

2000 ANNUAL REPORT

Kellogg's[®]

The Best 2 You



2000 ANNUAL REPORT

With sales of nearly \$7 billion, Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including wholesome snacks, toaster pastries, cereal bars, frozen waffles, and meat alternatives. The Company's brands include *Kellogg's*,[®] *Special K*,[®] *Rice Krispies*,[®] *Eggo*,[®] *Pop-Tarts*,[®] *Nutri-Grain*,[®] *Morningstar Farms*,[®] and *Kashi*.[®] In March 2001, Kellogg expects to complete the acquisition of Keebler Foods Company, the second-largest U.S. producer of cookies and crackers.

FINANCIAL HIGHLIGHTS

(millions, except per share data)	2000	Change	1999	Change	1998	Change
Net Sales	\$6,954.7	—%	\$6,984.2	+3%	\$6,762.1	– 1%
Operating profit, excluding charges (a)	1,076.3	—%	1,073.4	+11%	965.6	–19%
Net earnings, excluding charges (a) (b) (c)	651.9	+8%	606.2	+10%	548.9	–22%
Net earnings per share (basic and diluted), excluding charges (a) (b) (c)	1.61	+7%	1.50	+11%	1.35	–21%
Operating profit	989.8	+19%	828.8	–7%	895.1	–11%
Net earnings	587.7	+74%	338.3	–33%	502.6	–8%
Net earnings per share (basic and diluted)	1.45	+75%	.83	–33%	1.23	–7%
Net cash provided from operating activities	880.9	+11%	795.2	+10%	719.7	–18%
Capital expenditures	230.9	–13%	266.2	–29%	373.9	+20%
Average shares outstanding	405.6		405.2		407.8	
Dividends per share	\$.995	+4%	\$.960	+4%	\$.920	+6%

(a) Refer to Management's Discussion and Analysis on pages 15-22 and Note 3 within Notes to Consolidated Financial Statements for further explanation of restructuring charges for years 1998-2000.

(b) Refer to Management's Discussion and Analysis on pages 15-22 and Note 2 within Notes to Consolidated Financial Statements for further explanation of disposition-related charges in 1999.

(c) Percentage changes in 1998 are versus 1997 earnings excluding restructuring and impairment charges and before cumulative effect of accounting change.

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Kellogg's®

The Best 2 You

After completing the acquisition of Keebler Foods Company, Kellogg Company will offer consumers a substantially expanded lineup of convenient, great-tasting foods.



To Our

"Acquiring Keebler will transform our business portfolio and dramatically strengthen our growth prospects for years to come."

Carlos M. Gutierrez

Kellogg Chairman of the Board
and Chief Executive Officer
Carlos M. Gutierrez with
Tony the Tiger™ and
Ernie Keebler.®



Share Owners

2000 Annual Report



Continuing a process of renewal we began in 1999, Kellogg Company achieved its second consecutive year of earnings growth in 2000, excluding charges. Net earnings were up 7.5 percent and earnings per share up 7.3 percent. Our cash flow* grew by 22.9 percent and our dividend increased for the 44th consecutive year, with a per share increase to \$.995 from \$.96.

However, sales declined by 0.4 percent, impacted to some degree by foreign currencies. Without that effect and before acquisitions and divestitures, sales grew by 1.1 percent. Our share performance remained disappointing, with Kellogg stock closing the year at a price of \$26.25 per share.

During 2000, it became clear that fundamental changes in our business

model were needed to support the superior, long-term returns we want to deliver for all Kellogg share owners. We saw our competition consolidating and further strengthening. Our largest business category, ready-to-eat cereal, remained stagnant in our largest market, the United States. Importantly, our sales have fallen short of our expectations, causing us to rely on cost-cutting and other short-term actions to achieve aggressive earnings targets. Clearly, we needed to change.

A BETTER STRATEGY FOR GROWTH

The strategy we adopted in 2000 responds to these issues and is designed to restore industry-leading growth and vitality to our company. Three principles drive this strategy:

1. Prioritize to Win. Rather than spread our investments too thinly, we

will allocate resources first to the United States and then to other core markets, including the United Kingdom/Republic of Ireland, Mexico, Canada, and Australia/New Zealand. Within these markets, we will invest to build our brands and reinvigorate our categories.

2. Set the Right Targets.

Too often, we have chased lofty, short-term earnings targets at the expense of healthy, long-term growth. Recognizing the realities of our business, we are setting more realistic targets, including mid-single-digit operating profit growth (EBITA**) over the next several years. We also will maintain an intense focus on cash flow throughout our organization.

3. Sweat the Execution.

Execution is at the heart of any food company's competitive edge. It is also at the heart of the company we want to be:

aligned behind a business plan and focused passionately on those things that deliver the plan. We are working to ensure that all aspects of our business are driven by a total commitment to superior execution.

A TRANSFORMING ACQUISITION

As a key part of our new strategy, on October 26, 2000, we reached agreement to acquire Keebler Foods Company. The Keebler acquisition, by far the largest in the 95-year history of Kellogg Company, is expected to close as this report is published in March 2001.

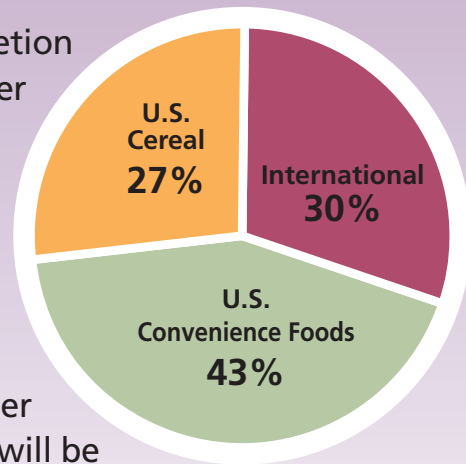
Acquiring Keebler will transform our business portfolio and dramatically strengthen our growth prospects for years to come. Specifically, the acquisition will add about \$2.8 billion of sales in fast-growing food categories and provide

*Net cash provided from operating activities less capital expenditures.

**Operating profit excluding charges and amortization.

A Transformed Portfolio

Upon completion of the Keebler acquisition, U.S. convenience foods (including all U.S. products other than cereal) will be the largest of Kellogg Company's three business segments in annual sales.



To Our

direct store door (DSD) delivery capabilities to grow our wholesome snacks business. Substantial cost synergies will enhance our ability to increase our earnings for the next several years. Upon completion of the acquisition, our U.S. cereal business will represent about 27 percent of worldwide sales, down from the current 37 percent.

The Keebler acquisition is reflected in the theme of this Annual Report, "The Best 2 You." This theme is inspired by Kellogg's long-standing commitment to provide "The Best to You Each Morning.™" It symbolizes the all-day value for consumers and the long-term value for share owners that can be created by bringing together two of the best names in the U.S. food industry.

Kellogg and Keebler are a natural fit, and I am

pleased to report that the planning process for the integration has gone extremely well.

In addition to acquiring Keebler's outstanding cookie and cracker brands and the ever-popular *Keebler Elves*®, we are pleased to join forces with a fine team of Keebler people with whom we share a commitment to create a winning organization. In particular, we are delighted that Sam K. Reed, president and chief executive officer of Keebler, will become vice chairman of Kellogg Company, and that David B. Vermylen, president of the Keebler Brands Division, will become senior vice president of Kellogg Company and president and chief executive officer of Keebler. These appointments take effect with the closing of the transaction. They will help ensure a successful integration and a continuation of Keebler's superb performance.

Share Owners

For more detail on the new company we are creating, see pages 6 and 7.

Kellogg Company's acquisition activity in 2000 also included the purchases of Kashi Company, a leading natural cereal company in the United States, two convenience food businesses in Australia that now operate under a company called *The Healthy Snack People™*, and Mondo Baking Company, a Rome, Georgia, manufacturer of convenience foods. These acquisitions further strengthen our competitive position.

ORGANIZATIONAL AND LEADERSHIP CHANGES

Consistent with our drive for organizational simplicity, during 2000 we reduced our number of operating units from four to two: Kellogg USA and Kellogg International.

I also reduced my number of direct reports from 10 to six, all working in close proximity at our Battle Creek headquarters.

Key management appointments during 2000 included David A. Mackay to executive vice president and president – Kellogg USA, Alan F. Harris to executive vice president and president – Kellogg International, and King T. Pouw to senior vice president – operations.

We extend thanks and best wishes to Michael J. Teale, executive vice president and assistant to the chairman, who retires from Kellogg Company in March 2001 after an exceptional 35-year career in cereal manufacturing and supply chain management. Mike held leadership positions in the United Kingdom and United States, then directed our worldwide supply chain from 1994 until his

promotion to executive vice president and assistant to the chairman last year.

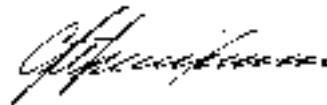
BOARD RECOGNITION AND APPOINTMENTS

We are grateful for the outstanding contributions of J. Richard Munro, who will retire from our Board of Directors in April 2001 after 11 years of exemplary service. Our thanks also go to Carleton (Carly) S. Fiorina, who resigned from the Board in January 2001 after four years of distinguished service in light of her responsibilities as president and chief executive officer of Hewlett-Packard Company.

In July 2000, John T. Dillon, chairman and chief executive officer of International Paper Company, and James M. Jenness, chief executive officer of Integrated Merchandising Systems LLC, were elected

to the Board of Directors. We welcome them to an active, dedicated, and diverse Board that has acted steadfastly to serve the long-term best interests of Kellogg share owners.

As we direct our strategy toward consistent, reliable growth, we are particularly appreciative of the continuing efforts of Kellogg people around the world. I am optimistic that their dedication and the confidence placed in us by you, our share owners, will be rewarded as a transformed Kellogg Company achieves its growth objectives in the future.







Carlos M. Gutierrez
Chairman of the Board
Chief Executive Officer



*A Stronger,
Broader Presence
In The United States*

A Winning Combination

	 	2000 Combined
Net sales	\$6.9	\$2.8 \$9.7 billion
Operating profit	\$1.1	\$.3 \$1.4 billion*
Worldwide assets	\$4.9	\$1.8 \$6.7 billion
Number of plants	35	18 53
Number of employees	15,000	13,000 28,000
	 Kellogg	 Keebler

Kellogg's

Brings to



- Increased scale for direct store door (DSD) delivery
- Research and development capabilities
- Classical brand marketing and consumer promotion
- International reach
- Scale and synergies

Keebler

Brings to

Kellogg's

- DSD delivery for wholesome snacks
- Presence in high-growth categories
- Point-of-purchase marketing
- Better single-serve capabilities
- Scale and synergies



Better Together

Kellogg & Keebler

The acquisition of Keebler Foods Company will transform Kellogg Company into a stronger and more diverse food company. Here are some facts about the new Kellogg Company, with particular emphasis on the major changes in our largest business unit, the United States.

Greater Importance to U.S. Customers

Holding the No. 1 or 2 position in seven major food categories will strengthen the new Kellogg Company's stature among its retail customers.

	Category Sales (billions)	Dollar Share	Rank
Ready-to-Eat Cereal	\$7.6	31%	#2*
Cookies	\$4.6	19%**	#2
Crackers	\$3.6	28%	#2
Cereal/Granola/Treat Bars	\$1.4	24%	#1
Toaster Pastries	\$.6	78%	#1
Frozen Waffles	\$.5	65%	#1
Meat Alternatives	\$.3	42%	#1

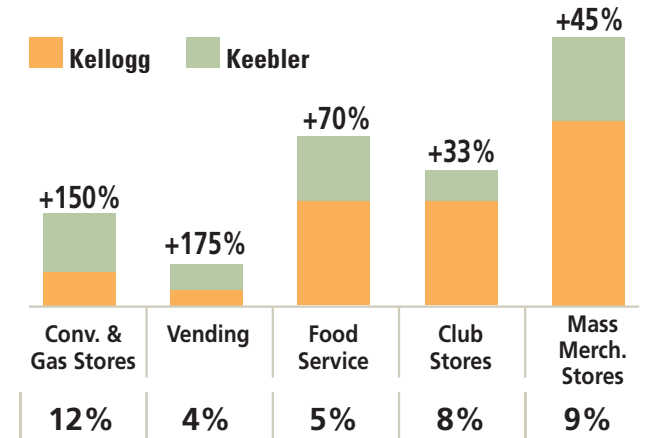
* Kellogg ranks #1 in volume share.

** Includes Keebler's private label business.

SOURCE: Based on IRI categories, 52 weeks ended 12/31/00, FDM channels

Growth in U.S. Non-Supermarket Channels

Adding Keebler's cracker and cookie brands will substantially increase Kellogg Company's sales in growing non-supermarket channels.



Channel Growth*

*Rate of annual sales growth for all consumer products by channel.

U.S. Power Brands of the New Kellogg Company

Together, Kellogg and Keebler brands are a powerful force in the U.S. food business. These 10 brands each generated \$120 million or more in U.S. sales† in 2000.



Kellogg's® cereal

\$2.5 Billion



Keebler® cookies/crackers

\$1.3 Billion



Pop-Tarts® toaster pastries

\$500 Million



Eggo® waffles

\$390 Million



Cheez-It® crackers

\$313 Million



Nutri-Grain® cereal bars

\$230 Million



Rice Krispies Treats® squares

\$150 Million



Murray® cookies

\$143 Million



Austin® snacks

\$129 Million



Morningstar Farms® products

\$120 Million

† Includes FDM, club, and military.

The Advantage of DSD

Keebler Foods Company's outstanding direct store door (DSD) delivery system will provide faster distribution as well as greater in-store display activity and more economical product launches for certain Kellogg wholesome snacks.



Kid favorite Kellogg's Rice Krispies Treats® squares could join Keebler brands like Chips Deluxe® cookies in Keebler's DSD system.



The Best 2 You

U.S. Convenience Foods

Kellogg Company's presence in U.S. convenience foods, which began with the introduction of *Kellogg's® Pop-Tarts®* toaster pastries in 1964, has grown to more than 20 percent of our worldwide sales. Upon completion of the acquisition of Keebler, U.S. convenience foods will represent about 43 percent of Kellogg's sales, by far our largest business segment.

Combining Keebler's cookie and cracker brands with Kellogg's toaster pastries, cereal bars, frozen waffles, and veggie foods will create a powerhouse lineup of products with both the great taste and convenience that consumers demand.

In addition, Keebler's direct store door (DSD) delivery system will dramatically change the profitability and growth potential of parts of this portfolio. DSD speeds products on Keebler trucks directly to the store, where Keebler sales representatives handle shelving and merchandising. In traditional distribution, companies ship product to wholesale or store warehouses, from where brokers and store personnel handle most shelving and merchandising.

While traditional distribution works well for many products, including ready-to-eat cereal, a strong DSD system offers greater distribution and sales potential for snack products, particularly those sold both in multiple- and single-serve portions

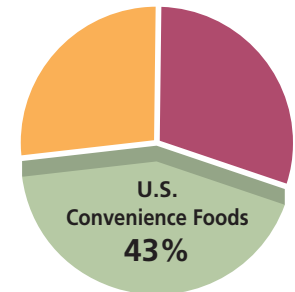
and those with shorter shelf lives. We believe certain Kellogg products, including *Rice Krispies Treats®* squares, will fit perfectly into the well-established Keebler DSD system. That will add further efficiency to the system and create a new and expanded business growth model for those products. DSD also makes the testing of many types of new products more efficient and less risky financially.

Keebler's cookie and cracker brands have enjoyed five consecutive years of strong growth. Kellogg's convenience foods have also delivered robust long-term growth.

We believe the new business model made possible by the Keebler acquisition will generate further growth for these great brands.

A revised, more selective new-product program in convenience foods led to the late 2000 national introduction of *Eggo® Waf-fulls™* filled waffles and the 2001 regional launch of *Krave™* great-tasting high-protein bars, two distinct new products with strong potential.

We believe new product initiatives, combined with the transforming impact of DSD and continued strength from Keebler's brands, will lead to favorable results in 2001 and consistent growth in ensuing years for Kellogg's convenience foods.

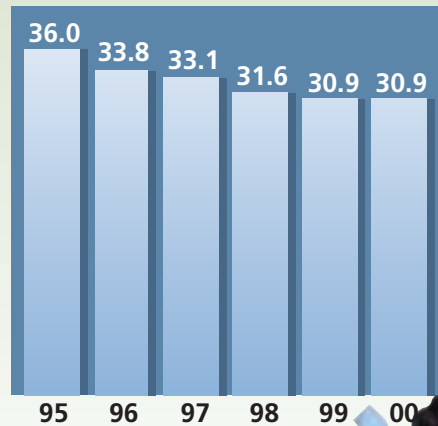


Upon completion of the acquisition of Keebler, U.S. convenience foods will comprise about 43 percent of Kellogg's worldwide sales.



Stabilizing Our Share

After many years of decline, Kellogg's cereal sales performance stabilized in 2000 at a 30.9 dollar share in the U.S. market.



Kellogg's® Raisin Bran Crunch® cereal is a favorite among consumers of all ages in the United States.



The Best 2 You

U.S.
Cereal

Improved consumer promotions and stronger advertising helped Kellogg Company's U.S. ready-to-eat cereal business deliver profitable growth in 2000 as well as its first stability in dollar market share in many years.

Kellogg's performance was paced by the continued strength of Kellogg's® Raisin Bran Crunch® cereal, the most successful new U.S. cereal product since the mid 1990s. This product maintained a 0.9 percent market share in its second year of distribution. New Kellogg's® Honey Frosted Mini-Wheats™ cereal also had a strong performance.

The mid-year acquisition of Kashi Company added a new line of high-growth

cereals and other natural food products to Kellogg's portfolio.

Kellogg's yearlong series of consumer promotions included *American Airlines** frequent flyer miles; *NASCAR*** *Olympics**** and *Major League Soccer*† tie-ins; and a strong association with the popular movie *"How the Grinch Stole Christmas."* Our company also benefited from the appeal of *Pokemon*†† with a highly successful special edition cereal as well as package inserts. Kellogg also launched *Eet & Ern*™, the cereal category's first Internet-based consumer loyalty program.

In 2000, we halted a five-year decline in advertising as a percentage of total U.S. cereal category advertising.

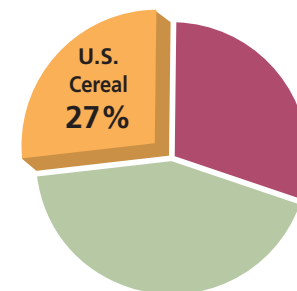
Our advertising also achieved significantly higher consumer recall, an important measure of effectiveness.

Even with this progress, great challenges lie ahead, including returning the U.S. cereal category to growth. Recognizing the importance of investing for growth in our U.S. cereal business, our plans for 2001 call for:

- A continued aggressive program of consumer promotions, beginning with a broad offering of *Disney*††† character package inserts in the first quarter.

- Increased investment in brand-building advertising, with a focus on our highest-potential brands.
- Selective new product launches, including the planned rollout of Kellogg's® Special K® Red Berries cereal early in the year.
- An intense focus on execution, including increased investment in our sales force.

We believe this strong investment is the key to returning the cereal category to growth and building Kellogg's market share.

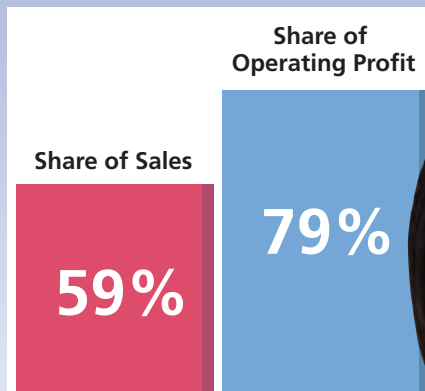


Upon completion of the acquisition of Keebler, U.S. cereal will represent about 27 percent of Kellogg Company's worldwide sales.



Core-Market Strength

Kellogg International's four largest markets contributed well over half of its sales and operating profit in 2000.



Core Markets' Share
of Kellogg International

Kellogg's® Nutri-Grain® and Kellogg's® Crusli™ bars are part of a growing lineup of convenience foods in Kellogg de Mexico's direct store door (DSD) delivery system.



The Best 2 You

Kellogg International

Kellogg International, with responsibility for all markets outside the United States, provides Kellogg cereal products to more than 160 countries on six continents around the world. Kellogg International also has growing convenience foods and foodservice businesses in core and other selected markets.

The four largest Kellogg International markets – the United Kingdom/Republic of Ireland, Mexico, Canada, and Australia/New Zealand – deliver well over half of the division's sales and operating profits. Results from each of these markets are highlighted here.

United Kingdom/Republic of Ireland. In Kellogg's largest market outside the United States, 2000 was

marked by strong operating profit growth and a 3 percent increase in cereal sales, excluding the negative effect of foreign exchange. This growth was driven by new products, including *Special K*® Red Berries cereal, and consumer promotions, including a two-week weight loss challenge. Plans for 2001 include the early-year introduction of *Kellogg's*® Real-Fruit *Winders*™ snacks.

Mexico. Kellogg's fastest-growing major market delivered double-digit sales growth again in 2000. Supplementing Kellogg de Mexico's strong cereal business is a rapidly expanding convenience foods business. Like Keebler in the United States, Kellogg de Mexico has accelerated the growth of

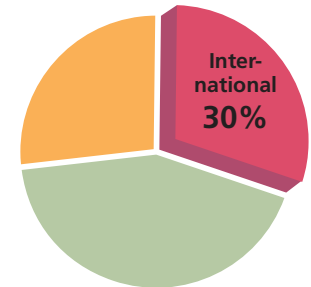
convenience foods by developing an effective direct store door (DSD) delivery system.

Canada. In 2000, Kellogg Canada increased its operating profit for the third consecutive year, with sales growth in both cereal and convenience foods. *Kellogg's*® *Vector*™ meal replacement product had a great second-year performance. Kellogg Canada's promotions included joining with nutrition groups in a program stressing the importance of breakfast.

Australia/New Zealand. Strong sales of Kellogg Australia's convenience foods largely offset a soft

performance from cereal in 2000, as the cereal category remained intensely competitive. Kellogg Australia further strengthened its convenience foods portfolio by acquiring the products that will be marketed by *The Healthy Snack People*™. Core cereal brand development in both Australia and New Zealand is a priority in 2001.

Although the largest markets will receive Kellogg International's highest priority for investment, every Kellogg operating unit plays a significant role in executing the Company's growth strategy. For example, growing markets such as France, Germany, Venezuela, Central America, and South Korea are of critical importance to reaching our worldwide growth goals.



Upon completion of the Keebler acquisition, Kellogg International will deliver about 30 percent of Kellogg Company's worldwide sales.



United Kingdom: Kellogg's Special K Red Berries cereal and Kellogg's Real-Fruit Winders snacks.



Mexico: Kellogg's All-Bran Capuchino cereal and Kellogg's Kuadri Krispis snack bars.



Canada: Kellogg's Vector meal replacement product and Kellogg's Milkcrunch snack bars.



Australia: Kellogg's Goldies cereal and Sunibrite yoghurt muesli bars.



Financial Results

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Management's Discussion and Analysis

Kellogg Company and Subsidiaries

Results of operations

Overview

Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including toaster pastries, cereal bars, frozen waffles, wholesome snacks, and meat alternatives. Principal markets for these products include the United States and United Kingdom. Additionally, the Company expects to complete its acquisition of Keebler Foods Company in March 2001. Keebler ranks second in the United States in the cookie and cracker categories and has the third largest food direct store door (DSD) delivery system in the United States. Beginning in the fourth quarter of 2000, the Company's operations are managed in two major divisions – U.S. and International – with International further delineated into Europe, Latin America, Canada, Australia, and Asia. This geographic organization is the basis of the Company's operating segment information in this report.

In 2000, the Company achieved growth in net earnings and earnings per share, excluding charges, despite softness in the Company's U.S. convenience foods business, higher energy prices and interest rates, weak foreign currencies, and inventory write-offs in Southeast Asia. The Company was able to more than offset these factors through manufacturing efficiencies, reduced advertising and overhead expenses, and recognition of benefits related to U.S. tax credits.

During 1999, the Company increased sales and achieved double-digit growth in net earnings and earnings per share, excluding charges. Volume gains in the Company's Latin America, Australia, and Asian cereal markets, continued expansion of the Company's global convenience foods business, and cost savings from ongoing streamlining and efficiency initiatives contributed significantly to these results.

During 1998, the Company realized declines in earnings per share, both with and without charges. The Company experienced significant competitive pressure combined with category softness in its major ready-to-eat cereal markets, to which it responded by accelerating investment in long-term growth strategies, including product development, technology, and efficiency initiatives.

Net earnings (in millions) and earnings per share (both basic and diluted), as reported, were:

	2000	1999	1998
Net earnings	\$587.7	\$338.3	\$502.6
Net earnings per share	\$ 1.45	\$.83	\$ 1.23

During the current and prior years, the Company reported restructuring and disposition-related charges. The table below summarizes the amounts that have been excluded from results of operations in the following sections for purposes of comparison between years. These items are discussed in detail in the sections on restructuring charges (page 18) and dispositions (page 20).

(millions, except per share data)	Impact on			
	Operating profit	Earnings before income taxes	Net earnings	Net earnings per share
2000				
Restructuring charges	\$ 86.5	\$ 86.5	\$ 64.2	\$.16
1999				
Restructuring charges	\$244.6	\$244.6	\$156.4	\$.40
Disposition-related charges	—	168.5	111.5	.27
Total charges	\$244.6	\$413.1	\$267.9	\$.67
1998				
Restructuring charges	\$ 70.5	\$ 70.5	\$ 46.3	\$.12

2000 compared to 1999

Excluding charges, net earnings (in millions) and earnings per share were:

	2000	1999	Change
Net earnings	\$651.9	\$606.2	+7.5%
Net earnings per share	\$ 1.61	\$ 1.50	+7.3%

The full-year increase in earnings per share of \$.11 consisted of \$.02 from business growth and \$.11 from favorable tax-rate movements, partially offset by \$.02 from unfavorable foreign currency movements.

The Company continued to lead the global ready-to-eat cereal category in 2000 with an estimated 38% annualized share of worldwide dollar sales. Category share for the Company's operating segments was approximately 31% in the United States, 43% in Europe, 60% in Latin America, 45% in Canada, 57% in Australia, and 50% in Asia.

During the fourth quarter of 1999, the Company divested the Lender's Bagels business and acquired Worthington Foods, Inc. While the net impact of these events on net sales was insignificant during 2000, convenience foods volume results were negatively affected, due to the higher density of Worthington's products versus Lender's products. Volume results for 2000 were:

Change vs. prior year	As reported	Comparable business (a)
Global cereal	+1.0%	+6%
Global convenience foods	-5.0%	+1.4%
Consolidated	-5%	+9%

United States	-2.4%	+3%
Europe	-.8%	-.8%
Latin America	+7.7%	+7.7%
Other operating	+1.8%	+1.4%
Consolidated	-5%	+9%

(a) Excluding acquisitions and dispositions. Refer to pages 19-20.

Excluding volume from the Kashi business acquired in June 2000, U.S. cereal volume for the year was essentially flat, negatively impacted by a sluggish category, heavy price promotion by competitors, and trade inventory reductions late in the year. Excluding volume from acquisitions and dispositions, U.S. convenience foods volume grew approximately 1%, a significantly slower rate than the last several years. Management believes factors reducing the growth rate in 2000 included having fewer new products in 2000 and lack of sustained marketing support for products introduced in 1999.

The volume shortfall in Europe during the year was attributable to decreased cereal sales. While management believes successful consumer promotions increased cereal volume growth approximately 1% in the United Kingdom, volume shortfalls in most other European markets more than offset this gain. Convenience foods volume in Europe was approximately even with the prior year.

Latin America continued to achieve solid growth in both cereal and convenience foods volume, particularly in the Mexican market, where an all-time annual cereal volume record was achieved.

In other segments – consisting of Canada, Australia, and Asia – volume results were mixed. In Canada, the Company achieved modest volume growth in both the cereal and convenience foods businesses, with total volume increasing approximately 2%. Excluding volume from *The Healthy Snack People™* convenience foods business acquired in July 2000, total shipments increased nearly 1% in Australia, as strong growth in convenience foods volume more than offset a shortfall in cereal sales. Cereal volume increased in Asia, led by strong shipments in Korea. Asian convenience foods volume decreased significantly, as the Company undertook restructuring initiatives to refocus these markets on sustainable growth.

Net sales by major product group were:

(millions)	2000	1999	Total change	Comparable business change (b)
Global cereal	\$5,177.6	\$5,304.7	-2.4%	+7%
Global convenience foods	1,777.1	1,679.5	+5.8%	+2.5%
Consolidated	\$6,954.7	\$6,984.2	-4%	+1.1%

(b) Excluding foreign exchange, acquisitions, and dispositions.

On an operating segment basis, net sales versus the prior year were:

	United States	Europe	Latin America	Other operating	Consolidated
Volume	+3%	-8%	+7.7%	+1.4%	+9%
Pricing/mix	-.6%	+1.4%	+4.7%	-.4%	+2%
Acquisitions & dispositions	+1.6%	—	—	+5%	+1.0%
Foreign currency impact	—	-10.0%	-1.9%	-3.0%	-2.5%
Total change	+1.3%	-9.4%	+10.5%	-1.5%	-4%

For 2000, the comparable business sales decline in the United States was .3% (favorable volume of .3% less unfavorable pricing/mix impact of .6%) versus a comparable business operating profit decline of 5.9%. The operating profit decline was attributable primarily to increased production, distribution, and promotional expenditures for convenience foods products, and higher energy costs. In Europe, operating efficiencies and a decline in marketing expense resulted in comparable business growth in operating profit of 14.0%, building on a sales increase of .6% (unfavorable volume of .8% offset by favorable pricing/mix of 1.4%). In Latin America, comparable business sales growth of 12.4% (favorable volume of 7.7% plus favorable pricing/mix of 4.7%) combined with operating efficiencies resulted in comparable business operating profit growth of 16.0%. In other operating segments, comparable business operating profit declined 1.8%, despite a sales increase of 1.0% (favorable volume of 1.4% less unfavorable pricing/mix impact of .4%). Significantly contributing to this operating profit decline was approximately \$14 million in aged inventory write-offs and related expenses in Southeast Asia as management initiated restructuring actions to refocus certain Asian markets on sustainable growth.

Operating profit on an operating segment basis was:

(millions)	United States	Europe	Latin America	Other operating (d)	Corporate	Consolidated
2000 operating profit	\$744.2	\$208.5	\$146.5	\$60.5	(\$169.9)	\$ 989.8
2000 restructuring charges (c)	2.0	26.7	14.6	28.7	14.5	86.5
2000 operating profit excluding restructuring charges	\$746.2	\$235.2	\$161.1	\$89.2	(\$155.4)	\$1,076.3
1999 operating profit	\$605.1	\$201.7	\$139.6	\$89.1	(\$206.7)	\$ 828.8
1999 restructuring charges (c)	197.9	22.4	1.7	4.6	18.0	244.6
1999 operating profit excluding restructuring charges	\$803.0	\$224.1	\$141.3	\$93.7	(\$188.7)	\$1,073.4
% change – 2000 vs. 1999:						
Comparable business	-5.9%	+14.0%	+16.0%	-1.8%	+6.8%	+1.8%
Acquisitions & dispositions	-1.2%	—	—	+1.1%	—	-.9%
Foreign currency impact	—	-9.1%	-2.0%	-4.1%	+10.9%	-.6%
Total change	-7.1%	+4.9%	+14.0%	-4.8%	+17.7%	+3%

(c) Refer to section on restructuring charges on page 18.

(d) Other operating includes Canada, Australia, and Asia. In 1999, other operating also includes the Company's functional foods division. This division was closed in 1999.

Consolidated margin performance was:

	2000	1999	Change
Gross margin	52.2%	52.4%	-.2%
SGA% (e)	36.7%	37.0%	+.3%
Operating margin	15.5%	15.4%	+.1%

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

For 2000, the gross margin was relatively flat versus the prior year, as higher costs of production for Worthington and other new products, aged inventory write-offs in Southeast Asia, and increased energy costs offset productivity gains and lower employee benefit costs. The decrease in SGA% versus the prior year was due to reduced advertising and overhead expenses.

Gross interest expense, prior to amounts capitalized, was up versus the prior year, due primarily to an increase in short-term interest rates.

(millions)	2000	1999	Change
Gross interest expense	\$143.1	\$127.2	+12.5%

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 2000 includes a credit of approximately \$12 million related to the 1999 sale of the Lender's Bagels business. The total amount consists of approximately \$9 million for disposal of assets associated with the business which were not purchased by Aurora Foods Inc. (refer to Note 2) and approximately \$3 million for final working capital settlement with Aurora.

During the fourth quarter of 2000, the Company recorded \$24 million in tax benefits, primarily related to utilization of U.S. foreign tax credit carryforwards. During the third quarter, the Company recorded a \$9 million tax benefit, based on completing studies with respect to U.S. research and experimentation credits for prior years. As a result, the effective income tax rate was down significantly from the prior year. Also contributing to the lower rate were the impact of lower statutory rates throughout the year in the United Kingdom

and Australia and enactment of a statutory rate reduction in Germany in the fourth quarter. Excluding the impact of the Keebler acquisition, management expects the Company's 2001 effective income tax rate to return to historical levels.

Consolidated effective tax rate	2000	1999	Change
Excluding charges (f)	31.7%	36.2%	-4.5%
As reported	32.3%	37.0%	-4.7%

(f) Refer to sections on restructuring charges (page 18) and dispositions (page 20).

The variance in the reported rates (as compared to the rates excluding the impact of restructuring and disposition-related charges) relates primarily to the disposition of nondeductible goodwill in 1999 and certain restructuring charges in both years for which no tax benefit was provided, based on management's assessment of the likelihood of recovering such benefit in future years.

1999 compared to 1998

Excluding charges, net earnings (in millions) and earnings per share were:

	1999	1998	Change
Net earnings	\$606.2	\$548.9	+10.4%
Net earnings per share	\$ 1.50	\$ 1.35	+11.1%

The \$.15 increase in earnings per share consisted of \$.14 from business growth, \$.01 from favorable foreign exchange movements, and \$.01 from prior-year share repurchase, partially offset by \$.01 due to a higher effective tax rate.

The Company realized the following volume results during 1999:

Change vs. prior year	As reported	Comparable business (a)
Global cereal	+1.6%	+1.6%
Global convenience foods	+8.8%	+13.9%
Consolidated	+3.4%	+4.1%

United States	+2.3%	+3.7%
Europe	+1.3%	+1.3%
Latin America	+8.8%	+8.8%
Other operating	+9.1%	+9.1%
Consolidated	+3.4%	+4.1%

(a) Excluding acquisitions and dispositions. Refer to pages 19-20.

In the United States, cereal volume was relatively flat, due primarily to a significant reduction in volume during the fourth quarter. Management believes this reduction resulted from a non-competitive level of marketing spending by the Company during the period. Excluding the impact of acquisitions and dispositions, the U.S. convenience foods business achieved low double-digit volume growth. Cereal volume increased slightly in the Company's European segment amid extremely competitive conditions and the loss of a major customer in Germany. The Company's Latin America segment achieved a record for annual cereal volume delivery. The Company experienced solid cereal volume gains in other operating segments of Canada, Australia, and Asia. Convenience foods volumes significantly exceeded the prior year in all operating segments, due primarily to continued new product rollouts and market expansion.

Net sales by major product group were:

(millions)	1999	1998	Change
Global cereal	\$5,304.7	\$5,265.4	+7.7%
Global convenience foods	1,679.5	1,496.7	+12.2%
Consolidated	\$6,984.2	\$6,762.1	+3.3%

On an operating segment basis, net sales versus the prior year were:

	United States	Europe	Latin America	Other operating	Consolidated
Volume	+3.7%	+1.3%	+8.8%	+9.1%	+4.1%
Pricing/mix	+9%	-2.4%	+11.3%	+9%	+8%
Acquisitions & dispositions	-.6%	—	—	—	-.3%
Foreign currency impact	—	-3.9%	-9.1%	+3.5%	-1.3%
Total change	+4.0%	-5.0%	+11.0%	+13.5%	+3.3%

Operating profit on an operating segment basis was:

(millions)	United States	Europe	Latin America	Other operating (d)	Corporate	Consolidated
1999 operating profit excluding restructuring charges	\$803.0	\$224.1	\$141.3	\$93.7	(\$188.7)	\$1,073.4
1998 operating profit	\$753.9	\$208.1	\$107.2	\$65.0	(\$239.1)	\$ 895.1
1998 restructuring charges (c)	32.8	3.3	—	11.4	23.0	70.5
1998 operating profit excluding restructuring charges	\$786.7	\$211.4	\$107.2	\$76.4	(\$216.1)	\$ 965.6
% change – 1999 vs. 1998:						
Comparable business	–1.1%	+10.3%	+39.1%	+18.3%	+12.0%	+9.7%
Acquisitions & dispositions	+3.2%	—	—	—	—	+2.7%
Foreign currency impact	—	–4.3%	–7.3%	+4.4%	+7%	–1.2%
Total change	+2.1%	+6.0%	+31.8%	+22.7%	+12.7%	+11.2%

(c) Refer to section on restructuring charges on page 18.

(d) Other operating includes Canada, Australia, Asia, and the Company's functional foods division.

Margin performance for 1999 and 1998 was:

	1999	1998	Change
Gross margin	52.4%	51.5%	+9%
SGA% (e)	37.0%	37.2%	+2%
Operating margin	15.4%	14.3%	+1.1%

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

The 1999 gross margin improved versus the prior year, due primarily to global manufacturing efficiencies. The SGA% was relatively flat, as increased spending on promotional activities offset benefits from overhead streamlining initiatives around the world. This level of spending is consistent with management's strategy to drive growth through increased marketing investment in the Company's established cereal markets, as well as supporting the introduction of new convenience food products around the world.

Gross interest expense, prior to amounts capitalized, was comparable to the prior year:

(millions)	1999	1998	Change
Gross interest expense	\$127.2	\$127.3	–.1%

Other income (expense), net for 1998 includes a credit of approximately \$6 million related to settlement of certain litigation. During 1996, the Company included in operating profit a provision of \$15 million for the potential settlement of this litigation, which brought the total settlement reserve to \$18 million. This litigation was settled during the second quarter of 1998 for a cost of approximately \$12 million, and the remaining reserve of approximately \$6 million was reversed.

The consolidated effective income tax rate was:

Consolidated effective tax rate	1999	1998	Change
Excluding charges (f)	36.2%	35.7%	+5%
As reported	37.0%	35.8%	+1.2%

(f) Refer to sections on restructuring charges (page 18) and dispositions (page 20).

A statutory rate reduction in Australia favorably impacted the consolidated 1999 tax rate by .6%. A statutory rate reduction in the United Kingdom reduced the consolidated 1998 effective rate by .3%. The variance in the 1999 reported rate (as compared to the rate excluding the impact of charges) relates primarily to the disposition of nondeductible goodwill from the Lender's Bagels business and certain restructuring charges for which no tax benefit was provided, based on management's assessment of the likelihood of recovering such benefit in future years.

Restructuring charges

During the past several years, management has commenced major productivity and operational streamlining initiatives in an effort to optimize the Company's cost structure and align resources with the Company's growth strategy. The incremental costs of these programs have been reported during these years as restructuring charges.

The 2000 charges of \$86.5 million consist of \$65.2 million for actions supporting the Company's "focus and align" strategy and \$21.3 million for a supply chain efficiency initiative in Europe.

In the fourth quarter of 2000, management adopted the "focus and align" strategy, emphasizing a stricter prioritization for resource allocation to the United States and the Company's other core markets. In conjunction with this strategy, the Company was reorganized from four operating areas into two divisions – U.S. and International. As a result, management initiated restructuring actions around the world to support this strategy and organization, including staff reductions in its global supply chain and innovation organization, rationalization of international convenience foods capacity, and restructuring of various non-core markets to improve return on investment. Approximately one-half of the total charges are comprised of asset write-offs with the remainder consisting primarily of cash costs associated with involuntary employee separation programs. Approximately 500 salaried and hourly positions were eliminated, primarily during the fourth quarter of 2000. As a result of these initiatives, the Company currently expects to realize approximately \$45 million on a pretax basis from cost reductions and elimination of operating losses in 2001.

During the second quarter of 2000, the Company implemented a supply chain efficiency initiative in Europe. The restructuring charges from this program were comprised principally of voluntary employee retirement and separation benefits. This program resulted in hourly and salaried head-count reductions of 190 during 2000 and is currently expected to generate approximately \$13 million in pretax savings in 2001.

The 1999 restructuring charges consist of \$193.2 million for closing the South Operations portion of the Company's Battle Creek, Michigan, cereal plant, \$32.7 million for workforce reduction initiatives around the world, and \$18.7 million, primarily for manufacturing equipment write-offs related to previously closed or impaired facilities in various locations.

Approximately one-half of the 1999 charges for the South Operations closing are comprised of asset write-offs, with the remainder consisting primarily of cash costs for employee retirement and separation benefits, equipment removal, and building demolition. As part of the Company's strategy of continuing cost reduction and efficiency improvement, these operations were closed in October 1999. Some production capacity was relocated to the Company's other U.S. cereal plants. Approximately 525 hourly and salaried positions at the Battle Creek plant were eliminated by the end of the first quarter of 2000 through a combination of voluntary and involuntary separation programs. These actions resulted in pretax savings of approximately \$30 million in 2000 and are currently expected to result in a further \$10 million of savings in 2001, for a total 2001 benefit of \$40 million.

The 1999 charges for workforce reduction initiatives are comprised principally of employee retirement and separation benefit costs in all of the Company's operating segments and in corporate operations. These initiatives eliminated approximately 325 employee positions in Europe, Latin America, Australia, and Asia during 1999 and generated approximately \$15 million of pretax savings during 1999, and a further \$10 million in pretax savings in 2000, for a total 2000 benefit of \$25 million.

The 1998 restructuring charges of \$70.5 million relate primarily to an overhead activity analysis that resulted in the elimination of approximately 550 employees and 240 contractors from the Company's headquarters and U.S. and Canadian operations through a combination of involuntary early retirement and severance programs. The charges consist mainly of employee retirement and separation benefits. This program generated approximately \$100 million of pretax savings during 1999.

Refer to Note 3 within Notes to Consolidated Financial Statements for information on the components of the restructuring charges by initiative, as well as reserve balances remaining at December 31, 2000, 1999, and 1998.

Incremental pretax savings achieved or expected from streamlining initiatives by year, and the relative impact on captions within the Consolidated Statement of Earnings, are:

(millions)	Incremental pretax savings	Relative impact on	
		Cost of goods sold	SGA (a)
1998	\$ 10	75%	25%
1999	125	10%	90%
2000	50	80%	20%
2001 expected	75	50%	50%

(a) Selling, general, and administrative expense.

Total cash outlays incurred or expected for streamlining initiatives by year are:

(millions)	
1998	\$47
1999	69
2000	68
2001 expected	38
2002 expected	2

The Company's streamlining initiatives are expected to continue in 2001, related primarily to the integration of the Kellogg and Keebler business models. In addition to incurring integration costs throughout 2001, during the first quarter of 2001 the Company expects to report restructuring charges for staff reductions and inventory and capacity rationalization as a result of this integration. As many of these initiatives are in the early stages of completion, management is currently unable to estimate the total amount of charges to be reported. Expected cash outlays and savings related to this integration are not included in the tables above.

Acquisitions and dispositions

Keebler acquisition

The Company expects to complete its acquisition of Keebler Foods Company in March 2001, in a transaction entered into with Keebler and with Flowers Industries, Inc., the majority

shareholder of Keebler. Keebler Foods Company, headquartered in Elmhurst, Illinois, ranks second in the United States in the cookie and cracker categories and has the third largest food direct store door (DSD) delivery system in the United States. Under the purchase agreement, the Company will pay \$42 in cash for each common share of Keebler or approximately \$3.6 billion, including related acquisition costs. As a result of the acquisition, the Company will assume approximately \$700 million of Keebler debt and \$216 million in obligations to cash out employee stock options, for a total projected cash outlay of approximately \$4.5 billion. The Company will finance the acquisition through a combination of short and long-term debt. The acquisition will be accounted for as a purchase.

During 2001, goodwill and intangibles amortization resulting from the acquisition is expected to be approximately \$125 million. A proposed FASB Statement of Financial Accounting Standards on Business Combinations, which would eliminate goodwill amortization, could reduce the total annual amortization expense by approximately one-half in periods subsequent to issuance of the final standard.

Other acquisitions and investments

In January 2000, the Company purchased certain assets and liabilities of the Mondo Baking Company Division of Southeastern Mills, Inc. for approximately \$93 million in cash, including related acquisition costs. Mondo Baking Company, located in Rome, Georgia, has manufactured convenience foods for Kellogg since 1993. The acquisition was accounted for as a purchase and was financed through short-term borrowings. Assets acquired consist primarily of a manufacturing facility and assembled workforce.

During June 2000, the Company acquired the outstanding stock of Kashi Company for approximately \$32 million in cash. Kashi is a leading natural cereal company located in La Jolla, California. Also during June, the Company committed to invest \$7 million of cash in Transora, a new global business-to-business e-marketplace for the consumer products industry. As of year-end 2000, the Company has paid

\$3.5 million under this commitment. The investment in Transora has been accounted for under the cost method. In July 2000, the Company acquired certain assets and liabilities of a convenience foods operation located in Australia for approximately \$12 million in cash. The Company is operating this business under the *The Healthy Snack People™* name.

In November 1999, the Company purchased the outstanding common stock of Worthington Foods, Inc. for approximately \$300 million in cash, including related acquisition costs. Additionally, during December 1999, the Company paid off approximately \$50 million of Worthington debt existing at the acquisition date. Worthington Foods, Inc. is the leading manufacturer and marketer of soy protein-based meat alternatives and other healthful foods. The acquisition was accounted for as a purchase and was financed through short-term borrowings. Results of Worthington Foods, Inc. operations have been included in the Company's consolidated results from the date of acquisition. The purchase price allocation included approximately \$12 million of exit liabilities, comprised principally of employee involuntary separation and relocation benefits, of which approximately \$3 million remained as of December 31, 2000. Refer to Note 2 within Notes to Consolidated Financial Statements for further information.

Dispositions

In November 1999, the Company sold certain assets and liabilities of the Lender's Bagels business to Aurora Foods Inc. for \$275 million in cash. As a result of this transaction, the Company recorded a pretax charge during the third quarter of 1999 of \$178.9 million. This charge included approximately \$57 million for the future disposal of other assets associated with the Lender's business, which were not purchased by Aurora. Disposal of these other assets was completed during 2000. The original reserve of \$57 million exceeded actual losses from asset sales and related disposal costs by approximately \$9 million. This amount was recorded as a credit to other income (expense), net during the year.

During July 1999, the Company sold its 51% interest in a United Kingdom corn milling operation to Cargill Inc., which owned the remaining 49%. As a result of this sale, the Company recorded a pretax gain of \$10.4 million during the third quarter of 1999.

Liquidity and capital resources

Management believes the Company's strong cash flow, combined with a program of issuing commercial paper and maintaining worldwide credit facilities, provides adequate liquidity to meet the Company's operational needs. In addition, during the second quarter of 2000, the Company's shareholders approved an increase in the Company's authorized number of shares from 500 million to one billion. This increase allows the Company to issue shares in the future for corporate purposes, including financings.

For 2000, net cash provided by operating activities was \$880.9 million, up 10.8% from \$795.2 million in 1999. The increase was due primarily to higher earnings (excluding charges) and favorable working capital movements. The favorable working capital movements were attributable principally to reduced inventory and lengthening of trade payable terms, partially offset by reductions in other accrued liabilities. The favorable inventory movement was driven by comparison to unusually high levels in the prior year, related primarily to temporary inventory build due to the South Operations plant closing, as discussed on page 19. The unfavorable movement in other accrued liabilities was due primarily to utilization of pre-2000 reserves for restructuring and disposition-related activities.

At December 31, 2000, the ratio of current assets to current liabilities was .6, down from 1.0 at December 31, 1999. This decrease was due primarily to a reclassification of \$900 million in long-term debt to current maturities during 2000.

Net cash used in investing activities was \$379.3 million, up from \$244.2 million in 1999. The increase was due primarily to an increase in the cost of business acquisitions net of dispositions, partially offset by a reduction in property additions.

Excluding the impact of the Keebler acquisition, management believes 2001 expenditures for property additions will be approximately \$225 million.

Net cash used in financing activities was \$441.8 million, related primarily to dividend payments of \$403.9 million and a net reduction in total debt of \$42.4 million. The Company's total 2000 per share dividend payment of \$.995, up from \$.96 in 1999, represents the 44th consecutive year the Company has increased its dividend.

For 2000, the Company's Board of Directors authorized management to repurchase up to \$150.0 million in common shares. There were no repurchases during the year.

Notes payable at December 31, 2000, consisted primarily of commercial paper and other short-term borrowings in the United States in the amount of \$429.8 million with an effective interest rate of 6.6%. Long-term debt consisted primarily of fixed rate issuances of U.S. and Euro Dollar Notes, including \$900 million due in 2001, \$500 million due in 2004, and \$200 million due in 2005. The amount due in 2001 included \$400 million in Notes which provided an option to holders to extend the obligation for an additional four years at a predetermined interest rate of 5.63% plus the Company's then-current credit spread. In February 2001, the Company will pay holders \$11.6 million to extinguish the Notes prior to the extension date. Thus, the Company will report an extraordinary loss, net of tax, of \$7.4 million during the first quarter of 2001.

Associated with the debt due in 2001, the Company has entered into \$600 million notional in fixed-to-floating interest rate swaps, which expire in conjunction with the debt issues. These swaps are indexed to either three-month LIBOR or the Federal Reserve AA Composite Rate on 30-day commercial paper.

As discussed on page 19, the Company expects to complete its acquisition of Keebler Foods Company in March 2001, resulting in a total projected cash outlay of approximately \$4.5 billion. To finance this transaction, the Company plans to

issue a combination of short and long-term debt during the first quarter of 2001. In anticipation of these future issuances, during December 2000 the Company entered into \$1.5 billion notional amount of forward-starting interest rate swaps that effectively fixed a portion of the interest rate on an equivalent amount of debt prior to issuance. These swaps will be settled in conjunction with the issuances, resulting in cash payments or receipts that will be amortized to interest expense over periods of five to thirty years. If these swaps had been settled at December 31, 2000, the Company would have made a total cash payment to counterparties of approximately \$26 million. The incremental amount of interest expense related to this payment will generally be offset by a lower coupon rate on the underlying future debt issuance. Refer to Supplemental Financial Information on pages 39-40 for further information.

Following the Company's announcement of its agreement to acquire Keebler, Moody's and Standard & Poor's (S&P) placed the credit ratings of the Company's senior unsecured debt and commercial paper under review for possible downgrade. Due to the significant amount of incremental debt to be created in this transaction, S&P downgraded the Company's senior unsecured debt from AA to BBB and the Company's commercial paper from A-1 to A-2. Moody's downgraded the Company's senior unsecured debt from Aa2 to Baa2 and the Company's commercial paper from P-1 to P-2. These ratings are subject to revision or withdrawal at any time.

S&P assigns a 'BBB' credit rating to obligations which it considers to *"exhibit adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation."* Similarly, Moody's assigns a 'Baa' credit rating to obligations it considers to *"be medium-grade obligations, i.e. neither highly protected nor poorly secured. Interest payments and principal security are considered adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time."*

As a result of these downgrades, the Company believes it will be moderately more expensive to finance its activities through the issuance of debt. During 2001, the Company believes that it will be able to continue paying dividends at current levels and will have sufficient flexibility to borrow additional funds as needed under the anticipated covenants in the debt it currently expects to issue during the first quarter of 2001.

As a result of issuing debt to finance the Keebler acquisition, combined with the downgrade of the Company's credit rating, management believes the Company's total 2001 interest expense will increase to approximately \$400-\$425 million.

The percentage of total debt to market capitalization at December 31, 2000, was 20%, up from 17% at December 31, 1999, due primarily to a lower stock price since year-end 1999.

Euro conversion

On January 1, 1999, eleven European countries (Germany, France, Spain, Italy, Ireland, Portugal, Finland, Luxembourg, Belgium, Austria, and the Netherlands) implemented a single currency zone, the Economic and Monetary Union (EMU). The new currency, the Euro, has become the official currency of the participating countries. Those countries' financial markets and banking systems have been quoting financial and treasury data in Euros since January 1, 1999.

The Euro is existing alongside the old national currencies during a transition period from January 1, 1999, to January 1, 2002. During this period, entities within participating countries must complete changes that enable them to transact in the Euro. National currencies will be withdrawn no later than July 1, 2002, and current plans indicate that Central Banks in most member countries expect to have withdrawn notes and coins by February 2002. This transition to the Euro currency involves changing budgetary, accounting, pricing, costing, and fiscal systems in companies and public administrations, as well as the simultaneous handling of parallel currencies and conversion of data. During 1999 and 2000, the Euro weakened against the U.S. Dollar and the

British Pound. The Euro needs to be observed over a longer period before conclusions can be drawn on the currency's long-term strength.

In early 1998, management formed a task force to monitor EMU developments, evaluate the impact of the Euro conversion on the Company's operations, and develop and execute action plans, as necessary. Required business strategy, system, and process changes within the Company's European region have been completed in accordance with the Company's timetable, in order to be ready to transact with those suppliers and customers with whom it was agreed to do so during 2001.

The Company's Euro program consists of two phases. Phase I aims to provide the business with the capability to recognize the Euro as the local currency for customer order-taking, invoice processing, and supplier payment purposes. The Company has completed the necessary changes to order management and related financial systems based on the current systems architecture and software. During December 2000, the Company successfully converted over 600 customers across Europe to Euro-based order-taking and invoicing.

In Phase II, the more significant portion of the program, all business systems (for example, raw materials management, manufacturing, warehousing, and human resource systems) and associated business processes will be reviewed and modified, as necessary, to handle the Euro as a functional currency. Legally, this capability must exist in Company business units operating in EMU member countries from January 1, 2002. Operational systems and business processes will continue to be analyzed and modified during 2001 in order to comply with the legal timetable. Management believes the project is on target to meet this date.

Although management currently believes the Company will be able to accommodate any required changes in its operations, there can be no assurance that the Company, its customers, suppliers, financial service providers, or government agencies will meet all of the Euro currency requirements on a timely basis. This is, in part, because new requirements may

emerge from individual national governments at later stages. Such failure to complete the necessary work could result in material financial risk.

Accounting and disclosure changes

Through June 2000, operations were managed via four major geographic areas – North America, Europe, Asia-Pacific, and Latin America. Beginning in July 2000, the Company changed its organizational structure, such that U.S. operations were managed separately. In October 2000, management announced a reorganization of the Company into two major divisions – U.S. and International – with International further delineated into Europe, Latin America, Canada, Australia, and Asia. Thus, beginning in the fourth quarter of 2000, the Company's reportable operating segments under Statement of Financial Accounting Standards (SFAS) No. 131 "Disclosures about Segments of an Enterprise and Related Information" consist of the United States, Europe, and Latin America. All other geographic areas have been combined under the quantitative threshold guidelines of SFAS No. 131 for purposes of disclosure.

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." This Statement establishes accounting and reporting standards for derivative instruments, requiring recognition of the fair value of all derivatives as assets or liabilities on the balance sheet. SFAS No. 133, as amended by Statements No. 137 and No. 138, is effective for fiscal years beginning after June 15, 2000. The Company adopted SFAS No. 133 on January 1, 2001. Management does not expect the adoption to have a significant impact on the Company's 2001 financial results.

In May 2000, the Emerging Issues Task Force (EITF) of the FASB reached consensus on Issue No. 00-14 "Accounting for Certain Sales Incentives." This Issue addresses the recognition, measurement, and income statement classification of sales incentives offered by vendors (including manufacturers) that have the effect of reducing the price of a product or

service to a customer at the point of sale. For cash sales incentives within the scope of this Issue, costs are generally recognized at the date on which the related revenue is recorded by the vendor and are to be classified as a reduction of revenue. For non-cash sales incentives, such as package inserts, costs are to be classified within cost of sales. Companies are to apply this consensus no later than in (a) annual financial statements for the fiscal year beginning after December 15, 1999, or (b) financial statements for the fiscal quarter beginning after March 15, 2001, whichever is later. The effect of adoption resulting from changes in recognition and measurement is reported either prospectively or as a cumulative effect of a change in accounting principle. As a result of adopting EITF No. 00-14 in the quarter ended June 30, 2001, the Company will report the cost of consumer coupons as a reduction of net sales and the cost of package inserts and similar items within cost of goods sold. The Company has historically reported these costs as promotional expenditures within selling, general, and administrative expense. As a result, full-year 2001 net sales are expected to decrease by \$90-\$100 million and cost of goods sold is expected to increase by \$60-\$70 million. (These estimates exclude the impact of the expected acquisition of Keebler Foods Company during the first quarter 2001.) Selling, general, and administrative expense will correspondingly decrease, such that net earnings will not be affected. The Statement of Earnings for all comparative periods will be consistently reclassified resulting in the following impacts for the full-year 2000: net sales decrease of approximately \$94 million, cost of goods sold increase of approximately \$75 million, and selling, general, and administrative expense decrease of approximately \$169 million.

Forward-looking statements

This Report contains "forward-looking statements" with projections concerning, among other things, the Company's strategy and plans for 2001; the Keebler acquisition and the Company's sales, products, distribution systems, business, and results after its completion; the 2001 effective income tax rate; charges, benefits, and savings from restructuring ac-

tions and streamlining initiatives; 2001 amortization expense and property addition expenditures; the terms of the debt to be issued to finance the Keebler acquisition; the 2001 interest expense; the results of the Euro conversion; and the impact of any accounting and disclosure changes. Forward-looking statements include predictions of future results or activities and may contain the words "expects," "believes," "will," "will deliver," "anticipates," "projects," or words or phrases of similar meaning. For example, forward-looking statements are found in several sections of Management's Discussion and Analysis above. The Company's actual results or activities may differ materially from these predictions. In particular, future results or activities could be affected by factors related to the pending Keebler acquisition, including integration problems, failures to achieve synergies, unanticipated liabilities, and the substantial amount of indebtedness incurred to finance the acquisition (which could, among other things, hinder the Company's ability to adjust rapidly to changing market conditions, make the Company more vulnerable in the event of a downturn, and place the Company at a competitive disadvantage in relation to less-leveraged competitors). The Company's future results could be affected by a variety of other factors, including competitive conditions and their impact, pricing and promotional and marketing spending, and/or incremental pricing actions on actual volumes and product mix; the effectiveness of advertising and marketing spending or programs; the success of new product introductions; the levels of spending on system initiatives, properties, business opportunities, integration of acquired businesses, and other general and administrative costs; the availability of and interest rates on short-term financing; changes in consumer preferences; commodity price and labor cost fluctuations; expenditures necessary to carry out streamlining initiatives and savings derived therefrom; foreign currency exchange rate fluctuations; changes in statutory tax and other laws; and other items. Forward-looking statements speak only as of the date they were made, and the Company undertakes no obligation to publicly update them.

Kellogg Company and Subsidiaries

Selected Financial Data

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

	2000	1999	1998	1997	1996
Operating Trends					
Net sales	\$6,954.7	\$6,984.2	\$6,762.1	\$6,830.1	\$6,676.6
Gross profit as a % of net sales	52.2%	52.4%	51.5%	52.1%	53.2%
Depreciation	275.6	273.6	261.8	272.0	251.5
Amortization	15.0	14.4	16.3	15.3	5.5
Advertising expense	604.2	674.1	695.3	780.4	778.9
R&D expense	118.4	104.1	121.9	106.1	84.3
Operating profit (a)	989.8	828.8	895.1	1,009.1	958.9
Operating profit, excluding charges	1,076.3	1,073.4	965.6	1,193.2	1,095.0
Operating profit, excluding charges, as a % of net sales	15.5%	15.4%	14.3%	17.5%	16.4%
Interest expense	137.5	118.8	119.5	108.3	65.6
Earnings before accounting change (a)(b)	587.7	338.3	502.6	564.0	531.0
Average shares outstanding (c)	405.6	405.2	407.8	414.1	424.9
Earnings before accounting change per common share (a)(b)(c)	1.45	.83	1.23	1.36	1.25

(a) Operating profit for 2000 includes restructuring charges of \$86.5 (\$64.2 after tax or \$.16 per share). Operating profit for 1999 includes restructuring charges of \$244.6 (\$156.4 after tax or \$.40 per share). Earnings before accounting change for 1999 include disposition-related charges of \$168.5 million (\$111.5 million after tax or \$.27 per share). Operating profit for 1998 includes restructuring charges of \$70.5 (\$46.3 after tax or \$.12 per share). Operating profit for 1997 includes restructuring charges of \$161.1 and asset impairment losses of \$23.0 (\$140.5 after tax or \$.34 per share). Operating profit for 1996 includes restructuring charges of \$136.1 (\$97.8 after tax or \$.23 per share). Earnings before accounting change for 1996 include a charge of \$35.0 (\$22.3 after tax or \$.05 per share) for a contribution to the Kellogg's Corporate Citizenship Fund. Refer to the Management's Discussion and Analysis on pages 15-22 and Notes 2 and 3 within Notes to Consolidated Financial Statements for further explanation of charges for years 1998-2000.

	2000	1999	1998	1997	1996
Cash Flow Trends					
Net cash provided from operating activities	\$ 880.9	\$ 795.2	\$ 719.7	\$ 879.8	\$ 711.5
Capital expenditures	230.9	266.2	373.9	312.4	307.3
Net cash provided from operating activities reduced by capital expenditures	650.0	529.0	345.8	567.4	404.2
Net cash used in investing activities	(379.3)	(244.2)	(398.0)	(329.3)	(786.8)
Net cash (used in) provided from financing activities	(441.8)	(527.6)	(358.3)	(607.3)	94.0
Interest coverage ratio (d)	9.9	11.5	10.4	13.7	20.6
Capital Structure Trends					
Total assets	\$4,896.3	\$4,808.7	\$5,051.5	\$4,877.6	\$5,050.0
Property, net	2,526.9	2,640.9	2,888.8	2,773.3	2,932.9
Short-term debt	1,386.3	521.5	621.5	579.8	1,153.8
Long-term debt	709.2	1,612.8	1,614.5	1,415.4	726.7
Shareholders' equity	897.5	813.2	889.8	997.5	1,282.4
Share Price Trends					
Stock price range (c)	\$ 21-32	\$ 30-42	\$ 30-50	\$ 32-50	\$ 31-40
Cash dividends per common share (c)	.995	.96	.92	.87	.81
Number of employees	15,196	15,051	14,498	14,339	14,511

(b) Earnings before accounting change for 1997 exclude the effect of a charge of \$18.0 after tax (\$.04 per share) to write off business process reengineering costs in accordance with guidance issued by the Emerging Issues Task Force of the FASB.

(c) All share data retroactively restated to reflect a 2-for-1 stock split in 1997. All earnings per share data represent both basic and diluted earnings per share.

(d) Interest coverage ratio was calculated based on operating profit excluding charges [refer to note (a)], depreciation, and amortization divided by interest expense.

Kellogg Company and Subsidiaries

Consolidated Statement of Earnings

Year ended December 31,

<i>(millions, except per share data)</i>	2000	1999	1998
Net sales	\$6,954.7	\$6,984.2	\$6,762.1
Cost of goods sold	3,327.0	3,325.1	3,282.6
Selling, general, and administrative expense	2,551.4	2,585.7	2,513.9
Restructuring charges	86.5	244.6	70.5
Operating profit	\$ 989.8	\$ 828.8	\$ 895.1
Interest expense	137.5	118.8	119.5
Disposition-related charges	—	168.5	—
Other income (expense), net	15.4	(4.8)	6.9
Earnings before income taxes	\$ 867.7	\$ 536.7	\$ 782.5
Income taxes	280.0	198.4	279.9
Net earnings	\$ 587.7	\$ 338.3	\$ 502.6
Net earnings per share (basic and diluted)	\$ 1.45	\$.83	\$ 1.23

Refer to Notes to Consolidated Financial Statements.

Kellogg Company and Subsidiaries

Consolidated Statement of Shareholders' Equity

(millions)	Common stock		Capital in excess of par value	Retained earnings	Treasury stock		Accumulated other comprehensive income	Total shareholders' equity	Total comprehensive income
	shares	amount			shares	amount			
Balance, January 1, 1998	414.8	\$103.7	\$ 92.6	\$1,240.4	4.1	(\$157.3)	(\$281.9)	\$997.5	
Common stock repurchases					6.3	(239.7)		(239.7)	
Net earnings				502.6				502.6	\$502.6
Dividends				(375.3)				(375.3)	
Other comprehensive income							(10.5)	(10.5)	(10.5)
Stock options exercised and other	.5	.1	12.4		(.1)	2.7		15.2	
Balance, December 31, 1998	415.3	\$103.8	\$105.0	\$1,367.7	10.3	(\$394.3)	(\$292.4)	\$889.8	\$492.1
Common stock repurchases								—	
Net earnings				338.3				338.3	338.3
Dividends				(388.7)				(388.7)	
Other comprehensive income							(39.0)	(39.0)	(39.0)
Stock options exercised and other	.2		(.5)	(.1)	(.3)	13.4		12.8	
Balance, December 31, 1999	415.5	\$103.8	\$104.5	\$1,317.2	10.0	(\$380.9)	(\$331.4)	\$813.2	\$299.3
Common stock repurchases								—	
Net earnings				587.7				587.7	587.7
Dividends				(403.9)				(403.9)	
Other comprehensive income							(103.9)	(103.9)	(103.9)
Stock options exercised and other			(2.5)		(.2)	6.9		4.4	
Balance, December 31, 2000	415.5	\$103.8	\$102.0	\$1,501.0	9.8	(\$374.0)	(\$435.3)	\$897.5	\$483.8

Refer to Notes to Consolidated Financial Statements.

Kellogg Company and Subsidiaries

Consolidated Balance Sheet

At December 31,

<i>(millions, except share data)</i>	2000	1999
Current assets		
Cash and cash equivalents	\$ 204.4	\$ 150.6
Accounts receivable, net	685.3	678.5
Inventories	443.8	503.8
Other current assets	273.3	236.3
Total current assets	\$1,606.8	\$1,569.2
Property, net	2,526.9	2,640.9
Other assets	762.6	598.6
Total assets	\$4,896.3	\$4,808.7
Current liabilities		
Current maturities of long-term debt	\$ 901.1	\$ 2.9
Notes payable	485.2	518.6
Accounts payable	388.2	305.3
Other current liabilities	718.1	761.0
Total current liabilities	\$2,492.6	\$1,587.8
Long-term debt	709.2	1,612.8
Other liabilities	797.0	794.9
Shareholders' equity		
Common stock, \$.25 par value, 1,000,000,000 shares authorized Issued: 415,451,198 shares in 2000 and 415,451,198 in 1999	103.8	103.8
Capital in excess of par value	102.0	104.5
Retained earnings	1,501.0	1,317.2
Treasury stock at cost: 9,812,543 shares in 2000 and 9,995,564 shares in 1999	(374.0)	(380.9)
Accumulated other comprehensive income	(435.3)	(331.4)
Total shareholders' equity	\$ 897.5	\$ 813.2
Total liabilities and shareholders' equity	\$4,896.3	\$4,808.7

Refer to Notes to Consolidated Financial Statements.

Kellogg Company and Subsidiaries

Consolidated Statement of Cash Flows

Year ended December 31,

<i>(millions)</i>	2000	1999	1998
Operating activities			
Net earnings	\$587.7	\$338.3	\$502.6
Items in net earnings not requiring (providing) cash:			
Depreciation and amortization	290.6	288.0	278.1
Deferred income taxes	(1.4)	(60.5)	46.2
Restructuring charges, net of cash paid	62.5	220.1	62.2
Disposition-related charges	—	168.5	—
Other	(1.2)	65.7	21.7
Pension and other postretirement benefit contributions	(84.3)	(78.1)	(88.8)
Changes in operating assets and liabilities	27.0	(146.8)	(102.3)
Net cash provided from operating activities	\$880.9	\$795.2	\$719.7
Investing activities			
Additions to properties	(230.9)	(266.2)	(373.9)
Acquisitions of businesses	(137.2)	(298.2)	(27.8)
Dispositions of businesses	—	291.2	—
Property disposals	4.8	36.6	6.8
Other	(16.0)	(7.6)	(3.1)
Net cash used in investing activities	(\$379.3)	(\$244.2)	(\$398.0)
Financing activities			
Net increase (reduction) of notes payable, with maturities less than or equal to 90 days	290.5	(410.8)	(152.9)
Issuances of notes payable, with maturities greater than 90 days	3.5	292.1	5.5
Reductions of notes payable, with maturities greater than 90 days	(331.6)	(19.0)	(.8)
Issuances of long-term debt	—	—	600.0
Reductions of long-term debt	(4.8)	(14.1)	(210.3)
Net issuances of common stock	4.5	12.9	15.2
Common stock repurchases	—	—	(239.7)
Cash dividends	(403.9)	(388.7)	(375.3)
Net cash used in financing activities	(\$441.8)	(\$527.6)	(\$358.3)
Effect of exchange rate changes on cash	(6.0)	(9.2)	(.2)
Increase (decrease) in cash and cash equivalents	53.8	14.2	(36.8)
Cash and cash equivalents at beginning of year	150.6	136.4	173.2
Cash and cash equivalents at end of year	\$204.4	\$150.6	\$136.4

Refer to Notes to Consolidated Financial Statements.

Kellogg Company and Subsidiaries

Notes to Consolidated Financial Statements

Note 1 Accounting policies

Consolidation

The consolidated financial statements include the accounts of Kellogg Company and its majority-owned subsidiaries. Inter-company balances and transactions are eliminated.

Certain amounts in the prior-year financial statements have been reclassified to conform to the current-year presentation.

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.

Property

Fixed assets are recorded at cost and depreciated over estimated useful lives using straight-line methods for financial reporting and accelerated methods for tax reporting. Cost includes an amount of interest associated with significant capital projects.

Goodwill and other intangible assets

Intangible assets are amortized principally on a straight-line basis over the estimated periods benefited, generally 40 years for goodwill and periods ranging from 5 to 40 years for other intangible assets. The realizability of goodwill and other intangibles is evaluated periodically when events or circumstances indicate a possible inability to recover the carrying amount. Evaluation is based on undiscounted cash flow projections over the remaining life of the asset. An excess of carrying value over cash flows would result in recognition of an impairment loss. The amount of the loss would be based on the difference between carrying value and fair value of the asset, as measured by market comparables or discounted cash flows in the absence of market data.

Revenue recognition

The Company recognizes sales upon delivery of its products to customers net of applicable provisions for discounts, returns, and allowances.

Advertising

The costs of advertising are generally expensed as incurred.

Recently adopted pronouncements

Effective January 1, 1999, the Company adopted two Statements of Position (SOP) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. SOP 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" provides guidance on the classification of software project costs between expense and capital. SOP 98-5 "Reporting on Costs of Start-up Activities" prescribes that the costs of opening a new facility, commencing business in a new market, or similar start-up activities must be expensed as incurred. SOP 98-1 has been applied on a prospective basis from January 1, 1999. The initial application of SOP 98-5 was to be reported as a cumulative effect of a change in accounting principle, if material. The adoption of these SOPs did not have a significant impact on the Company's financial results during 1999.

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities." This Statement establishes accounting and reporting standards for derivative instruments, requiring recognition of the fair value of all derivatives as assets or liabilities on the balance sheet. SFAS No. 133, as amended by Statements No. 137 and No. 138, is effective for fiscal years beginning after June 15, 2000. The Company adopted SFAS No. 133 on January 1, 2001. Management does not expect the adoption to have a significant impact on the Company's 2001 financial results.

Recently issued pronouncements

In May 2000, the Emerging Issues Task Force (EITF) of the FASB reached consensus on Issue No. 00-14 "Accounting for Certain Sales Incentives." This Issue addresses the recognition, measurement, and income statement classification of sales incentives offered by vendors (including manufacturers) that have the effect of reducing the price of a product or service to a customer at the point of sale. For cash sales incentives within the scope of this Issue, costs are generally recognized at the date on which the related revenue is recorded by the vendor and are to be classified as a reduction of revenue. For non-cash sales incentives, such as package inserts, costs are to be classified within cost of sales. Companies are to apply this consensus no later than in (a) annual financial statements for the fiscal year beginning after December 15, 1999, or (b) financial statements for the fiscal quarter beginning after March 15, 2001, whichever is later. The effect of adoption resulting from changes in recognition and measurement is reported either prospectively or as a cumulative effect of a change in accounting principle. As a result of adopting EITF No. 00-14 in the quarter ended June 30, 2001, the Company will report the cost of consumer coupons as a reduction of net sales and the cost of package inserts and similar items within cost of goods sold. The Company has historically reported these costs as promotional expenditures within selling, general, and administrative expense. As a result, full-year 2001 net sales are expected to decrease by \$90-\$100 million and cost of goods sold is expected to increase by \$60-\$70 million. (These estimates exclude the impact of the expected acquisition of Keebler Foods Company during the first quarter 2001.) Selling, general, and administrative expense will correspondingly decrease, such that net earnings will not be affected. The Statement of Earnings for all comparative periods will be consistently reclassified resulting in the following impacts for the full-year 2000: net sales decrease of approximately \$94 million, cost of goods sold increase of approximately \$75 million, and selling, general, and administrative expense decrease of approximately \$169 million.

Stock compensation

The Company follows Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," in accounting for its employee stock options and other stock-based compensation. Under APB No.25, 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. As permitted, the Company has elected to adopt the disclosure provisions only of SFAS No.123, "Accounting for Stock-Based Compensation." Refer to Note 8 for further information.

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 Acquisitions, investments, and dispositions

Acquisitions and investments

In January 2000, the Company purchased certain assets and liabilities of the Mondo Baking Company Division of Southeastern Mills, Inc. for approximately \$93 million in cash, including related acquisition costs. Mondo Baking Company, located in Rome, Georgia, has manufactured convenience foods for Kellogg since 1993. The acquisition was accounted for as a purchase and was financed through short-term borrowings. Assets acquired consist primarily of a manufacturing facility and assembled workforce.

During June 2000, the Company acquired the outstanding stock of Kashi Company for approximately \$32 million in cash. Kashi is a leading natural cereal company located in La Jolla, California. Also during June, the Company committed to invest \$7 million of cash in Transora, a new global business-to-business e-marketplace for the consumer products industry. As of year-end 2000, the Company has paid \$3.5 million under this commitment. The investment in Transora has been accounted for under the cost method. In July 2000, the Company acquired certain assets and liabilities of a convenience foods operation located in Australia for

approximately \$12 million in cash. The Company is operating this business under *The Healthy Snack People*™ name.

In November 1999, the Company purchased the outstanding common stock of Worthington Foods, Inc. for approximately \$300 million in cash, including related acquisition costs. Additionally, during December 1999, the Company paid off approximately \$50 million of Worthington debt existing at the acquisition date. Worthington Foods, Inc. is the leading manufacturer and marketer of soy protein-based meat alternatives and other healthful foods. The acquisition was accounted for as a purchase and was financed through short-term borrowings. Results of Worthington Foods, Inc. operations have been included in the Company's consolidated results from the date of acquisition.

The components of intangible assets included in the final allocation of purchase price, along with the related straight-line amortization periods, were:

	Amount (millions)	Amortization period (yrs.)
Trademarks and tradenames	\$100.0	40
Goodwill	190.0	40
Total	\$290.0	

The purchase price allocation included approximately \$12 million of exit liabilities, comprised principally of employee involuntary separation and relocation benefits, of which approximately \$3 million remained as of December 31, 2000.

The unaudited pro forma combined historical results, as if Worthington Foods, Inc. had been acquired at the beginning of fiscal 1999 and 1998, respectively, are estimated to be:

(millions, except per share data)	1999	1998
Net sales	\$7130.1	\$6,901.6
Net earnings	\$ 323.6	\$ 493.3
Net earnings per share	\$.80	\$ 1.21

The pro forma results include amortization of the intangibles presented above and interest expense on debt assumed issued to finance the purchase. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of each of the fiscal periods presented, nor are they necessarily indicative of future consolidated results.

Dispositions

During November 1999, the Company sold certain assets and liabilities of the Lender's Bagels business to Aurora Foods Inc. for \$275 million in cash. As a result of this transaction, the Company recorded a pretax charge of \$178.9 million (\$119.3 million after tax or \$.29 per share). This charge included approximately \$57 million for disposal of other assets associated with the Lender's business, which were not purchased by Aurora. Disposal of these other assets was completed during 2000. The original reserve of \$57 million exceeded actual losses from asset sales and related disposal costs by approximately \$9 million. This amount was recorded as a credit to other income (expense), net during the year.

During July 1999, the Company sold its 51% interest in a United Kingdom corn milling operation to Cargill Inc., which owned the remaining 49%. As a result of this sale, the Company recorded a pretax gain of \$10.4 million (\$7.8 million after tax or \$.02 per share).

In total, the Company recorded net disposition-related charges of \$168.5 million (\$111.5 million after tax or \$.27 per share) during the third quarter of 1999.

Keebler acquisition

The Company expects to complete its acquisition of Keebler Foods Company in March 2001, in a transaction entered into with Keebler and with Flowers Industries, Inc., the majority shareholder of Keebler. Keebler Foods Company, headquartered in Elmhurst, Illinois, ranks second in the United States in the cookie and cracker categories and has the third largest food direct store door (DSD) delivery system in the United States. Under the purchase agreement, the Company will pay \$42 in cash for each common share of Keebler or approximately \$3.6 billion, including related acquisition costs. As a result of the acquisition, the Company will assume approximately \$700 million of Keebler debt and \$216 million in obligations to cash out employee stock options, for a total projected cash outlay of approximately \$4.5 billion. The Company will finance the acquisition through a combination of short and long-term debt. The acquisition will be accounted for as a purchase.

Note 3 Restructuring charges

Operating profit for 2000 includes restructuring charges of \$86.5 million (\$64.2 million after tax or \$.16 per share) for streamlining initiatives.

Operating profit for 1999 includes restructuring charges of \$244.6 million (\$156.4 million after tax or \$.40 per share) for streamlining initiatives.

Operating profit for 1998 includes restructuring charges of \$70.5 million (\$46.3 million after tax or \$.12 per share) for streamlining initiatives.

During the past several years, management has commenced major productivity and operational streamlining initiatives in an effort to optimize the Company's cost structure and align resources with the Company's growth strategy. The incremental costs of these programs have been reported during these years as restructuring charges.

The 2000 charges of \$86.5 million consist of \$65.2 million for actions supporting the Company's "focus and align" strategy and \$21.3 million for a supply chain efficiency initiative in Europe.

In the fourth quarter of 2000, management adopted the "focus and align" strategy, emphasizing a stricter prioritization for resource allocation to the United States and the Company's other core markets. In conjunction with this strategy, the Company was reorganized from four operating areas into two divisions – U.S. and International. As a result, management initiated restructuring actions around the world to support this strategy and organization, including staff reductions in its global supply chain and innovation organization, rationalization of international convenience foods capacity, and restructuring of various non-core markets to improve return on investment. Approximately one-half of the total charges are comprised of asset write-offs with the remainder consisting primarily of cash costs associated with involuntary employee separation programs. Approximately 500 salaried and hourly positions were eliminated, primarily during the fourth quarter of 2000. As a result of these initiatives, the Company currently expects to realize approximately \$45 million on a pretax basis from cost reductions and elimination of operating losses in 2001.

During the second quarter of 2000, the Company implemented a supply chain efficiency initiative in Europe. The restructuring charges from this program were comprised principally of voluntary employee retirement and separation benefits. This program resulted in hourly and salaried headcount reductions of 190 during 2000 and is currently expected to generate approximately \$13 million in pretax savings in 2001.

The 1999 restructuring charges consist of \$193.2 million for closing the South Operations portion of the Company's Battle Creek, Michigan, cereal plant, \$32.7 million for workforce reduction initiatives around the world, and \$18.7 million, primarily for manufacturing equipment write-offs related to previously closed or impaired facilities in various locations.

Approximately one-half of the 1999 charges for the South Operations closing are comprised of asset write-offs, with the remainder consisting primarily of cash costs for employee retirement and separation benefits, equipment removal, and building demolition. As part of the Company's strategy of continuing cost reduction and efficiency improvement, these operations were closed in October 1999. Some production capacity was relocated to the Company's other U.S. cereal plants. Approximately 525 hourly and salaried positions at the Battle Creek plant were eliminated by the end of the first quarter of 2000 through a combination of voluntary and involuntary separation programs. These actions resulted in pretax savings of approximately \$30 million in 2000 and are currently expected to result in a further \$10 million in savings in 2001, for a total 2001 benefit of \$40 million.

The 1999 charges for workforce reduction initiatives are comprised principally of employee retirement and separation benefit costs in all of the Company's operating segments and in corporate operations. These initiatives eliminated approximately 325 employee positions in Europe, Latin America, Australia, and Asia during 1999 and generated approximately \$15 million of pretax savings during 1999, and a further \$10 million in pretax savings in 2000, for a total 2000 benefit of \$25 million.

The 1998 restructuring charges of \$70.5 million relate primarily to an overhead activity analysis that resulted in the elimination of approximately 550 employees and 240 contractors from the Company's headquarters and U.S. and Canadian operations

through a combination of involuntary early retirement and severance programs. The charges consist mainly of employee retirement and separation benefits. This program generated approximately \$100 million of pretax savings during 1999.

Incremental pretax savings achieved or expected from streamlining initiatives by year, and the relative impact on captions within the Consolidated Statement of Earnings, are:

(millions)	Incremental pretax savings	Relative impact on	
		Cost of goods sold	SGA (a)
1998	\$ 10	75%	25%
1999	125	10%	90%
2000	50	80%	20%
2001 expected	75	50%	50%

(a) Selling, general, and administrative expense.

Total cash outlays incurred or expected for streamlining initiatives by year are:

(millions)	
1998	\$47
1999	69
2000	68
2001 expected	38
2002 expected	2

The Company's streamlining initiatives are expected to continue in 2001, related primarily to the integration of the Kellogg and Keebler business models. In addition to incurring integration costs throughout 2001, during the first quarter of 2001 the Company expects to report restructuring charges for staff reductions and inventory and capacity rationalization as a result of this integration. As many of these initiatives are in the early stages of completion, management is currently unable to estimate the total amount of charges to be reported. Cash outlays and savings related to this integration are not included in the tables above.

The components of the restructuring charges by initiative, as well as reserve balances remaining at December 31, 2000, 1999, and 1998, were:

U.S. operational streamlining	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$ —	\$ —	\$15.1	\$ —	\$ 15.1
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	—	—	(6.6)	—	(6.6)
Remaining reserve at December 31, 1998	—	—	8.5	—	8.5
1999 restructuring charges	55.5	108.4	28.2	1.1	193.2
Amounts utilized during 1999	(34.1)	(108.4)	(8.6)	(1.1)	(152.2)
Remaining reserve at December 31, 1999	21.4	—	28.1	—	49.5
2000 restructuring charges	—	—	—	—	—
Amounts utilized during 2000	(20.0)	—	(17.4)	—	(37.4)
Remaining reserve at December 31, 2000	\$ 1.4	\$ —	\$10.7	\$ —	\$ 12.1

Pan-European reorganization	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$19.4	\$ —	\$10.1	\$ —	\$29.5
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	(17.6)	—	(11.5)	—	(29.1)
Remaining reserve at December 31, 1998 (b)	1.8	—	(1.4)	—	.4
1999 restructuring charges	10.9	10.9	.6	—	22.4
Amounts utilized during 1999	(10.0)	(10.9)	(.4)	—	(21.3)
Remaining reserve at December 31, 1999 (b)	2.7	—	(1.2)	—	1.5
2000 restructuring charges	19.6	—	—	1.7	21.3
Amounts utilized during 2000	(21.3)	—	1.2	(1.7)	(21.8)
Remaining reserve at December 31, 2000	\$ 1.0	\$ —	\$ —	\$ —	\$ 1.0

Australian plant productivity program	Employee retirement & severance benefits	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$ 4.0	\$ —	\$2.5	\$ —	\$ 6.5
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	(1.4)	—	(.9)	—	(2.3)
Remaining reserve at December 31, 1998	2.6	—	1.6	—	4.2
1999 restructuring charges	1.5	.2	(.4)	.1	1.4
Amounts utilized during 1999	(1.0)	(.2)	(.6)	(.1)	(1.9)
Remaining reserve at December 31, 1999	3.1	—	.6	—	3.7
2000 restructuring charges	—	—	—	—	—
Amounts utilized during 2000	(3.1)	—	(.6)	—	(3.7)
Remaining reserve at December 31, 2000	\$ —	\$ —	\$ —	\$ —	\$ —

North American overhead activity analysis	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$ —	\$ —	\$ —	\$ —	\$ —
1998 restructuring charges	57.1	5.2	3.0	1.8	67.1
Amounts utilized during 1998	(22.7)	(5.2)	(.1)	(1.8)	(29.8)
Remaining reserve at December 31, 1998	34.4	—	2.9	—	37.3
1999 restructuring charges	5.5	—	1.1	4.5	11.1
Amounts utilized during 1999	(35.7)	—	(3.0)	(4.5)	(43.2)
Remaining reserve at December 31, 1999	4.2	—	1.0	—	5.2
2000 restructuring charges	—	—	—	—	—
Amounts utilized during 2000	(3.1)	—	(.5)	—	(3.6)
Remaining reserve at December 31, 2000	\$ 1.1	\$ —	\$.5	\$ —	\$ 1.6

Global strategy realignment	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$ —	\$ —	\$ —	\$ —	\$ —
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	—	—	—	—	—
Remaining reserve at December 31, 1998	—	—	—	—	—
1999 restructuring charges	—	—	—	—	—
Amounts utilized during 1999	—	—	—	—	—
Remaining reserve at December 31, 1999	—	—	—	—	—
2000 restructuring charges	25.7	29.9	7.3	2.3	65.2
Amounts utilized during 2000	(5.9)	(29.9)	(1.6)	(2.3)	(39.7)
Remaining reserve at December 31, 2000	\$19.8	\$ —	\$5.7	\$ —	\$25.5

All other	Employee retirement & severance benefits	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$.2	\$ —	\$.6	\$ —	\$.8
1998 restructuring charges	2.7	.3	—	.4	3.4
Amounts utilized during 1998	(2.1)	(.3)	(.3)	(.4)	(3.1)
Remaining reserve at December 31, 1998	.8	—	.3	—	1.1
1999 restructuring charges	4.8	11.7	—	—	16.5
Amounts utilized during 1999	(5.6)	(11.7)	(.3)	—	(17.6)
Remaining reserve at December 31, 1999	—	—	—	—	—
2000 restructuring charges	—	—	—	—	—
Amounts utilized during 2000	—	—	—	—	—
Remaining reserve at December 31, 2000	\$ —	\$ —	\$ —	\$ —	\$ —

Consolidated	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (c)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1997	\$23.6	\$ —	\$28.3	\$ —	\$51.9
1998 restructuring charges	59.8	5.5	3.0	2.2	70.5
Amounts utilized during 1998	(43.8)	(5.5)	(19.4)	(2.2)	(70.9)
Remaining reserve at December 31, 1998	39.6	—	11.9	—	51.5
1999 restructuring charges	78.2	131.2	29.5	5.7	244.6
Amounts utilized during 1999	(86.4)	(131.2)	(12.9)	(5.7)	(236.2)
Remaining reserve at December 31, 1999	31.4	—	28.5	—	59.9
2000 restructuring charges	45.3	29.9	7.3	4.0	86.5
Amounts utilized during 2000	(53.4)	(29.9)	(18.9)	(4.0)	(106.2)
Remaining reserve at December 31, 2000	\$23.3	\$ —	\$16.9	\$ —	\$40.2

(a) Includes pension and postretirement health care curtailment losses and special termination benefits recognized as follows (refer to Notes 9 and 10):

	2000	1999	1998
U.S. operational streamlining	\$—\$32	\$ —	—
Pan-European reorganization	5	—	—
North American overhead activity analysis	—	4	18
Global strategy realignment	3	—	—
Consolidated	\$ 8	\$36	\$18

(b) Negative removal reserves in Europe result from netting of anticipated proceeds from asset sales with removal costs.

(c) Consist primarily of program-related non-exit costs incurred during the period of the reported charge.

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 2000 includes a credit of approximately \$12 million related to the 1999 sale of the Lender's Bagels business. The total amount consists of approximately \$9 million for disposal of assets associated with the business which were not purchased by Aurora Foods Inc. (refer to Note 2) and approximately \$3 million for final working capital settlement with Aurora.

Other income (expense), net for 1998 includes a credit of approximately \$6 million related to settlement of certain litigation. During 1996, the Company included in operating profit a provision of \$15 million for the potential settlement of this litigation, which brought the total settlement reserve to \$18 million. This litigation was settled during the second quarter of 1998 for a cost of approximately \$12 million, and the remaining reserve of approximately \$6 million was reversed.

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 and had an insignificant impact on earnings per share during the periods

presented. Basic net earnings per share is reconciled to diluted net earnings per share as follows:

<i>(millions, except per share data)</i>	Net earnings	Average shares outstanding	Net earnings per share
2000			
Basic	\$587.7	405.6	\$1.45
Dilutive employee stock options	—	.2	—
Diluted	\$587.7	405.8	\$1.45
1999			
Basic	\$338.3	405.2	\$.83
Dilutive employee stock options	—	.5	—
Diluted	\$338.3	405.7	\$.83
1998			
Basic	\$502.6	407.8	\$1.23
Dilutive employee stock options	—	.8	—
Diluted	\$502.6	408.6	\$1.23

Comprehensive Income

Comprehensive income includes all changes in equity during a period except those resulting from investments by or distributions to shareholders. For the Company, comprehensive income for the periods presented consists of net earnings, minimum pension liability adjustments (refer to Note 9), and foreign currency translation adjustments pursuant to SFAS No. 52 "Foreign Currency Translation" as follows:

<i>(millions)</i>	2000	1999	1998
Net earnings	\$587.7	\$338.3	\$502.6
Other comprehensive income:			
Foreign currency translation adjustments	(97.4)	(39.0)	(11.1)
Minimum pension liability adjustments	(10.0)	—	—
Related tax effect	3.5	—	.6
	(103.9)	(39.0)	(10.5)
Total comprehensive income	\$483.8	\$299.3	\$492.1

Note 6 Leases

Operating leases are generally for equipment and warehouse space. Rent expense on all operating leases was \$36.7 million in 2000, \$31.5 million in 1999, and \$36.5 million in 1998. At December 31, 2000, future minimum annual rental commitments under non-cancelable operating leases totaled \$71 million consisting of (in millions): 2001-\$23; 2002-\$15; 2003-\$13; 2004-\$9; 2005-\$8; 2006 and beyond-\$3.

Note 7 Debt

Notes payable consist of commercial paper and other short-term borrowings in the United States and, to a lesser extent, bank loans of foreign subsidiaries at competitive market rates. U.S. borrowings at December 31, 2000, were \$429.8 million with an effective interest rate of 6.6%. U.S. borrowings at December 31, 1999, were \$448.3 million with an effective interest rate of 5.9%.

Additionally, the Company has entered into financing arrangements that provide for the sale of future foreign currency revenues. As of December 31, 2000, the Company had committed to borrowings during 2001 in the cumulative principal amount of approximately \$160 million. As of December 31, 1999, the Company had committed to borrowings during 2000 in the cumulative principal amount of approximately \$366 million. No borrowings were outstanding under these arrangements at December 31, 2000 or 1999. On January 1, 2001, these borrowing commitments were cancelled and replaced with foreign currency forward contracts.

At December 31, 2000, the Company had \$796.0 million of total short-term lines of credit, of which \$747.9 million were unused and available for borrowing on an unsecured basis.

Long-term debt at year-end consisted of:

(millions)	2000	1999
(a) Seven-Year Notes due 2005	\$ 200.0	\$ 200.0
(b) Seven-Year Notes due 2004	500.0	500.0
(c) Four-Year Notes due 2001	500.0	500.0
(d) Three-Year Notes due 2001	400.0	400.0
Other	10.3	15.7
	1,610.3	1,615.7
Less current maturities	(901.1)	(2.9)
Balance, December 31	\$ 709.2	\$1,612.8

(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. The Company entered into a series of interest rate hedges throughout 1998 to effectively fix the interest rate prior to issuance. The effect of the hedges, when combined with original issue discounts, resulted in an effective interest rate on this debt of 6.07%.

(b) In January 1997, the Company issued \$500 of seven-year 6.625% fixed rate Euro Dollar Notes. 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 6.354%. Associated with this debt, during September 1997, the Company entered into a \$225 notional, 4 1/2-year fixed-to-floating interest rate swap, indexed to the three-month London Interbank Offered Rate (LIBOR). Under the terms of this swap, if three-month LIBOR decreased to 4.71% or below, the swap would expire. The Company terminated this swap agreement in November 1999. The amount paid to discharge the agreement was insignificant.

(c) In August 1997, the Company issued \$500 of four-year 6.125% Euro Dollar Notes. In conjunction with this issuance, the Company settled \$400 notional amount of interest rate forward swap agreements that effectively fixed the interest rate on the debt at 6.4%. Associated with this debt, during September 1997, the Company entered into a \$200 notional, four-year fixed-to-floating interest rate swap, indexed to three-month LIBOR.

(d) In February 1998, the Company issued \$400 of three-year 5.75% fixed rate U.S. Dollar Notes. These Notes were issued under an existing "shelf registration" with the Securities and Exchange Commission, and provided an option to holders to extend the obligation for an additional four years at a predetermined interest rate of 5.63% plus the Company's then-current credit spread. As a result of this option, the effective interest rate on the three-year Notes was 5.23%. Concurrent with this issuance, the Company entered into a \$400 notional, three-year fixed-to-floating interest rate swap, indexed to the Federal Reserve AA Composite Rate on 30-day commercial paper. In February 2001, the Company will pay holders \$11.6 to extinguish the Notes prior to the extension date. Thus, the Company will report an extraordinary loss, net of tax, of \$74 during the first quarter of 2001.

Scheduled principal repayments on long-term debt are (in millions): 2001-\$901; 2002-\$1; 2003-\$1; 2004-\$500; 2005-\$200; 2006 and beyond-\$7.

Interest paid was (in millions): 2000-\$141; 1999-\$124; 1998-\$113. Interest expense capitalized as part of the construction cost of fixed assets was (in millions): 2000-\$5.6; 1999-\$8.4; 1998-\$7.8.

As discussed in Note 2, the Company expects to complete its acquisition of Keebler Foods Company in March 2001, resulting in a total projected cash outlay of approximately \$4.5 billion. To finance this transaction, the Company plans to issue a combination of short and long-term debt during the first quarter of 2001. In anticipation of these future issuances, during December 2000 the Company entered into \$1.5 billion notional amount of forward-starting interest rate swaps that effectively fixed a portion of the interest rate on an equivalent amount of debt prior to issuance. These swaps will be settled in conjunction with the issuances, resulting in cash payments or receipts that will be amortized to interest expense over periods of five to thirty years. If these swaps had been settled at December 31, 2000, the Company would have made a total cash payment to counterparties of approximately \$26 million. The incremental amount of interest expense related to this payment will generally be offset by a lower coupon rate on the underlying future debt issuance.

Following the Company's announcement of its agreement to acquire Keebler, Moody's and Standard & Poor's (S&P) placed the credit ratings of the Company's senior unsecured debt and commercial paper under review for possible downgrade. Due to the significant amount of incremental debt to be created in this transaction, S&P downgraded the Company's senior unsecured debt from AA to BBB and the Company's commercial paper from A-1 to A-2. Moody's downgraded the Company's senior unsecured debt from Aa2 to Baa2 and the Company's commercial paper from P-1 to P-2. These ratings are subject to revision or withdrawal at any time.

S&P assigns a 'BBB' credit rating to obligations which it considers to "exhibit adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation." Similarly, Moody's assigns a 'Baa' credit rating to obligations it considers to "be medium-grade obligations, i.e. neither highly protected nor poorly secured. Interest payments and principal security are considered adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time."

Note 8 Stock options

The Key Employee Long Term Incentive Plan provides for benefits to be awarded to executive-level employees in the form of incentive and non-qualified stock options, performance units, restricted stock grants and other stock-based awards. Options granted under this plan generally vest over two years with the restricted stock grants under this plan generally vesting in three years. Under the Key Employee Long Term Incentive Plan, approximately 100,000 shares were granted to eligible employees during 2000.

The 2001 Long Term Incentive Plan, approved by shareholders in 2000, provides for benefits to be awarded to employees and officers in the form of incentive and non-qualified stock options, performance shares, performance units, restricted stock grants, and other stock-based awards. Options granted under this plan generally vest over two years, subject to earlier vesting if a change of control occurs.

The Bonus Replacement Stock Option Plan allows certain key executives to receive stock options that generally vest immediately in lieu of part or all of their respective bonus. Options granted under this plan are issued from the Key Employee Long Term Incentive Plan.

The Kellogg Employee Stock Ownership Plan is designed to offer stock and other incentive awards based on Company performance to employees who are not eligible to participate in the Key Employee Long Term Incentive Plan. Options awarded under this plan generally vest over five years.

Options under all the 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 options.

The Key Employee Long Term Incentive Plan and the 2001 Long Term Incentive Plan 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 common stock. For all AOF options, the original expiration date is not changed but the options vest immediately.

The Non-Employee Director Stock 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 and annual grants of options to purchase 5,000 shares of the Company's common stock. The shares 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. During 2000, there were 57,500 options and 20,000 shares of common stock granted under this plan.

As permitted by SFAS No.123 "Accounting for Stock-Based Compensation", the Company has elected to account for the stock option plans under APB No. 25 "Accounting for Stock Issued to Employees." Accordingly, no compensation cost has been recognized for these plans.

For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Had compensation cost for the stock option plans been determined based on the fair value at the grant date consistent with SFAS No.123, the Company's net earnings and earnings per share are estimated as follows:

<i>(millions, except per share data)</i>	2000	1999	1998
Net earnings			
As reported	\$587.7	\$338.3	\$502.6
Pro forma	\$569.2	\$311.4	\$484.4
Net earnings per share (basic and diluted)			
As reported	\$ 1.45	\$.83	\$ 1.23
Pro forma	\$ 1.40	\$.77	\$ 1.19

The fair value of each option grant was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2000	1999	1998
Risk-free interest rate	6.59%	4.83%	5.56%
Dividend yield	3.90%	3.00%	2.00%
Volatility	25.43%	23.16%	21.28%
Average expected term (years)	3.17	3.76	3.47
Fair value of options granted	\$4.60	\$6.38	\$8.45

Transactions under these plans were:

<i>(millions, except per share data)</i>	2000	1999	1998
Under option, January 1	19.9	16.4	12.4
Granted	6.4	6.6	6.8
Exercised	(1)	(1.1)	(1.7)
Cancelled	(2.8)	(2.0)	(1.1)
Under option, December 31	23.4	19.9	16.4
Exercisable, December 31	13.7	10.1	8.7
Shares available, December 31, for options that may be granted under the following plans:			
Key Employee Long Term Incentive Plan	3.2	7.1	9.8
Kellogg Employee Stock Ownership Plan	4.8	4.6	6.0
2000 Non-employee Directors Stock Plan	.9	—	—
2001 Long Term Incentive Plan	26.0	—	—
Total shares available, December 31, for options that may be granted	34.9	11.7	15.8
Average prices per share			
Under option, January 1	\$38	\$38	\$35
Granted	24	36	43
Exercised	26	32	34
Cancelled	36	39	33
Under option, December 31	\$34	\$38	\$38
Exercisable, December 31	\$38	\$39	\$36

Employee stock options outstanding and exercisable under these plans as of December 31, 2000, were:

<i>(millions, except per share data)</i>					
Range of exercise prices	Outstanding		Exercisable		
	Number of options	Weighted average exercise price	Weighted average remaining contractual life (yrs.)	Number of options	Weighted average exercise price
\$15-29	7.6	\$25	8.7	1.5	\$27
30-39	9.3	36	7.1	6.2	36
40-44	5.8	43	7.3	5.3	43
45-50	0.7	48	6.7	0.7	48
	23.4			13.7	

Note 9 Pension benefits

The Company has a number of U.S. and foreign pension plans to provide retirement benefits for its employees. Benefits for salaried employees are generally based on salary and years of service, while union employee benefits are generally a negotiated amount for each year of service. Plan funding strategies are influenced by tax regulations. Plan assets consist primarily of equity securities with smaller holdings of bonds, real estate, and other investments. Investment in Company common stock represented 1.9% of consolidated plan assets at December 31, 2000 and 1999.

The components of pension expense were:

<i>(millions)</i>	2000	1999	1998
Service cost	\$34.5	\$42.6	\$41.3
Interest cost	91.1	83.7	81.3
Expected return on plan assets	(143.3)	(125.1)	(113.9)
Amortization of unrecognized transition obligation	.6	2.0	.7
Amortization of unrecognized prior service cost	7.0	7.4	7.5
Recognized net (gain) loss	(4.2)	10.9	10.0
Curtailment loss and special termination benefits	8.5	33.5	17.4
Pension (income) expense – Company plans	(5.8)	55.0	44.3
Pension expense – multiemployer plans	2.2	1.4	1.2
Total pension (income) expense	(\$3.6)	\$56.4	\$45.5

The worldwide weighted average actuarial assumptions were:

	2000	1999	1998
Discount rate	7.0%	7.2%	6.7%
Long-term rate of compensation increase	4.6%	4.2%	4.9%
Long-term rate of return on plan assets	10.4%	10.4%	10.5%

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

(millions)	2000	1999
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	\$1,350.4	\$1,331.2
Service cost	34.5	42.6
Interest cost	91.1	83.7
Plan participants' contributions	1.4	1.3
Amendments	5.3	36.6
Actuarial (gain) loss	32.1	(58.4)
Benefits paid	(91.8)	(76.1)
Foreign currency adjustments	(42.4)	(9.8)
Other	.9	(.7)
Projected benefit obligation at end of year	\$1,381.5	\$1,350.4
Change in plan assets		
Fair value of plan assets at beginning of year	\$1,578.0	\$1,318.3
Actual return on plan assets	(86.4)	299.8
Employer contribution	41.7	42.9
Plan participants' contributions	1.4	1.3
Benefits paid	(91.8)	(76.1)
Foreign currency adjustments	(38.1)	(3.5)
Other	.2	(4.7)
Fair value of plan assets at end of year	\$1,405.0	\$1,578.0
Funded status	\$ 23.5	\$ 227.6
Unrecognized net (gain) loss	118.5	(135.4)
Unrecognized transition amount	2.7	3.4
Unrecognized prior service cost	34.8	38.4
Prepaid pension	\$ 179.5	\$ 134.0
Amounts recognized in statement of financial position consist of		
Prepaid benefit cost	\$ 252.0	\$ 207.9
Accrued benefit liability	(87.1)	(86.9)
Intangible asset	4.6	13.0
Minimum pension liability	10.0	—
Net amount recognized	\$ 179.5	\$ 134.0

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were:

(millions)	2000	1999
Projected benefit obligation	\$104.6	\$89.7
Accumulated benefit obligation	86.1	76.1
Fair value of plan assets	71	—

All gains and losses, other than curtailment gains and losses and special termination benefits, are recognized over the average remaining service period of active plan participants. Curtailment losses and special termination benefits recognized in 1998-2000 were recorded as a component of restructuring charges. Refer to Note 3 for further information.

Certain of the Company's subsidiaries sponsor 401(k) or similar savings plans for active employees. Expense related to these plans was (in millions): 2000-\$16; 1999-\$17; 1998-\$16.

Note 10 Nonpension postretirement benefits

Certain of the Company's U.S. and Canadian subsidiaries provide health care and other benefits to substantially all retired employees, their covered dependents, and beneficiaries. Generally, employees are eligible for these benefits when one of the following service/age requirements is met: 30 years and any age; 20 years and age 55; 5 years and age 62. Plan assets consist primarily of equity securities with smaller holdings of bonds.

Components of postretirement benefit expense were:

(millions)	2000	1999	1998
Service cost	\$ 7.7	\$ 9.3	\$ 9.1
Interest cost	44.4	37.4	36.8
Expected return on plan assets	(21.4)	(17.8)	(15.0)
Amortization of unrecognized prior service cost	(1.1)	(.5)	(.5)
Recognized net gains	(3.2)	(4.8)	(5.3)
Curtailment loss (gain) and special termination benefits	(.1)	.5	1.0
Postretirement benefit expense	\$26.3	\$24.1	\$26.1

The weighted average actuarial assumptions were:

	2000	1999	1998
Discount rate	7.5%	8.0%	7.0%
Long-term rate of return on plan assets	10.5%	10.5%	10.5%

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

(millions)	2000	1999
Change in accumulated benefit obligation		
Accumulated benefit obligation at beginning of year	\$580.2	\$548.8
Service cost	7.7	9.3
Interest cost	44.4	37.4
Actuarial loss	28.9	15.3
Amendments	—	(.2)
Benefits paid	(42.3)	(30.6)
Other	(.3)	.2
Accumulated benefit obligation at end of year	\$618.6	\$580.2
Change in plan assets		
Fair value of plan assets at beginning of year	\$230.0	\$177.4
Actual return on plan assets	(7.4)	48.0
Employer contribution	42.6	35.2
Benefits paid	(42.3)	(30.6)
Fair value of plan assets at end of year	\$222.9	\$230.0
Funded status	(\$395.7)	(\$350.2)
Unrecognized net gain	(26.4)	(88.9)
Unrecognized prior service cost	(9.4)	(10.7)
Accrued postretirement benefit cost	(\$431.5)	(\$449.8)
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	(\$431.5)	(\$449.8)

The assumed health care cost trend rate was 5% for 2000, decreasing gradually to 4.75% by the year 2003 and remaining at that level thereafter. These trend rates reflect the Company's prior 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)	One percentage point increase	One percentage point decrease
Effect on total of service and interest cost components	\$ 7.2	(\$ 6.0)
Effect on postretirement benefit obligation	\$71.5	(\$60.0)

All gains and losses, other than curtailment gains and losses and special termination benefits, are recognized over the average remaining service period of active plan participants. Curtailment gains or losses and special termination benefits recognized in 1998 and 2000 were recorded as a component of restructuring charges. The net curtailment loss and special termination benefits for 1999 include a \$2.2 million loss recorded as a component of re-

structuring charges and a \$1.7 million gain recorded as a component of disposition-related charges. The Company contributes to a voluntary employee benefit association (VEBA) trust for funding of its nonpension postretirement benefit obligations.

Note 11 Income taxes

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

(millions)	2000	1999	1998
Earnings before income taxes			
United States	\$561.9	\$235.1	\$564.0
Foreign	305.8	301.6	218.5
	\$867.7	\$536.7	\$782.5
Income taxes			
Currently payable			
Federal	\$134.0	\$135.9	\$128.7
State	20.3	20.6	17.8
Foreign	127.1	102.4	87.2
	281.4	258.9	233.7
Deferred			
Federal	(1.2)	(60.7)	30.6
State	4.1	(4.5)	1.7
Foreign	(4.3)	4.7	13.9
	(1.4)	(60.5)	46.2
Total income taxes	\$280.0	\$198.4	\$279.9

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

	2000	1999	1998
U.S. statutory rate	35.0%	35.0%	35.0%
Foreign rates varying from 35%	(.6)	(.5)	(2.0)
State income taxes, net of federal benefit	1.8	2.0	2.4
Net change in valuation allowances	(3.0)	(1.3)	2.9
Statutory rate changes, deferred tax impact	(.3)	(.6)	(.3)
Other	(.6)	2.4	(2.2)
Effective income tax rate	32.3%	37.0%	35.8%

The changes in valuation allowances on deferred tax assets and corresponding impacts on the effective income tax rate, as presented above, result from management's assessment of the Company's ability to utilize certain operating loss and tax credit carryforwards. For 2000, the change in valuation allowance relates primarily to utilization of U.S. foreign tax credit carryforwards. As a result, the effective income tax rate was down significantly from the prior year. Also contributing to the lower rate were the impact of lower statutory rates throughout the year

in the United Kingdom and Australia and enactment of a statutory rate reduction in Germany in the fourth quarter.

Total tax benefits of carryforwards at year-end 2000 and 1999 were \$20.3 million and \$43.2 million, respectively, and expire principally after five years.

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

(millions)	Deferred tax assets		Deferred tax liabilities	
	2000	1999	2000	1999
Current:				
Promotion and advertising	\$ 14.0	\$ 18.0	\$ 8.1	\$ 7.4
Wages and payroll taxes	16.8	17.3	.3	—
Inventory valuation	8.7	9.6	11.0	11.4
Health and postretirement benefits	20.2	34.3	.2	.3
State taxes	6.9	6.7	—	—
Operating loss and credit carryforwards	.5	1.5	.1	—
Deferred intercompany revenue	53.3	—	7.0	—
Other	32.9	35.0	7.3	7.1
	153.3	122.4	34.0	26.2
Less valuation allowance	(3.6)	(2.2)	—	—
	149.7	120.2	34.0	26.2
Noncurrent:				
Depreciation and asset disposals	12.8	16.7	289.1	291.9
Health and postretirement benefits	151.0	158.9	69.5	68.9
Capitalized interest	—	—	23.3	24.0
State taxes	—	1.6	5.2	—
Operating loss and credit carryforwards	19.8	41.7	—	—
Trademarks	—	—	30.6	29.8
Other	25.2	32.2	7.8	14.4
	208.8	251.1	425.5	429.0
Less valuation allowance	(32.5)	(59.6)	—	—
	176.3	191.5	425.5	429.0
Total deferred taxes	\$326.0	\$311.7	\$459.5	\$455.2

At December 31, 2000, foreign subsidiary earnings of approximately \$1.0 billion were considered permanently invested in those businesses. Accordingly, U.S. income taxes have not been provided on these earnings. Foreign withholding taxes of approximately \$58 million would be payable upon remittance of these earnings. Subject to certain limitations, the withholding taxes would then be available for use as credits against the U.S. tax liability.

Cash paid for income taxes was (in millions): 2000-\$246; 1999-\$242; 1998-\$211.

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, notes payable, and long-term debt approximate fair value.

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. Deferred gains or losses related to any instrument 1) designated but ineffective as a hedge of existing assets, liabilities, or firm commitments, or 2) designated as a hedge of an anticipated transaction which is no longer likely to occur, are recognized immediately in the statement of earnings.

For all derivative financial and commodity instruments held by the Company, changes in fair values of these instruments and the resultant impact on the Company's cash flows and/or earnings would generally be offset by changes in value of underlying exposures. The impact on the Company's results and financial position of holding derivative financial and commodity instruments was insignificant during the periods presented.

Foreign exchange risk

The Company is exposed to fluctuations in foreign currency cash flows related primarily to third-party purchases, intercompany product shipments, and intercompany loans. 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 enters into forward contracts and other commitments to sell foreign currency revenues, generally less than 12 months duration, to reduce fluctuations in net long or short cur-

rency positions. Foreign currency contracts are marked to market with net amounts due to or from counterparties recorded in accounts receivable or payable. For contracts hedging firm commitments, mark-to-market gains and losses are deferred and recognized as adjustments to the basis of the transaction. For contracts hedging subsidiary investments, mark-to-market gains and losses are recorded in the accumulated other comprehensive income component of shareholders' equity. For all other contracts, mark-to-market gains and losses are recognized currently in other income or expense. Commitments to sell future foreign currency revenues are accounted for as contingent borrowings.

The notional amounts of open forward contracts were \$238.6 million and \$3.8 million at December 31, 2000 and 1999, respectively. No borrowings were outstanding under commitments to sell foreign currency revenues at December 31, 2000 or 1999.

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 uses interest rate caps, and currency and interest rate swaps, including forward 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.

Mark-to-market gains and losses on interest rate forward swaps are deferred and recognized over the life of the debt issue as a component of interest expense. For other caps and swaps entered into concurrently with the debt issue, the interest or currency differential to be paid or received on the instrument is recognized in the statement of earnings as incurred, as a component of interest expense. If a position were to be terminated prior to maturity, the gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt issue or would be recognized immediately if the underlying debt issue were settled prior to maturity.

The notional amounts of interest rate swaps were \$2.1 billion and \$600.0 million at December 31, 2000 and 1999, respectively. Refer to Note 7 for further information regarding these swaps.

Price risk

The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials. 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 one year. Commodity contracts are marked to market with net amounts due to or from brokers recorded in accounts receivable or payable. Mark-to-market gains and losses are deferred and recognized as adjustments to the basis of the underlying material purchase.

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 that 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. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers, generally short payment terms, and their dispersion across geographic areas.

Note 13 Quarterly financial data (unaudited)

	Net sales		Gross profit	
	2000	1999	2000	1999
First	\$1,751.9	\$1,745.3	\$ 915.0	\$ 908.9
Second	1,801.1	1,784.4	951.6	946.1
Third	1,845.7	1,868.4	970.0	984.7
Fourth	1,556.0	1,586.1	791.1	819.4
	\$6,954.7	\$6,984.2	\$3,627.7	\$3,659.1
	Net earnings (a)		Net earnings per share (a) (b)	
	2000	1999	2000	1999
First	\$161.7	\$118.8	\$.40	\$.29
Second	150.9	154.2	.37	.38
Third	181.9	(35.6)	.45	(.08)
Fourth	93.2	100.9	.23	.25
	\$587.7	\$338.3		

(a) The quarterly results of 2000 and 1999 include the following restructuring and disposition-related charges. Refer to Notes 2 and 3 for further information.

	Net earnings		Net earnings per share (b)	
	2000	1999	2000	1999
First	\$ —	(\$ 25.6)	\$ —	(\$.07)
Second	(14.7)	—	(.04)	—
Third	—	(206.4)	—	(.50)
Fourth	(49.5)	(35.9)	(.12)	(.09)
	(\$64.2)	(\$267.9)		

(b) Earnings per share presented represents both basic and diluted earnings per share.

The principal market for trading Kellogg shares is the New York Stock Exchange (NYSE). The shares are also traded on the Boston, Chicago, Cincinnati, Pacific, and Philadelphia Stock Exchanges. At year-end 2000, the closing price (on the NYSE) was \$26.25 and there were 46,711 shareholders of record.

Dividends paid and the quarterly price ranges on the NYSE during the last two years were:

2000 – Quarter	Dividend	Stock price	
		High	Low
Fourth	\$.2525	\$28.75	\$21.56
Third	.2525	30.75	22.63
Second	.2450	32.00	23.31
First	.2450	30.50	20.75
	\$.9950		
1999 – Quarter			
Fourth	\$.245	\$40.94	\$30.00
Third	.245	39.00	31.50
Second	.235	38.13	31.38
First	.235	42.25	33.69
	\$.960		

Note 14 Operating segments

Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including toaster pastries, cereal bars, frozen waffles, and meat alternatives. Principal markets for these products include the United States and United Kingdom. Through June 2000, operations were managed via four major geographic areas – North America, Europe, Asia-Pacific, and Latin America.

Beginning in July 2000, the Company changed its organizational structure, such that U.S. operations were managed separately. In October 2000, management announced a reorganization of the Company into two major divisions — U.S. and International — with International further delineated into Europe, Latin America, Canada, Australia, and Asia. Thus, beginning in the fourth quarter of 2000, the Company's reportable operating segments under SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" consist of the United States, Europe, and Latin America. All other geographic areas have been combined under the quantitative threshold guidelines of SFAS No. 131 for purposes of the information presented below. Comparative periods have been restated to conform to the current-year presentation.

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.

(millions)	2000	1999	1998
Net sales			
United States	\$4,067.4	\$4,014.1	\$3,858.0
Europe	1,463.4	1,614.4	1,700.2
Latin America	626.7	567.0	510.7
All other operating segments	776.7	788.8	694.8
Corporate	20.5	(.1)	(1.6)
Consolidated	\$6,954.7	\$6,984.2	\$6,762.1
Operating profit excluding charges (a)			
United States	\$ 746.2	\$ 803.0	\$ 786.8
Europe	235.2	224.1	211.4
Latin America	161.1	141.3	107.2
All other operating segments	89.2	93.7	76.3
Corporate	(155.4)	(188.7)	(216.1)
Consolidated	\$1,076.3	\$1,073.4	\$ 956.6
Charges (a)	(86.5)	(244.6)	(70.5)
Operating profit as reported	\$ 989.8	\$ 828.8	\$ 895.1
Charges (a)			
United States	\$ 2.0	\$ 197.9	\$ 32.8
Europe	26.7	22.4	3.3
Latin America	14.6	1.7	—
All other operating segments	28.7	4.6	11.4
Corporate	14.5	18.0	23.0
Consolidated	\$ 86.5	\$ 244.6	\$ 70.5
Depreciation and amortization			
United States	\$ 131.4	\$ 138.1	\$ 138.9
Europe	57.1	57.8	54.6
Latin America	17.2	14.5	14.2
All other operating segments	40.8	35.7	34.5
Corporate	44.1	41.9	35.9
Consolidated	\$ 290.6	\$ 288.0	\$ 278.1
Interest expense			
United States	\$ —	\$.2	\$.2
Europe	4.7	9.3	4.4
Latin America	.1	.6	.9
All other operating segments	.4	(.1)	.4
Corporate	132.3	108.8	113.6
Consolidated	\$ 137.5	\$ 118.8	\$ 119.5
Income taxes excluding charges (b)			
United States	\$ 197.1	\$ 214.9	\$ 214.1
Europe	43.4	28.8	37.0
Latin America	40.0	34.4	28.1
All other operating segments	11.1	26.7	18.0
Corporate	10.7	38.8	6.9
Consolidated	\$ 302.3	\$ 343.6	\$ 304.1
Effect of charges	(22.3)	(145.2)	(24.2)
Income taxes as reported	\$ 280.0	\$ 198.4	\$ 279.9

(millions)	2000	1999	1998
Total assets			
United States	\$2,188.9	\$2,214.9	\$2,216.9
Europe	1,102.5	1,157.3	1,336.0
Latin America	444.6	414.3	380.9
All other operating segments	627.8	641.3	542.2
Corporate	2,061.2	1,755.9	1,760.6
Elimination entries	(1,528.7)	(1,375.0)	(1,185.1)
Consolidated	\$4,896.3	\$4,808.7	\$5,051.5
Additions to long-lived assets			
United States	\$ 135.4	\$ 460.0	\$ 79.3
Europe	71.7	67.4	169.1
Latin America	39.7	47.4	41.7
All other operating segments	42.7	37.0	44.2
Corporate	138.1	41.7	98.5
Consolidated	\$ 427.6	\$ 653.5	\$ 432.8

(a) Charges include restructuring charges in 2000, 1999, and 1998. Refer to Note 3 for further information.

(b) Charges include those described in (a) and disposition-related charges in 1999 reported in earnings before income taxes. Refer to Note 2 for further information.

Supplemental geographic information is provided below for revenues from external customers and long-lived assets:

(millions)	2000	1999	1998
Net sales			
United States	\$4,067.4	\$4,014.1	\$3,858.0
United Kingdom	652.8	689.3	743.6
Other foreign countries	2,234.5	2,280.8	2,160.5
Consolidated	\$6,954.7	\$6,984.2	\$6,762.1
Long-lived assets			
United States	\$1,553.5	\$1,549.3	\$1,644.2
United Kingdom	535.4	552.3	553.0
Other foreign countries	1,154.0	1,110.3	1,330.3
Consolidated	\$3,242.9	\$3,211.9	\$3,527.5

Supplemental product information is provided below for revenues from external customers:

(millions)	2000	1999	1998
Ready-to-eat cereal net sales	\$5,177.6	\$5,304.7	\$5,265.4
Convenience foods net sales	1,777.1	1,679.5	1,496.7
Consolidated	\$6,954.7	\$6,984.2	\$6,762.1

Note 15 Supplemental financial statement data

(millions)

Consolidated Statement of Earnings	2000	1999	1998
Research and development expense	\$ 118.4	\$ 104.1	\$121.9
Advertising expense	\$ 604.2	\$ 674.1	\$695.3

Consolidated Statement of Cash Flows	2000	1999	1998
Accounts receivable	\$ 1.1	\$ 21.0	(\$102.6)
Inventories	54.5	(39.1)	(15.0)
Other current assets	(20.2)	14.7	33.2
Accounts payable	75.1	(84.8)	58.9
Other current liabilities	(83.5)	(58.6)	(76.8)
Changes in operating assets and liabilities	\$ 27.0	(\$146.8)	(\$102.3)

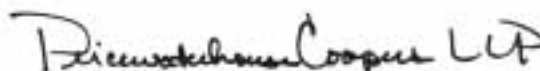
Consolidated Balance Sheet	2000	1999
Trade receivables	\$ 607.2	\$ 561.5
Allowance for doubtful accounts	(8.6)	(8.6)
Other receivables	86.7	125.6
Accounts receivable, net	\$ 685.3	\$ 678.5
Raw materials and supplies	\$ 138.2	\$ 141.2
Finished goods and materials in process	305.6	362.6
Inventories	\$ 443.8	\$ 503.8
Deferred income taxes	\$ 136.5	\$ 108.5
Other prepaid assets	136.8	127.8
Other current assets	\$ 273.3	\$ 236.3
Land	\$ 40.5	\$ 44.1
Buildings	1,197.1	1,255.3
Machinery and equipment	3,683.1	3,595.5
Construction in progress	114.5	261.8
Accumulated depreciation	(2,508.3)	(2,515.8)
Property, net	\$2,526.9	\$ 2,640.9
Goodwill	\$ 218.7	\$ 205.1
— Accumulated amortization	(10.5)	(44)
Other intangibles	217.8	144.5
— Accumulated amortization	(18.6)	(9.6)
Other	355.2	263.0
Other assets	\$ 762.6	\$ 598.6
Accrued income taxes	\$ 130.8	\$ 83.5
Accrued salaries and wages	96.6	126.0
Accrued advertising and promotion	178.2	211.8
Other	312.5	339.7
Other current liabilities	\$ 718.1	\$ 761.0
Nonpension postretirement benefits	\$ 408.5	\$ 424.9
Deferred income taxes	266.7	251.3
Other	121.8	118.7
Other liabilities	\$ 797.0	\$ 794.9

Report of Independent Accountants

PricewaterhouseCoopers LLP

To the Shareholders and Board of Directors
of Kellogg Company

In our opinion, the accompanying consolidated balance sheet 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 December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, 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 auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 opinion.



Battle Creek, Michigan

January 24, 2001

Supplemental financial information

Quantitative and qualitative disclosures related to market risk sensitive instruments

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. The 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

The Company is exposed to fluctuations in foreign currency cash flows related to third-party purchases, intercompany product shipments, and intercompany loans. 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. Primary exposures include the U.S. Dollar versus the British Pound, member currencies of the European Monetary Union, Australian Dollar, Canadian Dollar, and Mexican Peso, and in the case of inter-sub-sidiary transactions, the British Pound versus other European currencies. The Company assesses foreign currency risk based on transactional cash flows and enters into forward contracts and other commitments to sell foreign currency revenues, generally less than twelve months duration, to reduce fluctuations in net long or short currency positions. No borrowings were outstanding under commitments to sell foreign currency revenues at December 31, 2000 or 1999. As of December 31, 2000, the Company had committed to borrowings during 2001 in the cumulative principal amount of approximately \$160 million. As of December 31, 1999, the Company had committed to borrowings during 2000 in the cumulative principal amount of approximately \$366 million. On January 1, 2001, these borrowing commitments were cancelled and replaced with foreign currency forward contracts.

The tables below summarize forward contracts held at year-end 2000 and 1999. All contracts are valued in U.S. Dollars using year-end exchange rates, are hedges of existing assets, liabilities, or anticipated transactions, and mature within one year, except where indicated.

Contracts to sell foreign currency							
Currency sold	Currency received	Notional value (millions)		Exchange rate (fc/1US\$)		Fair value (millions)	
		2000	1999	2000	1999	2000	1999
Japanese Yen	U.S. Dollar	\$ —	\$3.8	—	102.12	\$ —	\$ —
New Zealand Dollar	Australian Dollar	4.0	—	2.38	—	(.2)	—
Pound Sterling (a)	Danish Kroner	18.3	—	.63	—	1.0	—
Spanish Peseta	Pound Sterling	21.4	—	179.45	—	(.3)	—
Euro	U.S. Dollar	15.9	—	1.12	—	(.7)	—
Australian Dollar	U.S. Dollar	27.4	—	1.84	—	(.6)	—
Mexican Peso	U.S. Dollar	67.4	—	9.51	—	1.5	—
Canadian Dollar	U.S. Dollar	33.0	—	1.51	—	(.3)	—
Total		\$187.4	\$3.8			\$.4	\$ —

(a) Several contracts maturing 2001-2003.

Contracts to purchase foreign currency							
Currency purchased	Currency exchanged	Notional value (millions)		Exchange rate (fc/1US\$)		Fair value (millions)	
		2000	1999	2000	1999	2000	1999
U.S. Dollar	Australian Dollar	\$ 3.5	\$ —	1.86	—	(\$1)	\$ —
Pound Sterling	South African Rand	1.8	—	.70	—	.1	—
U.S. Dollar	South African Rand	.2	—	7.07	—	—	—
Swiss Franc	Euro	5.2	—	1.44	—	—	—
Pound Sterling	U.S. Dollar	40.5	—	.68	—	.6	—
Total		\$51.2	\$ —			\$.6	\$ —

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. Primary exposures include movements in U.S. Treasury rates, London Interbank Offered Rates (LIBOR), and commercial paper rates. The Company uses interest rate caps, and currency and interest rate swaps, including forward 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.

The tables below provide information on the Company's significant debt issues and related hedging instruments at year-end 2000 and 1999. For foreign currency-denominated debt, the information is presented in U.S. Dollar equivalents. Variable interest rates are based on effective rates or implied forward rates as of year-end 2000. Refer to Note 7 within Notes to Consolidated Financial Statements for further information.

Significant debt issues (millions)							
Debt characteristics	Principal by year of maturity				Fair value		
	2000	2001	2004	2005	2000	1999	
Euro Dollar fixed rate		\$500.0			\$500.0	\$494.7	
effective rate (a)		6.125%					
		6.400%					
U.S. Dollar fixed rate		\$400.0			\$409.0	\$397.1	
effective rate (b)		5.75%					
		5.23%					
Euro Dollar fixed rate			\$500.0		\$499.7	\$488.9	
effective rate (a)			6.625%				
			6.354%				
U.S. Dollar fixed rate				\$200.0	\$189.7	\$179.4	
effective rate (a)				4.875%			
				6.070%			
U.S. commercial paper weighted avg. variable	\$448.3	\$429.8			\$429.8	\$448.3	
	5.9%	6.6%					
Multi-currency revolving credit facility	\$16.2				\$ —	\$ 16.2	
effective rate	5.6%						

(a) Effective fixed interest rate paid, as a result of settlement of forward interest rate swap at date of debt issuance.

(b) Effective fixed interest rate paid, as a result of extendable feature. Refer to Note 7 within Notes to Consolidated Financial Statements for further information.

Interest rate swaps (millions)				
Instrument characteristics		Year of maturity	Fair value	
		2001	2000	1999
Interest rate swap – pay variable/receive fixed – hedge of existing debt issue	Notional amt.	\$200.0	(\$.4)	(\$1.1)
	Pay	6.60%		
	Receive	6.40%		
Interest rate swap – pay variable/receive fixed – hedge of existing debt issue	Notional amt.	\$400.0	(\$ 2.2)	(\$3.2)
	Pay	5.99%		
	Receive	5.23%		
Interest rate swap – pay fixed/receive variable – hedge of future debt issue (a)	Notional amt.	\$100.0	\$ —	\$ —
	Pay	5.98%		
	Receive	6.36%		
Interest rate swap – pay fixed/receive variable – hedge of future debt issue (a)	Notional amt.	\$975.0	(\$26.9)	\$ —
	Pay	6.53%		
	Receive	6.36%		
Interest rate swap – pay fixed/receive variable – hedge of future debt issue (a)	Notional amt.	\$425.0	\$.5	\$ —
	Pay	6.13%		
	Receive	6.36%		

(a) Forward-starting interest rate swaps which will be settled in conjunction with a future debt issuance in 2001.

Price risk

The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials. Primary exposures include corn, wheat, soybeans, soybean oil, sugar, and paperboard. 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 one year. The fair values of commodity contracts held at year-end 2000 and 1999 were insignificant, and potential near-term changes in commodity prices were not expected to have a significant impact on the Company's future earnings or cash flows.

For all derivative financial and commodity instruments presented in the tables above, changes in fair values of these instruments and the resultant impact on the Company's cash flows and/or earnings would generally be offset by changes in values of underlying transactions and positions. Therefore, it should be noted that the exclusion of certain of the underlying exposures from the tables above may be a limitation in assessing the net market risk of the Company.

Products and Manufacturing Locations

Kellogg USA

Products

Kellogg's® cereals, croutons, bread-ing and stuffing products

Pop-Tarts® toaster pastries

Nutri-Grain,® *Rice Krispies Treats*,®

Nutri-Grain Twists® cereal bars

Eggo® waffles, pancakes

Morningstar Farms,® *Natural Touch*,®

Loma Linda,® *Worthington*® meat and dairy alternatives

Krave™ refueling bars

Toaster Delights™ muffins

Kashi® cereals, nutrition bars and mixes

Snack 'Ums™ cereal snacks

Manufacturing Locations

San Jose, California

Atlanta, Georgia

Rome, Georgia

Pikeville, Kentucky

Battle Creek, Michigan

Omaha, Nebraska

Blue Anchor, New Jersey

Worthington, Ohio

Zanesville, Ohio

Lancaster, Pennsylvania

Muncy, Pennsylvania

Memphis, Tennessee

Rossville, Tennessee

Kellogg International

Products

Kellogg's® cereals, bread-ing products, cereal bars

Nutri-Grain,® *Rice Krispies*

Squares,® *Rice Krispies Treats*,®

Kuadri Krispis,® *Rice Bubbles*

Treats,® *Day Dawn*,® *Coco Pops*,®

Crusli,™ *Sunibrite*,™ *Nutri-Grain*

Twists,™ *K-time*,™ *Milkcrunch*™ cereal bars

Pop-Tarts® toaster pastries

Cerola,® *Day Dawn*® cereals

Eggo® waffles

Keloketas™ cookies

Komplete™ biscuits

Vector™ meal replacement products

Winders™ fruit snacks

Manufacturing Locations

Pilar, Argentina

Brisbane, Australia

Charmhaven, Australia

Sydney, Australia

Sao Paulo, Brazil

London, Ontario, Canada

Guangzhou, China

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





Board of Directors

Benjamin S. Carson, M.D. (N,S)
Professor and Director of
Pediatric Neurosurgery
The Johns Hopkins
Medical Institutions
Baltimore, Maryland
Board member since 1997

John T. Dillon (A,F)
Chairman and
Chief Executive Officer
International Paper Company
Purchase, New York
Board member since 2000

Carleton (Carly) S. Fiorina+
President and
Chief Executive Officer
Hewlett-Packard Company
Palo Alto, California
Board member since 1997

Claudio X. Gonzalez (E,C*,F,N)
Chairman of the Board
Chief Executive Officer
Kimberly-Clark de Mexico,
S.A. de C.V.
Mexico City, Mexico
Board member since 1990

Gordon Gund (E,C,F,N*)
Chairman and
Chief Executive Officer
Gund Investment Corporation
Princeton, New Jersey
Board member since 1986

Carlos M. Gutierrez (E*)
Chairman of the Board
Chief Executive Officer
Kellogg Company
Board member since 1999

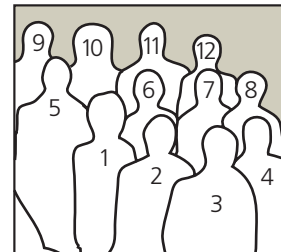
James M. Jenness (S)
Chief Executive Officer
Integrated Merchandising
Systems LLC
Chicago, Illinois
Board member since 2000

Dorothy A. Johnson (A,F,S)
President
Ahlburg Company
Grand Haven, Michigan
Board member since 1998

Ann McLaughlin Korologos (E,A*,N,S)
Chairman
The Aspen Institute
Aspen, Colorado
Board member since 1989

J. Richard Munro (E,C,S*)++
Chairman and
Chief Executive Officer, Retired
Time Warner Inc.
New York, New York
Board member since 1990

Board of Directors



- 1 Ann McLaughlin Korologos
- 2 William C. Richardson
- 3 Carlos M. Gutierrez
- 4 Gordon Gund
- 5 J. Richard Munro
- 6 James M. Jenness
- 7 Benjamin S. Carson, M.D.
- 8 William D. Perez
- 9 John L. Zabriskie
- 10 Dorothy A. Johnson
- 11 Claudio X. Gonzalez
- 12 John T. Dillon

William D. Perez (A,F)
President and
Chief Executive Officer
S.C. Johnson & Son, Inc.
Racine, Wisconsin
Board member since 2000

William C. Richardson (E,C,F,S)
President and
Chief Executive Officer
W. K. Kellogg Foundation
Battle Creek, Michigan
Board member since 1996

John L. Zabriskie (E,A,C,F,*N)
Chairman and
Chief Executive Officer, Retired
NEN Life Science Products, Inc.
Boston, Massachusetts
Board member since 1995

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

* Committee Chairman

+ Resigned from Board in January 2001

++ Will retire from Board in April 2001

Officers

Carlos M. Gutierrez*
Chairman of the Board
Chief Executive Officer

Alan F. Harris*
Executive Vice President
President, Kellogg International

Janet L. Kelly*
Executive Vice President
Corporate Development,
General Counsel and Secretary

David A. Mackay*
Executive Vice President
President, Kellogg USA

Michael J. Teale*
Executive Vice President
Assistant to the Chairman

Thomas J. Webb*
Executive Vice President
Chief Financial Officer

Donna J. Banks
Senior Vice President
Research, Quality and
Technology

King T. Pouw*
Senior Vice President
Operations

Joseph M. Stewart
Senior Vice President
Corporate Affairs
Chief Ethics Officer

E. Joseph Alberding, M.D.
Vice President – Medical Affairs

Stephen C. Benoit
Vice President

Jeffrey M. Boromisa
Vice President
Corporate Controller

Arthur A. Byrd
Vice President

Celeste A. Clark
Vice President

George A. Franklin
Vice President
Worldwide Government Affairs

Harold G. Gobble
Vice President
Product Development

James W. Larson
Vice President
Human Resources

Richard J. Lilly
Vice President – Travel Services

Gustavo Martinez
Vice President

Timothy P. Mobsby
Vice President

Jayaraman Nagarajan
Vice President
Chief Information Officer

W. Stephen Perry
Vice President – Taxes
Treasurer

Gary H. Pilnick
Vice President
Deputy General Counsel

Joseph J. Tubilewicz
Vice President
Worldwide Purchasing

* Member of Executive Management
Committee



Share Owner Information

Kellogg Company

One Kellogg Square
Battle Creek, MI 49016-3599
(616) 961-2000

Common Stock:

Listed on the New York Stock
Exchange
Ticker Symbol: K

Independent Accountants:

PricewaterhouseCoopers LLP

Transfer Agent, Registrar, and Dividend Disbursing Agent:

Communications concerning
stock transfer, dividend
payments, lost certificates, and
change of address should be
directed to:

Wells Fargo Shareowner Services
161 North Concord Exchange
South St. Paul, MN 55075
(877) 910-5385

Fiscal Agent:

5.75% Extendable Notes
Due February 2, 2001

4.875% Notes
Due October 15, 2005

Harris Trust and Savings Bank
Indenture Trust Division
311 West Monroe, 11th floor
P.O. Box 1878
Chicago, IL 60690

6.625% Euro Dollar Notes
Due January 29, 2004

Citibank N.A., London
336 Strand
London WC2R 1HB England

Trustee and Collateral Agent:

6.125% Euro Dollar Notes
Due August 6, 2001

Citibank N.A., London
336 Strand
London WC2R 1HB England

Dividend Reinvestment and Stock Purchase Plan:

This plan, available to share
owners, allows for full or partial
dividend reinvestment and
voluntary cash purchases, with
brokerage commissions and
service charges paid by the
Company. For details, contact:

Wells Fargo Shareowner Services
161 North Concord Exchange
South St. Paul, MN 55075
(877) 910-5385

Company Information:

Kellogg Company's website –
<http://www.kelloggs.com> –
contains a wide range of
information about the Company,
including news releases, the
Annual Report, nutritional
information, and recipes.

Kellogg news releases, including
earnings announcements, are
available by fax 24 hours a day
through Company News On-Call
at (800) 758-5804. The Kellogg
extension is 483375.

Copies of the Annual Report
on audio cassette for visually
impaired share owners, the
Annual Report on Form 10-K,
quarterly reports on Form 10-Q,
and other Company information
are available upon request from:

Kellogg Company
P.O. Box CAMB
Battle Creek, MI 49016-1986
(800) 962-1413

Investor Relations:

John P. Renwick
(616) 961-6365

Share Owner Services:

(616) 961-2380

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 the growth

of government. Interested share
owners are invited to write
for further information:

Kellogg Better Government
Committee
ATTN: Joseph M. Stewart
One Kellogg Square
Battle Creek, MI 49016-3599

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Stock Car Auto Racing, Inc.

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For more information about Kellogg Company and Keebler Foods Company,
including lots of facts and fun, visit our Internet websites:

www.kelloggs.com

and

www.keebler.com



Kellogg's[®]

The Best 2 You

Kellogg Company
One Kellogg Square
Battle Creek, MI 49016-3599
Telephone (616) 961-2000

