KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
31 DECEMBER 1998

KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

REPORT OF THE DIRECTORS

1. The Directors present their report together with the audited financial statements for the year ended 31 December 1998 (comparative results are shown in respect of the prior financial period of 73 weeks from the Company's incorporation on 2 August 1996 to 31 December 1997).

PRINCIPAL ACTIVITY

2. The Company provides management and related services to the European operating units of its ultimate parent undertaking, Kellogg Company.

BUSINESS REVIEW AND STATE OF AFFAIRS

3. The profit and loss account for the year ended 31 December 1998 is set out on page 4. There are no other matters material for an appreciation of the state of the Company's affairs by its members.

DIVIDENDS

4. The Directors do not recommend the payment of any dividend for the year (1997: none).

DIRECTORS

5. The current Directors of the Company, whose dates of appointment are shown below, are:
AF Harris (Chairman)(appointed 19 April 1999)
TP Mobsby (appointed 22 December 1998)
GW McKinzie (appointed 3 August 1999)

DG Fritz, who was a Director and Chairman at 31 December 1997, resigned on 1 October 1998; CJ Roling, G Gluscic and PJ Legg who were Directors at 31 December 1997, resigned on 15 January 1999, 15 May 1999, and 31 August 1999 respectively; J-L Gourbin served as a Director and Chairman from 16 October 1998 to 15 March 1999; BF O'Connor and D Avronsart served as Directors from 22 December 1998 to 12 April 1999 and 30 June 1999 respectively.

No Director had any interest in the shares of the Company or in any material contract with the Company.

REPORT OF THE DIRECTORS continued

STATEMENT OF DIRECTORS' RESPONSIBILITIES

6. The Directors are required by the Companies Act 1985 to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company as at the end of the financial period and of the Company's profit or loss for the financial period. The Directors consider that, in preparing the financial statements on pages 4 to 10, appropriate accounting policies have been used, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985. The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities. In addition, the Directors are required to prepare financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

POLICY ON THE PAYMENT OF CREDITORS

7. The Company endeavours to pay all its creditors in accordance with the terms and conditions of trading established when purchase orders are placed, provided all relevant documentary evidence is made available in time. Year end trade creditors, included balances owing to affiliated companies, represented 46 days' purchases (1997: 32 days).

YEAR 2000

8. The Company has a project underway to identify, and remediate before the end of 1999, any of its computer systems which are not year 2000 compliant. Whilst there can be no absolute assurance of immunity from difficulties caused by year 2000 problems in the Company, its suppliers or other third parties, remediation work is now substantially complete and the Directors consider that all reasonable steps have been taken to achieve year 2000 compliance.

AUDITORS

9. Consequent on the merger of Price Waterhouse (who were the Company's auditors) and Coopers & Lybrand on 1 July 1998, the Directors have appointed the successor firm of PricewaterhouseCoopers as Auditors. A resolution will be proposed at the Annual General Meeting to re-appoint them as auditors for the ensuing year and to fix their remuneration.

BY ORDER OF THE BOARD

J. N. Ainley

JN AINLEY
Secretary
Registered number 3233144
Manchester, England

20 October 1999

REPORT OF THE AUDITORS TO THE SHAREHOLDERS OF KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

We have audited the financial statements on pages 4 to 10 which have been prepared under the historical cost convention and under the accounting policies set out on page 6.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report including, as described on page 2, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board and our profession's ethical guidance. We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions is not disclosed. We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company at 31 December 1998 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers

PRICEWATERHOUSECOOPERS

Chartered Accountants
and Registered Auditors,
Manchester

20 October 1999

KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 1998

	1998 (52 weeks) £000	1997 (73 weeks) £000
Turnover (note 3)	41,354	58,541
Administrative expenses (note 4)	(39,825)	(57,864)
Operating profit	1,529	677
Interest receivable and similar income	288	-
Profit on ordinary activities before taxation (note 5)	1,817	677
Tax on profit on ordinary activities (note 6)	(566)	(213)
Profit for the financial period	1,251	464
Revenue reserves brought forward	464	-
Revenue reserves carried forward	1,715	464

The results shown above comprise the Company's total recognised gains and losses during the year from continuing activities.

The notes on pages 6 to 10 form part of these accounts.

KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

BALANCE SHEET - 31 DECEMBER 1998

	1998	1997
	£000	£000
CURRENT ASSETS		
Debtors (note 7)	7,021	15,852
Cash at bank and in hand	576	215
	7,597	16,067
CREDITORS (Amounts falling due within one year)(note 8)	(5,882)	(15,603)
NET CURRENT ASSETS	1,715	464
CAPITAL AND RESERVES		
Called up share capital (note 9)	-	-
Profit and loss account	1,715	464
TOTAL EQUITY SHAREHOLDERS' FUNDS (note 10)	1,715	464

Approved by the Board of Directors on 20 October 1999.

TP MOBSBY
Director

The notes on pages 6 to 10 form part of these accounts.

KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 1998

1 PERIOD COVERED

The financial statements cover the financial year ended 31 December 1998; comparative results shown are for the period of 73 weeks from the Company's incorporation on 2 August 1996 to 31 December 1997. The Company commenced trading on 1 January 1997.

2 ACCOUNTING POLICIES

The principal accounting policies followed in preparing the financial statements are as follows:

Accounting convention

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards, except for the treatment of deferred taxation, as explained below.

Turnover

Turnover, which excludes value added tax, represents the invoiced value of services supplied.

Taxation

Corporation tax is provided on the assessable profits of the Company. Provision is made for deferred taxation in accordance with accounting principles applicable in the United States of America, on the basis of all timing differences evaluated at the tax rate anticipated to be effective when the timing differences will mature.

Foreign currencies

Assets, liabilities and forward contracts expressed in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date and any foreign exchange differences are dealt with in the profit and loss account.

Business process re-engineering and restructuring costs

Costs incurred in redesigning business processes and improving working practices are written off in the period in which they are incurred.

Leased assets

Rental payments due under operating lease agreements are charged to the profit and loss account in the period to which they relate.

Pensions

Pension contributions paid to the trustees of the Kellogg pension schemes are based upon independent actuarial advice. Contributions are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives.

3 TURNOVER

An analysis of turnover by country is as follows:

	1998	1997
	(52 weeks)	(73 weeks)
	£000	£000
United Kingdom	20,726	32,713
Other Europe	20,628	25,828
	41,354	58,541

4 ADMINISTRATIVE EXPENSES

Administrative expenses comprise:

	1998	1997
	(52 weeks)	(73 weeks)
	£000	£000
Restructuring costs (see below):		
Business process re-engineering costs	-	14,300
Other business restructuring and reorganisation costs	2,091	26,764
Other administrative costs	37,734	16,800
	39,825	57,864

The Company along with other European affiliates of the Company's ultimate parent undertaking, Kellogg Company, has embarked on an ambitious project lasting several years to improve working practices and re-engineer business processes in all aspects of their operations. Incremental costs incurred by the Company related to the project are recognised in the financial statements when the relevant obligations are incurred, and are reported in the profit and loss account as part of administrative expenses, above. Such costs include redundancy and early retirement, consultancy, and staff relocation and retraining. Affiliated companies are charged for the benefits they receive from the project.

5 PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit on ordinary activities before taxation is stated after charging:

	1998	1997
	(52 weeks)	(73 weeks)
	£000	£000
Wages and salaries	7,404	5,820
Social security costs	644	474
Other pension costs	430	325
Operating lease rentals for plant & machinery	4,272	2,334
Auditor's remuneration:		
- audit services	25	10
- other services	781	762

KELLOGG MANAGEMENT SERVICES (EUROPE) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 1998 - continued

6 TAX ON PROFIT ON ORDINARY ACTIVITIES

The charge relating to the Company's profits on ordinary activities for the period comprises UK Corporation tax at the rate of 31.0% (1997: 31.5%). No provision for deferred taxation arises under accounting principles applicable in the United States of America, nor would have arisen under UK accounting standards.

7 DEBTORS

	1998	1997
	£000	£000
Amounts owed by group undertakings - fellow subsidiaries	7,021	15,852

8 CREDITORS (Amounts falling due within one year)

	1998	1997
	£000	£000
Amounts owed to group undertakings - fellow subsidiaries	-	5,447
Taxation and social security	693	213
Accruals and deferred income	5,189	9,943
	5,882	15,603

9 CALLED UP SHARE CAPITAL

	1998 & 1997
Authorised:	
1,000 ordinary shares of £1 each	£1,000
Allotted, called up and fully paid:	
2 ordinary shares of £1 each	£2

10 RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

	1998	1997
	£000	£000
Opening equity shareholders' funds	464	-
Net proceeds of issue of shares	-	-
Profit for the financial period	1,251	464
Closing equity shareholders' funds	1,715	464

11 EMPLOYEES

The average number of persons employed during the year was 204 (1997: 168).

12 PENSIONS AND SIMILAR COMMITMENTS

Employees of the Company can apply to become members of group pension schemes established for employees of Kellogg Company's UK subsidiaries. The schemes provide defined benefits based on final pensionable salary. The assets of the schemes are managed by independent investment managers and are held separately from those of the Companies. Contributions to the schemes are charged to the profit and loss account so as to spread the cost of pensions, calculated for the group as a whole, over employees' working lives with the Companies. The contributions are determined by an independent qualified actuary on the basis of actuarial valuations using the projected unit method. The most recent actuarial valuations of the UK schemes were at 5 April 1996. The assumptions which have the most significant effect on the pension charge are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns will, on average, exceed salary increases by 2.0% per annum and that present and future pensions would increase at the rate provided under the rules of the schemes.

The most recent actuarial valuations showed that the market value of the assets of the principal scheme amounted to £113.9 million and that the actuarial value of those assets represented 98% of the benefits that had accrued to members.

13 OPERATING LEASE COMMITMENTS

Future minimum payments due in the next financial year under operating leases for plant and machinery are as follows:

	1998	1997
	£000	£000
Commitments expiring within one year	217	-
Commitments expiring between one and five years	34	300

14 DIRECTORS' EMOLUMENTS

The aggregate amount of emoluments paid to Directors during the year was £905,000 (1997:£727,000), including £482,000 (1997: £252,000) in respect of the highest paid Director of which £283,000 (1997: £nil) represented compensation for loss of office. Three (1997: three) Directors were members during the period of one of the UK Group's defined benefits pension schemes and also participated in an employee share ownership scheme. Five (1997: four) Directors including the highest paid Director were members of defined benefit pension schemes operated by the ultimate parent undertaking; in the case of the highest paid Director, accrued annual benefits under such schemes at the end of the financial period amounted to £68,000 (1997: £68,000). Eight (1997: seven) Directors participated in share option incentive schemes operated by the ultimate parent undertaking. Amounts paid to the ultimate parent undertaking in respect of Directors' services amounted to £287,000 (1997: £342,000).

15 PARENT UNDERTAKING

The Company's immediate parent company is Kellogg U.K. Holding Company Limited (registered in England) and the Company's ultimate holding company and controlling party is Kellogg Company (incorporated in the United States of America). Copies of the accounts of Kellogg U.K. Holding Company Limited can be obtained from Companies House, Crown Way, Maindy, Cardiff and copies of the accounts of Kellogg Company can be obtained from One Kellogg Square, PO Box 3599, Battle Creek, Michigan, USA.

16 RELATED PARTY TRANSACTIONS

As a 100% owned subsidiary, the Company is exempt under Financial Reporting Standard number 8 from disclosing separately transactions with other entities in the Group. Consolidated financial statements of Kellogg U.K. Holding Company Limited, which incorporate the accounts of the Company, are publicly available. The Company was not involved in any other related party transactions during the financial year.

17 CASH FLOW STATEMENT

The Company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard no.1 (as revised) on the grounds that a group cash flow statement is included in the consolidated financial statements of its ultimate parent undertaking, Kellogg Company, whose accounts are publicly available and include the results of the Company.