

KRAFT FOODS INC
Form 10-Q
November 04, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-16483

Kraft Foods Inc.

(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

52-2284372
(I.R.S. Employer
Identification No.)

Three Lakes Drive,

Northfield, Illinois
(Address of principal executive offices)

60093-2753
(Zip Code)

Registrant's telephone number, including area code: **(847) 646-2000**

Not Applicable

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At October 31, 2011, there were 1,766,748,686 shares of the registrant's common stock outstanding.

Kraft Foods Inc.

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In this report, Kraft Foods, we, us and our refers to Kraft Foods Inc. and subsidiaries, and Common Stock refers to Kraft Foods' Class A common stock.

PART I FINANCIAL INFORMATION**Item 1. Financial Statements.**

Kraft Foods Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(in millions of dollars, except per share data)

(Unaudited)

	00,000,000		00,000,000	
	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Net revenues	\$ 13,226	\$ 11,863	\$ 39,677	\$ 35,434
Cost of sales	8,611	7,542	25,555	22,330
Gross profit	4,615	4,321	14,122	13,104
Selling, general and administrative expenses	2,866	2,758	8,807	8,541
Asset impairment and exit costs	(7)	(9)	(7)	(9)
Amortization of intangibles	58	53	172	146
Operating income	1,698	1,519	5,150	4,426
Interest and other expenses, net	425	433	1,312	1,496
Earnings from continuing operations before income taxes	1,273	1,086	3,838	2,930
Provision for income taxes	346	326	1,133	982
Earnings from continuing operations	927	760	2,705	1,948
Earnings and gain from discontinued operations, net of income taxes (Note 3)				1,644
Net earnings	927	760	2,705	3,592
Noncontrolling interest	5	6	8	18
Net earnings attributable to Kraft Foods	\$ 922	\$ 754	\$ 2,697	\$ 3,574
Per share data:				
Basic earnings per share attributable to Kraft Foods:				
Continuing operations	\$ 0.52	\$ 0.43	\$ 1.53	\$ 1.13
Discontinued operations				0.97
Net earnings attributable to Kraft Foods	\$ 0.52	\$ 0.43	\$ 1.53	\$ 2.10
Diluted earnings per share attributable to Kraft Foods:				

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Continuing operations	\$	0.52	\$	0.43	\$	1.52	\$	1.13
Discontinued operations								0.96
Net earnings attributable to Kraft Foods	\$	0.52	\$	0.43	\$	1.52	\$	2.09
Dividends declared	\$	0.29	\$	0.29	\$	0.87	\$	0.87

See notes to condensed consolidated financial statements.

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Kraft Foods Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars, except share data)

(Unaudited)

	September 30, September 30, 2011	September 30, December 31, 2010
ASSETS		
Cash and cash equivalents	\$ 1,976	\$ 2,481
Receivables (less allowances of \$151 in 2011 and \$246 in 2010)	6,835	6,539
Inventories, net	6,399	5,310
Deferred income taxes	973	898
Other current assets	1,146	993
Total current assets	17,329	16,221
Property, plant and equipment, net	13,856	13,792
Goodwill	37,592	37,856
Intangible assets, net	25,416	25,963
Prepaid pension assets	169	86
Other assets	1,470	1,371
TOTAL ASSETS	\$ 95,832	\$ 95,289
LIABILITIES		
Short-term borrowings	\$ 896	\$ 750
Current portion of long-term debt	4,843	1,115
Accounts payable	5,293	5,409
Accrued marketing	2,681	2,515
Accrued employment costs	1,363	1,292
Other current liabilities	5,284	4,812
Total current liabilities	20,360	15,893
Long-term debt	23,139	26,859
Deferred income taxes	7,580	7,984
Accrued pension costs	1,777	2,382
Accrued postretirement health care costs	2,995	3,046
Other liabilities	3,281	3,183
TOTAL LIABILITIES	59,132	59,347
Commitments and Contingencies (Note 12)		
EQUITY		
Common Stock, no par value (1,996,537,778 shares issued in 2011 and 2010)		
Additional paid-in capital	31,279	31,231
Retained earnings	17,695	16,619
Accumulated other comprehensive losses	(4,864)	(3,890)
Treasury stock, at cost	(7,518)	(8,126)
Total Kraft Foods Shareholders' Equity	36,592	35,834

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Noncontrolling interest		108		108
TOTAL EQUITY		36,700		35,942
TOTAL LIABILITIES AND EQUITY	\$	95,832	\$	95,289

See notes to condensed consolidated financial statements.

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Kraft Foods Inc. and Subsidiaries

Condensed Consolidated Statements of Equity

(in millions of dollars, except per share data)

(Unaudited)

	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000	00,000,000
	Kraft Foods Shareholders			Equity			
	Common	Additional	Retained	Accumulated	Treasury	Noncontrolling	Total
	Stock	Paid-in	Earnings	Other	Stock	Interest	Equity
		Capital		Comprehensive			
				Earnings /			
				(Losses)			
Balances at January 1, 2010	\$	\$ 23,611	\$ 14,636	\$ (3,955)	\$ (8,416)	\$ 96	\$ 25,972
Comprehensive earnings / (losses):							
Net earnings			4,114			25	4,139
Other comprehensive earnings, net of income taxes				65		(19)	46
Total comprehensive earnings *						6	4,185
Exercise of stock options and issuance of other stock awards		153	(106)		290		337
Cash dividends declared (\$1.16 per share)			(2,025)				(2,025)
Net impact of noncontrolling interests from Cadbury acquisition		38				33	71
Purchase from noncontrolling interest, dividends paid and other activities		(28)				(27)	(55)
Issuance of Common Stock		7,457					7,457
Balances at December 31, 2010	\$	\$ 31,231	\$ 16,619	\$ (3,890)	\$ (8,126)	\$ 108	\$ 35,942
Comprehensive earnings / (losses):							
Net earnings			2,697			8	2,705
Other comprehensive losses, net of income taxes				(974)			(974)
Total comprehensive earnings*						8	1,731
Exercise of stock options and issuance of other stock awards		61	(81)		608		588
Cash dividends declared (\$0.87 per share)			(1,540)				(1,540)
Purchase from noncontrolling interest, dividends paid and other activities		(13)				(8)	(21)
Balances at September 30, 2011	\$	\$ 31,279	\$ 17,695	\$ (4,864)	\$ (7,518)	\$ 108	\$ 36,700

* Total comprehensive earnings / (losses) were (\$1,948) million for the three months ended and \$1,731 million for the nine months ended September 30, 2011, as compared to \$2,009 million for the three months ended and \$2,794 million for the nine months ended September 30, 2010. Comprehensive earnings / (losses) attributable to Kraft Foods were (\$1,938) million for the three months ended and \$1,723 million for the nine months ended September 30, 2011, as compared to \$1,994 million for the three months ended and \$2,809 million for the nine months ended September 30, 2010.

See notes to condensed consolidated financial statements.

Kraft Foods Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in millions of dollars)

(Unaudited)

	00,000,000	00,000,000
	For the Nine Months Ended	
	September 30,	
	2011	2010
CASH PROVIDED BY / (USED IN) OPERATING ACTIVITIES		
Net earnings	\$ 2,705	\$ 3,592
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	1,117	1,019
Stock-based compensation expense	137	132
Deferred income tax provision	(429)	127
Gain on discontinued operations (Note 3)		(1,596)
Other non-cash expense / (income), net	6	4
Change in assets and liabilities, excluding the effects of acquisitions and divestitures:		
Receivables, net	(437)	264
Inventories, net	(1,188)	(870)
Accounts payable	(61)	(181)
Other current assets	(278)	(44)
Other current liabilities	489	(1,383)
Change in pension and postretirement assets and liabilities, net	(396)	160
Net cash provided by operating activities	1,665	1,224
CASH PROVIDED BY / (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(1,281)	(1,020)
Acquisitions, net of cash received		(9,843)
Proceeds from divestitures		4,039
Proceeds from sale of property, plant and equipment and other	37	13
Net cash used in investing activities	(1,244)	(6,811)
CASH PROVIDED BY / (USED IN) FINANCING ACTIVITIES		
Net issuance / (repayments) of short-term borrowings	145	(1,285)
Long-term debt proceeds	35	9,438
Long-term debt repaid	(10)	(512)
Dividends paid	(1,535)	(1,664)
Proceeds from stock option exercises and other	522	(89)
Net cash (used in) / provided by financing activities	(843)	5,888
Effect of exchange rate changes on cash and cash equivalents	(83)	(114)
Cash and cash equivalents:		
(Decrease) / Increase	(505)	187
Balance at beginning of period	2,481	2,101

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Balance at end of period	\$	1,976	\$	2,288
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See notes to condensed consolidated financial statements.

Kraft Foods Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Basis of Presentation

The consolidated financial statements include Kraft Foods, as well as our wholly owned and majority-owned subsidiaries.

Our interim condensed consolidated financial statements are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been omitted. It is management's opinion that these financial statements include all normal and recurring adjustments necessary for a fair presentation of our financial position and operating results. Net revenues and net earnings for any interim period are not necessarily indicative of future or annual results.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. You should read these interim condensed consolidated financial statements in conjunction with our consolidated financial statements and related notes in our Annual Report on Form 10-K for the year ended December 31, 2010. Certain reclassifications of prior-year amounts were made to conform to current-year presentation.

The majority of our operating subsidiaries report results as of the last Saturday of the period. A portion of our international operating subsidiaries report results as of the last calendar day of the period or two weeks prior to the last Saturday of the period.

In the second quarter of 2011, we changed the consolidation date for certain operations of our Kraft Foods Europe segment and operations in certain regions of our Kraft Foods Developing Markets segment [Latin America and Central and Eastern Europe, Middle East and Africa (CEEMA)]. Previously, these operations primarily reported results two weeks prior to the end of the period. Now, our Kraft Foods Europe segment reports results as of the last Saturday of each period. Our operations in Latin America and certain operations in CEEMA report results as of the last calendar day of the period. These changes resulted in a favorable impact to net revenues of \$360 million and a favorable impact of \$50 million to operating income.

In the second quarter of 2010, we changed the consolidation date for certain European biscuits operations within our Kraft Foods Europe segment and certain operations in Asia Pacific within our Kraft Foods Developing Markets segment. Previously, these operations primarily reported period-end results one month prior to the end of the period and moved to reporting results two weeks prior to the last Saturday of the period. These changes resulted in a favorable impact to net revenues of \$70 million and had an insignificant impact on operating income.

We believe these changes are preferable and will improve business planning and financial reporting by better matching the close dates of the operating subsidiaries within our Kraft Foods Europe segment and Kraft Foods Developing Markets segment and by bringing the reporting date closer to the period-end date. As the impact to prior-period results was not material, we have not revised prior-period results.

Highly Inflationary Accounting:

We account for our Venezuelan subsidiaries under highly inflationary accounting rules, which principally means all transactions are recorded in U.S. dollars. Venezuela has two exchange rates: the official rate and the government-regulated Transaction System for Foreign Currency Denominated Securities (SITME) rate. We used both the official rate and the SITME rate to translate our Venezuelan operations into U.S. dollars, based on the nature of the operations of each individual subsidiary.

We recorded \$11 million of favorable foreign currency impacts relating to highly inflationary accounting in Venezuela during the first nine months of 2011 and approximately \$85 million of unfavorable foreign currency impacts during the first nine months of 2010. The 2010 loss included a one-time impact to translate cash of \$34 million that we previously carried at the secondary market exchange rate. Upon the change to highly inflationary accounting in January 2010, we were required to translate the U.S. dollars on hand using the official rate.

New Accounting Pronouncements:

In September 2011, the Financial Accounting Standards Board (FASB) issued an amendment related to multiemployer pension plans. This amendment increases the quantitative and qualitative disclosures about an employer's participation in individually significant multiemployer plans that offer pension and other postretirement benefits. The guidance is effective for fiscal years ended after December 15, 2011. The adoption of this standard will not have an impact on our financial results, but will expand our annual disclosures related to multiemployer pension plans within the notes to our annual financial statements.

In September 2011, the FASB issued an amendment to simplify how entities test goodwill for impairment. An entity now has the option to first assess qualitative factors to determine whether it is more likely than not that goodwill may be impaired. If, after assessing the totality of events and circumstances, goodwill impairment is determined to be not likely, then performing the quantitative two-step impairment test would not be required. The new guidance also modifies goodwill evaluation during the year to make it consistent with the new annual qualitative approach. The update is effective for annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We plan to early adopt in the quarter ended December 31, 2011. The new guidance will not have an impact on our financial results but is expected to simplify the goodwill testing we do on an annual and interim basis.

In June 2011, the FASB issued an amendment related to statements of comprehensive income. This amendment requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This amended guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance is effective for fiscal years and interim periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this standard will not have an impact on our financial results, but will change the financial presentation of other comprehensive income within our financial statements.

In May 2011, the FASB issued an amendment to revise certain fair value measurement and disclosure requirements. This amendment establishes common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards. These changes will be effective January 1, 2012 on a prospective basis. Early adoption is not permitted. The adoption of this standard is not expected to have a material impact on our financial results.

Subsequent Events:

We evaluated subsequent events and included all accounting and disclosure requirements related to subsequent events in our financial statements.

Note 2. Proposed Spin-off Transaction

On August 4, 2011, we announced that our Board of Directors intends to create two independent public companies: (i) a global snacks business (the Global Snacks Business) and (ii) a North American grocery business (the North American Grocery Business). The Global Snacks Business will consist of our current Kraft Foods Europe and Developing Markets segments as well as our North American snack and confectionary brands. The North American Grocery Business will primarily consist of our current U.S. Beverages, Cheese, Convenient Meals and Grocery segments, grocery-related categories in our Canada & N.A. Foodservice segment as well as the *Planters* and *Corn Nuts* brands and businesses. We expect to create these companies through a U.S. tax-free spin-off of the North American Grocery Business to our shareholders.

The transaction is subject to a number of conditions, including the receipt of regulatory approvals, a favorable ruling from the Internal Revenue Service to ensure the U.S. tax-free status of the spin-off, execution of intercompany agreements, further diligence as appropriate and final approval from our Board of Directors. While our current target is to complete the spin-off before year-end 2012, we cannot assure that the spin-off will be completed on the anticipated timeline or that the terms of the spin-off will not change.

Note 3. Acquisitions and Divestitures

Cadbury Acquisition and related Divestitures:

On February 2, 2010, we acquired 71.73% of Cadbury Limited (Cadbury) and as of June 1, 2010, we owned 100% of all outstanding Cadbury Shares. The Cadbury acquisition was valued at \$18,547 million, or \$17,503 million net of cash and cash equivalents.

As part of our Cadbury acquisition, we expensed and incurred transaction-related fees of \$2 million for the three months and \$217 million for the nine months ended September 30, 2010. We recorded these expenses within selling, general and administrative expenses. We also incurred acquisition financing fees of \$96 million in the first quarter of 2010. We recorded these expenses within interest and other expense, net.

The EU Commission required, as a condition of our Cadbury acquisition, that we divest certain Cadbury confectionery operations in Poland and Romania. In the third quarter of 2010, we completed the sale of the assets of the confectionery operations in Poland and Romania. The total proceeds from the divestitures were \$342 million and the impacts of these divestitures were reflected as adjustments to the purchase price allocations.

Cadbury contributed net revenues of \$6,376 million and net earnings of \$369 million from February 2, 2010 through September 30, 2010. The following unaudited pro forma summary presents Kraft Foods consolidated information as if Cadbury had been acquired on January 1, 2010. These amounts were calculated after conversion to U.S. GAAP, applying our accounting policies, and adjusting Cadbury's results to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment, and intangible assets had been applied from January 1, 2010, together with the consequential tax effects. These adjustments also reflect the additional interest expense incurred on the debt to finance the purchase and the divestitures of the Cadbury confectionery operations in Poland and Romania.

	00,000,000
	Pro forma for the Nine Months Ended September 30, 2010 (in millions)
Net revenues	\$ 35,997
Net earnings attributable to Kraft Foods	3,420

Pizza Divestiture:

On March 1, 2010, we completed the sale of the assets of our North American frozen pizza business (Frozen Pizza) to Nestlé USA, Inc. for \$3.7 billion. Accordingly, the results of the Frozen Pizza business have been reflected as discontinued operations on the condensed consolidated statement of earnings in the prior-period results.

Summary results of operations for the Frozen Pizza business through September 30, 2010 were:

	00,000,000
	For the Nine Months Ended September 30, 2010 (in millions)
Net revenues	\$ 335
Earnings before income taxes	73
Provision for income taxes	(25)
Gain on discontinued operations, net of income taxes	1,596
Earnings and gain from discontinued operations, net of income taxes	\$ 1,644

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Earnings before income taxes related to the Frozen Pizza business excluded overhead allocations of \$25 million during 2010 prior to the divestiture. The gain on discontinued operations from the sale of the Frozen Pizza business included a \$1.2 billion tax expense.

Note 4. Inventories

Inventories at September 30, 2011 and December 31, 2010 were:

	00,000,000 September 30, 2011	00,000,000 December 31, 2010
	(in millions)	
Raw materials	\$ 2,085	\$ 1,743
Finished product	4,314	3,567
Inventories, net	\$ 6,399	\$ 5,310

Note 5. Property, Plant and Equipment

Property, plant and equipment at September 30, 2011 and December 31, 2010 were:

	00,000,000 September 30, 2011	00,000,000 December 31, 2010
	(in millions)	
Land and land improvements	\$ 782	\$ 795
Buildings and building equipment	4,968	4,934
Machinery and equipment	16,678	16,147
Construction in progress	1,489	1,154
	23,917	23,030
Accumulated depreciation	(10,061)	(9,238)
Property, plant and equipment, net	\$ 13,856	\$ 13,792

Note 6. Goodwill and Intangible Assets

Goodwill by reportable segment at September 30, 2011 and December 31, 2010 was:

	00,000,000 September 30, 2011	00,000,000 December 31, 2010
	(in millions)	
Kraft Foods North America:		
U.S. Beverages	\$ 1,290	\$ 1,290
U.S. Cheese	3,000	3,000
U.S. Convenient Meals	985	985
U.S. Grocery	3,046	3,046
U.S. Snacks	9,125	9,125
Canada & N.A. Foodservice	3,346	3,430
Kraft Foods Europe	9,239	9,023
Kraft Foods Developing Markets	7,561	7,957
Total goodwill	\$ 37,592	\$ 37,856

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Intangible assets at September 30, 2011 and December 31, 2010 were:

	00,000,000 September 30, 2011	00,000,000 December 31, 2010
	(in millions)	
Non-amortizable intangible assets	\$ 22,994	\$ 23,351
Amortizable intangible assets	2,902	2,928
	25,896	26,279
Accumulated amortization	(480)	(316)
	&nb	