GENERAL MILLS INC
Form 10-Q
October 02, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED AUGUST 27, 2006**
o	**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: 1-1185

GENERAL MILLS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**41-0274440** (I.R.S. Employer Identification No.)
Number One General Mills Boulevard **Minneapolis, MN** (Mail: P.O. Box 1113) (Address of principal executive offices)	**55426** (Mail: 55440) (Zip Code)

(763) 764-7600

(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of September 27, 2006, General Mills had 343,072,762 shares of its $.10 par value common stock outstanding (excluding 159,233,902 shares held in treasury).

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

GENERAL MILLS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited) (In Millions, Except per Share Data)

	Thirteen Weeks Ended	
	Aug. 27, 2006	**Aug. 28, 2005**
Net Sales	**$ 2,860**	$ 2,679
Cost of sales	**1,796**	1,686
Selling, general and administrative expense	**575**	532
Operating Profit	**489**	461
Restructuring and other exit costs (income)	**(2)**	9
Interest expense, net	**105**	90

Earnings before Income Taxes and After-tax Earnings from Joint Ventures	**386**	362
Income Taxes	**138**	129
After-tax Earnings from Joint Ventures	**19**	19
Net Earnings	**$ 267**	$ 252
Earnings per Share Basic	**$ .76**	$ .69
Earnings per Share Diluted	**$ .74**	$ .64
Dividends per Share	**$ .35**	$ .33

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Millions)

	Aug. 27, 2006	May 28, 2006
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 425**	$ 647
Receivables	**1,165**	1,076
Inventories	**1,427**	1,055
Prepaid expenses and other current assets	**207**	216
Deferred income taxes	**159**	182
Total Current Assets	**3,383**	3,176

Land, Buildings and Equipment, at Cost	**5,858**	5,806
Less accumulated depreciation	**(2,910)**	(2,809)
Net Land, Buildings and Equipment	**2,948**	2,997
Goodwill	**6,643**	6,652
Other Intangible Assets	**3,667**	3,607
Other Assets	**1,945**	1,775
Total Assets	**$ 18,586**	$ 18,207
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	**$ 860**	$ 708
Current portion of long-term debt	**2,082**	2,131
Notes payable	**2,221**	1,503
Other current liabilities	**1,778**	1,796
Total Current Liabilities	**6,941**	6,138
Long-term Debt	**2,406**	2,415
Deferred Income Taxes	**1,810**	1,822
Other Liabilities	**962**	924
Total Liabilities	**12,119**	11,299
Minority Interests	**1,137**	1,136
Stockholders' Equity:		
Cumulative preference stock, none issued		
Common stock, 502 shares issued, $.10 par value	**50**	50
Additional paid-in capital	**5,725**	5,653
Retained earnings	**5,248**	5,107
Common stock in treasury, at cost, shares of 157 and 146, respectively	**(5,809)**	(5,163)
Accumulated other comprehensive income	**116**	125
Total Stockholders' Equity	**5,330**	5,772
Total Liabilities and Equity	**$ 18,586**	$ 18,207

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In Millions)

	Thirteen Weeks Ended	
	Aug. 27, 2006	**Aug. 28, 2005**
Cash Flows Operating Activities		
Net earnings	**$ 267**	$ 252
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**104**	105
Stock-based compensation	**53**	11
After-tax earnings from joint ventures	**(19)**	(19)
Tax benefit on exercised options		9
Deferred income taxes	**10**	(6)
Changes in current assets and liabilities	**(332)**	(245)
Distributions of joint venture earnings	**11**	18
Pension and other postretirement costs	**(13)**	2
Restructuring and other exit costs	**(2)**	9
Other, net	**25**	22
Net Cash Provided by Operating Activities	**104**	158
Cash Flows Investing Activities		
Purchases of land, buildings and equipment	**(61)**	(45)
Acquisitions	**(58)**	(1)
Investments in affiliates, net	**(127)**	(5)
Proceeds from disposal of land, buildings and equipment	**10**	3
Other, net	**(4)**	(13)
Net Cash Used by Investing Activities	**(240)**	(61)
Cash Flows Financing Activities		
Change in notes payable	**720**	571
Payment of long-term debt	**(67)**	
Common stock issued	**71**	37
Tax benefit on exercised options	**15**	
Purchases of common stock for treasury	**(699)**	(546)
Dividends paid	**(126)**	(123)
Net Cash Used by Financing Activities	**(86)**	(61)
Increase (decrease) in Cash and Cash Equivalents	**(222)**	36
Cash and Cash Equivalents Beginning of Year	**647**	573
Cash and Cash Equivalents End of Period	**$ 425**	$ 609

Cash Flows from Changes in Current Assets and Liabilities:		
Receivables	**$ (88)**	$ (79)
Inventories	**(373)**	(278)
Prepaid expenses and other current assets	**14**	36
Accounts payable	**151**	25
Other current liabilities	**(36)**	51
Changes in Current Assets and Liabilities	**$ (332)**	$ (245)

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Background

The accompanying Consolidated Financial Statements of General Mills, Inc. (we, us, our, or the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not include certain information and disclosures required for comprehensive financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the thirteen weeks ended August 27, 2006, are not necessarily indicative of the results that may be expected for the fiscal year ending May 27, 2007.

These statements should be read in conjunction with the consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended May 28, 2006. The accounting policies used in preparing these consolidated financial statements are the same as those described in Note 1 to the consolidated financial statements in that Form 10-K, except as disclosed in Notes 2 and 3 below. Certain prior years amounts have also been reclassified to conform to the current year presentation as disclosed in Note 3 below.

In addition, at the beginning of fiscal 2007, we shifted responsibility for several customers from our Bakeries and Foodservice segment to our U.S. Retail segment. All prior year amounts have been reclassified for comparative purposes. See Notes 6 and 15 below.

(2) Stock-Based Compensation

We have various stock-based compensation programs under which awards, including stock options, restricted stock, and restricted stock units, may be granted to employees and non-employee directors.

Options may be priced at 100 percent or more of the fair market value of our stock on the date of grant, and generally vest four years after the date of grant. Options generally expire within 10 years and one month after the date of grant. The 2006 Compensation Plan for Non-Employee Directors (2006 Director Plan) allows each nonemployee director to receive upon election and re-election to the Board of Directors options to purchase shares of common stock that generally vest one year, and expire within 10 years, after the date of grant.

Stock and units settled in stock subject to a restricted period and a purchase price, if any (as determined by the Compensation Committee of the Board of Directors), may be granted to key employees under the 2005 Stock Compensation Plan. Restricted shares and restricted stock units, up to 50 percent of the value of an individual s cash incentive award, may also be granted. Certain restricted share and restricted stock unit awards require the employee to deposit personally owned shares (on a one-for-one basis) with us during the restricted period. Restricted shares and restricted stock units generally vest and become unrestricted four years after the date of grant. Participants are entitled to cash dividends on such awarded shares and units, but the sale or transfer of these shares and units is restricted during the vesting period. Participants holding restricted shares, but not restricted stock units, are also entitled to vote on matters submitted to holders of common stock for a vote. The 2006 Director Plan allows each nonemployee director to receive upon election and re-election to the Board restricted stock units that generally vest one year after the date of grant.

We issue shares from treasury stock upon the exercise of stock options and the vesting of restricted stock units.

Prior to May 29, 2006, we applied Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations in accounting for stock-based compensation. No compensation expense for stock options was recognized in our Consolidated Statements of Earnings prior to fiscal 2007, as the exercise price was equal to the market price of our stock at the date of grant. Expense attributable to other types of share-based awards was recognized in our results under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123).

Effective May 29, 2006, we adopted Statement of Financial Accounting Standards No. 123(Revised) Share-Based Payment (SFAS 123R), which changed the accounting for compensation expense associated with stock options, restricted stock awards, and other forms of equity compensation. We elected the modified prospective transition method as permitted by SFAS 123R; accordingly, results from prior periods have not been restated. Under this method, stock-based compensation expense for the thirteen weeks ended August 27, 2006, includes quarterly amortization related to the remaining unvested portion of all equity compensation awards granted prior to May 29, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and quarterly amortization related to all equity compensation awards granted on or subsequent to May 29, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Prior to the adoption of SFAS 123R, we made pro forma disclosures in accordance with SFAS 123, in which we calculated compensation expense for stock option awards on a straight-line basis over their vesting periods. This treatment differs from the requirements of SFAS 123R, which requires that a stock-based award be considered vested for expense attribution purposes when the award recipient s retention of the award is no longer contingent on providing subsequent service. Accordingly, beginning in fiscal 2007, we have prospectively revised our expense attribution method so that the compensation expense is recognized immediately for awards granted to retirement-eligible individuals or over the lesser of the award s vesting period or the period from the grant date of the award to the recipient s retirement eligibility date.

The compensation expense related to share-based payments recognized in selling, general and administrative expense in the Consolidated Statements of Earnings for the thirteen weeks ended August 27, 2006, was $53 million. The impact of adoption of SFAS 123R was an incremental expense of $40 million ($25 million after-tax or $0.07 cents per diluted share) in the thirteen weeks ended August 27, 2006.

Amounts for the thirteen weeks ended August 28, 2005, are presented in the table below in accordance with SFAS 123. Reported amounts are principally related to restricted stock unit awards; pro forma amounts also reflect expenses related to stock option grants.

	Thirteen Weeks Ended
In Millions, except per share data	**Aug. 28, 2005**
Net earnings, as reported	$ 252
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects	7
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(12)
Pro forma net earnings	$ 247
Earnings per share:	
Basic as reported	$ .69
Basic pro forma	$ .68
Diluted as reported	$ .64
Diluted pro forma	$ .62

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Prior to the adoption of SFAS 123R, we reported all tax benefits resulting from the exercise of stock options as operating cash flows in our Consolidated Statements of Cash Flows. In accordance with SFAS 123R, for the thirteen weeks ended August 27, 2006, the presentation of our Consolidated Statements of Cash Flows has changed from prior periods to report the excess tax benefits from the exercise of stock options as financing cash flows. For the thirteen weeks ended August 27, 2006, $15 million of excess tax benefits were reported as financing cash flows.

Net cash proceeds from the exercise of stock options were $75 million for the thirteen weeks ended August 27, 2006, and $38 million for the thirteen weeks ended August 28, 2005.

The weighted-average grant date fair values of stock options granted during the thirteen weeks ended August 27, 2006, were estimated at $10.74 per share and during the thirteen weeks ended August 28, 2005, were estimated at $8.04 per share using the Black-Scholes option-pricing model with the following assumptions:

Thirteen Weeks Ended	**Aug. 27, 2006**	**Aug. 28, 2005**
Risk-free interest rate	5.3%	4.3%
Expected term	8 years	7 years
Expected volatility	19.7%	20.0%
Expected dividend growth rate	9.2%	10.2%

Information on stock option activity follows:

	Shares (thousands)	**Weighted-average exercise price**	**Weighted-average remaining contractual term (years)**	**Aggregate intrinsic value (millions)**
Outstanding at May 28, 2006	58,203	$ 41.45		
Granted	5,175	51.26		
Exercised	(2,257)	35.23		
Forfeited or expired	(42)	45.67		
Outstanding at Aug. 27, 2006	61,079	$ 42.51	5.11	$ 709
Exercisable at Aug. 27, 2006	39,836	$ 40.20	3.63	$ 554

The intrinsic value of options exercised during the thirteen weeks ended August 27, 2006, was $38 million and $24 million in the thirteen weeks ended August 28, 2005.

Information on restricted stock unit activity follows:

	Shares (thousands)	Weighted-average grant-date fair value
Non-vested at May 28, 2006	3,672	$ 46.87
Granted	1,530	51.28
Vested	(247)	44.91
Forfeited	(53)	47.41
Non-vested at Aug. 27, 2006	4,902	$ 48.34

The total grant-date fair value of restricted stock unit awards which vested in the first thirteen weeks of fiscal 2007 was $11 million. The total grant-date fair value of restricted stock unit awards which vested in the first thirteen weeks of fiscal 2006 was $17 million. At August 27, 2006, compensation cost related to non-vested stock options and restricted stock units was $203 million. This cost will be recognized over 35 months, on average.

(3) Reclassifications

At the beginning of fiscal 2007, we made certain changes in the classifications of revenues and expenses.

We made a change in accounting principle to classify shipping costs associated with the distribution of finished products to our customers as cost of sales (previously recorded in selling, general and administrative expense). We made the change in principle because we believe the classification of these shipping costs in cost of sales better reflects the cost of producing and distributing our products and aligns our external financial reporting with the results we use internally to evaluate segment operating performance. The impact of this change in principle was an increase to cost of goods sold of $121 million in the thirteen weeks ended August 27, 2006, and $104 million in the thirteen weeks ended August 28, 2005.

We also reclassified certain trade-related costs and customer allowances as cost of sales or selling, general and administrative expense (previously recorded as reductions of net sales). The impact of this reclassification was an increase to net sales of $16 million, an increase in cost of sales of $24 million, a decrease in selling, general and administrative expense of $6 million and an increase in earnings of joint ventures before taxes of $2 million in the thirteen weeks ended August 28, 2005.

During the quarter, we also reclassified certain liabilities, including trade and consumer promotion accruals, from accounts payable to other current liabilities, and we began classifying certain distributions from joint ventures as operating cash flows (previously reported as investing cash flows). The impact of this reclassification was a decrease to accounts payable of $443 million at May 28, 2006, and an increase to cash flows from operations of $18 million in the thirteen weeks ended August 28, 2005.

We have reclassified previously reported Consolidated Statements of Earnings, Consolidated Balance Sheets and Consolidated Statements of Cash Flows to conform to the current year presentation. These reclassifications had no effect on previously reported net earnings.

(4) Acquisitions

During the first quarter of fiscal 2007 Cereal Partners Worldwide (CPW), our joint venture with Nestlé, completed the acquisition of the Uncle Tobys cereal business in Australia. We funded our 50 percent share of the purchase price by making additional advances to and equity contributions in CPW totaling $135 million (classified as investments in affiliates, net on the Consolidated Statements of Cash Flows) and by acquiring a 50 percent beneficial interest in certain intellectual property for $58 million (classified as acquisitions on the Consolidated Statements of Cash Flows).

(5) Restructuring and Other Exit Costs

In the first quarter of fiscal 2007, we recorded income related to restructuring and other exit activities of $2 million. We sold our previously closed plant in San Adrian, Spain resulting in a gain of $9 million. We also committed to a plan to divest our par-baked bread product line, including its plants in Chelsea, Massachusetts and Tempe, Arizona. This product line had tangible and intangible assets with a net book value of $19 million at August 27, 2006. We incurred an impairment loss of $6 million on the long-lived assets, including associated goodwill, as a result of the planned divestiture based on the expected sales proceeds and costs to dispose of the product line. We also incurred $1 million of charges in the first quarter of fiscal 2007 associated with restructuring actions previously announced.

In the first quarter of fiscal 2006, we recorded restructuring and other exit costs of $9 million, consisting of $8 million of charges related to an asset impairment recognized at our Swedesboro, New Jersey plant and $1 million of charges associated with restructuring actions previously announced. The restructuring actions previously announced also resulted in certain associated expenses, primarily adjustments to the depreciable life of the assets necessary to reflect the shortened asset lives which coincided with final production dates. These associated expenses were recorded as a cost of sales and totaled $2 million in the first quarter of fiscal 2006.

(6) Goodwill and Intangible Assets

At the beginning of fiscal 2007, we shifted selling responsibility for several customers from our Bakeries and Foodservice segment to our U.S. Retail segment. Goodwill of $216 million previously reported in our Bakeries and Foodservice segment as of May 28, 2006, has now been recorded in the U.S. Retail segment. The changes in our carrying amount of goodwill for the thirteen weeks ended August 27, 2006, were as follows:

In Millions	**International**	**Total**

	U.S. Retail		Bakeries and Foodservice	
Balance at May 28, 2006	$ 4,960	$ 491	$ 1,201	$ 6,652
Reclassification for customer shift	216		(216)	
Divestiture			(6)	(6)
Foreign currency translation		(3)		(3)
Balance at Aug. 27, 2006	**$ 5,176**	**$ 488**	**$ 979**	**$ 6,643**

The acquisition of Uncle Tobys by CPW increased our intangibles, primarily brands, by $58 million in the first quarter of fiscal 2007, as described in Note 4 above.

(7) Inventories

The components of inventories are as follows:

In Millions	**Aug. 27, 2006**	**May 28, 2006**
Raw materials, work in process and supplies	**$ 276**	$ 226
Finished goods	**1,109**	813
Grain	**111**	78
Reserve for LIFO valuation method	**(69)**	(62)
Total Inventories	**$ 1,427**	$ 1,055

(8) Stockholders Equity

The following table provides detail of Total Comprehensive Income:

In Millions	**Thirteen Weeks Ended Aug. 27, 2006**			**Thirteen Weeks Ended Aug. 28, 2005**		
	Pretax	**Tax**	**Net**	**Pretax**	**Tax**	**Net**
Net Earnings			**$ 267**			$ 252

Other Comprehensive Income
(Loss):