-level employees for the achievement of cumulative three-year performance targets as follows: awarded in 2001 for cash flow targets ending in 2003; awarded in 2002 for sales growth targets ending in 2004; awarded in 2003 for gross margin targets ending in 2005. If the performance targets are met, the award of units represents the right to receive shares of common stock (or a combination of shares and cash) equal to the dollar award valued on the vesting date. No awards are earned unless a minimum threshold is attained. The 2001 award was earned at 200% of target and vested in February 2004 for a total dollar equivalent of $15.5 million. The 2002 award was earned at 200% of target and vested in February 2005 for a total dollar equivalent of $6.8 million. The maximum future dollar award that could be attained under the 2003 award is approximately $8 million.

The 2002 Employee Stock Purchase Plan was approved by shareholders in 2002 and permits eligible employees to purchase Company stock at a discounted price. This plan allows for a maximum of 2.5 million shares of Company stock to be issued at a purchase price equal to the lesser of 85% of the fair market value of the stock on the first or last day of the quarterly purchase period. Total purchases through this plan for any employee are limited to a fair market value of $25,000 during any calendar year. Shares were purchased by employees under this plan as follows (approximate number of shares): 2004-214,000; 2003-248,000; 2002-119,000. Additionally, during 2002, a foreign subsidiary of the Company established a stock purchase plan for its employees. Subject to limitations, employee contributions to this plan are matched 1:1 by the Company. Under this plan, shares were granted by the Company to match an approximately equal number of shares purchased by employees as follows (approximate number of shares): 2004-82,000; 2003-94,000; 2002-82,000.
The Executive Stock Purchase Plan was established in 2002 to encourage and enable certain eligible employees of the Company to acquire Company stock, and to align more closely the interests of those individuals and the Company’s shareholders. This plan allows for a maximum of 500,000 shares of Company stock to be issued. Under this plan, shares were granted by the Company to executives in lieu of cash bonuses as follows (approximate number of shares): 2004-8,000; 2003-11,000; 2002-14,000.

Transactions under these plans are presented in the tables below. Refer to Note 1 for information on the Company’s method of accounting for these plans.

### Obligations and funded status

The aggregate change in projected benefit obligation, change in plan assets, and funded status were:

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in projected benefit obligation</td>
<td>$2,640.9</td>
<td>$2,261.4</td>
</tr>
<tr>
<td>Service cost</td>
<td>76.0</td>
<td>675.0</td>
</tr>
<tr>
<td>Interest cost</td>
<td>157.3</td>
<td>151.1</td>
</tr>
<tr>
<td>Plan participants’ contributions</td>
<td>2.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Amendments</td>
<td>23.0</td>
<td>8.1</td>
</tr>
<tr>
<td>Actuarial loss</td>
<td>144.2</td>
<td>195.8</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(135.0)</td>
<td>(134.9)</td>
</tr>
<tr>
<td>Foreign currency adjustments</td>
<td>68.8</td>
<td>82.7</td>
</tr>
<tr>
<td>Curtailment and special termination benefits</td>
<td>8.7</td>
<td>72.0</td>
</tr>
<tr>
<td>Other</td>
<td>6.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Projected benefit obligation at end of year</td>
<td>$2,972.9</td>
<td>$2,640.9</td>
</tr>
</tbody>
</table>

### Change in plan assets

- **Fair value of plan assets at beginning of year**: $2,319.2 million; $1,849.5 million
- **Actual return on plan assets**: $319.1 million; $456.9 million
- **Employer contributions**: $139.6 million; $82.4 million
- **Plan participants’ contributions**: $2.8 million; $1.7 million
- **Benefits paid**: $(139.3) million; $(132.3) million
- **Foreign currency adjustments**: $53.0 million; $61.0 million
- **Other**: $1.5 million; $—

- Fair value of plan assets at end of year: $2,685.9 million; $2,319.2 million

### Funded status

- **(millions)**
- **Prepaid pension**: $653.8 million; $557.4 million

### Amounts recognized in the Consolidated Balance Sheet consist of

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepaid pension benefit cost</td>
<td>$730.9</td>
<td>$388.1</td>
</tr>
<tr>
<td>Accrued benefit liability</td>
<td>$(190.5)</td>
<td>$(256.3)</td>
</tr>
<tr>
<td>Intangible asset</td>
<td>24.7</td>
<td>28.0</td>
</tr>
<tr>
<td>Minimum pension liability</td>
<td>88.7</td>
<td>397.6</td>
</tr>
<tr>
<td>Net amount recognized</td>
<td>$653.8</td>
<td>$557.4</td>
</tr>
</tbody>
</table>

The accumulated benefit obligation for all defined benefit pension plans was $2.70 billion and $2.41 billion at January 1, 2005 and December 27, 2003, respectively. Information for pension plans with accumulated benefit obligations in excess of plan assets were:
The significant reduction in under-funded plans for 2004 relates to increased funding and favorable performance of trust assets during 2004, leading to a reduction in the minimum pension liability at January 1, 2005. At January 1, 2005, a cumulative after-tax charge of $59.0 million ($88.7 million pretax) has been recorded in other comprehensive income to recognize the additional minimum pension liability in excess of unrecognized prior service cost. Refer to Note 5 for further information on the changes in minimum liability included in other comprehensive income for each of the periods presented.

Expense

The components of pension expense were:

<table>
<thead>
<tr>
<th>(millions)</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost</td>
<td>76.0</td>
<td>65.5</td>
<td>57.0</td>
</tr>
<tr>
<td>Interest cost</td>
<td>157.3</td>
<td>151.1</td>
<td>140.7</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>8.2</td>
<td>7.3</td>
<td>6.9</td>
</tr>
<tr>
<td>Amortization of unrecognized transition obligation</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Amortization of unrecognized prior service cost</td>
<td>54.1</td>
<td>28.6</td>
<td>11.5</td>
</tr>
<tr>
<td>Recognized net loss</td>
<td>12.2</td>
<td>8.1</td>
<td>—</td>
</tr>
<tr>
<td>Total pension expense</td>
<td>73.7</td>
<td>41.6</td>
<td>11.0</td>
</tr>
</tbody>
</table>

Certain of the Company’s subsidiaries sponsor 401(k) or similar savings plans for active employees. Expense related to these plans was (in millions): 2004—$26; 2003—$26; 2002—$26. Company contributions to these savings plans approximate annual expense. Company contributions to multiemployer and other defined contribution pension plans approximate the amount of annual expense presented in the table above.

All gains and losses, other than those related to curtailment or special termination benefits, are recognized over the average remaining service period of active plan participants. Net losses from special termination benefits and curtailment recognized in 2004 are related primarily to special termination benefits granted to the Company’s former CEO and other former executive officers pursuant to separation agreements, and to a lesser extent, liquidation of the Company’s pension fund in South Africa and continuing plant workforce reductions in Great Britain. Net losses from special termination benefits recognized in 2003 are related primarily to a plant workforce reduction in Great Britain. Refer to Note 3 for further information on this initiative.

Assumptions

The worldwide weighted average actuarial assumptions used to determine benefit obligations were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>5.7%</td>
<td>5.9%</td>
<td>6.6%</td>
</tr>
<tr>
<td>Long-term rate of compensation increase</td>
<td>4.3%</td>
<td>4.3%</td>
<td>4.7%</td>
</tr>
</tbody>
</table>

To determine the overall expected long-term rate of return on plan assets, the Company works with third party financial consultants to model expected returns over a 20-year investment horizon with respect to the specific investment mix of its major plans. The return assumptions used reflect a combination of rigorous historical performance analysis and forward-looking views of the financial markets including consideration of current yields on long-term bonds, price-earnings ratios of the major stock market indices, and long-term inflation. The U.S. model, which corresponds to approximately 70% of consolidated trust assets, incorporates a long-term inflation assumption of 2.7% and an active management premium of 1% (net of fees) validated by historical analysis. Similar methods are used for various foreign plans with invested assets, reflecting local economic conditions. Although management reviews the Company’s expected long-term rates of return annually, the benefit trust investment performance for one particular year does not, by itself, significantly influence this evaluation. The expected rates of return are generally not revised, provided these rates continue to fall within a “more likely than not” corridor of between the 25th and 75th percentile of expected long-term returns, as determined by the Company’s modeling process. The expected rate of return for 2004 of 9.3% equated to approximately the 50th percentile expectation. Any future variance between the expected and actual rates of return on plan assets is recognized in the calculated value of plan assets over a five-year period and once recognized, experience gains and losses are amortized using a declining-balance method over the average remaining service period of active plan participants.

Plan assets

The Company’s year-end pension plan weighted-average asset allocations by asset category were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity securities</td>
<td>76%</td>
<td>75%</td>
</tr>
<tr>
<td>Debt securities</td>
<td>23%</td>
<td>24%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Company’s investment strategy for its major defined benefit plans is to maintain a diversified portfolio of asset classes with the primary goal of meeting long-term cash requirements as they become due. Assets are invested in a prudent manner to maintain the security of funds while maximizing returns within the Company’s guidelines. The current weighted-average target asset allocation reflected by this strategy is: equity securities-74%; debt securities-24%; other-2%. Investment in Company common stock represented less than 2% of consolidated plan assets at January 1, 2005 and December 27, 2003. Plan funding strategies are influenced by tax regulations. The Company currently expects to contribute approximately $26 million to its defined benefit pension plans during 2005.
Benefit payments
The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

(millions)

Expected benefit payments by year:
2005 $138.3
2006 148.3
2007 151.7
2008 155.4
2009 158.9
2010-2014 879.9

NOTE 10 NONPENSION POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

Postretirement
The Company sponsors a number of plans to provide health care and other welfare benefits to retired employees in the United States and Canada, who have met certain age and service requirements. The majority of these plans are funded or unfunded defined benefit plans, although the Company does participate in a few multiemployer or other defined contribution plans for certain employee groups. The Company contributes to voluntary employee benefit association (VEBA) trusts to fund certain U.S. retiree health and welfare benefit obligations. The Company uses its fiscal year end as the measurement date for these plans.

Obligations and funded status
The aggregate change in accumulated postretirement benefit obligation, change in plan assets, and funded status were:

(millions)

Change in accumulated benefit obligation
Accumulated benefit obligation at beginning of year $1,006.6 $908.6
Service cost 12.1 12.5
Interest cost 55.6 60.4
Actuarial loss 24.3 78.4
Amortization — (5.9)
Benefits paid (52.9) (51.4)
Foreign currency adjustments 2.0 3.4
Other 6
Accumulated benefit obligation at end of year $1,046.7 $1,006.6

Change in plan assets
Fair value of plan assets at beginning of year $402.2 $280.4
Actual return on plan assets 54.4 69.6
Employer contributions 64.4 201.8
Benefits paid (52.6) (50.1)
Other 6
Fair value of plan assets at end of year $468.4 $402.2
Funded status
Unrecognized net loss 291.2 295.6
Unrecognized prior service cost (29.2) (32.0)
Accrued postretirement benefit cost recognized as a liability (316.3) (340.8)

Expense
Components of postretirement benefit expense were:

(millions)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost</td>
<td>$12.1</td>
<td>$12.5</td>
<td>$11.9</td>
</tr>
<tr>
<td>Interest cost</td>
<td>55.6</td>
<td>60.4</td>
<td>60.3</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>(39.8)</td>
<td>(32.8)</td>
<td>(26.8)</td>
</tr>
<tr>
<td>Amortization of unrecognized prior service cost</td>
<td>(2.9)</td>
<td>(2.5)</td>
<td>(2.3)</td>
</tr>
<tr>
<td>Recognized net losses</td>
<td>14.8</td>
<td>12.3</td>
<td>9.2</td>
</tr>
<tr>
<td>Curtailment and special termination benefits - net gain</td>
<td>—</td>
<td>—</td>
<td>(16.9)</td>
</tr>
<tr>
<td>Postretirement benefit expense</td>
<td>$39.8</td>
<td>$49.9</td>
<td>$35.4</td>
</tr>
</tbody>
</table>

All gains and losses, other than those related to curtailment or special termination benefits, are recognized over the average remaining service period of active plan participants. During 2002, the Company recognized a $16.9 million curtailment gain related to a change in certain retiree health care benefits from employer-provided defined benefit plans to multiemployer defined contribution plans.

Assumptions
The weighted average actuarial assumptions used to determine benefit obligations were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>5.8%</td>
<td>6.0%</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

The weighted average actuarial assumptions used to determine annual net periodic benefit cost were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>6.0%</td>
<td>6.9%</td>
<td>7.3%</td>
</tr>
<tr>
<td>Long-term rate of return on plan assets</td>
<td>9.3%</td>
<td>9.3%</td>
<td>10.5%</td>
</tr>
</tbody>
</table>

The Company determines the overall expected long-term rate of return on VEBA trust assets in the same manner as that described for pension trusts in Note 9.

The assumed health care cost trend rate is 8.5% for 2005, decreasing gradually to 4.5% by the year 2009 and remaining at that level thereafter. These trend rates reflect the Company’s recent historical experience and management’s expectation that future rates will decline. A one percentage point change in assumed health care cost trend rates would have the following effects:

(millions)

<table>
<thead>
<tr>
<th></th>
<th>One percentage point increase</th>
<th>One percentage point decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effect on total of service and interest cost components</td>
<td>$8.3</td>
<td>$(11.1)</td>
</tr>
<tr>
<td>Effect on postretirement benefit obligation</td>
<td>$112.0</td>
<td>$(103.9)</td>
</tr>
</tbody>
</table>

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) became law. The Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. While detailed regulations necessary to implement the Act have only recently been issued, management believes that certain health care benefit plans covering a significant portion of the Company’s U.S. workforce will qualify for the
Medicare Part D subsidy, resulting in a reduction in the Company’s expense related to providing prescription drug benefits under these plans. Upon remeasurement at year-end 2003, the reduction in the benefit obligation attributable to past service cost was approximately $73 million and the total reduction in benefit cost for full-year 2004 was approximately $10 million. Refer to Note 1 for further information.

**Plan assets**
The Company’s year-end VEBA trust weighted-average asset allocations by asset category were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity securities</td>
<td>77%</td>
<td>66%</td>
</tr>
<tr>
<td>Debt securities</td>
<td>23%</td>
<td>21%</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td>13%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Company’s asset investment strategy for its VEBA trusts is consistent with that described for its pension trusts in Note 9. The current target asset allocation is 74% equity securities, 25% debt securities and 1% other. Actual asset allocations at year-end 2003 differ significantly from the target due to late-year cash contributions not yet invested. The Company currently expects to contribute approximately $63 million to its VEBA trusts during 2005.

**Postemployment**
Under certain conditions, the Company provides benefits to former or inactive employees in the United States and several foreign locations, including salary continuance, severance, and long-term disability. The Company recognizes an obligation for any of these benefits that vest or accumulate with service. Postemployment benefits that do not vest or accumulate with service (such as severance based solely on annual pay rather than years of service) or costs arising from actions that offer benefits to employees in excess of those specified in the respective plans are charged to expense when incurred. The Company’s postemployment benefit plans are unfunded. Actuarial assumptions used are consistent with those presented for postretirement benefits on page 46. The aggregate change in accumulated postemployment benefit obligation and the net amount recognized were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in accumulated benefit obligation</td>
<td>$35.0</td>
<td>$21.0</td>
</tr>
<tr>
<td>Service cost</td>
<td>3.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Interest cost</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Actuarial loss</td>
<td>7.8</td>
<td>11.3</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(10.8)</td>
<td>(9.2)</td>
</tr>
<tr>
<td>Foreign currency adjustments</td>
<td>.5</td>
<td>.8</td>
</tr>
<tr>
<td>Accumulated benefit obligation at beginning of year</td>
<td>$37.9</td>
<td>$35.0</td>
</tr>
<tr>
<td>Funded status</td>
<td>($37.9)</td>
<td>($35.0)</td>
</tr>
<tr>
<td>Unrecognized net loss</td>
<td>15.1</td>
<td>11.8</td>
</tr>
<tr>
<td>Accrued postemployment benefit cost recognized as a liability</td>
<td>($22.8)</td>
<td>($23.2)</td>
</tr>
</tbody>
</table>

**Benefit payments**
The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<table>
<thead>
<tr>
<th></th>
<th>Postretirement</th>
<th>Postemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected benefit payments by year:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>$58.8</td>
<td>$75</td>
</tr>
<tr>
<td>2006</td>
<td>59.1</td>
<td>70</td>
</tr>
<tr>
<td>2007</td>
<td>61.5</td>
<td>58</td>
</tr>
<tr>
<td>2008</td>
<td>63.7</td>
<td>43</td>
</tr>
<tr>
<td>2009</td>
<td>65.5</td>
<td>35</td>
</tr>
<tr>
<td>2010-2014</td>
<td>348.3</td>
<td>13.0</td>
</tr>
</tbody>
</table>

**NOTE 11 INCOME TAXES**
Earnings before income taxes and and the provision for U.S. federal, state, and foreign taxes on these earnings were:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings before income taxes</td>
<td>$952.0</td>
<td>$799.9</td>
<td>$791.3</td>
</tr>
<tr>
<td>Foreign</td>
<td>413.9</td>
<td>369.6</td>
<td>353.0</td>
</tr>
<tr>
<td>United States</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income taxes</td>
<td>$1,365.9</td>
<td>$1,169.5</td>
<td>$1,144.3</td>
</tr>
<tr>
<td>Currently payable:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td>$249.8</td>
<td>$141.9</td>
<td>$157.1</td>
</tr>
<tr>
<td>State</td>
<td>30.0</td>
<td>40.5</td>
<td>46.2</td>
</tr>
<tr>
<td>Foreign</td>
<td>137.8</td>
<td>125.2</td>
<td>108.9</td>
</tr>
<tr>
<td>Income taxes</td>
<td>417.6</td>
<td>307.6</td>
<td>312.2</td>
</tr>
<tr>
<td>Deferred:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td>51.5</td>
<td>91.7</td>
<td>82.8</td>
</tr>
<tr>
<td>State</td>
<td>5.3</td>
<td>(8.6)</td>
<td>8.4</td>
</tr>
<tr>
<td>Foreign</td>
<td>.9</td>
<td>(8.3)</td>
<td>20.0</td>
</tr>
<tr>
<td>Deferred taxes</td>
<td>57.7</td>
<td>80.8</td>
<td>111.2</td>
</tr>
<tr>
<td>Total income taxes</td>
<td>$475.3</td>
<td>$382.4</td>
<td>$423.4</td>
</tr>
</tbody>
</table>

The difference between the U.S. federal statutory tax rate and the Company’s effective income tax rate was:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. statutory tax rate</td>
<td>35.0%</td>
<td>35.0%</td>
<td>35.0%</td>
</tr>
<tr>
<td>Foreign rates varying from 35%</td>
<td>-.5</td>
<td>-.9</td>
<td>-.8</td>
</tr>
<tr>
<td>State income taxes, net of federal benefit</td>
<td>1.7</td>
<td>1.8</td>
<td>3.1</td>
</tr>
<tr>
<td>Foreign earnings repatriation</td>
<td>2.1</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>Donation of appreciated assets</td>
<td>—</td>
<td>—</td>
<td>-1.5</td>
</tr>
<tr>
<td>Net change in valuation allowances</td>
<td>-1.5</td>
<td>-1.1</td>
<td>-2.0</td>
</tr>
<tr>
<td>Statutory rate changes, deferred tax impact</td>
<td>.1</td>
<td>-1.1</td>
<td>—</td>
</tr>
<tr>
<td>Other</td>
<td>-2.1</td>
<td>-3.0</td>
<td>-1.4</td>
</tr>
<tr>
<td>Effective income tax rate</td>
<td>34.8%</td>
<td>32.7%</td>
<td>37.0%</td>
</tr>
</tbody>
</table>
The Company’s consolidated effective income tax rate has benefited from tax planning initiatives over the past several years, declining from 37% in 2002 to slightly less than 35% in 2004. The 2003 rate was even lower at less than 33%, as it included over 200 basis points of discrete benefits, such as favorable audit closures and revaluation of deferred state tax liabilities.

On October 22, 2004, the American Jobs Creation Act (“AJCA”) became law. The AJCA creates a temporary incentive for U.S. multinationals to repatriate foreign earnings by providing an 85 percent dividend received deduction for qualified dividends. The Company may elect to claim this deduction for qualified dividends received in either its fiscal 2004 or 2005 years, and management currently plans to elect this deduction for 2005. Management cannot fully evaluate the effects of this repatriation provision until the Treasury Department issues clarifying regulations. Furthermore, pending technical corrections legislation is needed to clarify that the dividend received deduction applies to both the cash and “section 78 gross-up” portions of qualifying dividend repatriations. While management believes that technical corrections legislation will pass in 2005, the Company has currently developed its repatriation plan based on the less favorable AJCA provisions in force as of year-end 2004. Under these assumptions, management currently intends to repatriate during 2005 approximately $70 million of foreign earnings under the AJCA and an additional $550 million of foreign earnings under regular rules. Prior to 2004, it was management’s intention to indefinitely reinvest substantially all of the Company’s undistributed foreign earnings. Accordingly, no deferred tax liability had been recorded in connection with the future repatriation of these earnings. Now that repatriation is foreseeable for up to $620 million of these earnings, the Company provided in 2004 a deferred tax liability of approximately $41 million. Within the preceding table, this amount is shown net of related foreign tax credits of approximately $12 million, for a net rate increase due to repatriation of 2.1 percent.

Should the technical corrections legislation pass during 2005, management currently believes that the Company would most likely repatriate a higher amount of foreign subsidiary earnings up to $1.1 billion under AJCA for a similar amount of tax cost. However, under the law as enacted at January 1, 2005, management has determined that reinvestment of these earnings in the local businesses should provide a superior rate of return to the Company, as compared to repatriation. Accordingly, U.S. income taxes have not yet been provided on approximately $730 million of foreign subsidiary earnings.

Generally, the changes in valuation allowances on deferred tax assets and corresponding impacts on the effective income tax rate result from management’s assessment of the Company’s ability to utilize certain operating loss and tax credit carryforwards. For 2004, the 1.5 percent rate reduction presented in the preceding table primarily reflects reversal of a valuation allowance against U.S. foreign tax credits, which management currently believes will be utilized in conjunction with the aforementioned 2005 foreign earnings repatriation. Total tax benefits of carryforwards at year-end 2004 and 2003 were approximately $48 million and $40 million, respectively. Of the total carryforwards at year-end 2004, approximately $3 million expire in 2005 and another $4 million will expire within five years. Based on management’s assessment of the Company’s ability to utilize these benefits prior to expiration, the carrying value of deferred tax assets associated with carryforwards was reduced by valuation allowances to approximately $37 million at January 1, 2005.

The deferred tax assets and liabilities included in the balance sheet at year-end were:

<table>
<thead>
<tr>
<th>Deferred tax assets</th>
<th>Deferred tax liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>(millions)</td>
<td>2004</td>
</tr>
<tr>
<td>Current:</td>
<td></td>
</tr>
<tr>
<td>Promotion and advertising</td>
<td>$17.0</td>
</tr>
<tr>
<td>Wages and payroll taxes</td>
<td>29.5</td>
</tr>
<tr>
<td>Inventory valuation</td>
<td>20.2</td>
</tr>
<tr>
<td>Health and postretirement benefits</td>
<td>34.7</td>
</tr>
<tr>
<td>State taxes</td>
<td>6.8</td>
</tr>
<tr>
<td>Operating loss and credit carryforwards</td>
<td>31.8</td>
</tr>
<tr>
<td>Unrealized hedging losses, net</td>
<td>26.5</td>
</tr>
<tr>
<td>Foreign earnings repatriation</td>
<td>—</td>
</tr>
<tr>
<td>Other</td>
<td>27.8</td>
</tr>
<tr>
<td>Total</td>
<td>194.3</td>
</tr>
<tr>
<td>Less valuation allowance</td>
<td>(3.9)</td>
</tr>
<tr>
<td>Total</td>
<td>190.4</td>
</tr>
<tr>
<td>Noncurrent:</td>
<td></td>
</tr>
<tr>
<td>Depreciation and asset disposals</td>
<td>8.0</td>
</tr>
<tr>
<td>Health and postretirement benefits</td>
<td>134.8</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>—</td>
</tr>
<tr>
<td>State taxes</td>
<td>—</td>
</tr>
<tr>
<td>Operating loss and credit carryforwards</td>
<td>16.3</td>
</tr>
<tr>
<td>Trademarks and other intangibles</td>
<td>—</td>
</tr>
<tr>
<td>Deferred compensation</td>
<td>37.6</td>
</tr>
<tr>
<td>Other</td>
<td>12.6</td>
</tr>
<tr>
<td>Total</td>
<td>209.3</td>
</tr>
<tr>
<td>Less valuation allowance</td>
<td>(12.9)</td>
</tr>
<tr>
<td>Total</td>
<td>196.4</td>
</tr>
<tr>
<td>Total deferred taxes</td>
<td>$386.8</td>
</tr>
</tbody>
</table>

Cash paid for income taxes was (in millions): 2004-$421; 2003-$289; 2002-$250.

**NOTE 12 FINANCIAL INSTRUMENTS AND CREDIT RISK CONCENTRATION**

The fair values of the Company’s financial instruments are based on carrying value in the case of short-term items, quoted market prices for derivatives and investments, and, in the case of long term debt, incremental borrowing rates currently available on loans with similar terms and maturities. The carrying amounts of the Company’s cash, cash equivalents, receivables, and notes payable approximate fair value. The fair value of the Company’s long-term debt at January 1, 2005, exceeded its carrying value by approximately $487 million.
The Company is exposed to certain market risks which exist as a part of its ongoing business operations and uses derivative financial and commodity instruments, where appropriate, to manage these risks. In general, instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract. In accordance with SFAS No. 133, the Company designates derivatives as either cash flow hedges, fair value hedges, net investment hedges, or other contracts used to reduce volatility in the translation of foreign currency earnings to U.S. Dollars. The fair values of all hedges are recorded in accounts receivable or other current liabilities. Gains and losses representing either hedge ineffectiveness, hedge components excluded from the assessment of effectiveness, or hedges of translational exposure are recorded in other income (expense), net. Within the Consolidated Statement of Cash Flows, settlements of cash flow and fair value hedges are classified as an operating activity; settlements of all other derivatives are classified as a financing activity.

**Cash flow hedges**
Qualifying derivatives are accounted for as cash flow hedges when the hedged item is a forecasted transaction. Gains and losses on these instruments are recorded in other comprehensive income until the underlying transaction is recorded in earnings. When the hedged item is realized, gains or losses are reclassified from accumulated other comprehensive income to the Statement of Earnings on the same line item as the underlying transaction. For all cash flow hedges, gains and losses representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness were insignificant during the periods presented.

The total net loss attributable to cash flow hedges recorded in accumulated other comprehensive income at January 1, 2005, was $46.6 million, related primarily to forward-starting interest rate swaps settled during 2001 and treasury rate locks settled during 2003 (refer to Note 7). This loss is being reclassified into interest expense over periods of 5 to 30 years. Other insignificant amounts related to foreign currency and commodity price cash flow hedges will be reclassified into earnings during the next 18 months.

**Fair value hedges**
Qualifying derivatives are accounted for as fair value hedges when the hedged item is a recognized asset, liability, or firm commitment. Gains and losses on these instruments are recorded in earnings, offsetting gains and losses on the hedged item. For all fair value hedges, gains and losses representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness were insignificant during the periods presented.

**Net investment hedges**
Qualifying derivative and nonderivative financial instruments are accounted for as net investment hedges when the hedged item is a foreign currency investment in a subsidiary. Gains and losses on these instruments are recorded as a foreign currency translation adjustment in other comprehensive income.

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

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

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

**Interest rate risk**
The Company is exposed to interest rate volatility with regard to future issuances of fixed rate debt and existing issuances of variable rate debt. The Company currently uses interest rate swaps, including forward-starting swaps, to reduce interest rate volatility and funding costs associated with certain debt issues, and to achieve a desired proportion of variable versus fixed rate debt, based on current and projected market conditions. Variable-to-fixed interest rate swaps are accounted for as cash flow hedges and the assessment of effectiveness is based on changes in the present value of interest payments on the underlying debt. Fixed-to-variable interest rate swaps are accounted for as fair value hedges and the assessment of effectiveness is based on changes in the fair value of the underlying debt, using incremental borrowing rates currently available on loans with similar terms and maturities.

**Price risk**
The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials and energy. The Company uses the combination of long cash positions with suppliers, and exchange-traded futures and option contracts to reduce price fluctuations in a desired percentage of forecasted purchases over a duration of generally less than 18 months. Commodity contracts are accounted for as cash flow hedges. The assessment of effectiveness is based on changes in futures prices.
Credit risk concentration
The Company is exposed to credit loss in the event of nonperformance by counterparties on derivative financial and commodity contracts. This credit loss is limited to the cost of replacing these contracts at current market rates. Management believes the probability of such loss is remote.

Financial instruments, which potentially subject the Company to concentrations of credit risk, are primarily cash, cash equivalents, and accounts receivable. The Company places its investments in highly rated financial institutions and investment-grade short-term debt instruments, and limits the amount of credit exposure to any one entity. Historically, concentrations of credit risk with respect to accounts receivable have been limited due to the large number of customers, generally short payment terms, and their dispersion across geographic areas. However, there has been significant worldwide consolidation in the grocery industry in recent years. At January 1, 2005, the Company’s five largest customers globally comprised approximately 20% of consolidated accounts receivable.

NOTE 13 QUARTERLY FINANCIAL DATA (UNAUDITED)

(millions, except per share data)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales</td>
<td>$2,390.5</td>
<td>$2,141.5</td>
<td>$1,035.0</td>
<td>$1,015.3</td>
</tr>
<tr>
<td>Gross profit</td>
<td>$2,387.3</td>
<td>$2,445.3</td>
<td>$1,126.2</td>
<td>$1,034.0</td>
</tr>
<tr>
<td></td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$4,315.2</td>
<td>$3,912.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends paid per share</td>
<td>$219.8</td>
<td>$163.9</td>
<td>$.54</td>
<td>$.53</td>
</tr>
<tr>
<td></td>
<td>$237.4</td>
<td>203.9</td>
<td>.58</td>
<td>.57</td>
</tr>
<tr>
<td></td>
<td>$247.0</td>
<td>231.3</td>
<td>.60</td>
<td>.59</td>
</tr>
<tr>
<td></td>
<td>$186.4</td>
<td>188.0</td>
<td>.45</td>
<td>.45</td>
</tr>
<tr>
<td></td>
<td>$890.6</td>
<td>$787.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NOTE 14 OPERATING SEGMENTS
Kellogg Company is the world’s leading producer of cereal and a leading producer of convenience foods, including cookies, crackers, toaster pastries, cereal bars, frozen waffles, and meat alternatives. Kellogg products are manufactured and marketed globally. Principal markets for these products include the United States and United Kingdom.

In recent years, the Company was managed in two major divisions - United States and International. During late 2003, the Company reorganized its geographic management structure to North America, Europe, Latin America, and Asia Pacific. This new organizational structure is the basis of the following operating segment data. The prior periods have been restated to conform to the current-period presentation. This restatement includes: 1) the combination of U.S. and Canadian results into North America, 2) the reclassification of certain U.S. export operations from U.S. to Latin America, and 3) the reallocation of certain selling, general, and administrative (SGA) expenses between Corporate and North America.

The measurement of operating segment results is generally consistent with the presentation of the Consolidated Statement of Earnings and Balance Sheet. Intercompany transactions between reportable operating segments were insignificant in all periods presented.

Net earnings per share

(millions)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>$6,369.3</td>
<td>$5,954.3</td>
<td>$5,800.1</td>
</tr>
<tr>
<td>Diluted</td>
<td>2,007.3</td>
<td>1,734.2</td>
<td>1,469.8</td>
</tr>
<tr>
<td>Latin America</td>
<td>718.0</td>
<td>666.7</td>
<td>640.9</td>
</tr>
<tr>
<td>Asia Pacific (a)</td>
<td>519.3</td>
<td>456.3</td>
<td>385.3</td>
</tr>
<tr>
<td>Consolidated</td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$8,304.1</td>
</tr>
</tbody>
</table>

Segment operating profit

(millions)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$1,240.4</td>
<td>$1,134.2</td>
<td>$1,130.0</td>
</tr>
<tr>
<td>Europe</td>
<td>292.3</td>
<td>279.8</td>
<td>252.5</td>
</tr>
<tr>
<td>Latin America</td>
<td>185.4</td>
<td>168.9</td>
<td>170.6</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>79.5</td>
<td>61.1</td>
<td>38.5</td>
</tr>
<tr>
<td>Corporate</td>
<td>(116.5)</td>
<td>(99.9)</td>
<td>(91.5)</td>
</tr>
<tr>
<td>Consolidated</td>
<td>$1,681.1</td>
<td>$1,544.1</td>
<td>$1,508.1</td>
</tr>
</tbody>
</table>

Depreciation and amortization

(millions)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$266.4</td>
<td>$246.4</td>
<td>$229.3</td>
</tr>
<tr>
<td>Europe</td>
<td>95.7</td>
<td>71.1</td>
<td>65.7</td>
</tr>
<tr>
<td>Latin America</td>
<td>15.4</td>
<td>21.6</td>
<td>17.1</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>20.9</td>
<td>20.0</td>
<td>21.9</td>
</tr>
<tr>
<td>Corporate</td>
<td>16.6</td>
<td>13.7</td>
<td>15.9</td>
</tr>
<tr>
<td>Consolidated</td>
<td>$410.0</td>
<td>$372.8</td>
<td>$349.9</td>
</tr>
</tbody>
</table>

(a) Includes Australia and Asia.
### (millions)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest expense</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>$1.7</td>
<td>$4.0</td>
<td>$6.3</td>
</tr>
<tr>
<td>Europe</td>
<td>15.6</td>
<td>18.2</td>
<td>22.3</td>
</tr>
<tr>
<td>Latin America</td>
<td>.2</td>
<td>2.6</td>
<td>.6</td>
</tr>
<tr>
<td>Asia Pacific (a)</td>
<td>.2</td>
<td>3.3</td>
<td>4.8</td>
</tr>
<tr>
<td>Corporate</td>
<td>290.9</td>
<td>348.7</td>
<td>361.6</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$308.6</td>
<td>$371.4</td>
<td>$391.2</td>
</tr>
<tr>
<td><strong>Income taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>$371.5</td>
<td>$345.0</td>
<td>$364.2</td>
</tr>
<tr>
<td>Europe</td>
<td>64.5</td>
<td>54.6</td>
<td>46.3</td>
</tr>
<tr>
<td>Latin America</td>
<td>39.8</td>
<td>40.0</td>
<td>42.5</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>(.8)</td>
<td>3.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Corporate</td>
<td>.3</td>
<td>(60.5)</td>
<td>(374)</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$475.3</td>
<td>$382.4</td>
<td>$423.4</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>$10,287.5</td>
<td>$10,381.8</td>
<td>$10,079.6</td>
</tr>
<tr>
<td>Europe</td>
<td>2,363.6</td>
<td>1,801.7</td>
<td>1,687.3</td>
</tr>
<tr>
<td>Latin America</td>
<td>411.1</td>
<td>341.2</td>
<td>337.4</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>347.4</td>
<td>300.4</td>
<td>259.1</td>
</tr>
<tr>
<td>Corporate</td>
<td>6,679.4</td>
<td>6,274.2</td>
<td>6,112.1</td>
</tr>
<tr>
<td>Elimination entries</td>
<td>(9,298.6)</td>
<td>(8,956.6)</td>
<td>(8,256.2)</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$10,790.4</td>
<td>$10,142.7</td>
<td>$10,219.3</td>
</tr>
<tr>
<td><strong>Additions to long-lived assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>$167.4</td>
<td>$105.6</td>
<td>$202.8</td>
</tr>
<tr>
<td>Europe</td>
<td>59.7</td>
<td>35.5</td>
<td>33.4</td>
</tr>
<tr>
<td>Latin America</td>
<td>37.2</td>
<td>15.4</td>
<td>13.6</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>9.9</td>
<td>10.1</td>
<td>4.7</td>
</tr>
<tr>
<td>Corporate</td>
<td>4.4</td>
<td>6.6</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$278.6</td>
<td>$247.2</td>
<td>$255.7</td>
</tr>
</tbody>
</table>

(a) Includes Australia and Asia.

The Company’s largest customer, Wal-Mart Stores, Inc. and its affiliates, accounted for approximately 14% of consolidated net sales during 2004, 13% in 2003, and 12% in 2002, comprised principally of sales within the United States.

### Supplemental geographic information is provided below for net sales to external customers and long-lived assets:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net sales</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>$5,968.0</td>
<td>$5,608.3</td>
<td>$5,507.7</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>859.6</td>
<td>740.2</td>
<td>667.4</td>
</tr>
<tr>
<td>Other foreign countries</td>
<td>2,786.3</td>
<td>2,463.0</td>
<td>2,129.0</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$8,304.1</td>
</tr>
<tr>
<td><strong>Long-lived assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>$7,264.7</td>
<td>$7,350.5</td>
<td>$7,434.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>734.1</td>
<td>435.1</td>
<td>423.5</td>
</tr>
<tr>
<td>Other foreign countries</td>
<td>648.2</td>
<td>627.6</td>
<td>584.6</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$8,647.0</td>
<td>$8,413.2</td>
<td>$8,422.3</td>
</tr>
</tbody>
</table>

### Supplemental product information is provided below for net sales to external customers:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>North America</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail channel cereal</td>
<td>$2,404.5</td>
<td>$2,304.7</td>
<td>$2,140.4</td>
</tr>
<tr>
<td>Retail channel snacks</td>
<td>2,801.4</td>
<td>2,547.6</td>
<td>2,587.6</td>
</tr>
<tr>
<td>Other</td>
<td>1,163.4</td>
<td>1,020.2</td>
<td>1,072.1</td>
</tr>
<tr>
<td><strong>International</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cereal</td>
<td>2,829.2</td>
<td>2,583.5</td>
<td>2,288.1</td>
</tr>
<tr>
<td>Snacks</td>
<td>415.4</td>
<td>273.7</td>
<td>215.9</td>
</tr>
<tr>
<td><strong>Consolidated</strong></td>
<td>$9,613.9</td>
<td>$8,811.5</td>
<td>$8,304.1</td>
</tr>
</tbody>
</table>
Management’s Responsibility for Financial Statements

Management is responsible for the preparation of the Company’s consolidated financial statements and related notes. Management believes that the consolidated financial statements present the Company’s financial position and results of operations in conformity with accounting principles that are generally accepted in the United States, using our best estimates and judgments as required.

The independent registered public accounting firm audits the Company’s consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board and provides an objective, independent review of the fairness of reported operating results and financial position.

The Board of Directors of the Company has an Audit Committee composed of four non-management Directors. The Committee meets regularly with management, internal auditors, and the independent registered public accounting firm to review accounting, internal control, auditing and financial reporting matters.

Formal policies and procedures, including an active Ethics and Business Conduct program, support the internal controls, and are designed to ensure employees adhere to the highest standards of personal and professional integrity. We have a vigorous internal audit program that independently evaluates the adequacy and effectiveness of these internal controls.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our evaluation under the framework in Internal Control – Integrated Framework, management concluded that our internal control over financial reporting was effective as of January 1, 2005. Our management’s assessment of the effectiveness of our internal control over financial reporting as of January 1, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which follows on page 53.

James M. Jenness
Chairman and Chief Executive Officer

Jeffrey M. Boromisa
Senior Vice President, Chief Financial Officer
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

PricewaterhouseCoopers LLP

To the Shareholders and Board of Directors of Kellogg Company

Introduction
We have completed an integrated audit of Kellogg Company's 2004 consolidated financial statements and of its internal control over financial reporting as of January 1, 2005 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements
In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Kellogg Company and its subsidiaries at January 1, 2005 and December 27, 2003, and the results of their operations and their cash flows for each of the three years in the period ended January 1, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

Internal Control over Financial Reporting
Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of January 1, 2005 based on criteria established in Internal Control – Integrated Framework issued by COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
Battle Creek, Michigan
March 1, 2005
Board of Directors

Back Row (left to right)
Claudio X. Gonzalez
(C,F,M,N)
Chairman of the Board
Chief Executive Officer
Kimberly-Clark de Mexico
Mexico City, Mexico
Age 70
Elected 1990

Gordon Gund
(E,C,F,M,N*)
Chairman and
Chief Executive Officer
Gund Investment Corporation
Princeton, New Jersey
Age 65
Elected 1986

John T. Dillon
(A,M,E)
Retired Chairman and Chief
Executive Officer
International Paper Company
Stamford, Connecticut
Age 66
Elected 2000

William C. Richardson, Ph.D.
(E,C,F,M,S)
President and
Chief Executive Officer
W. K. Kellogg Foundation
Battle Creek, Michigan
Age 64
Elected 1996

Ann McLaughlin Korologos
(C,M,N,S)
Senior Advisor
Benedetto, Gartland & Company, Inc.
New York, New York
Chairman
RAND Corporation
Santa Monica, California
Age 63
Elected 1989

A. D. David Mackay
President
Chief Operating Officer
Kellogg Company
Age 49
Elected 2005

L. Daniel Jorndt
(A,M,C)
Retired Chairman
Walgreen Co.
Deerfield, Illinois
Age 63
Elected 2002

John L. Zabriskie, Ph.D.
(E,A,C,N)
Co-Founder
PureTech Ventures, L.L.C.
Boston, Massachusetts
Age 65
Elected 1995

Benjamin S. Carson, Sr., M.D.
(E,N,S*)
Professor and Director of
Pediatric Neurosurgery
The John Hopkins Medical
Institutions
Baltimore, Maryland
Age 53
Elected 1997

Front Row (left to right)
James M. Jenness
(E*)
Chairman of the Board
Chief Executive Officer
Kellogg Company
Age 58
Elected 2000

A. D. David Mackay
President
Chief Operating Officer
Kellogg Company
Age 49
Elected 2005

Benjamin S. Carson, Sr., M.D.
(E,N,S*)
Professor and Director of
Pediatric Neurosurgery
The John Hopkins Medical
Institutions
Baltimore, Maryland
Age 53
Elected 1997

Dorothy A. Johnson
(F,M,S)
President
Ahlburg Company
Grand Haven, Michigan
Age 64
Elected 1998

E= Executive Committee
A= Audit Committee
S= Social Responsibility Committee
C= Compensation Committee
F= Finance Committee
M= Consumer Marketing Committee
N= Nominating and Corporate Governance Committee
Executive Management Committee

A. D. David Mackay
Donna J. Banks
Alan F. Harris

Celeste A. Clark
Jeffrey W. Montie
Jeffrey M. Boromisa

Annunciata Cerioli
John A. Bryant
Gary H. Pilnick

Corporate Officers

James M. Jenness*
Chairman of the Board
Chief Executive Officer
Age 58

A. D. David Mackay*
President
Chief Operating Officer
Age 49

Donna J. Banks*
Senior Vice President
Worldwide Product Innovation & Operations
Age 48

Jeffrey M. Boromisa*
Senior Vice President
Chief Financial Officer
Age 49

John A. Bryant*
Executive Vice President
President, Kellogg International
Age 39

Annunciata Cerioli*
Vice President
Human Resources
Age 43

Celeste A. Clark*
Senior Vice President
Corporate Affairs
Age 51

Alan F. Harris*
Executive Vice President
Chief Marketing & Customer Officer
Age 50

Jeffrey W. Montie*
Executive Vice President
President, Kellogg North America
Age 43

Gary H. Pilnick*
Senior Vice President
General Counsel, Corporate Development & Secretary
Age 40

Alan R. Andrews
Vice President
Corporate Controller
Age 49

Margaret R. Bath
Vice President
Research, Quality and Technology
Age 40

Bradford J. Davidson
Senior Vice President
President, U.S. Snacks
Age 43

Elisabeth Fleuriot
Vice President
Managing Director, France / Benelux / Scandinavia
Age 48

George A. Franklin
Vice President
Worldwide Government Relations
Age 53

Timothy P. Mobsby
Senior Vice President
Executive Vice President, Kellogg International
President, Kellogg Europe
Age 49

Michael J. Libbing
Vice President
Corporate Development
Age 35

Paul T. Norman
Vice President
President, U.S. Morning Foods
Age 40

David J. Pfanzelter
Senior Vice President
President, Kellogg Specialty Channels
Age 50

H. Ray Shei
Senior Vice President
Chief Information Officer
Age 54

Kevin C. Smith
Vice President
Senior Vice President, U.S. Marketing Services
Age 54

Joseph J. Tubilewicz
Vice President
Global Procurement
Age 57

Juan Pablo Villalobos
Vice President
Executive Vice President, Kellogg International
President, Kellogg Latin America
Age 39

Joel R. Wittenberg
Vice President
Treasurer
Age 44

*Member of Executive Management Committee

Note: Italicized type denotes subsidiary or other sub-title
Kellogg North America

Products

Kellogg's® cereals, croutons, breading and stuffing products
Kellogg's Corn Flakes®, Kellogg's Frosted Flakes®, All-Bran®, Apple Jacks®, Corn Pops®, Crispix®, Froot Loops®, Honey Crunch Corn Flakes®, Mini-Wheats®, Raisin Bran Crunch®, Rice Krispies®, Smart Start®, Special K®, Variety® Pak cereals
Keebler® cookies, crackers, pie crusts, ice cream cones
Pop-Tarts® toaster pastries
Nutri-Grain®, Rice Krispies Treats®, Nutri-Grain Twists™, Special K® cereal bars
Eggo® waffles, pancakes
Cheez-It® crackers, snacks
Murray®, Famous Amos® cookies
Austin® snacks
Morningstar Farms®, Natural Touch®, Loma Linda®, Worthington® meat and dairy alternatives
Kashi® cereals, nutrition bars and mixes
Kellogg's Krave® refueling bars
Vector® meal replacement products, energy bar nutritional supplements

Manufacturing Locations

San Jose, California
Athens, Georgia
Atlanta, Georgia
Augusta, Georgia
Columbus, Georgia
Macon, Georgia
Rome, Georgia
Chicago, Illinois
Des Plaines, Illinois
Kansas City, Kansas
Florence, Kentucky
Louisville, Kentucky
Pikeville, Kentucky
Battle Creek, Michigan
Grand Rapids, Michigan
Omaha, Nebraska
Blue Anchor, New Jersey
London, Ontario, Canada
Cary, North Carolina
Charlotte, North Carolina
Cincinnati, Ohio
Fremont, Ohio
Zanesville, Ohio
Lancaster, Pennsylvania
Muncy, Pennsylvania
Memphis, Tennessee
Marion, Tennessee

Kellogg International

Products

Kellogg's® cereals, breading products, cereal bars
All-Bran®, Choco Big®, Choco Krispis®, Chocos®, Coco Pops®, Choco Pops®, Corn Frosties®, Crispix®, Crunchy Nut Corn Flakes®, Day Dawn®, Kellogg's Extra®, Froot Loops®, Froot Ring™, Frosties®, Fruit 'n Fibre®, Just Right®, Nutri-Grain®, Optima®, Smacks®, Special K®, Sucrilhos®, Zucaritas® cereals
Nutri-Grain®, Rice Krispies Squares®, Rice Krispies Treats®, Special K®, Kuadri Krispis®, Day Dawn®, Coco Pops®, Crusli®, Sunibrite®, Nutri-Grain Twists®, K-time®, Elevenses®, Milkrunch®, Be Natural®, LCM® cereal bars
Pop-Tarts® toaster pastries
Eggo® waffles
Kaos® snacks
Keloketas® cookies
Komplete® biscuits
Winders® fruit snacks

Manufacturing Locations

Charmhaven, Australia
Sydney, Australia
Sao Paulo, Brazil
Bogota, Colombia
Guayaquil, Ecuador
Bremen, Germany
Manchester, Great Britain
Wrexham, Great Britain
Guatemala City, Guatemala

Taloja, India
Takasaki, Japan
Linares, Mexico
Queretaro, Mexico
Springs, South Africa
Anseong, South Korea
Valls, Spain
Rayong, Thailand
Maracay, Venezuela
Corporate and Share Owner Information

World Headquarters
Kellogg Company
One Kellogg Square
Battle Creek, MI 49016-3599
(269) 961-2000
Corporate website: www.kelloggcompany.com
General information by telephone: (800) 962-1413

Common Stock
Listed on The New York Stock Exchange
Ticker Symbol: K

Annual Meeting of Share Owners
Friday, April 29, 2005, 1:00 p.m. ET
Battle Creek, Michigan
A video replay of the presentation will be available on http://investor.kelloggs.com for one year. For further information, call (269) 961-2830.

Share Owner Account Assistance
U.S., Puerto Rico & Canada: (877) 910-5385 Toll Free
All other locations: (651) 450-4064
TDD for hearing impaired: (651) 450-0144
Transfer agent, registrar and dividend disbursing agent:
Wells Fargo Bank, N.A.
Kellogg Share Owner Services
PO. Box 64854
St. Paul, MN 55164-0854
Online account access and inquiries:
http://www.wellsfargo.com/shareownerservices

Dividend Reinvestment and Cash Investment Plan
The Dividend Reinvestment Plan (the "Plan") permits share owners of record to reinvest dividends from Company stock in shares of Kellogg Company. The Plan provides a convenient, economical and systematic method of acquiring additional shares of our common stock. Share owners also may purchase Company stock through voluntary cash investments of up to $25,000 per year, with the company paying all fees.

If your shares are held in street name by your broker and you are interested in participating in the Plan, you may have your broker transfer the shares electronically to Wells Fargo Bank, N.A., through the Direct Registration System.

For more details on the Plan, please contact Kellogg Share Owner Services at (877) 910-5385 or visit the DRIP section of our investor website, http://investor.kelloggs.com.

Certifications
The most recent certifications by our chief executive and chief financial officers pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits to our Form 10-K. Our chief executive officer's most recent certification to the New York Stock Exchange was submitted May 21, 2004.

Independent Registered Public Accounting Firm
PricewaterhouseCoopers LLP

Company Information
Kellogg Company's website – www.kelloggcompany.com – contains a wide range of information about the Company, including news releases, financial reports, investor information, corporate governance, nutritional information, and recipes.

Audio cassettes of annual reports for visually impaired share owners, and printed materials such as the Annual Report on Form 10-K, quarterly reports on Form 10-Q and other company information may be requested via this website, or by calling (800) 962-1413.

Trustee
BNY Midwest Trust Company
2 North LaSalle Street, Suite 1020
Chicago, IL 60602
4.875% Notes – Due October 15, 2005
6.000% Notes – Due April 1, 2006
2.875% Notes – Due June 1, 2008
6.600% Notes – Due April 1, 2011
7.450% Debentures – Due April 1, 2031

Kellogg Better Government Committee
This committee is organized to permit Company share owners, executives, administrative personnel, and their families to pool their contributions in support of candidates for elected offices at the federal level who believe in sound economic policy and real growth, and who will fight inflation and unemployment, try to decrease taxes, and reduce growth of government. Interested share owners are invited to write for further information:
Kellogg Better Government Committee
Attn: Neil G. Nyberg
One Kellogg Square
Battle Creek, MI 49016-3599

Investor Relations
Simon D. Burton, CFA
Director, Investor Relations
(269) 961-2800
e-mail: investor.relations@kellogg.com
website: http://investor.kelloggs.com

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