Sara Lee Corp
Form 10-Q
May 06, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 29, 2008

OR

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

Commission file number 1-3344

Sara Lee Corporation

(Exact name of registrant as specified in its charter)

Maryland	**36-2089049**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

3500 Lacey Road, Downers Grove, Illinois 60515

(Address of principal executive offices) (Zip Code)

(630) 598-6000

(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 ¨

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 accelerated filer, large accelerated filer, smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ 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 x

On March 29, 2008, the Registrant had 706,307,100 outstanding shares of common stock $.01 par value, which is the Registrant s only class of common stock.

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SARA LEE CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets at March 29, 2008 and June 30, 2007

(Unaudited)

In millions	March 29, 2008	June 30, 2007
Assets		
Cash and equivalents	$ 1,258	$ 2,517
Trade accounts receivable, less allowances	1,433	1,277
Inventories		
Finished goods	810	712
Work in process	44	34
Materials and supplies	443	294
	1,297	1,040
Current deferred income taxes	348	33
Other current assets	372	277
Assets of discontinued operations		64
Total current assets	4,708	5,208
Other non-current assets	252	196
Property, net of accumulated depreciation of $3,147 and $2,837, respectively	2,511	2,393
Trademarks and other identifiable intangibles, net	1,053	1,002
Goodwill	3,020	2,698
Deferred income taxes	248	137
Assets of discontinued operations		121
	$ 11,792	$ 11,755
Liabilities and Stockholders Equity		
Notes payable	$ 23	$ 23
Accounts payable	1,068	1,055
Accrued liabilities	1,814	1,763
Current maturities of long-term debt	864	1,427
Liabilities of discontinued operations		48
Total current liabilities	3,769	4,316
Long-term debt	2,478	2,770
Pension obligation	574	662
Deferred income taxes	302	128
Other liabilities	1,282	1,157
Liabilities of discontinued operations		93
Minority interests in subsidiaries	22	14
Common stockholders equity	3,365	2,615
	$ 11,792	$ 11,755

See accompanying Notes to Consolidated Financial Statements

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SARA LEE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

For the Quarter and Nine Months ended March 29, 2008 and March 31, 2007

(Unaudited)

In millions, except per share data	Quarter Ended March 29, 2008	Quarter Ended March 31, 2007	Nine Months Ended March 29, 2008	Nine Months Ended March 31, 2007
Continuing operations				
Net sales	$ 3,243	$ 2,935	$ 9,705	$ 8,857
Cost of sales	1,984	1,778	5,997	5,448
Selling, general and administrative expenses	1,020	973	3,064	2,893
Net charges (benefits) for exit activities, asset and business dispositions	(3)	30	8	69
Impairment charges		4		156
Contingent sale proceeds			(130)	(120)
Interest expense	42	65	143	200
Interest income	(20)	(36)	(66)	(96)
	3,023	2,814	9,016	8,550
Income from continuing operations before income taxes	220	121	689	307
Income tax expense (benefit)	(14)	8	73	(15)
Income from continuing operations	234	113	616	322
Discontinued operations				
Net income from discontinued operations, net of tax expense of nil, $1, nil and $31	1		1	51
(Loss) gain on sale of discontinued operations, net of tax expense of $1, nil, $1 and $2	(24)	3	(24)	14
Net income	$ 211	$ 116	$ 593	$ 387
Income from continuing operations per share of common stock				
Basic	$ 0.33	$ 0.15	$ 0.86	$ 0.43
Diluted	$ 0.33	$ 0.15	$ 0.86	$ 0.43
Net income per share of common stock				
Basic	$ 0.30	$ 0.16	$ 0.83	$ 0.52
Diluted	$ 0.30	$ 0.16	$ 0.82	$ 0.52
Average shares outstanding				
Basic	709	735	718	744
Diluted	710	738	719	746
Cash dividends per share of common stock	$ 0.105	$ 0.10	$ 0.31	$ 0.30

See accompanying Notes to Consolidated Financial Statements.

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SARA LEE CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Common Stockholders Equity

For the Period July 1, 2006 to March 29, 2008

Unaudited

In millions, except per share data	Total	Common Stock	Capital Surplus	Retained Earnings	Unearned Stock	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income
Balances at July 1, 2006	$ 2,449	$ 8	$ 62	$ 3,855	$ (137)	$ (1,339)	
Net income	387			387			$ 387
Translation adjustments, net of tax	462					462	462
Minimum pension liability, net of tax	(36)					(36)	(36)
Net unrealized gain (loss) on qualifying cash flow hedges, net of tax	29					29	29
Comprehensive income							$ 842
Dividends common ($0.30 per share)	(225)			(225)			
Spin off of Hanesbrands Inc. business	(18)			(85)		67	
Stock issuances							
Stock option and benefit plans	39		39				
Restricted stock	26		26				
Share repurchases and retirement	(490)		(105)	(385)			
ESOP tax benefit, redemptions and other	7	(1)	3		5		
Balances at March 31, 2007	2,630	7	25	3,547	(132)	(817)	
Adjustment to apply SAB No. 108	58			53		5	
Net income	117			117			$ 117
Translation adjustments, net of tax	42					42	42
Minimum pension liability, net of tax	179					179	179
Net unrealized gain (loss) on qualifying cash flow hedges, net of tax	5					5	5
Comprehensive income							$ 343
Adjustment to apply SFAS No. 158, net of tax	(168)					(168)	
Dividends common ($0.10 per share)	(73)			(73)			
Spin off of Hanesbrands Inc. business	(11)			(11)			
Stock issuances							
Stock option and benefit plans	8		8				
Restricted stock	3		3				
Share repurchases and retirement	(196)	(1)	(34)	(161)			
ESOP tax benefit, redemptions and other	21	1	(2)	13	9		
Balances at June 30, 2007	2,615	7		3,485	(123)	(754)	
Net income	593			593			$ 593
Translation adjustments, net of tax	642					642	642
Net unrealized gain (loss) on qualifying cash flow hedges, net of tax	17					17	17

Pension/Postretirement activity, net of tax	(8)					(8)	(8)
Comprehensive income							$ 1,244
Adoption of SFAS Interpretation No. 48	13			13			
Dividends common ($0.31 per share)	(224)			(224)			
Stock issuances							
Stock option and benefit plans	8		8				
Restricted stock	18		18				
Share repurchases and retirement	(315)		(27)	(288)			
ESOP tax benefit, redemptions and other	6		1		5		
Balances at March 29, 2008	$ 3,365	$ 7	$	$ 3,579	$ (118)	$ (103)	

See accompanying Notes to Consolidated Financial Statements.

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SARA LEE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Nine Months ended March 29, 2008 and March 31, 2007

(Unaudited)

In millions	Nine Months Ended March 29, 2008	Nine Months Ended March 31, 2007
OPERATING ACTIVITIES		
Net income	$ 593	$ 387
Less: Cash received from contingent sale proceeds	(130)	(120)
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	295	320
Amortization	90	89
Impairment charges		156
Net loss (gain) on business dispositions	24	(38)
Increase (decrease) in deferred income taxes	29	(29)
Other	71	75
Changes in current assets and liabilities, net of businesses acquired and sold	(734)	(742)
Net cash from operating activities	238	98
INVESTMENT ACTIVITIES		
Purchases of property and equipment	(306)	(354)
Purchase of software and other intangibles	(44)	(73)
Dispositions of businesses and investments	(2)	351
Cash received from loans receivable		688
Cash received from contingent sale proceeds	130	120
Cash received from (used in) derivative transactions	74	(25)
Cash used to invest in short-term investments		(639)
Cash received from maturing short-term investments		299
Sales of assets	28	59
Net cash (used in) received from investment activities	(120)	426
FINANCING ACTIVITIES		
Issuances of common stock	5	33
Purchases of common stock	(315)	(490)
Borrowings of long-term debt		2,895
Repayments of long-term debt	(1,003)	(407)
Repayments of short-term debt, net	(5)	(1,713)
Cash transferred to Hanesbrands Inc. in spin off		(650)
Payments of dividends	(222)	(301)
Net cash used in financing activities	(1,540)	(633)
Effect of changes in foreign exchange rates on cash	160	96
(Decrease) in cash and equivalents	(1,262)	(13)
Add: Cash balance of discontinued operations at beginning of year	3	18
Less: Cash balance of discontinued operations at end of quarter		2
Cash and equivalents at beginning of year	2,517	2,227

Cash and equivalents at end of quarter	$ 1,258	$ 2,230
COMPONENTS OF CHANGES IN CURRENT ASSETS AND LIABILITIES		
(Increase) decrease in trade accounts receivable	$ (38)	$ 8
(Increase) in inventories	(158)	(138)
(Increase) in other current assets	(13)	(36)
(Decrease) in accounts payable	(71)	(52)
(Decrease) in accrued liabilities	(255)	(245)
(Decrease) in accrued taxes	(199)	(279)
Changes in current assets and liabilities, net of businesses acquired and sold	$ (734)	$ (742)

See accompanying Notes to Consolidated Financial Statements

SARA LEE CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Basis of Presentation and Balance Sheet Revision

Basis of Presentation:

The consolidated financial statements for the quarter and nine month periods ended March 29, 2008 and March 31, 2007 have not been audited by an independent registered public accounting firm, but in the opinion of Sara Lee Corporation (the corporation or the company), these financial statements include all normal and recurring adjustments necessary for a fair presentation of our financial position, operating results, and cash flows. The results of operations for the quarter and first nine months ended March 29, 2008 are not necessarily indicative of the operating results to be expected for the full fiscal year.

The interim consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Although the corporation believes the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the corporation s Form 10-K for the year ended June 30, 2007 and other financial information filed with the Securities and Exchange Commission.

The corporation s fiscal year ends on the Saturday closest to June 30. The third quarter and first nine months of fiscal 2008 ended on March 29, 2008 and the third quarter and first nine months of fiscal 2007 ended on March 31, 2007. Each of these quarters was a thirteen-week period and each nine month period was a thirty-nine week period. Unless otherwise stated, references to years relate to fiscal years.

Balance Sheet Revision:

In the third quarter of 2008, the corporation determined that a $420 million deferred income tax liability related to the anticipated repatriation of foreign earnings was misclassified as a noncurrent deferred income tax liability on the consolidated balance sheet at June 30, 2007. Because these deferred income tax amounts are settled at the time the earnings are repatriated and it was anticipated the repatriation would occur within twelve months, the deferred income tax liability should have been classified as current. Additionally, during the third quarter 2008 financial statement closing process, the corporation reviewed the detail of its balance sheet classification of other significant deferred tax items and identified $30 million of additional items that were incorrectly classified as noncurrent at June 30, 2007. Correction of these errors moves most of the reclassification from long-term deferred income tax liabilities to current deferred income tax assets because the tax jurisdiction the corrections pertain to is in a net current deferred income tax asset position. These classification errors resulted in a $435 million overstatement of current deferred income tax assets, a $450 million overstatement of noncurrent deferred income tax liabilities, and a $15 million understatement of accrued liabilities but had no impact on net income, common stockholders equity or cash flows. While the corporation has concluded that this misclassification did not materially misstate any previously issued financial statements, the June 30, 2007 balance sheet was revised in order to improve the consistency and comparability of deferred income tax and working capital balances. The impact of this revision on the relevant lines in the balance sheet (as adjusted for discontinued operations) is summarized below:

	Balances at June 30, 2007	
	As reported	**As adjusted**
Current deferred income tax asset	$ 468	$ 33
Total current assets	5,643	5,208
Total assets	12,190	11,755
Accrued liabilities	1,748	1,763
Total current liabilities	4,301	4,316
Noncurrent deferred income taxes	578	128
Total liabilities and equity	12,190	11,755

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2. Net Income Per Share

Net income per share basic is computed by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding for the period. Net income per share diluted reflects the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted into common stock. For the quarter and nine months ended March 29, 2008, options to purchase 31.4 million and 29.4 million shares, respectively, of the corporation s common stock had exercise prices that were greater than the average market price of those shares during the respective reporting periods. For the quarter and nine months ended March 31, 2007, options to purchase 33.4 million and 35.9 million shares, respectively, of the corporation s common stock had exercise prices that were greater than the average market price of those shares during the respective reporting periods. As a result, these shares are excluded from the earnings per share calculation, as they are anti-dilutive.

The average shares outstanding declined in the first nine months of 2008 as a result of shares repurchased under the corporation s ongoing share repurchase program. The corporation repurchases common stock at times management deems appropriate, given current market valuations. During the first nine months of 2008, the corporation repurchased 19.7 million shares of common stock for a purchase price of $315 million. The corporation has a continuing share repurchase program under which the corporation may repurchase shares of common stock. At March 29, 2008, 24.8 million shares remain authorized for repurchase under this program. The timing and amount of future share repurchases will be based upon market conditions and other factors.

The following is a reconciliation of net income to net income per share basic and diluted for the third quarter and first nine months of 2008 and 2007:

Computation of Net Income per Common Share

(In millions, except per share data)

	Quarter ended		Nine Months ended	
	Mar. 29, 2008	Mar. 31, 2007	Mar. 29, 2008	Mar. 31, 2007
Income from continuing operations	$ 234	$ 113	$ 616	$ 322
Income from discontinued operations, net of tax	1		1	51
Gain (loss) on disposition of discontinued operations, net of tax	(24)	3	(24)	14
Net income	$ 211	$ 116	$ 593	$ 387
Average shares outstanding basic	709	735	718	744
Dilutive effect of stock option and award plans	1	3	1	2
Diluted shares outstanding	710	738	719	746
Income from continuing operations per share				
Basic	$ 0.33	$ 0.15	$ 0.86	$ 0.43
Diluted	$ 0.33	$ 0.15	$ 0.86	$ 0.43
Income (loss) from discontinued operations per share				
Basic	$ (0.03)	$	$ (0.03)	$ 0.09
Diluted	$ (0.03)	$	$ (0.03)	$ 0.09
Net income per common share [(1)]				
Basic	$ 0.30	$ 0.16	$ 0.83	$ 0.52
Diluted	$ 0.30	$ 0.16	$ 0.82	$ 0.52

(1) EPS amounts are rounded to the nearest $0.01 and may not add to the total.

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3. Segment Information

The following is a general description of the corporation s six business segments:

North American Retail Meats sells a variety of packaged meat products to retail customers in North America.

North American Retail Bakery sells a variety of bakery products to retail customers in North America and includes the corporation s U.S. *Senseo* retail coffee business.

Foodservice sells a variety of meats, bakery, and beverage products to foodservice customers in North America.

International Beverage sells coffee and tea products in major markets around the world, including Europe, Australia and Brazil.

International Bakery sells a variety of bakery and dough products to retail and foodservice customers in Europe and Australia.

Household and Body Care sells products in four primary categories body care, air care, shoe care and insecticides in markets around the world, including the U.S., Europe and India.

The following is a summary of net sales and operating segment income by business segment for the third quarter and first nine months of 2008 and 2007:

	Net Sales			
(In millions)	**Third Quarter 2008**	**Third Quarter 2007**	**Nine Months 2008**	**Nine Months 2007**
North American Retail Meats	$ 590	$ 577	$ 1,781	$ 1,750
North American Retail Bakery	528	476	1,593	1,474
Foodservice	529	529	1,676	1,681
International Beverage	807	658	2,334	1,896
International Bakery	231	195	686	594
Household and Body Care	571	507	1,674	1,481
Total business segments	3,256	2,942	9,744	8,876
Intersegment sales	(13)	(7)	(39)	(19)
Net sales	$ 3,243	$ 2,935	$ 9,705	$ 8,857

	Income from Continuing Operations Before Income Taxes			
(In millions)	**Third Quarter 2008**	**Third Quarter 2007**	**Nine Months 2008**	**Nine Months 2007**
North American Retail Meats	$ 53	$ 28	$ 127	$ 67
North American Retail Bakery	14	(12)	29	(4)
Foodservice	35	39	112	117
International Beverage	129	121	375	203
International Bakery	17	14	39	32
Household and Body Care	77	59	198	193

Total operating segment income		325		249		880		608
Amortization of intangibles		(17)		(16)		(49)		(47)
General corporate expenses		(66)		(83)		(195)		(270)
Contingent sale proceeds						130		120
Operating income		242		150		766		411
Net interest expense		(22)		(29)		(77)		(104)
Income from continuing operations before income taxes	$	220	$	121	$	689	$	307

At the beginning of the first quarter of 2008, the corporation centralized operating responsibility for the management of trade accounts receivable in the U.S. to the corporation s shared services operations. As a result, the corporation s management, including the chief operating decision maker, no longer includes U.S. accounts receivable in the total assets of the U.S. business segments for purposes of evaluating and

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monitoring performance of these segments. These assets are evaluated as part of the operating performance of the corporation s shared services operations and are now reported as part of other corporate assets in the corporation s total assets disclosures. There have been no changes in the reporting responsibility for trade receivables of the international operations and those assets continue to be reported in the international segments. Prior period asset amounts have been restated to reflect this change.

	March 29, 2008	June 30, 2007
Assets		
North American Retail Meats	$ 1,001	$ 929
North American Retail Bakery	1,118	1,129
Foodservice	1,649	1,608
International Beverage	2,580	2,886
International Bakery	1,555	1,485
Household and Body Care	2,614	2,880
	10,517	10,917
Net assets held for sale	13	2
Discontinued operations		185
Other corporate assets (a)	1,262	651
Total assets	$ 11,792	$ 11,755

(a) Principally trade receivables of the U.S. operations that are centrally managed, cash and cash equivalents, certain corporate fixed assets, deferred tax assets and certain other noncurrent assets.

4. Impairment Review and Goodwill

2008

The corporation tests goodwill and intangible assets not subject to amortization for impairments in the second quarter of each fiscal year and whenever a significant event occurs or circumstances change that would more likely than not reduce the fair value of these intangible assets. As a result of the review in the second quarter of 2008, the corporation concluded that no impairment of goodwill or intangibles not subject to amortization exists. During the course of this review, the corporation determined that the amount of goodwill attributed to certain reporting units needed to be revised. Goodwill has been reallocated based upon the relative fair value of the reporting units that existed at the time the corporation realigned its business units into new segments during 2006. During 2006 and through the first quarter of 2008, the goodwill allocated to the International Bakery segment had been denominated in U.S. dollars. In the second quarter of 2008, the corporation determined that goodwill allocated to its International Bakery segment should have been denominated in European euros and subject to translation into the company s reporting currency from 2006 to the present. While the adjustment related to the reallocation of goodwill had no impact on the corporation s total goodwill value, the adjustment related to the redenomination of goodwill had the impact of increasing the corporation s total value of goodwill and increasing the total currency translation adjustment included in the accumulated other comprehensive income section of stockholders equity and other comprehensive income. The following table summarizes goodwill reported in continuing operations by reportable business segment for 2007 and 2008 and includes the impact of the revisions described above:

	North American Retail Meats	North American Retail Bakery	Foodservice	International Beverage	International Bakery	Household and Body Care	Total
Net book value at July 1, 2006	$ 92	$ 294	$ 954	$ 272	$ 622	$ 517	$ 2,751
Impairment				(92)			(92)

Foreign exchange/other				13		26	39
Net book value at June 30, 2007	92	294	954	193	622	543	2,698
Goodwill reallocation		3	48		(51)		
Redenomination				24	63	19	106
Foreign exchange				43	110	63	216
Net book value at March 29, 2008	$ 92	$ 297	$ 1,002	$ 260	$ 744	$ 625	$ 3,020

The goodwill redenomination of $106 million presented above represents the cumulative adjustment up to the end of 2007. As the error was discovered and corrected in the second quarter of 2008, the impact of this error on the currency translation adjustment in the first quarter of 2008 was $41 million, and the

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cumulative error amount was $147 million through the end of the first quarter of 2008, an amount which management believes to be immaterial to the consolidated quarterly and annual financial statements.

The corporation continues to believe that it is reasonably likely that the goodwill of certain reporting units may become impaired in future periods. The term reasonably likely refers to an occurrence that is more than remote but less than probable in the judgment of management. These reporting units include a bakery operation in Europe with $540 million of goodwill and a bakery operation in the Foodservice segment with $859 million of goodwill as of March 29, 2008. Both of these reporting units are currently generating sufficient amounts of operating earnings to support the recoverability of goodwill but need to show continued improvement in operating earnings to support the value of their goodwill. Additionally, because some of the inherent assumptions and estimates used in determining the fair value of these reporting units are outside the control of management, including interest rates, the cost of capital, and tax rates, changes in these underlying assumptions and our credit rating can also adversely impact the business units fair values. The amount of any impairment is dependent on all these factors, which cannot be predicted with certainty, and can result in impairment for a portion or all of the goodwill amounts noted previously.

2007

The corporation recognized a $156 million pretax and $135 million after tax impairment charge in the first nine months of 2007 which is comprised of the following components:

(In millions)	Goodwill Impairment	Trademark Impairment	Property Impairment	Investment Impairment	Total Impairment
International Beverage	$ 92	$ 26	$	$	$ 118
North American Retail Meats			34		34
Household and Body Care				4	4
Pretax impairment charge	92	26	34	4	156
Tax expense (benefit)		(9)	(12)		(21)
Impact on net income	$ 92	$ 17	$ 22	$ 4	$ 135

Goodwill Impairment As part of its annual review, in the second quarter of 2007, the corporation concluded that the carrying amount of its Brazilian and Austrian coffee reporting units, which are reported in the International Beverage segment, exceeded their respective fair values. As a result, the corporation compared the implied fair value of the goodwill in each reporting unit with the carrying value and concluded that a $92 million impairment loss needed to be recognized. Of this amount, $86 million related to the Brazilian reporting unit and $6 million related to the Austrian reporting unit. The impairment loss recognized equaled the entire remaining amount of goodwill in each reporting unit. The fair values of the reporting units were determined using discounted future cash flows. No tax benefit was recognized on either the Brazilian or Austrian goodwill impairment losses.

After considering the lower future profit expectations for the Brazilian operations, the corporation also concluded that it was necessary to recognize a full $27 million valuation reserve on the net deferred tax assets related to the Brazilian tax jurisdiction which is reported as tax expense in the Consolidated Statement of Income.

Trademark Impairment In conjunction with the actions resulting in the impairment of the Brazilian goodwill, in the second quarter of 2007, the corporation assessed the realization of its long-lived assets associated with this held-for-use asset grouping. The primary asset in the asset group was determined to be trademarks, which had a carrying value of $47 million and are being amortized over 10 years. Using the anticipated undiscounted cash flows of the asset group, the corporation concluded that the asset group was not fully recoverable. As a result of this evaluation, the corporation concluded that the carrying value of the trademarks exceeded the fair value by $26 million. The fair value of the trademarks was estimated using the royalty saved method. The after tax impact of the trademark impairment is $17 million.

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Property Impairment During the second quarter of 2007, management decided to close a facility that was part of the North American Retail Meats segment and recognized an impairment charge of $34 million for this asset group. The after tax impact of this impairment loss is $22 million.

Investment Impairment The corporation owns and operates a manufacturing plant in Zimbabwe that is included in the Household and Body Care segment. Changes in local governmental regulations in Zimbabwe include severe foreign exchange restrictions which inhibit the corporation from declaring dividends and repatriating earnings from the local operation. Based on these severe foreign exchange restrictions and general economic uncertainty in this economy, the corporation has considered the investment in the local business impaired, recognized a pretax and after tax impairment charge in the third quarter of 2007 for $4 million, and deconsolidated the business at the end of the third quarter of 2007. The remaining investment in these operations is being recorded as a cost basis investment and has a value of less than $1 million.

5. Discontinued Operations

The following is a summary of the operating results of the corporation s discontinued operations for the quarter and first nine months of 2008 and 2007.

	Quarter ended March 29, 2008			Nine Months ended March 29, 2008		
(In millions)	Net Sales	Pretax Income	Income	Net Sales	Pretax Income	Income
Meats Mexico	$ 79	$ 1	$ 1	$ 238	$ 1	$ 1

	Quarter ended March 31, 2007			Nine Months ended March 31, 2007		
(In millions)	Net Sales	Pretax Income	Income	Net Sales	Pretax Income (Loss)	Income (Loss)
Meats Mexico	$ 71	$ 1	$	$ 222	$ (10)	$ (11)
European Meats				114	7	3
Branded Apparel Americas/Asia				787	85	59
Total	$ 71	$ 1	$	$ 1,123	$ 82	$ 51

Results of Discontinued Operations The corporation closed on the sale of its meats Mexico business, which was part of the North American Retail Meats segment, on March 29, 2008 and closed on the sale of its European Meats business on August 8, 2006. It completed the spin off of the Branded Apparel Americas/Asia business on September 5, 2006. The operating results of these businesses are reflected in discontinued operations through the date of disposition.

The prior year balance sheet amounts of our meats Mexico business have been reclassified as discontinued operations. These amounts, which related to working capital, fixed assets and related lease liabilities of the business, and $31 million of cumulative translation adjustments, were removed from the balance sheet as of March 29, 2008 with the close of the sale of this business.

Gain (loss) on the Sale of Discontinued Operations

The corporation completed the disposition of its Mexican meat business in March 2008 as it wanted to more closely focus on its core brands in the U.S. The corporation recognized a pretax loss of $23 million and an after tax loss of $24 million. As the cash proceeds were received after the end of the quarter, a $55 million receivable was reported on the Other Current Assets line of the condensed consolidated balance sheet at March 29, 2008.

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During the first nine months of 2007, the corporation completed the disposition of three businesses reported as discontinued operations. The gain (loss) recognized in the third quarter and first nine months of 2007 is as follows:

	Quarter ended March 31, 2007			Nine Months ended March 31, 2007		
(In millions)	Pretax Gain on Disposition	Tax Charge	After Tax Gain	Pretax Gain (Loss) on Disposition	Tax Charge	After Tax Gain (Loss)
European Meats	$	$	$	$ 29	$	$ 29
U.K. Apparel	3		3	3		3
Philippines Portion of European Branded Apparel				8	(2)	6
Branded Apparel Americas/Asia				(24)		(24)
Total	$ 3	$	$ 3	$ 16	$ (2)	$ 14

<u>European Meats</u> The corporation completed the disposition of its European Meats business in August 2006 and recognized a pretax and after tax gain of $29 million. Included in this amount is a $5 million charge to recognize certain customary postclosing adjustments, which resulted from certain working capital and other reconciliations and completed various tax reporting requirements.

<u>U.K. Apparel</u> The U.K. Apparel business was sold in June 2006 in two transactions, with one buyer purchasing certain manufacturing operations in Sri Lanka and a separate buyer purchasing the Courtaulds operations centered in the U.K. The sale agreement provides for working capital and other customary postclosing adjustments relating to the assets transferred. In the third quarter of 2007, the corporation recognized $3 million of income resulting from the settlement of the working capital adjustment.

<u>Philippines Portion of European Branded Apparel</u> Substantially all of the European Branded Apparel business was sold in February 2006. However, the sale of the Philippine portion of the European Branded Apparel business did not legally close until September 2006 when final approval was received from the Philippine government. The buyer agreed to assume financial responsibility for the Philippines business in February 2006 upon the initial closing of the sale transaction. As such, no financial results for the Philippines business are included in the operating results of the corporation after that date. In September 2006, upon receiving local government approval, the corporation completed the legal transfer of the assets and recognized a pretax gain of $8 million and an after tax gain of $6 million.

<u>Branded Apparel Americas/Asia</u> In February 2005, the corporation announced its intent to spin off the corporation s Branded Apparel Americas/Asia business. In preparation for the spin off, the corporation incorporated Hanesbrands Inc. (Hanesbrands), a Maryland corporation to which it transferred the assets and liabilities that related to the Branded Apparel Americas/Asia business. On September 5, 2006, Hanesbrands borrowed $2,600 million from a group of banks. Net of loan origination fees, Hanesbrands received $2,558 million of cash proceeds. Using a portion of the proceeds received from the borrowing, Hanesbrands paid a dividend of $1,950 million to the corporation. Immediately following this dividend payment, Sara Lee distributed to each stockholder of record one share of Hanesbrands common stock for every eight shares of Sara Lee common stock held. The spin off was tax free on a U.S. tax basis to the corporation and its shareholders. The corporation recognized $24 million of expense in the first quarter of 2007 for certain investment banker and other fees as a direct result of this transaction, which are recognized as part of the net gain on disposal of discontinued operations.

Subsequent to the spin off date, the corporation has completed certain postclosing adjustments, tax reporting and other postclosing reconciliations in various areas, including completing the split of the corporation s pension plans and the determination of the relevant asset split to each plan under ERISA rules. Further postclosing tax adjustments may occur after certain future tax reporting requirements are completed. The net assets of the Hanesbrands business distributed are reflected as a dividend in the corporation s Consolidated Statements of Common Stockholders Equity.

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Discontinued Operations Cash Flows

The corporation s discontinued operations impacted the cash flows of the corporation in the first nine months of 2008 and 2007 as summarized in the table below:

(In millions) Increase / (Decrease)	Nine Months Ended March 29, 2008		Nine Months Ended March 31, 2007	
Discontinued operations impact on:				
Cash flow from operating activities	$	10	$	76
Cash flow (used in) from investing activities		(8)		(45)
Cash flow (used in) from financing activities		(5)		(47)
Effect of foreign exchange rates on cash				
Net cash impact of discontinued operations	$	(3)	$	(16)
Cash balance of discontinued operations:				
At start of period	$	3	$	18
At end of period				2
Decrease in cash of discontinued operations	$	(3)	$	(16)

6. Exit, Disposal and Transformation Activities

The company announced a transformation plan in February 2005 designed to improve performance and better position the company for long-term growth. The plan involved significant changes in the company s organizational structure, portfolio changes involving the disposition of a significant portion of the corporation s business, and a number of actions to improve operational efficiency. As part of its ongoing efforts to improve its operational performance, the corporation initiated additional actions in 2008 and recognized certain trailing costs related to transformation actions initiated in earlier years, including the impact of certain activities that were completed for amounts more favorable than previously estimated.

The nature of the costs incurred under actions initiated in 2008 and the long-term transformation plan includes the following:

1) Exit Activities, Asset and Business Disposition Actions These amounts primarily relate to:

- Employee termination costs
- Lease exit costs
- Gains or losses on the disposition of assets or asset groupings that do not qualify as discontinued operations

2) Transformation Costs These amounts primarily relate to:

- Expenses associated with the installation of new information systems, including the amortization of capitalized software costs

Costs to retain and relocate employees, as well as costs to recruit new employees

Consulting costs

Accelerated depreciation and amortization associated with decisions to dispose of or abandon the use of certain tangible and intangible assets at dates earlier than previously anticipated, pursuant to an exit plan. Accelerated depreciation represents the incremental impact of the revised estimate of remaining depreciation expense in excess of the original depreciation expense.

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The following is a summary of the (income) expense associated with new and ongoing actions, which also highlights where the costs are reflected in the Consolidated Statements of Income along with the impact on diluted EPS from continuing operations:

	Quarter ended		Nine Months ended	
(In millions)	**March 29, 2008**	**March 31, 2007**	**March 29, 2008**	**March 31, 2007**
Cost of sales:				
Accelerated depreciation	$	$	$ 1	$ 29
Transformation charges	1	2	7	6
Selling, general and administrative expenses:				
Accelerated depreciation				1
Transformation charges	9	33	33	87
Net charges for (income from):				
Exit activities		33	10	85
Asset and business dispositions	(3)	(3)	(2)	(16)
Reduction in income from continuing operations before income taxes	7	65	49	192
Income tax benefit	(2)	(24)	(17)	(71)
Reduction in income from continuing operations	5	41	32	121
Impact on diluted EPS from continuing operations	$ 0.01	$ 0.06	$ 0.05	$ 0.16

The impact of these actions on the corporation s business segments and unallocated corporate expenses is summarized as follows:

	Quarter Ended		Nine Months Ended	
(In millions)	**March 29, 2008**	**March 31, 2007**	**March 29, 2008**	**March 31, 2007**
North American Retail Meats	$ (1)	$ 24	$	$ 64
North American Retail Bakery		14	1	24
Foodservice	(1)	3	(1)	9
International Beverage	1	7	8	16
International Bakery		1	8	10
Household and Body Care	3	7	6	10
Decrease in operating segment income	2	56	22	133
Increase in general corporate expenses	5	9	27	59
Total	$ 7	$ 65	$ 49	$ 192

The following discussion provides information concerning the exit, disposal and transformation activities for each year where actions were initiated.

2008 Actions

During the third quarter and first nine months of 2008, the corporation approved certain actions related to exit, disposal and transformation activities. Net charges of $8 million and $49 million were recognized during the third quarter and first nine months of 2008, respectively, related to the 2008 actions. The composition of these charges and the remaining accruals are as follows:

(In millions)	Employee Termination and Other Benefits	Asset and Business Disposition Actions	Accelerated Depreciation	Transformation Costs IT and Other	Total
Exit and disposal costs recognized during 2008	$ 10	$ (2)	$ 1	$ 40	$ 49
Charges against assets			(1)	(10)	(11)
Asset and business disposition gains (losses)		2			2
Cash payments	(4)			(28)	(32)
Change in estimate					
Foreign exchange impact	1				1
Accrued costs as of March 29, 2008	$ 7	$	$	$ 2	$ 9
Exit and disposal costs (income) recognized in Q3 2008	$ 1	$ (3)	$	$ 10	$ 8

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Employee Termination and Other Benefits During the year, the corporation implemented plans to terminate 120 employees, primarily in our Foodservice and International Bakery segments, of which 72 were not yet terminated by quarter end.

Asset and Business Disposition Actions During the third quarter, the corporation recognized a $3 million gain related to the disposition of a Foodservice manufacturing facility. Total proceeds from the sale were $6 million.

Transformation Costs The corporation recognized costs related to the implementation of common information systems across the organization in order to improve operational efficiencies. These primarily relate to costs associated with assessing current systems, the evaluation of system alternatives, and process re-engineering costs, as well as the amortization of certain capitalized software costs.

The remaining accrued costs noted above are expected to be paid out within the next two years.

2007 Actions

In 2007, the corporation implemented certain actions related to exit, disposal and transformation activities including the following:

Implemented a plan to terminate 2,582 employees concentrated primarily in our North American Retail Meats, North American Retail Bakery, Foodservice, and International Beverage segments. As of March 29, 2008, 180 employees related to this plan were not yet terminated. Reductions in the planned headcount terminations from prior periods reflect the impact of certain employees not being terminated as originally planned.

Incurred costs to exit certain leased space, including those costs related to the relocation of the corporation s headquarters to Downers Grove, Illinois.

Recognized net gains associated with the disposal of certain Household and Body Care facilities offset by charges related to various disposition costs primarily associated with the spin off of the Branded Apparel business.

Recognized accelerated depreciation primarily on domestic meat processing facilities and equipment. All of the facilities were closed by the end of 2007.

Incurred transformation costs as a result of management s decision to centralize the management of its North American and European operations. Costs were incurred to relocate employees, recruit new employees, and pay retention bonuses to preserve business continuity. The corporation also incurred consulting costs to assist in the development of strategic operating and financial plans and employee training. Certain information technology costs were also incurred and related to the implementation of common information systems across the organization.

Significant actions completed during the third quarter and first nine months of 2008 and the status of the remaining elements of the 2007 actions along with the remaining accruals are as follows:

(In millions)	Employee Termination and Other Benefits	Non-cancelable lease and other contractual obligations	Losses on abandonment of assets	Asset and business disposition actions	Accelerated Depreciation	Transformation Costs IT and Other	Total
Accrued costs as of June 30, 2007	$ 68	$ 11	$	$	$	$ 7	$ 86
Cash payments	(34)	(3)				(7)	(44)
Change in estimate	(1)	1					
Foreign exchange impacts	5						5

Accrued costs as of March 29, 2008	$	38	$	9	$		$		$		$		$	47
Exit and disposal costs (income) recognized in Q3 2008	$	(2)	$		$		$		$		$		$	(2)

Employee termination and other benefits During the third quarter and first nine months of 2008, the corporation severed 84 and 276 employees, respectively, and expects to sever the majority of the

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remaining 180 employees before the end of the fiscal year. Also during the quarter, costs previously accrued for were adjusted as a result of certain termination actions not being completed as originally planned. The majority of the $38 million of remaining accrued costs is expected to be paid out within the next two years.

Noncancelable lease and other contractual obligations   As of the end of 2007, the corporation had exited all of the facilities contemplated in the original charge. The remaining accrual represents the amounts expected to be due under these arrangements, the majority of which is expected to be paid out over the next year.

2006 Actions

In 2006, the corporation implemented certain actions related to exit, disposal and transformation activities including the following:

Implemented a plan to terminate 1,873 employees concentrated primarily in our North American Retail Meats, North American Retail Bakery, International Beverage, and Household and Body Care segments. All of these employees were terminated by the end of 2007.

Incurred costs to exit certain leased space as well as costs to terminate contracts with foreign sales agents.

Recognized net gains related to various asset and business disposition actions related primarily to our European operations. All of these assets were disposed of by the end of 2006.

Recognized accelerated depreciation on disposed manufacturing facilities and equipment impacting all of our segments and also recognized charges related to closure of administrative buildings in order to consolidate the administration of our North American operations.

Incurred transformation costs as a result of management s decision to improve operational efficiency and standardize systems. Costs were incurred to relocate employees, recruit new employees, and pay retention bonuses to preserve business continuity. The corporation also incurred consulting costs to assist in the development of strategic operating and financial plans and employee training costs. Certain information technology costs were also incurred and related to the implementation of common information systems across the organization.

Realized a net gain related to the corporation s decision to modify its vacation policy for U.S. employees.

Significant actions completed during the third quarter and first nine months of 2008 and the status of the remaining elements of the 2006 actions along with the remaining accruals are as follows:

(In millions)	Employee Termination and Other Benefits	Non-cancelable lease and other contractual obligations	Transformation Costs IT and Other	Total
Accrued costs as of June 30, 2007	$ 60	$ 3	$ 1	$ 64
Cash payments	(21)			(21)
Change in estimate				
Foreign exchange impacts	8			8

Accrued costs as of March 29, 2008	$	47	$	3	$	1	$	51
Exit and disposal costs recognized in Q3 2008	$	1	$		$		$	1

Employee Termination and Other Benefits All termination actions were completed as of the end of 2007. The majority of the $47 million of remaining accrued costs is expected to be paid out within the next two years.

Noncancelable Lease and Other Contractual Obligations The corporation had exited all of the facilities contemplated in this charge by the end of 2006. The remaining accrual represents the amounts expected to be due under these arrangements.

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2005 Actions

During 2005, the corporation approved certain exit, disposal and restructuring actions to exit certain business activities and improve its performance under its previously announced transformation plan. These actions have since been completed. As of March 29, 2008, the accrued liabilities remaining in the Condensed Consolidated Balance Sheet related to these actions total $9 million and represent various severance obligations. The majority of the remaining accrued costs are expected to be paid out in the next year.

7. Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income are as follows:

(In millions)	Cumulative Translation Adjustment	Net Unrealized Gain (Loss) on Qualifying Cash Flow Hedges	Pension Adjustment	Accumulated Other Comprehensive Income
Balance at July 1, 2006	$ (661)	$ (42)	$ (636)	$ (1,339)
Spin off of Hanesbrands	5	4	58	67
Disposition of European Meats business	229			229
Other comprehensive income (loss) activity	233	29	(36)	226
Balance at March 31, 2007	(194)	(9)	(614)	(817)
Other comprehensive income (loss) activity	47	5	11	63
Balance at June 30, 2007	(147)	(4)	(603)	(754)
Goodwill redenomination	106			106
Disposition of Meats Mexico business	31			31
Other comprehensive income (loss) activity	505	17	(8)	514
Balance at March 29, 2008	$ 495	$ 13	$ (611)	$ (103)

Comprehensive income in the third quarters of 2008 and 2007 was $447 million and $179 million, respectively. Comprehensive income in the first nine months of 2008 and 2007 was $1,244 million and $842 million, respectively.

In the second quarter of 2008, the corporation redenominated goodwill that previously was recorded in U.S. dollars into currencies other than the corporation s functional currency which resulted in a $106 million goodwill increase. See Note 4, Impairment Review and Goodwill for additional information.

8. Derivative Reporting

The corporation is exposed to changes in interest rates, foreign exchange rates and commodity prices. To manage the risk from these changes, the corporation uses derivative instruments and enters into various hedging transactions. A description of the corporation s hedging programs and instruments is included in the corporation s 2007 Annual Report on Form 10-K which is filed with the Securities and Exchange Commission. As of June 30, 2007, the net accumulated derivative loss recorded in Accumulated Other Comprehensive Income was $4 million. During the nine months ended March 29, 2008, $32 million of accumulated net derivative losses were deferred into Accumulated Other Comprehensive Income and $49 million of accumulated net derivative losses were reclassified from Accumulated Other Comprehensive Income into earnings since the related hedged item was realized during the period, resulting in a balance in Accumulated Other Comprehensive Income at March 29, 2008 of an accumulated gain of $13 million.

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At March 29, 2008, the maximum maturity date of any cash flow hedge was approximately 5.2 years (principally two currency swaps that mature in 2012 and 2013), excluding forward exchange, option or swap contracts related to the payment of variable interest on existing financial instruments. The corporation expects to reclassify into earnings during the next twelve months net gains from Accumulated Other Comprehensive Income of approximately $12 million, at the time the underlying hedged transaction is realized.

Other disclosures related to amounts excluded from the assessment of effectiveness, amounts of hedge ineffectiveness and amounts reclassified into earnings as a result of the discontinuation of hedge accounting because it was probable that the original forecasted transaction would not occur have been omitted due to the insignificance of these amounts. The corporation uses non-U.S. dollar financing transactions as net investment hedges of long-term investments in corresponding foreign currency. Hedges that meet the effectiveness requirements are accounted for under net investment hedging rules. During the nine months ended March 29, 2008, a net loss of $373 million arising from effective hedges of net investments has been reflected in the cumulative translation adjustments account within the Consolidated Statements of Common Stockholders Equity.

9. Pension and Other Postretirement Benefit Plans

The components of the net periodic pension cost and the postretirement medical cost (income) related to continuing operations for the third quarter and first nine months of 2008 and 2007 are as follows:

	Third Quarter Fiscal 2008		Third Quarter Fiscal 2007	
(In millions)	**Pension**	**Postretirement Medical and Life Insurance**	**Pension**	**Postretirement Medical and Life Insurance**
Service cost	$ 23	$ 2	$ 24	$ 2
Interest cost	67	4	63	3
Expected return on plan assets	(74)		(70)	
Amortization of				
Prior service cost	2	(6)	2	(6)
Net actuarial loss	9	2	17	
Net periodic benefit cost	$ 27	$ 2	$ 36	$ (1)

	Nine Months Fiscal 2008		Nine Months Fiscal 2007	
(In millions)	**Pension**	**Postretirement Medical and Life Insurance**	**Pension**	**Postretirement Medical and Life Insurance**
Service cost	$ 67	$ 6	$ 72	$ 6
Interest cost	199	12	188	9
Expected return on plan assets	(219)		(208)	
Amortization of				
Transition (asset) obligation		(1)		(1)
Prior service cost	6	(17)	6	(18)
Net actuarial loss	26	5	49	2
Net periodic benefit cost	$ 79	$ 5	$ 107	$ (2)
Settlement loss	$	$	$ 5	$

The net periodic benefit cost for the continuing operations of the corporation s defined benefit pension plans in the third quarter and first nine months of 2008 was $9 million and $28 million lower than in 2007 as a result of the following:

Service cost declined primarily as a result of an increase in the discount rate, which reflects the higher interest rates in various jurisdictions.

The expected return on assets increased as a result of significant cash contributions made to the corporation s pension plans in 2007 as well as the favorable impact of foreign currencies, both of which resulted in plan assets at the start of 2008 exceeding plan assets at the start of 2007.

The amortization of net actuarial losses in the third quarter and first nine months of 2008 is lower than in 2007 primarily as a result of actuarial gains in 2007 which reduced the amount of unamortized actuarial losses at the end of 2007. This in turn resulted in a lower level of loss amortization in 2008.

The settlement loss recognized in the first nine months of 2007 was the result of the termination of certain foreign employees.

The corporation sold a branded apparel business in the U.K. and retained certain of the pension obligations of this business. An agreement was reached with the trustees of this retained plan that annuities would be purchased to settle the related obligations. At the present time, the corporation expects that annuities will be purchased and the pension obligation will be settled either late in 2008 or early in 2009. Upon the settlement of this obligation, the corporation will need to recognize in earnings any unamortized actuarial gains or losses related to this plan. As of the end of 2007, the plan had an unamortized loss of $28 million. The impact of the settlement on the corporation s earnings will depend upon the amount of the unamortized actuarial loss at the settlement date.

During the first nine months of 2008 and 2007, the corporation contributed $148 million and $183 million, respectively, to its defined benefit pension plans. At the present time, the corporation expects to contribute $221 million of cash to its defined benefit pension plans in 2008. The exact amount of cash contributions made to pension plans in any year is dependent upon a number of factors including minimum funding requirements in the jurisdictions in which the corporation operates and arrangements made with trustees of certain foreign plans. As a result, the actual funding in 2008 may differ from the current estimate.

10. Receipt of Contingent Sale Proceeds

The corporation sold its European cut tobacco business in 1999. Under the terms of that agreement, the corporation will receive an annual cash payment of 95 million euros if tobacco continues to be a legal product in the Netherlands, Germany and Belgium through July 15, 2009. The legal status of tobacco in each country accounts for a portion of the total contingency with the Netherlands accounting for 67%, Germany 22% and Belgium 11%. If tobacco ceases to be a legal product within any of these countries, the corporation forfeits the receipt of all future amounts related to that country. The contingencies associated with the 2008 and 2007 payments each passed in the first quarter of each fiscal year and the corporation received the annual payments. The 2008 annual payment was equivalent to $130 million and the 2007 annual payment was equivalent to $120 million based upon the respective exchange rates on the dates of receipt. These amounts were recognized in the corporation s earnings when received. The amount received in 2007 increased diluted earnings per share by $0.16 per share and the amount received in 2008 is expected to increase diluted earnings per share by $0.18 per share.

11. Income Taxes

Effective Annual Tax Rate for Interim Reporting   Generally accepted accounting principles require that the interim period tax provision be determined as follows:

At the end of each quarter, the corporation estimates the tax that will be provided for the fiscal year stated as a percent of estimated ordinary income for the fiscal year. The term ordinary income refers to income from continuing operations before income taxes, excluding significant unusual or infrequently occurring items. Discontinued operations are excluded in determining ordinary income.

The estimated annual effective tax rate is applied to the year-to-date ordinary income at the end of each quarter to compute the year-to-date tax applicable to ordinary income. The tax expense or benefit related to ordinary income in each quarter is the difference between the most recent year-to-date and the prior quarter year-to-date computations.

The tax effects of significant unusual or infrequently occurring items are recognized as discrete items in the interim period in which the events occur. The impact of changes in tax laws or rates

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on deferred tax amounts, the effects of changes in judgment about beginning of the year valuation allowances and changes in tax reserves resulting from the finalization of tax audits or reviews are examples of significant unusual or infrequently occurring items which are recognized as discrete items in the interim period in which the event occurs.

The determination of the annual effective tax rate is based upon a number of significant estimates and judgments, including the estimated annual pretax income of the corporation in each tax jurisdiction in which it operates and the development of tax planning strategies during the year. In addition, as a global commercial enterprise, the corporation s tax expense can be impacted by changes in tax rates or laws, the finalization of tax audits and reviews, as well as other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

Continuing Operations The following table sets out the tax expense (benefit) and the effective tax rate for the corporation s continuing operations:

	Third Quarter		Nine Months	
(In millions)	**2008**	**2007**	**2008**	**2007**
Continuing Operations				
Income before income taxes	$ 220	$ 121	$ 689	$ 307
Income tax expense (benefit)	(14)	8	73	(15)
Effective tax rate	(6.2)%	6.8%	10.6%	(4.8)%

Third Quarter and First Nine Months of 2008

In the third quarter of 2008, the corporation recognized a tax benefit on continuing operations of $14 million on pretax income of $220 million, or a negative effective tax rate of 6.2%. The tax rate in the quarter was impacted by $86 million of tax benefits related to the following discrete tax items:

$73 million resulted from the completion of tax audits and the expiration of statutes of limitations in France, Morocco, the Netherlands, the Philippines and various state and local jurisdictions. Of this amount, $45 million related to the completion of tax audits and $28 million related to the expiration of statutes of limitations.

$13 million relates to adjustments recorded on the taxes previously provided on the 2007 earnings of the corporation, consisting primarily of a $14 million overstatement related to an intercompany transaction. Management believes this error is immaterial to both the consolidated quarterly and annual financial statements.

The tax expense and related effective tax rate on continuing operations for the first nine months of 2008 was determined by applying a 30.4% estimated annual tax rate to pretax earnings and then recognizing the impact of $136 million of tax benefits related to the following discrete tax items:

$37 million relates to the reversal of valuation allowances on German net deferred tax assets. The corporation determined that a valuation allowance was no longer necessary due to the recent projected profitability of the German operations.

$79 million resulted from the completion of tax audits and the expiration of statutes of limitations in France, Morocco, the Netherlands, the Philippines and various state and local jurisdictions. Of this amount, $48 million related to the completion of tax audits and $31 million related to the expiration of statutes of limitations.

$13 million relates to adjustments recorded on the taxes previously provided on the 2007 earnings of the corporation as previously described above.

$7 million relates to the reduction of contingent tax obligations due to a change in estimated foreign earnings.

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The resulting effective tax rate for the nine month period was 10.6%. The 30.4% estimated annual effective tax rate related to ordinary income for 2008 includes an annual charge of $97 million to repatriate a portion of 2008 foreign earnings. This estimated charge increases the estimated annual effective tax rate by approximately 10%.

Third Quarter and First Nine Months of 2007

In the third quarter of 2007, the corporation recognized a tax expense from continuing operations of $8 million on pretax income of $121 million, or an effective tax rate of 6.8%. The low tax expense in the quarter is primarily attributable to the significant unusual or infrequently occurring benefits recognized as discrete items in the quarter and quantified below.

In the first nine months of 2007, the corporation recognized a tax benefit from continuing operations of $15 million on pretax income of $307 million, or a negative effective tax rate of 4.8%. The estimated annual effective tax rate related to ordinary income for the first nine months of 2007 was 59.8%, which assumed the recognition of a $194 million cost to repatriate substantially all foreign earnings to the U.S. and 43 percentage points of the annual effective rate related to this annual cost. The tax benefit and related effective tax rate on continuing operations, for the first nine months of 2007, was determined by applying this estimated annual rate to pretax earnings, which included the recognition of a $92 million non-deductible goodwill impairment charge, and then recognizing the impact of the following discrete tax items:

The corporation sold the shares of a subsidiary which resulted in a $158 million tax benefit in the first quarter of 2007. The proceeds received and the net book value of the entity sold in the first quarter was less than $1 million. As a result of a capital gain resulting from the disposition of another business, the corporation determined in the third quarter that this benefit could be increased to $169 million or an additional $11 million in the quarter.

Contingent tax obligations were reduced by $32 million after the statutes of limitation in multiple tax jurisdictions lapsed in the third quarter of 2007.

The taxes provided on the 2006 earnings of the corporation were reduced by $20 million in the third quarter of 2007 primarily as a result of a change in the estimated cost of repatriating $1.6 billion of cash to the U.S. from multiple foreign jurisdictions.

After considering the lower future profit expectations of a Brazilian coffee operation, the corporation concluded that it was necessary to recognize a full $27 million valuation allowance on the net deferred tax assets related to the Brazilian tax jurisdiction in the second quarter of 2007.

Discontinued Operations

For the third quarter of 2008, the pretax earnings of discontinued operations were $1 million and the related tax expense and effective tax rate were less than $1 million and 26.0%, respectively. For the first nine months of 2008, the pretax earnings of discontinued operations were $1 million and the related tax expense and effective tax rate were less than $1 million and 46.8%, respectively. The 2008 results of discontinued operations only include the results of the Meats Mexico business as the corporation completed the disposition of all other discontinued operations in the first quarter of 2007.

In the quarter and nine months ended March 29, 2008, the corporation recognized a pretax loss on the disposition of a discontinued operation of $23 million and the related tax expense was $1 million, resulting in a negative effective tax rate of 4.1%.

For the third quarter of 2007, the pretax earnings of discontinued operations were $1 million and the related tax expense was $1 million. For the first nine months of 2007, the pretax earnings of discontinued operations were $82 million and the related tax expense was $31 million resulting in an effective tax rate of 38.6%.

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In the third quarter of 2007, the corporation recognized a $3 million gain on the disposition of discontinued operations for which there was no tax expense or benefit recognized. In the first nine months of 2007, the corporation recognized a pretax gain on the disposition of discontinued operations of $16 million and the related tax expense was $2 million related to a gain on the disposal of an apparel operation in the Philippines.

FASB Interpretation No. 48

In June 2006, the FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48), which provides guidance on the financial statement recognition, measurement, reporting and disclosure of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 addresses the determination of whether tax benefits, either permanent or temporary, should be recorded in the financial statements. For those tax benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by the taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

The company adopted the provisions of FIN 48 on July 1, 2007 and recognized an increase in the retained earnings component of shareholders equity of $13 million.

As a result of the completion of tax audits and the expiration of statutes of limitations in France, Morocco, the Netherlands, the Philippines and various state and local jurisdictions, there was a decrease in the gross liability for uncertain tax positions of $84 million for the nine months ended March 29, 2008. Of this amount, $49 million relates to the completion of tax audits and $35 million relates to the expiration of statutes. This decrease was offset by $39 million of increases to reserves for uncertain tax positions and $41 million of unfavorable foreign currency exchange impacts. As a result, the net decrease in the gross liabilities for uncertain tax positions was $4 million resulting in an ending balance of $615 million as of March 29, 2008.

At this time, the corporation estimates that it is reasonably possible that the liability for unrecognized tax benefits will decrease by approximately $10 - $30 million in the next twelve months from a variety of uncertain tax positions as a result of the completion of various worldwide tax audits currently in process and the expiration of the statute of limitations in several jurisdictions.

In addition, the company recognizes interest and penalties related to unrecognized tax benefits in tax expense. As of July 1, 2007, the corporation had accrued interest and accrued penalties of $96 million. The change in accrued interest and accrued penalties during the nine months ended March 29, 2008 was insignificant.

The corporation s tax returns are routinely audited by federal, state, and foreign tax authorities and these audits are at various stages of completion at any given time. The Internal Revenue Service (IRS) has completed examinations of the company s U.S. income tax returns through July 3, 2004. Fiscal years remaining open to examination in the Netherlands include 2003 and forward. Other foreign jurisdictions remain open to audits ranging from 1999 to 2007. With few exceptions, the company is no longer subject to state and local income tax examinations by tax authorities for years before June 28, 2003.

12. Litigation

Aris Since 1995, three complaints have been filed on behalf of employees of a former subsidiary of the corporation known as Aris Philippines, Inc. (Aris) alleging unfair labor practices associated with Aris termination of manufacturing operations in the Philippines. Each of these three complaints includes allegations with the same issues and facts. With regard to two of these complaints, Aris prevailed in the administrative hearings held in the Philippines. Although implicated in these complaints, the corporation was not a party. The third complaint is a consolidation of cases filed in the Republic of the Philippines, Department of Labor and Employment and the National Labor Relations Commission (NLRC) from 1998 through July 1999 by individual complainants. On December 11, 1998, the third complaint was amended to name the corporation as a party. The case is styled: Emelinda Mactlang, et al. v. Aris Philippines, Inc., et al. In the underlying proceedings during 2006, the arbitrator ruled against the corporation and awarded the plaintiffs $60 million in damages and fees. The corporation appealed this administrative ruling. On

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December 19, 2006, the NLRC issued a ruling setting aside the arbitrator s ruling, and remanded the case to the arbitrator for further proceedings. The complainants and the corporation have filed motions for reconsideration the corporation seeking a final judgment and outright dismissal of the case, instead of a remand to the arbitrator; and complaints seeking to reinstate the original arbitrator s judgment against the defendants, including the corporation. The respective motions for reconsideration have been fully briefed by the parties and we await the NLRC s rulings.

The corporation s request to the Court of Appeals to reconsider its decision to require that the bond related to the arbitrator s original ruling be set at approximately $23 million has been denied. On December 10, 2007, the corporation petitioned the Supreme Court for review, arguing, among other things, that the appellate court s decision is now moot in light of the December 19, 2006 ruling by the NLRC setting aside the underlying judgment. No additional bond posting is required until all allowable appeals have been exhausted.

The corporation continues to believe that the plaintiffs claims are without merit; however, no assurance can be given that this matter will not have a material adverse impact on the corporation s financial position, results of operations or cash flows.

American Bakers Association (ABA) Retirement Plan The corporation is a participating employer in the American Bakers Association Retirement Plan. In 1979, the Pension Benefit Guaranty Corporation (PBGC) determined that the ABA plan was an aggregate of single-employer pension plans (multiple employer plans), rather than a multi-employer plan. Under the express terms of the ABA plan s governing documents, the corporation s contributions can only be used to pay for the benefits of its own employee-participants. Based upon the PBGC determination and the advice of counsel, the corporation has recognized its obligations under the plan as if it participated in a single-employer defined benefit plan under the provisions of Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions.

In August 2006, the PBGC rescinded its 1979 determination and concluded that the ABA plan was a multi-employer plan in which the participating parties share in the plan underfunding. The other major participant in the ABA plan is a bankrupt third party that is seeking an injunction to enforce the PBGC determination made in August 2006. If the ABA plan were declared to be a multi-employer pension plan, this third party would successfully reduce its underfunded liability under the ABA plan by roughly $60-$80 million. The corporation has initiated litigation seeking to overturn the August 2006 PBGC determination and intends to vigorously defend the position that it is responsible only for the obligations related to its current and former employees. The corporation believes that the PBGC s August 2006 determination is without merit; however, no assurance can be given that this matter will not have a material adverse impact on the corporation s financial position, results of operations or cash flows.

Other Plans The corporation participates in multi-employer pension plans that provide retirement benefits to employees covered by certain collective bargaining agreements and certain of these plans have unfunded vested benefits. Under the Multi-employer Pension Plan Amendments Act, a cessation of contributions to a multi-employer pension fund, which has unfunded vested benefits, and a series of other factors could result in a termination, withdrawal or significant partial withdrawal, which could render us liable for our proportionate share of the unfunded vested benefits and may require the recognition of a liability. The corporation has been contacted by one of the multi-employer pension funds regarding a prior plant closing and at the present time no assessment has been made by the fund. However, an assessment may be made in the future. If an assessment is made by the fund, the corporation intends to dispute the matter, but would be required to pay the assessment amount under ERISA rules while the dispute is resolved. No assurances can be given that this matter will not have a material impact on the corporation s financial position, results of operations or cash flows.

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Item 2

Management s Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following is management s discussion and analysis of the results of operations for the third quarter and first nine months of 2008 compared with the third quarter and first nine months of 2007 and a discussion of the changes in financial condition and liquidity during the first nine months of 2008. The following is an outline of the analyses included herein:

- Business Overview
- Consolidated Results
  - Third Quarter of 2008
  - First Nine Months of 2008
- Operating Results by Business Segment
- Financial Condition
- Liquidity
- Significant Accounting Policies and Critical Estimates
- Forward-Looking Information

Business Overview

Our Business

Sara Lee is a global manufacturer and marketer of high-quality, brand name products for consumers throughout the world focused primarily in the meats, bakery, beverage, and household products categories. Our brands include *Ambi Pur, Ball Park, Douwe Egberts, Hillshire Farm, Jimmy Dean, Kiwi, Sanex, Senseo* and our namesake, *Sara Lee*.

In North America, the company sells a variety of packaged meat products that include hot dogs, corn dogs, breakfast sausages, dinner sausages and deli meats as well as a variety of fresh and frozen baked products and specialty items that include bread, buns, bagels, cakes and cheesecakes. These products are sold through the retail channel to supermarkets, warehouse clubs and national chains. The company also sells a variety of meat, bakery and beverage products to foodservice customers in North America. Internationally, the company sells coffee and tea products in Europe, Brazil, Australia and Asia through both the retail and foodservice channels as well as a variety of bakery and dough products to retail and foodservice customers in Europe and Australia. It also sells body care, air care, shoe care and insecticides to retail customers primarily in Western and Central Europe and the Asia Pacific region.

Challenges and Risks

As an international consumer products company, we face certain risks and challenges that impact our business and financial performance. The risks and challenges described below have impacted our performance and are likely to impact our future results as well.

The food and consumer products businesses are highly competitive. In many product categories, we compete not only with widely advertised branded products, but also with private label products that are generally sold at lower prices. The consumers willingness to purchase our products depends upon our ability to offer brand value propositions selling products that consumers perceive as higher value at economical prices.

Commodity prices directly impact our business because of their effect on the cost of raw materials used to make our products and the cost of inputs to manufacture, package and ship our products. The commodities we use, including beef, pork, coffee, wheat, corn, corn syrup, soybean and corn oils, butter, sugar and fuel, may experience price volatility due to factors beyond our control. The company s objective is to be able to offset commodity price increases with pricing actions and to offset any operating costs increases with continuous improvement savings.

We also face significant price competition. From time to time, we may need to reduce the prices for some of our products to respond to competitive pressures. Such pressures also may restrict our ability to increase prices in response to raw material and other cost increases. Any reduction in prices as a result of competitive pressures, or our failure to increase prices when raw material costs increase, reduces our profit margins.

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To maintain and increase our existing market share in this highly competitive environment, we need to regularly spend on promotions and advertising and introduce new products. Due to inherent risks and uncertainty in the marketplace associated with the success of advertising and new product introductions, including uncertainties about trade and consumer acceptance, these expenditures may not result in increased sales and as a result could lower our profits.

The company s business results are also heavily influenced by changes in foreign currency exchange rates. For the most recently completed fiscal year, nearly 50% of net sales and more than 50% of operating segment income were generated outside of the U.S. As a result, changes in foreign currency exchange rates, particularly the European euro, can have a significant impact on the reported results.

The company s international operations provide a significant portion of the company s cash flow from operating activities, which is expected to require the company to continue to repatriate a greater portion of cash generated outside of the U.S. The repatriation of these funds has and is expected to continue to result in higher income tax expense and cash tax payments.

Transformation Actions and Other Significant Items Affecting Comparability

The reported results for 2008 and 2007 reflect amounts recognized for actions associated with the corporation s ongoing business transformation program and other significant amounts that impact comparability. The nature of these items includes the following:

Exit Activities, Asset and Business Dispositions These costs are reported on a separate line of the Consolidated Statements of Income. Exit activities primarily relate to charges taken to recognize severance actions approved by the corporation s management and the exit of leased facilities or other contractual arrangements. Asset and business disposition activities include costs associated with separating businesses targeted for sale and preparing financial statements for these businesses, as well as gains and losses associated with the disposition of asset groups that do not qualify for discontinued operations reporting. More information on these costs can be found in Note 6 to the Consolidated Financial Statements, Exit, Disposal and Transformation Activities.

Business Transformation Costs These include costs to retain and relocate existing employees, recruit new employees, third-party consulting costs associated with transformation efforts, and amortization costs for new enterprise-wide software. In addition, these costs include incremental depreciation associated with decisions to close facilities at dates sooner than originally anticipated, pursuant to an exit plan. These costs are recognized in the Consolidated Statements of Income in Selling, General and Administrative Expenses or Cost of Sales. More information on these costs can be found in Note 6 to the Consolidated Financial Statements, Exit, Disposal and Transformation Activities.

Impairment Charges These costs are included on a separate line of the Consolidated Statements of Income and represent charges for the impairment of fixed assets, intangible assets, goodwill and investments held by the corporation. More information regarding impairment charges can be found in Note 4 to the Consolidated Financial Statements, Impairment Review and Goodwill.

The impact of the transformation plan; exit activities, asset and business dispositions actions; and impairment charges are summarized as follows:

	Quarter ended		**Nine Months ended**	
(In millions)	**March 29, 2008**	**March 31, 2007**	**March 29, 2008**	**March 31, 2007**
Exit activities, asset and business dispositions	$ (3)	$ 30	$ 8	$ 69
Transformation charges:				
Cost of Sales	1	2	8	35
SG&A	9	33	33	88
Impairment charges		4		156
Total	$ 7	$ 69	$ 49	$ 348

The savings in 2008 related to the benefits derived from the actions taken from 2006 to 2008 approximates $113 million for the nine months year-to-date and is projected to be $151 million for the full year as compared to $67 million and $104 million, respectively in 2007. The corporation anticipates annual saving for these actions in 2009 to be approximately the same as in 2008.

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The impact of the above exit activities, asset and business dispositions actions; transformation plan; and impairment charges by business segment are summarized as follows:

(In millions)	Quarter ended March 29, 2008	Quarter ended March 31, 2007	Nine Months ended March 29, 2008	Nine Months ended March 31, 2007
North American Retail Meats	$ (1)	$ 24	$	$ 98
North American Retail Bakery		14	1	24
Foodservice	(1)	3	(1)	9
International Beverage	1	7	8	134
International Bakery		1	8	10
Household and Body Care	3	11	6	14
Impact on the business segments	2	60	22	289
Corporate office	5	9	27	59
Impact on income from continuing operations before income taxes	$ 7	$ 69	$ 49	$ 348

Consolidated Results Third Quarter of 2008 Compared with Third Quarter of 2007

The following table summarizes net sales and operating income for the third quarter of 2008 and 2007 and certain items that affected the comparability of these amounts:

Total Corporation Performance (In millions)	Quarter ended March 29, 2008	Quarter ended March 31, 2007	Change	Percent Change
Net sales	$ 3,243	$ 2,935	$ 308	10.5%
Increase / (Decrease) in net sales from:				
Changes in foreign currency exchange rates	$	$ (176)	$ 176	
Acquisition				
Total	$	$ (176)	$ 176	
Operating income (loss)	$ 242	$ 150	$ 92	61.2%
Increase / (Decrease) in operating income from:				
Changes in foreign currency exchange rates	$	$ (23)	$ 23	
Exit activities, asset and business dispositions	3	(30)	33	
Transformation charges	(10)	(35)	25	
Impairment charges		(4)	4	
Total	$ (7)	$ (92)	$ 85	

Net Sales

Net sales increased by $308 million or 10.5%. The strengthening of foreign currencies, particularly the European euro, Brazilian real and Australian dollar increased reported net sales by $176 million, or 6.2%. Net sales also increased due to pricing actions, generally across all segments, to offset increased commodity costs; and increased unit volumes across all business segments except Foodservice.

Third Quarter 2008

Net Sales Changes	Unit Volumes	+	Price/ Mix/Other	+	Acquisitions/ Divestitures	+	Foreign Exchange	=	Net Sales Change
Total Continuing Business	2.4%		1.9%		0.0%		6.2%		10.5%

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Operating Income

Operating income increased by $92 million, or 61.2%. Of the increase, $23 million was due to the favorable impact of changes in foreign currency exchange rates; $58 million was due to a reduction in charges related to exit activities, asset and business dispositions and transformation charges and $4 million was due to the non-recurrence of an impairment charge. The remaining change in operating income is an increase of $7 million. The individual components that comprise operating income are discussed in more detail below.

Gross Margin

The gross margin dollars in the quarter increased $102 million over the prior year due to the favorable impact of pricing actions; changes in foreign currency exchange rates; savings from continuous improvement programs; and an increase in unit volumes, which were partially offset by higher commodity and labor costs. The gross margin percent in the third quarter of 2008 declined 0.6%, from 39.4% in the third quarter of 2007 to 38.8% in 2008.

Selling, General and Administrative Expenses

	Quarter ended			
(In millions)	**March 29, 2008**	**March 31, 2007**	**Change**	**Percent Change**
SG&A expenses in the business segment results:				
Media advertising and promotion	$ 146	$ 135	$ 11	7.2%
Other	791	739	52	7.1
Total business segments	937	874	63	7.1
Amortization of identifiable intangibles	17	16	1	3.9
General corporate expenses	66	83	(17)	(19.6)
Total SG&A Expenses	$ 1,020	$ 973	$ 47	4.8%

Selling, general and administrative (SG&A) expenses increased by $47 million, or 4.8%. Measured as a percent of sales, SG&A expenses decreased from 33.2% in 2007 to 31.4% in 2008. Changes in foreign currency exchange rates increased SG&A costs by $57 million, or 5.8%. The remaining decrease in SG&A expenses is $10 million. SG&A expenses in the business segments increased by $63 million, or 7.1%, which was primarily due to the strengthening of foreign currencies and the impact of inflation on labor and other costs. The decline in general corporate expenses of $17 million was due to decreases in transformation costs and employee pension costs.

Transformation Actions, Impairment Charges, Exit Activities and Other Significant Items

The reported results for the third quarter of 2008 and 2007 reflect amounts recognized for actions associated with the corporation s ongoing business transformation program and other exit and disposal actions. The following table illustrates where the costs (income) associated with these activities are recognized in the Consolidated Statements of Income of the corporation along with the related tax and diluted EPS impacts.

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Impact of Significant Items on Income from Continuing Operations and Net Income

	Quarter ended March 29, 2008				Quarter ended March 31, 2007			
In millions, except per share data	**Pretax Impact**	**Tax (2)**	**Net Income**	**Diluted EPS Impact (1)**	**Pretax Impact**	**Tax (2)**	**Net Income**	**Diluted EPS Impact (1)**
Income from continuing operations	$ 220	$ 14	$ 234	$ 0.33	$ 121	$ (8)	$ 113	$ 0.15
Net income			$ 211	$ 0.30			$ 116	$ 0.16
Significant items affecting comparability of income from continuing operations and net income:								
Charges for exit activities, asset and business dispositions:								
Charges for exit activities	$	$	$	$	$ (33)	$ 11	$ (22)	$ (0.03)
Charges for business disposition activities	3	(1)	2		3	1	4	
Subtotal	3	(1)	2		(30)	12	(18)	(0.03)
Charges to cost of sales:								
Transformation charges IT costs	(1)		(1)		(2)		(2)	
Charges to SG&A expenses:								
Transformation charges IT costs	(8)	3	(5)	(0.01)	(9)	3	(6)	(0.01)
Transformation charges Other	(1)		(1)		(24)	9	(15)	(0.02)
Impairment charges					(4)		(4)	
Impact of significant items on income from continuing operations before income taxes	(7)	2	(5)	(0.01)	(69)	24	(45)	(0.06)
Significant tax matters affecting comparability:								
Tax benefit on disposition of a business						11	11	0.02
Contingent tax obligation adjustment		73	73	0.10		32	32	0.04
Change in estimated tax		(1)	(1)			20	20	0.03
Tax overstatement		14	14	0.02				
Other tax adjustments						(3)	(3)	
Impact of significant items on income from continuing operations	(7)	88	81	0.11	(69)	84	15	0.02
Significant items impacting discontinued operations:								
Loss on disposition of discontinued operations	(23)	(1)	(24)	(0.03)	3		3	
Impact of significant items on net income	$ (30)	$ 87	$ 57	$ 0.08	$ (66)	$ 84	$ 18	$ 0.03

Notes:

(1) EPS amounts are rounded to the nearest $0.01 and may not add to the total.
(2) Taxes computed at applicable statutory rates.

Costs related to exit activities, asset and business dispositions are down $33 million year over year primarily due to a reduction in exit costs related to employee termination costs and lease termination costs. The 2007 costs were higher because the corporation had implemented extensive restructuring plans to terminate employees in all our North American segments and the International Beverage segment. In 2007, the corporation also recognized costs to exit leased space in connection with the relocation of the corporation s headquarters to Downers Grove, Illinois.

Transformation costs related to information technology and consulting were down $25 million primarily due to extensive work needed in 2007 to assess current systems, evaluate alternative systems and re-engineer processes in anticipation of moving to one common system platform. Additionally, in 2007 the corporation decided to centralize the management of its North American and European operations which resulted in costs for employee relocation, recruitment and retention bonuses in order to maintain business continuity. These cost reductions were partially offset by $4 million of computer software amortization expense related to systems that were put into use in 2008. The total amortization expense for the year is expected to be $15 million.

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The corporation did not recognize an impairment charge in the third quarter of 2008. In the third quarter of 2007, the corporation recognized a $4 million impairment charge related to its investment in a business in Zimbabwe.

These actions are more fully described in the Exit, Disposal and Transformation Activities and Impairment Review and Goodwill Notes to the Consolidated Financial Statements.

Net Interest Expense

Net interest expense in the third quarter of 2008 was $22 million, a decrease of $7 million over the third quarter of the prior year. Interest expense declined by $23 million due to the repayment of debt using proceeds from prior business dispositions and cash on hand, while interest income declined by $16 million due to lower cash and cash equivalents.

Income Tax Expense

Note 11 to the consolidated financial statements provides a detailed explanation of the determination of the interim tax provision.

The following table sets out the tax expense (benefit) and effective tax rate for the corporation s continuing operations:

	Third Quarter	
(In millions)	**2008**	**2007**
Continuing Operations		
Income (loss) before income taxes	$ 220	$ 121
Income tax expense (benefit)	(14)	8
Effective tax rate	(6.2)%	6.8%

In the third quarter of 2008, the corporation recognized a tax benefit on continuing operations of $14 million on pretax income of $220 million, or a negative effective tax rate of 6.2%. The tax rate in the quarter was impacted by $86 million of tax benefits. These benefits include $45 million related to the completion of tax audits; $28 million related to the expiration of statutes of limitations; and $13 million related to adjustments recorded on taxes previously provided on the 2007 earnings of the corporation.

In the third quarter of 2007, the corporation recognized tax expense on continuing operations of $8 million on pretax income of $121 million, an effective tax rate of 6.8%. Tax expense was impacted by a $32 million reduction in contingent tax obligations after the statutes of limitations in multiple tax jurisdictions lapsed in the third quarter; a $20 million reduction in the taxes provided on 2006 earnings of the corporation primarily as a result of a change in the estimated cost of repatriating $1.6 billion of cash to the U.S. from multiple foreign jurisdictions; and a $11 million increase in the benefit on a prior capital loss resulting from the disposition of another business.

Income from Continuing Operations and Diluted Earnings per Share (EPS)

Income from continuing operations in the third quarter of 2008 was $234 million versus $113 million in the comparable period of the prior year. The $121 million increase was due to a $92 million improvement in operating income year over year as well as a reduction in net interest expense and income taxes. Diluted EPS from continuing operations increased from $0.15 per share in the third quarter of 2007 to $0.33 per share in the third quarter of 2008. The diluted EPS from continuing operations was favorably impacted by lower average shares outstanding during the third quarter of 2008 than the third quarter of 2007. The lower average shares are due to the corporation s ongoing share repurchase program. Under this program, the corporation repurchased a total of 19.7 million shares during the first nine months of 2008.

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Discontinued Operations

Discontinued operations reported $1 million for both income before income taxes and net income in 2008 and $1 million and nil, respectively in 2007. In 2008, the corporation reported a pretax and after tax loss on the disposition of businesses of $23 million and $24 million, respectively, which was related to the disposition of the Meats Mexico business. In 2007, the corporation reported a pretax and after tax gain on the disposition of discontinued operations of $3 million, which was related to certain customary postclosing working capital adjustments related to the disposition of the U.K. Apparel business.

Consolidated Results First Nine Months of 2008 Compared with First Nine Months of 2007

The following table summarizes net sales and operating income for the first nine months of 2008 and 2007 and certain items that affected the comparability of these amounts:

	Nine Months Ended			
Total Corporation Performance (In millions)	**March 29, 2008**	**March 31, 2007**	**Change**	**Percent Change**
Net sales	$ 9,705	$ 8,857	$ 848	9.6%
Increase / (decrease) in net sales from				
Changes in foreign currency exchange rates	$	$ (448)	$ 448	
Acquisition	2		2	
Total	$ 2	$ (448)	$ 450	
Operating income	$ 766	$ 411	$ 355	86.6%
Increase / (decrease) in operating income from				
Contingent sale proceeds	$ 130	$ 120	$ 10	
Changes in foreign currency exchange rates		(55)	55	
Exit activities, asset and business dispositions	(8)	(69)	61	
Transformation charges	(40)	(93)	53	
Impairment charges		(156)	156	
Accelerated depreciation on facilities sold	(1)	(30)	29	
Acquisition	(1)		(1)	
Total	$ 80	$ (283)	$ 363	

Net Sales

Consolidated net sales for the first nine months of 2008 were $9,705 million, an increase of $848 million, or 9.6%. The strengthening of foreign currencies, particularly the European euro, Brazilian real and Australian dollar increased reported net sales by $448 million, or 5.3%. Net sales in the first nine months of 2008 include $2 million from a business acquired after the start of 2007. Sales increased due to pricing actions generally across all segments as the corporation has implemented several rounds of pricing increases to offset increased commodity costs, as well as an increase in unit volumes.

First Nine Months 2008

Net Sales Changes	**Unit Volumes**	+	**Price/ Mix/Other**	+	**Acquisitions/ Divestitures**	+	**Foreign Exchange**	=	**Net Sales Change**
Total Continuing Business	1.3%		3.0%		0.0%		5.3%		9.6%

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Operating Income

Operating income increased by $355 million, or 86.6%. Of the increase, $55 million was due to the favorable impact of changes in foreign currency exchange rates; $143 million was due to a reduction in charges related to exit activities, asset and business dispositions, transformation charges and accelerated depreciation; $156 million was due to the non-recurrence of impairment charges; and $10 million was due to an increase in the contingent sales proceeds. The remaining change in operating income is a decrease of $8 million. The individual components that comprise operating income are discussed in more detail below.

Gross Margin

The year-to-date gross margin dollars increased $299 million over the prior year due to the favorable impact of pricing actions; changes in foreign currency exchange rates; savings from continuous improvement programs; and an increase in unit volumes, which were partially offset by higher commodity and labor costs. The gross margin percent of 38.2% in 2008 was 0.3% lower than the 38.5% reported in 2007.

Selling, General and Administrative Expenses

	Nine Months ended			
(In millions)	**March 29, 2008**	**March 31, 2007**	**Change**	**Percent Change**
SG&A expenses in the business segment results:				
Media advertising and promotion	$ 469	$ 408	$ 61	15.0%
Other	2,351	2,168	183	8.4
Total business segments	2,820	2,576	244	9.5
Amortization of identifiable intangibles	49	47	2	5.5
General corporate expenses	195	270	(75)	(28.0)
Total SG&A Expenses	$ 3,064	$ 2,893	$ 171	5.9%

Selling, general and administrative (SG&A) expenses increased by $171 million, or 5.9%. Measured as a percent of sales, SG&A expenses decreased from 32.7% in 2007 to 31.6% in 2008. Changes in foreign currency exchange rates increased SG&A costs by $147 million, or 5.1%. The remaining increase in SG&A expenses is $24 million, or 0.8%. SG&A expenses in the business segments increased by $244 million, or 9.5%, which was primarily attributable to the strengthening of foreign currencies, higher media advertising and promotion expenses and the impact of inflation on labor and other costs. The decrease in general corporate expenses of $75 million, or 28.0%, was primarily due to a $32 million decrease in business transformation costs, lower pension and other benefit plan costs and the non-recurrence of costs related to corporate hedging programs.

Transformation Actions, Impairment Charges and Other Significant Items

The reported results for the first nine months of 2008 and 2007 reflect amounts recognized for actions associated with the corporation s ongoing business transformation program and other significant items. The following table illustrates where the costs (income) associated with these activities are recognized in the Consolidated Statements of Income of the corporation along with the related tax and diluted EPS impacts.

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Impact of Significant Items on Income from Continuing Operations and Net Income

In millions, except per share data	Nine Months ended March 29, 2008 Pretax Impact	Tax (2)	Net Income	Diluted EPS Impact (1)	Nine Months ended March 31, 2007 Pretax Impact	Tax (2)	Net Income	Diluted EPS Impact (1)
Income from continuing operations	$ 689	$ (73)	$ 616	$ 0.86	$ 307	$ 15	$ 322	$ 0.43
Net income			$ 593	$ 0.82			$ 387	$ 0.52
Significant items affecting comparability of income from continuing operations and net income:								
Charges for exit activities, asset and business dispositions:								
Charges for exit activities	$ (10)	$ 3	$ (7)	$ (0.01)	$ (85)	$ 29	$ (56)	$ (0.08)
Income from business disposition activities	2	(1)	1		16	(2)	14	0.02
Subtotal	(8)	2	(6)	(0.01)	(69)	27	(42)	(0.06)
(Charges) income in cost of sales:								
Transformation charges:								
Information technology costs	(7)	3	(4)	(0.01)	(6)	2	(4)	
Accelerated depreciation	(1)		(1)		(29)	11	(18)	(0.02)
(Charges) income in SG&A expenses:								
Information technology costs	(30)	11	(19)	(0.03)	(33)	12	(21)	(0.03)
Other transformation costs	(3)	1	(2)		(54)	19	(35)	(0.05)
Accelerated depreciation					(1)		(1)	
Impairment charges					(156)	21	(135)	(0.18)
Impact of significant items on income from continuing operations before income taxes	(49)	17	(32)	(0.05)	(348)	92	(256)	(0.34)
Significant tax matters affecting comparability:								
Deferred tax valuation allowance adjustment		37	37	0.05		(27)	(27)	(0.04)
Contingent tax obligation adjustment		86	86	0.12		32	32	0.04
Change in estimated tax		(1)	(1)			20	20	0.03
Tax overstatement		14	14	0.02				
Other tax adjustments						(3)	(3)	
Tax benefit on disposition of a business						169	169	0.23
Impact of significant items on income from continuing operations	(49)	153						