IMPROVING OUR PROFITABILITY

To be able to afford increased brand building and innovation investment, we need to improve our gross profit margin and control our overhead expenses. In 2003, we improved our underlying profitability enough to invest for the future. While our reported gross profit margin declined modestly, this was largely due to investment. We incurred $70 million of asset write-offs and other up-front costs related to cost-savings initiatives; these are investments in future profitability. We also increased the use of toys in the box and other inserts, a form of consumer promotion that is accounted for in cost of goods sold. We faced higher costs in the form of commodities, fuel, and benefits, but we were able to offset them with a combination of the following:

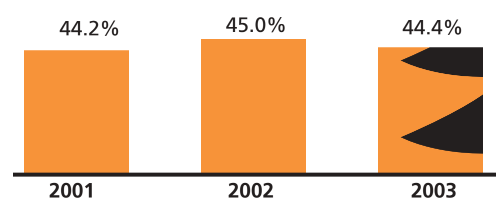
- Increased net sales, which leveraged our fixed costs;
- A favorable mix shift toward our more profitable products, thanks to the *Volume to Value* focus;
- Synergies related to the Keebler acquisition, which reached their targeted level;
- Ongoing productivity improvements, which we have relentlessly pursued and achieved over the past several years.

Kellogg Company has a significant competitive advantage in its global infrastructure. The decision to expand our business internationally was taken early in the Company's history and was a far-sighted one. This scale allows us to take advantage of global sourcing, decrease our input costs, transfer production and administrative functions between regions, and share best practices and ideas across all our markets. In 2003, our global packaging sourcing group, which has members around the world, instituted a broad program to coordinate the sourcing of materials, adhesives, and cartons in many of our markets. This program is expected to dramatically improve efficency and save the Company millions of dollars each year. Yet another way we are earning our stripes.

These factors are expected to raise our gross profit margin over time, even as we continue to face rising commodity, fuel, and benefits costs. Importantly, we plan to use this improved profitability to reinvest in our brands. When we refer to brand building, we mean advertising and consumer promotion, not price discounting. In 2003, our brand-building investment was increased at a strong double-digit rate, and we plan for this investment to again outpace sales growth in 2004.

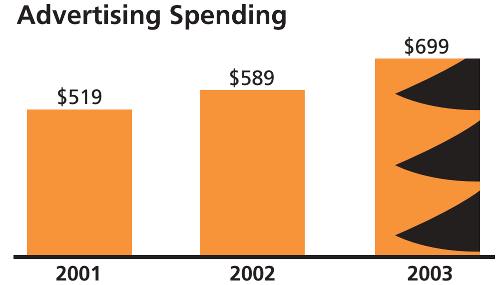
Our earnings growth in 2003 was of very high quality. It included the investment in brand building and cost-savings projects, as well as nearly $30 million of other charges related to asset impairments and bond repurchases that are not typical events. To post a strong earnings gain in the face of these signficant charges and investments suggests a very strong underlying profitability that can be used to drive growth in the future.

Gross Profit Margin



% of Net Sales

Investing in Our Business: Advertising Spending



Millions