

LEE SARA CORP
Form 10-K
September 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended July 1, 2006

Commission file number 001-03344

Sara Lee Corporation

(Exact name of registrant as specified in its charter)

Maryland
(State of incorporation)

Three First National Plaza
Chicago, Illinois
(Address of principal executive offices)

36-2089049
(I.R.S. Employer Identification No.)

60602-4260
(Zip Code)

Registrant's telephone number including area code: (312) 726-2600

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SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, \$.01 par value per share	The Chicago Stock Exchange
	The New York Stock Exchange
	The Pacific Exchange
	The Stock Exchange (London)
Preferred Stock Purchase Rights	The Chicago Stock Exchange
	The New York Stock Exchange
	The Pacific Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

On August 18, 2006, the registrant had outstanding 770,449,856 shares of common stock, par value \$.01 per share, which is the registrant's only class of common stock.

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on December 30, 2005, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$14 billion (based upon the closing price per share of the registrant's common stock on the New York Stock Exchange on such date).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Annual Report to Stockholders for the fiscal year ended July 1, 2006 are incorporated by reference into Parts I, II and IV of this Form 10-K, and are filed as Exhibit 13. Portions of the registrant's Proxy Statement for its 2006 annual meeting of stockholders are incorporated by reference into Items 10-12 and Item 14 of Part III of this Form 10-K.

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PART I

Item 1. Business

Sara Lee Corporation (Sara Lee, we, our or the Company) is a global manufacturer and marketer of high-quality, brand-name products for consumers throughout the world. The Company was organized in Baltimore, Maryland in 1939 as the C.D. Kenny Company and adopted its current name in 1985. Sara Lee's principal executive offices are located in Chicago, Illinois.

Recent Business Developments

In February 2005, Sara Lee announced a comprehensive transformation plan designed to improve performance and better position the company for long-term growth. The transformation plan is expected to be completed by 2010 and involves several components:

Transform Sara Lee's business portfolio by disposing of a number of businesses. Sara Lee decided to dispose of select businesses in order to focus on its key food, beverage and household products businesses. During fiscal 2006, Sara Lee disposed of its Direct Selling, European Branded Apparel, U.K. Apparel, U.S. Retail Coffee, European Nuts and Snacks, and U.S. Meat Snacks businesses. In August 2006, after the end of fiscal year 2006, Sara Lee completed the sale of its European Meats business. Additionally, on September 5, 2006, Sara Lee completed the spin off of its Branded Apparel Americas/Asia business, which was spun off as an independent public company named Hanesbrands Inc.

Reorganize continuing operations. At the beginning of fiscal 2006, Sara Lee reorganized its business operations around distinct consumers, customers and geographic markets. As a result, our business is organized around seven business segments: North American Retail Meats, North American Retail Bakery, Foodservice, International Beverage, International Bakery, Household and Body Care and Branded Apparel.

Improve operational efficiency. In order to improve operational efficiency, Sara Lee is utilizing continuous improvement methods to streamline processes and is centralizing its procurement and information technology across the organization.

Consolidate North American and European headquarters. As part of the transformation, Sara Lee is consolidating the headquarters of its North American businesses to one location in the Chicago area and the headquarters of its European businesses to one location in Utrecht, the Netherlands.

Description of the Business

At the beginning of fiscal 2006, Sara Lee reorganized its business operations around distinct consumers, customers and geographic markets in order to build functional excellence, increase strategic focus and simplify the organization. Sara Lee's new structure is organized around seven business segments: North American Retail Meats, North American Retail Bakery, Foodservice, International Beverage, International Bakery, Household and Body Care and Branded Apparel. Results of operations for fiscal year 2006 are presented based upon this reporting structure. Sara Lee also completed the spin off of its Branded Apparel Americas/Asia businesses into an independent public company called Hanesbrands Inc. The spin off was completed on September 5, 2006, after the end of fiscal year 2006.

North American Retail Meats

North American Retail Meats sells a variety of packaged meat products to retail customers in North America. Products include hot dogs and corn dogs, breakfast sausages and sandwiches, smoked and dinner sausages, premium deli and luncheon meats, bacon, and cooked and dry hams. North American Retail Meats

significant brands include *Hillshire Farm*, *Ball Park*, *Jimmy Dean*, *Sara Lee*, *Bryan*, *State Fair*, *Kahn's* and *Best's Kosher* in the U.S. and *Kir*, *Zwan* and *Duby* in Mexico.

North American Retail Meats primarily sells its products in the U.S. and Mexico, and 89% of the segment's fiscal 2006 sales were generated in U.S. dollars. Sales are made in the retail channel to supermarkets, warehouse clubs and national chains and generally are transacted through Sara Lee's own sales force and outside brokers.

The primary raw materials for the segment's products include pork, turkey, beef and chicken, which are purchased almost entirely from independent farmers and vendors. Sara Lee does not rely on any one vendor or small group of vendors for these raw materials, and prices fluctuate based on supply and demand in the marketplace.

The meats business is highly competitive, with an emphasis on product quality, innovation and price. New product innovations are a key component to success. The North American Retail Meats segment competes with other international, national, regional and local companies in each of the product groups.

The North American Retail Meats' operations are regulated by the U.S. Department of Agriculture, whose focus is the quality, sanitation and safety of meat products, and to a lesser extent by state and local government agencies. North American Retail Meats' operations in Mexico are regulated by local authorities in a similar fashion.

North American Retail Meats' business accounted for 15.9%, 15.2% and 15.2% of Sara Lee's consolidated sales during fiscal years 2006, 2005 and 2004, respectively.

North American Retail Bakery

North American Retail Bakery sells a wide variety of fresh and frozen baked products and specialty items to retail customers in North America. Products include bread, buns, bagels, rolls, muffins, specialty bread, frozen pies, cakes, cheesecakes and other desserts. North American Retail Bakery sells its products under the brands *Sara Lee*, *Earth Grains*, *Grant's Farm*, *Colonial*, *Rainbo*, *Holsum*, *IronKids*, *Mother's*, *Sunbeam*, *Healthy Choice* and *Chef Pierre*. Certain brands are used under licensing arrangements; however sales of products sold under licensing arrangements represent less than 8% of total North American Retail Bakery sales. The North American Retail Bakery segment also includes the results of the corporation's *Senseo* retail coffee business in the U.S.

Substantially all of the North American Retail Bakery's sales are generated in the U.S. Sales are made in the retail channel to supermarkets, warehouse clubs and national chains, and generally are made through Sara Lee's sales force and independent wholesalers. The North American Retail Bakery segment offers delivery directly to retail customer stores and warehouses through its direct store delivery system, which maintains approximately 4,500 delivery routes.

North American Retail Bakery's primary raw materials include wheat flour, sugar, corn syrup, butter, fruit, eggs and cooking oils, which are purchased from independent suppliers. Sara Lee does not rely on any one vendor or small group of vendors for these raw materials, and prices fluctuate based upon supply and demand in the marketplace, weather and government price supports.

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The bakery business is highly competitive, with an emphasis on product quality, innovation and value. New product innovations drive growth in this segment. The North American Retail Bakery segment competes with other international, national, regional and local companies in each of the product groups.

North American Retail Bakery's business accounted for 11.7%, 11.3% and 12.5% of Sara Lee's consolidated sales during fiscal years 2006, 2005 and 2004, respectively.

Foodservice

Foodservice sells a variety of meats, bakery and beverage products to foodservice customers in North America. Products include hot dogs and corn dogs, breakfast sausages and sandwiches, smoked and dinner sausages, premium deli and luncheon meats, bacon, meat snacks, cooked and dry hams, bread, buns, bagels, rolls, muffins, specialty bread, refrigerated dough, frozen pies, cakes, cheesecakes, roast, ground and liquid coffee, cappuccinos, lattes, teas, and a variety of sauces, dressings and condiments.

During fiscal 2006, virtually all of the segment's sales were generated in the U.S. Sales are made in the foodservice channel to distributors, restaurants, hospitals and other large institutions. The Foodservice segment also offers direct delivery of beverage products to restaurants and warehouses through its direct delivery system. Unit volumes in the Foodservice segment are generally a function of consumer eating patterns outside of the home.

The primary raw materials for Foodservice's products include pork, turkey, beef, chicken, wheat flour, sugar, corn syrup, butter, fruit, eggs, cooking oils and green coffee beans, which are purchased from independent vendors and farmers. The Foodservice segment does not rely on any one vendor or small group of vendors for these raw materials, and prices fluctuate based upon supply and demand in the marketplace, weather and government price supports.

The Foodservice segment competes with other international, national, regional and local companies in each of the product groups and is regulated by various U.S. government agencies such as the U.S. Department of Agriculture and the Food and Drug Administration.

Foodservice's business accounted for 13.7%, 13.4% and 13.4% of Sara Lee's consolidated sales during fiscal years 2006, 2005 and 2004, respectively.

International Beverage

International Beverage sells coffee and tea products in major markets around the world, including Europe, Australia and Brazil. In Europe, some of the more prominent brands are *Douwe Egberts*, *Senseo*, *Maison du Café*, *Marcilla*, *Merrild* and *Pickwick*. In South America, significant brands include *Café do Ponto*, *Café Caboclo*, *União* and *Café Pilão*.

In fiscal 2006, 85% of the segment's sales were generated in Western and Central Europe, 11% in Brazil and 4% in Australia. Sales are made in both the retail channel to supermarkets, warehouse clubs and national chains, and in the foodservice channel to distributors. The International Beverage segment also offers direct delivery to restaurants and warehouses through its direct delivery system.

The beverage business is highly competitive, with an emphasis on quality and value, and the International Beverage segment competes with other international and regional companies. Consumer preferences as to the blend or flavor and convenience of their purchases continue to change, with differing preferences around the world.

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The most significant cost item in the production of coffee products is the price of green coffee beans, which are purchased from farmers and coffee bean vendors in various countries around the world. The price of green coffee fluctuates based upon supply and demand, weather, the political climate in the producing nations, unilateral pricing policies of various nations and speculation in the commodities markets.

Sara Lee's International Beverage business accounted for 14.8%, 14.4% and 13.3% of Sara Lee's consolidated revenues during fiscal years 2006, 2005 and 2004, respectively.

International Bakery

International Bakery sells a variety of bakery and dough products to retail and foodservice customers in Europe and Australia. Products include a variety of bread, buns, rolls, specialty bread, refrigerated dough, frozen desserts and ice cream. The major brands under which International Bakery sells its products include *Bimbo*, *CroustiPate*, *Ortiz*, *BonGateaux* and *Sara Lee*.

During fiscal 2006, 86% of the segment's sales were generated in Western Europe, while the remaining sales were generated in Australia. Sales are made in the retail channel to supermarkets, warehouse clubs and national chains and in the foodservice channel to distributors and other institutions. Sales generally are made through Sara Lee's sales force and independent wholesalers. The International Bakery segment offers delivery directly to retail customer stores and warehouses through its direct store delivery system.

International Bakery's primary raw materials include wheat flour, sugar, corn syrup, butter, fruit, eggs, milk and cooking oils, which are purchased from independent suppliers. The International Bakery segment does not rely on any one vendor or small group of vendors for these raw materials, and prices fluctuate based upon supply and demand in the marketplace, weather and government price supports.

The bakery business is highly competitive, with an emphasis on product quality, innovation and value. New product innovations drive growth in this segment. The International Bakery segment competes with other international, national, regional and local companies in each of the product groups.

The International Bakery's business accounted for 4.7%, 4.8% and 4.5% of Sara Lee's consolidated revenues during fiscal years 2006, 2005 and 2004, respectively.

Household and Body Care

Household and Body Care sells products in four primary categories: body care, air care, shoe care and insecticides. Body care consists of soaps, shampoos, bath and shower products, deodorants, shaving creams and toothpastes, which are sold primarily in Europe under brands such as *Sanex*, *Duschdas*, *Radox*, *Monsavon* and *Prodent*. Air care provides air fresheners under the *Ambi Pur* brand in Europe and certain Asian countries. Shoe care includes polishes, cleaners and wax under the *Kiwi* and *Meltonian* brands in many countries around the world. Insecticides are sold primarily in Europe and Asia under brands such as *Vapona*, *Catch*, *GoodKnight*, *Bloom* and *Ridsect*.

In fiscal 2006, 67% of the segment's sales were generated in Western and Central Europe, 22% in the Asia Pacific region and 5% in the U.S. The remaining portion of the segment's sales was generated primarily in Africa.

The Household and Body Care business is highly competitive, with an emphasis on innovation, quality and value. Sara Lee competes with other international and regional companies.

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Sara Lee's Household and Body Care segment accounted for 11.5%, 12.0% and 12.2% of Sara Lee's consolidated revenues during fiscal years 2006, 2005 and 2004, respectively.

Branded Apparel

Branded Apparel designs, manufactures, sources and sells a broad range of apparel essentials such as t-shirts, bras, panties, men's underwear, kids' underwear, socks, hosiery, casualwear and activewear. Branded Apparel's principal brands include *Hanes*, *Champion*, *Playtex*, *Bali*, *Just My Size*, *barely there* and *Wonderbra*. On September 5, 2006, Sara Lee spun off the Branded Apparel segment into an independent, publicly traded business named Hanesbrands Inc. Sara Lee completed the spin off by distributing Hanesbrands' common stock in a pro rata dividend to holders of Sara Lee common stock as of August 18, 2006. The dividend represented 100% of the common stock of Hanesbrands Inc. outstanding at the time of the spin off.

Branded Apparel sells its products primarily in the U.S. and certain parts of Asia. In fiscal 2006, 90% of the segment's sales were generated in the U.S. The primary distribution channel for this segment's products is wholesale sales to retailers, including sales to mass merchants, national chains and traditional department stores. Branded Apparel also makes wholesale sales to third-party embellishers and sales direct-to-consumers.

Sara Lee's Branded Apparel segment accounted for 28.1%, 29.2% and 29.2% of Sara Lee's consolidated revenues during fiscal years 2006, 2005 and 2004, respectively.

Customers

Sara Lee considers major mass retailers and supermarket chains in both the United States and Europe to be significant customers across one or more business segments, and it has developed specific approaches to working with these individual customers. During fiscal 2006, Wal-Mart Stores Inc. was Sara Lee's largest customer. Net sales to Wal-Mart Stores Inc. were \$2.5 billion, or 15.6% of Sara Lee's fiscal 2006 net sales. Of this amount, \$1.3 billion of net sales were made by the Branded Apparel business and \$1.1 billion of net sales were made by the Food and Beverage business. Although no other single customer accounts for 10% or more of Sara Lee's consolidated revenues, the loss of one of our major mass retailer or supermarket chain customers could have a material adverse effect on one or more of our business segments.

Trademarks

Sara Lee is the owner of approximately 28,000 active trademark registrations and applications in countries around the world (excluding trademarks transferred to Hanesbrands Inc. in connection with the spin off) and believes that, as it continues to build brands globally, its trademarks are among its most valuable assets. Although the laws vary by jurisdiction, trademarks generally are valid as long as they are in use and/or their registrations are properly maintained and have not been found to have become generic. Trademark registrations generally can be renewed indefinitely as long as the trademarks are in use. Sara Lee believes that its core brands are covered by trademark registrations in most countries of the world in which Sara Lee does business, and Sara Lee has an active program designed to ensure that its marks and other intellectual property rights are registered, renewed, protected and maintained. Some of Sara Lee's products are sold under brands that have been licensed from third parties. Sara Lee also owns a number of valuable patents; however, it does not regard any segment of its business as being dependent upon any single patent or group of related patents. In addition, Sara Lee owns numerous copyrights, both registered and unregistered, and proprietary trade secrets, technology, know-how processes and other intellectual property rights that are not registered.

Seasonality

Generally, seasonal changes in demand for certain Sara Lee products are offset by Sara Lee's diverse product offerings. Seasonality in the North American Retail Meats segment is balanced by the diverse offering of products that tends to offset seasonal changes in demand. For example, sales of hot dogs and lunchmeat increase during the summer months, and ham and breakfast sausage sales increase during the winter holiday periods. Seasonality in the North American Retail Bakery and International Bakery segments also is balanced by the diverse offering of products that tends to offset the seasonal changes in demand. For example, sales of buns increase in the warm summer months, and sales of dough products, specialty cakes and pies increase for the winter holiday season. Seasonality in the Foodservice segment is balanced by a diverse offering of products to meet the consumer's seasonal eating patterns. Sales of beverage products are higher in the second quarter due to higher consumer consumption in the winter months. The Household and Body Care segment experiences higher sales in the second half of the fiscal year, as sales of both body care products and insecticides increase in anticipation of the warmer summer months.

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In total during fiscal 2006, 24.5% of Sara Lee's consolidated net sales from continuing operations were recognized in the first quarter, 26.0% in the second quarter, 23.8% in the third quarter and 25.7% in the fourth quarter.

Regulations

Sara Lee's North American Retail Meats, North American Retail Bakery and Foodservice operations, food products and packaging materials are subject to regulations administered by the U.S. Department of Agriculture and the Food and Drug Administration. Among other things, these agencies enforce statutory prohibitions against misbranded and adulterated foods; establish safety standards for food processing; establish standards for ingredients and manufacturing procedures for certain foods; establish standards for identifying certain foods; determine the safety of food additives; and establish labeling standards and nutrition labeling requirements for food products. In addition, various states regulate these businesses by enforcing federal and state standards of identity for selected food products, grading food products, inspecting plants and imposing their own labeling requirements on food products.

Sara Lee buys livestock, meat and poultry products and processed food ingredients from numerous sources based on factors such as price, quality and availability. Many of these products and processed food ingredients are subject to governmental agricultural programs. These programs have substantial effects on prices and supplies and are subject to U.S. Congressional and administrative review.

The food industry is highly regulated on a worldwide basis, and Sara Lee's food operations outside of the U.S. are subject to local and national regulations that are similar in nature to those applicable to our U.S. businesses. In some cases, Sara Lee's food products are subject to international regulatory provisions, such as those of the European Union relating to labeling, packaging, food content, pricing, marketing and advertising and other areas.

Sara Lee's operations, like those of similar businesses, also are subject to various federal, state, and local environmental laws and regulations including the Clean Water Act, Clean Air Act, Solid Waste Disposal Act (as amended by the Resource Conservation and Recovery Act), Comprehensive Environmental Response, Compensation and Liability Act, Emergency Planning Community Right-to-Know Act, Safe Drinking Water Act, Toxic Substances Control Act, and the Federal Insecticide, Fungicide, and Rodenticide Act, and related state and local laws and regulations (collectively Environmental Laws). These Environmental Laws require permits for the discharge of pollutants into the air or water; impose limitations on the discharge of pollutants into the air or water; require the installation of pollution control equipment; establish standards for the treatment, storage, transportation, and disposal of solid and hazardous wastes; impose obligations to investigate and remediate contamination in certain circumstances; govern underground storage tanks; require reporting of certain information to the public; and impose other requirements intended to protect public health and the environment.

While Sara Lee expects to make capital and other expenditures in compliance with Environmental Laws, it does not anticipate that such compliance will have a material adverse effect on its consolidated results of operations, financial position or cash flows. Sara Lee has an ongoing program to monitor compliance with Environmental Laws.

Employees

At the end of fiscal year 2006, Sara Lee employed approximately 109,000 employees worldwide in its continuing operations. Approximately 50,000 of these employees are part of the Branded Apparel business that was spun off in September 2006.

Information Available on Sara Lee's Web Site

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This Annual Report on Form 10-K and Sara Lee's Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, any amendments to those reports, and other documents filed with or furnished to the Securities and Exchange Commission (SEC) are available on Sara Lee's Web site (www.saralee.com, under Investors Stock Information SEC Reports) as soon as reasonably practicable after such documents are electronically filed with or furnished to the SEC.

The following documents also are available on Sara Lee's Web site, www.saralee.com, under the captions indicated:

current versions of Sara Lee's corporate charter and bylaws, under Our Company

Corporate Governance Guidelines, under Investors-Corporate Governance

Global Business Standards, Sara Lee's corporate code of business conduct and ethics, and any amendments to or waivers of such code, if applicable, under Our Company-Global Business Practices

current charters for the Audit, Compensation and Employee Benefits, and Corporate Governance and Nominating Committees of Sara Lee's Board of Directors, under Our Company-Board of Directors-Board Committee Charters

procedures for communicating with Sara Lee's Board of Directors, or the chair of any committee of the Board, under Our Company-Board of Directors-Communications with the Board

A copy of Sara Lee's Corporate Governance Guidelines, Global Business Standards or the charter of Sara Lee's Audit, Compensation and Employee Benefits, or Corporate Governance and Nominating Committees will be sent to any stockholder without charge upon written request addressed to Sara Lee Corporation, Attn: Investor Relations Department, at 70 W. Madison Street, Chicago, Illinois, 60602-4260, or by calling (312) 558-4947 (as of January 2007, at 3500 Lacey Road, Downers Grove, Illinois, 60515-5424 or by calling (630) 598-8100).

Throughout this Annual Report and as permitted by the SEC, Sara Lee incorporates by reference certain information from parts of other documents filed or to be filed with the SEC, including Sara Lee's 2006 Annual Report to Stockholders and Sara Lee's Proxy Statement. Readers of this Annual Report on Form 10-K are encouraged to read the information referenced in such other documents. Portions of Sara Lee's 2006 Annual Report to Stockholders are filed as Exhibit 13 to this Form 10-K, and full copies of Sara Lee's 2006 Annual Report to Stockholders and Proxy Statement will be available, on or about September 21, 2006, on Sara Lee's Web site, www.saralee.com, under Investors Reports and Documents.

Financial Information About Industry Segments

For financial reporting purposes, Sara Lee's businesses are divided into seven business segments: North American Retail Meats, North American Retail Bakery, Foodservice, International Beverage, International Bakery, Household and Body Care and Branded Apparel. Financial information about Sara Lee's business segments is incorporated herein by reference to Note 24, Business Segment Information, to the Consolidated Financial Statements contained in Sara Lee's 2006 Annual Report to Stockholders.

Financial Information About Foreign and Domestic Operations and Export Sales

Sara Lee's foreign operations are conducted primarily through wholly or partially owned subsidiaries incorporated outside the United States. Sara Lee's principal foreign subsidiary is Sara Lee International, B.V., a Netherlands limited liability company headquartered in Utrecht, the Netherlands (Sara Lee International). Sara Lee International has responsibility for managing the International Beverage, International Bakery and worldwide Household and Body Care divisions of Sara Lee. Household and Body Care's operations are conducted by subsidiaries in over forty countries. The financial information about Sara Lee's foreign and domestic operations in Note 25, Geographic Area Information, to the

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Consolidated Financial Statements contained in the Company's 2006 Annual Report to Stockholders is incorporated herein by reference. Financial information about the impact on Sara Lee of foreign exchange rates appearing under the heading "Financial Review" of the Company's 2006 Annual Report to Stockholders is incorporated herein by reference.

Item 1A. Risk Factors

This Annual Report on Form 10-K, including the information incorporated herein by reference, contains certain forward-looking statements including the anticipated costs and benefits of restructuring actions, Sara

Lee's access to credit markets and the corporation's credit ratings, the planned extinguishment of debt, the funding of pension plans, potential payments under guarantees and amounts due under future contractual obligations and commitments. In addition, from time to time, in oral statements and written reports, the corporation discusses its expectations regarding the corporation's future performance by making forward-looking statements preceded by terms such as expects, projects, anticipates or believes. These forward-looking statements are based on currently available competitive, financial and economic data, as well as management's views and assumptions regarding future events, and are inherently uncertain. Readers should recognize that actual results may differ from those expressed or implied in the forward-looking statements. The risk factors described below could have a material impact on Sara Lee's business.

Sara Lee's potential inability to implement the transformation plan, or to realize the anticipated benefits of the transformation plan, could adversely affect our results of operations and financial condition.

On February 10, 2005, Sara Lee announced a transformation plan designed to improve performance and better position Sara Lee for long-term growth. Our transformation plan is designed to focus Sara Lee's business portfolio and to dramatically increase operating efficiency and generate significant cost savings by fiscal 2010. These plans include integrating our businesses into the new business structure described in this Annual Report on Form 10-K and consolidating our North American and European headquarters in the Chicago area and in Utrecht. The projected cost savings from these plans are important to enable Sara Lee to make the needed marketing and R&D investments to achieve our business growth goals and to improve ongoing financial returns. If Sara Lee is unable to implement any of the elements of the transformation plan as planned, we may not reap the anticipated benefits of the plan. Any negative impact the transformation plan has on our relationships with employees, major customers, vendors or our cost of funds, and any failure to generate the anticipated efficiencies and savings from the plan, also could adversely affect our results of operations or financial condition.

Sara Lee is subject to risks associated with our international operations, which could negatively affect our sales to customers in foreign countries as well as our operations and assets in such countries.

In fiscal year 2006, we derived approximately 34% of our net sales from customers located outside of the United States. In addition, we have substantial assets located outside of the United States and use non-U.S. third-party suppliers for inventory and distribution services. As a result, Sara Lee is subject to numerous risks and uncertainties relating to international sales and operations, including:

difficulties and costs associated with complying with, and enforcing remedies under, a wide variety of complex laws, treaties and regulations;

different regulatory structures and unexpected changes in regulatory environments;

political and economic instability, including the possibility of civil unrest;

nationalization of properties by foreign governments;

tax rates that may exceed those in the United States and earnings that may be subject to withholding requirements and incremental taxes upon repatriation;

potentially negative consequences from changes in tax laws;

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the imposition of tariffs, quotas, trade barriers, other trade protection measures and import or export licensing requirements;

increased costs, disruptions in shipping or reduced availability of freight transportation; and

the impact of currency exchange rate fluctuations between the U.S. dollar and foreign currencies, particularly the European euro, the British pound, the Australian dollar and the Brazilian real.

The occurrence of any of these events in the markets where Sara Lee operates or in other developing markets could jeopardize or limit Sara Lee's ability to transact business in those markets and could adversely affect our revenues and operating results.

Our profitability may suffer as a result of competition in our markets.

The brand-name consumer products industry is intensely competitive. In order to protect our existing market share or capture increased market share in this highly competitive retail environment, we may be required to increase expenditures for promotions and advertising and introduce and establish new products. Due to inherent risks in the marketplace associated with advertising and new product introductions, including uncertainties about trade and consumer acceptance, increased expenditures may not prove successful in maintaining or enhancing our market share and could result in lower sales and profits. In addition, we may incur increased credit and other business risks as a result of competing for customers in a highly competitive retail environment.

Our consumer products also are subject to significant price competition. From time to time, we may need to reduce the prices for some of our products to respond to competitive and customer pressures and to maintain market share. 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 any failure to increase prices when raw material costs increase, would harm profit margins and, if our sales volumes fail to grow sufficiently to offset any reduction in margins, our results of operations will suffer.

As a result of the transformation plan, we may be required to take additional write downs in connection with impairment of our intangible assets.

Intangible assets and goodwill comprise a significant portion of our total assets. Intangible assets include trademarks, customer relationships, software and certain contractual relationships. 85% of all of Sara Lee's intangible assets have a finite life and are amortized, and 15% have an indefinite life and are not amortized. Intangible assets with a finite life are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Such events include adverse changes in the business climate, current period operating or cash flow losses, forecasted continuing losses or a current expectation that an asset group will be disposed of before the end of its useful life. An impairment review of goodwill and intangible assets not subject to amortization is conducted at least once a year and if events or changes in circumstances indicate that their carrying value may not be recoverable. In implementing the transformation plan, we disposed of several of our businesses and also disposed or abandoned certain other intangible assets. As a result of such actions, we recognized a number of impairment charges relating to these activities. Similar events may require us to recognize increased levels of future intangible amortization, or incur charges to recognize the impairment of certain other assets.

Sara Lee may not be able to implement the capital structure strategic initiatives we announced or realize the anticipated benefits of these strategic initiatives.

Sara Lee has announced several major capital structure initiatives that we intend to implement as we complete the transformation plan. In particular, we announced that we intend to (i) repurchase approximately \$2 billion of our common stock during the transformation period, with \$500 million being repurchased in fiscal 2007, (ii) use divestiture proceeds and cash from operations to reduce debt by \$1.0 billion in fiscal 2007, and (iii) continue to target a dividend payout ratio of 40% to 50%. These initiatives are designed to return value to shareholders, optimize our capital structure and help us maintain a strong credit profile as we complete the transformation plan. We believe that we will be able to generate sufficient cash necessary to implement each of these initiatives and maintain current investments in our businesses, but there is no guarantee that this will be the case. Even if we are able to implement these capital structure initiatives, there is no guarantee that they will achieve their intended results. In particular, we cannot be certain that the initiatives will not result in a downgrade of our credit ratings or that committing cash to these initiatives will be viewed by analysts and investors as an appropriate use of our resources.

Volatility in the equity markets or interest rates could substantially increase our pension costs.

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The projected benefit obligation and assets of Sara Lee's defined benefit pension plans as of the end of fiscal 2006 was \$5.8 billion and \$4.7 million, respectively. The difference between plan obligations and assets, or

the funded status of the plans, is a significant factor in determining the net periodic benefit costs of our pension plans and the ongoing funding requirements of those plans. Changes in interest rates and the market value of plan assets can impact the funded status of these plans and cause volatility in the net periodic benefit cost and future funding requirements of these plans. In addition, in April 2006 we signed an agreement with the trustees of the Sara Lee U.K. Pension Plan in which we agreed to make specified payments to the Plan each year through 2015, and then make a lump sum payment in 2016, if necessary, to ensure the Plans have achieved the level of funding required by U.K. legislation. Under this agreement, the amount of the annual payments may be increased 20% if Sara Lee ceases to maintain specified credit ratings, and the lump sum payment we may be required to make in 2016 will depend upon changes in interest rate and the market value of assets in the U.K. Pension Plan. A significant increase in our pension funding requirements could have a negative impact on our results of operations.

The transformation plan is expected to increase Sara Lee's effective tax rate.

As a global business, Sara Lee's tax rate from period to period can be affected by many factors, including changes in tax legislation, our global mix of earnings, the tax characteristics of our income, acquisitions and dispositions, and the portion of the income of foreign subsidiaries that we expect to remit to the U.S. In connection with our transformation plan, we disposed of several significant businesses, which will impact our future results in several ways. First, the tax expense or benefit directly associated with these dispositions will impact our net income and liquidity. Second, the spin off of the Branded Apparel Americas/Asia business, which was completed on September 5, 2006, will increase the effective tax rate of Sara Lee's remaining business. The Branded Apparel Americas/Asia business historically has had a lower effective tax rate than the remainder of the business and generates a significant amount of operating cash flow. The elimination of this cash flow may require us to remit a greater portion of the earnings of foreign subsidiaries to the U.S. than we have historically, which is likely to result in higher levels of tax expense and cash taxes paid.

Changes in our relationship with our major customers, or in the trade terms required by such customers, may reduce sales and profits.

Because of the competitive environment facing retailers, many of our customers have increasingly sought to obtain pricing concessions or better trade terms. This trend has become more pronounced with increasing retailer consolidation and the rise in hard discounters in Europe. To the extent we provide concessions or better trade terms, our margins are reduced. Further, if we are unable to maintain terms that are acceptable to our major trade customers, such as Wal-Mart Stores Inc., our largest customer, or our customers determine that less inventory is necessary to service consumers, these customers could reduce purchases of our products and increase purchases of products from our competitors, which would harm our sales and profitability.

Commodity price increases would increase operating costs and may reduce profits.

We use many different commodities in our various businesses, including beef, pork, coffee, wheat, cotton, corn, corn syrup, soybean and corn oils, butter and sugar. Commodities are subject to price volatility caused by commodity market fluctuations, the quality and availability of supply, weather, currency fluctuations, trade agreements among producing and consuming nations, consumer demand and changes in governmental agricultural programs. Commodity price increases result in corresponding increases in our raw material costs. We do use commodity financial instruments to hedge commodity prices, but not at significant levels. We may be able to pass some or all of raw material cost increases to customers in the form of higher product prices; however higher product prices may also result in a reduction in unit volume. If we are not able to increase our product prices to significantly offset increased raw material costs, or if unit volume sales are significantly reduced, it could have a negative impact on our profitability.

Various food safety issues may negatively impact the consumption of meat products by our customers and may lead to increased governmental regulation.

Food safety issues have received increased media attention over the past few years. One prominent issue in the United States and Europe has been concern relating to mad cow disease. Any future outbreak of livestock

disease in the United States may result in adverse publicity and a loss of customer confidence in the protein products affected by the particular disease. A reduction in consumption of such protein sources in the United States or Europe would have a negative impact on the profitability of our North American meats business. Outbreaks of livestock disease may also result in import and export restrictions.

The food production industry is also subject to extensive government regulation. Our U.S. food processing facilities and food products are subject to frequent inspection by the United States Department of Agriculture (USDA), and our meat business in Mexico is regulated by local authorities in a similar fashion. Recently, the food safety practices and procedures in the meat processing industry have been subject to more intense scrutiny and oversight and future outbreaks of diseases among cattle, poultry or pigs could lead to further governmental regulation. We anticipate increased regulation by various governmental agencies concerning food safety. More stringent requirements could result in changes in industry practices that could increase our costs and reduce margins.

Changes in our credit ratings may have a negative impact on our financing costs in future periods.

Sara Lee has numerous credit facilities available which management considers sufficient to satisfy our operating requirements. Our current short-term credit rating allows us to participate in a commercial paper market that has a large number of potential investors and a high degree of liquidity. A downgrade in our credit ratings, particularly our short-term credit rating, would likely reduce the amount of commercial paper we could issue, raise our commercial paper borrowing costs, or both.

Resolution of tax disputes may impact our earnings and cash flow.

Significant judgment is required in determining our effective tax rate and in evaluating our tax positions. We establish accruals for certain tax contingencies when, despite the belief that our tax return positions are fully supported, we believe that certain positions will be challenged and that our positions may not be fully sustained. The tax contingency accruals are adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. Our effective tax rate includes the impact of tax contingency accruals and changes to the accruals, including related interest and penalties, as considered appropriate by management. When particular matters arise, a number of years may elapse before such matters are audited and finally resolved. Favorable resolution of such matters could be recognized as a reduction to our effective tax rate in the year of resolution. Unfavorable resolution of any particular issue could increase the effective tax rate and may require the use of cash in the year of resolution.

Environmental matters create potential liability risks.

We must comply with various environmental laws and regulations in the jurisdictions in which we operate, including those relating to air emissions, water discharges, the handling and disposal of solid and hazardous wastes and the remediation of contamination associated with the use and disposal of hazardous substances. We have incurred, and will continue to incur, capital and operating expenditures and other costs in complying with environmental laws and regulations and in providing physical security for our worldwide operations. We are currently involved in or have potential liability with respect to the remediation of past contamination in the operation of some of our presently and formerly owned and leased facilities. In addition, some of our present and former facilities have been or had been in operation for many years, and over that time, some of these facilities may have used substances or generated and disposed of wastes that are or may be considered hazardous. It is possible that those sites, as well as disposal sites owned by third parties to which we have sent waste, may in the future be identified and become the subject of remediation. It is possible that we could become subject to additional environmental liabilities in the future that could result in an adverse effect on our results of operations or financial condition.

Failure to maximize or to successfully assert our intellectual property rights could impact our competitiveness.

We rely on trademark, trade secret, patent and copyright laws to protect our intellectual property rights. We cannot be sure that these intellectual property rights will be maximized or that they can be successfully asserted.

There is a risk that we will not be able to obtain and perfect our own, or, where appropriate, license intellectual property rights necessary to support new product introductions. We cannot be sure that these rights, if obtained, will not be invalidated, circumvented or challenged in the future. In addition, even if such rights are obtained in the United States, the laws of some of the other countries in which our products are or may be sold do not protect our intellectual property rights to the same extent as the laws of the United States. Our failure to perfect or successfully assert our intellectual property rights could make us less competitive and could have an adverse effect on our business, operating results and financial condition.

Failure of tobacco to remain a legal product in certain European nations would result in a loss of certain contingent sale proceeds.

We sold our European cut tobacco business in fiscal 1999. Under the terms of that agreement, we 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 2010. If tobacco ceases to be a legal product prior to that date in any or all of these countries, future cash payments associated with the sale agreement will be reduced or eliminated in their entirety.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Sara Lee's corporate headquarters are located in leased facilities in Chicago, Illinois; however, Sara Lee is in the process of relocating management of its North American businesses and most of its corporate staff to a single leased facility just outside Chicago, Illinois. In addition, Sara Lee operates more than 440 food processing and consumer product manufacturing plants, warehouses and distribution facilities that each contains more than 20,000 square feet in building area. Sara Lee or its subsidiaries own most of these facilities, and the majority of the leased facilities are subject to lease terms of less than 10 years. Management believes that Sara Lee's facilities are maintained in good condition and are generally suitable and of sufficient capacity to support Sara Lee's current business operations and that the loss of any single facility would not have a material adverse effect on the operations or financial results of Sara Lee or any of its lines of business.

The following table identifies the locations of Sara Lee facilities (owned or leased) containing more than 20,000 square feet in building area by line of business. The table does not include facilities owned by the Branded Apparel segment, which was spun off as an independent public company on September 5, 2006.

Food & Beverage (includes North American Retail Meats and North American Retail Bakery)	
United States facilities (30 states)	approximately 12.9 million square feet
International facilities (Mexico)	approximately 2.2 million square feet
Foodservice	
United States facilities (17 states)	approximately 3.3 million square feet
International facilities	N/A

Sara Lee International (includes International Beverage, International Bakery and Household and Body Care)

United States facilities (1 state)	approximately 20,000 square feet	
International facilities	approximately 11.7 million square feet	
Australia	Hungary	Poland
Belgium	India	Portugal
Brazil	Indonesia	South Africa
China	Italy	Spain
Czech Republic	Kenya	Thailand
Denmark	Malaysia	United Kingdom
France	The Netherlands	Zambia
Germany	Philippines	Zimbabwe
Greece		

Item 3. Legal Proceedings

As described in the corporation's annual report on Form 10-K for the fiscal year ended July 2, 2005, John Gallo, a purported Sara Lee stockholder, filed a putative class action lawsuit in the United States District Court for the Northern District of Illinois, Eastern Division, on May 13, 2003. Subsequently, seven other putative class action lawsuits were filed in the United States District Court for the Northern District of Illinois, Eastern Division. The complaints name Sara Lee, C. Steven McMillan, former Chairman, President and Chief Executive Officer of Sara Lee, and Lambertus M. de Kool, Executive Vice President and Chief Financial and Administrative Officer of Sara Lee, as defendants. Each of the foregoing actions were consolidated in a single proceeding captioned *In re Sara Lee Securities Litigation* on July 18, 2003. Judge Charles R. Norgle appointed co-lead plaintiffs and class counsel, who filed their consolidated amended complaint on January 20, 2004. The complaint alleges a class period from August 1, 2002 to April 24, 2003, and asserts that the defendants misstated or omitted material adverse facts regarding Sara Lee's business, operations, management, and financial statements, and the value of Sara Lee's common stock, which allegedly enabled Sara Lee to complete securities offerings, enabled the individual defendants to increase their bonus compensation, and caused the class to purchase the stock at artificially inflated prices. The plaintiffs seek relief under Sections 10(b) and 20(a) of the United States Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

On October 19, 2005, defendants filed a motion for judgment on the pleadings based on the plaintiffs' failure to adequately plead loss causation. The motion was fully briefed at the end of November 2005. On July 10, 2006, the motion was granted and the case has been dismissed. The Court found that plaintiffs failed to allege and prove that defendants' misrepresentations and other fraudulent conduct proximately caused plaintiffs' economic losses. On July 24, 2006, plaintiffs moved for relief from final judgment and for leave to amend the consolidated amended complaint under Federal Rules 15(a), 59(e), and 60(b). Sara Lee believes that the allegations stated in the proposed amended consolidated amended complaint remain without merit and it intends to continue to defend the action vigorously.

Also as described in the corporation's annual report on Form 10-K for the fiscal year ended July 2, 2005, two purported Sara Lee stockholders filed individual and derivative actions in the Circuit Court of Cook County, Illinois against Sara Lee and its Board of Directors purporting to seek recovery for Sara Lee and its shareholders for purported breaches of fiduciary duty relating to the allegations asserted in the federal securities litigation described above. Each complaint seeks damages in an unspecified amount allegedly sustained by the purported breaches of fiduciary duties, loyalty and due care, and attorneys' fees and expenses, punitive damages and interest. Both purported derivative actions have been consolidated. Sara Lee believes that the allegations in these complaints are without merit and intends to defend each of these actions vigorously. Should the plaintiffs not dismiss this case given the federal action's dismissal, defendants are prepared to move to dismiss.

In addition, since 1995, three complaints have been filed on behalf of former employees of 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, Sara Lee was not a party. The third complaint is a consolidation of cases filed from 1998 through July 1999 by individual complainants in the Republic of the Philippines, Department of Labor and Employment, National Labor Relations Commission. On December 11, 1998, the complaint was amended to name Sara Lee as a party. The case is styled: *Emelinda Mactlang, et al. v. Aris Philippines, Inc., et al.* In the underlying proceedings, the arbitrator ruled against Sara Lee and awarded the plaintiffs \$60 million in damages and fees. Sara Lee is appealing this administrative ruling. Sara Lee believes that the plaintiffs' claims are without merit and is vigorously defending the remaining complaint. However, no assurance can be given that an adverse outcome in the matter will not occur.

Sara Lee is a party to various other pending legal proceedings and claims. Some of the proceedings and claims against Sara Lee are for alleged environmental contamination and arise under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund). CERCLA imposes liability, regardless of fault, on certain classes of parties that are considered to be responsible for contamination at a site. Although any one party can be held responsible for all the costs of investigation and cleanup, those costs are usually allocated among parties based on a variety of factors, such as the amount of waste each contributed to the site.

Although the outcome of the pending legal proceedings, including Superfund claims, cannot be determined with certainty, Sara Lee believes that the final outcomes should not have a material adverse effect on Sara Lee's consolidated results of operations, financial position or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Executive Officers of Sara Lee

Set forth below is certain information with respect to the current executive officers of Sara Lee. There are no family relationships between any of the executive officers listed below.

Brenda C. Barnes, Age 52. Chairman and Chief Executive Officer of Sara Lee Corporation since October 2005, President and Chief Executive Officer from February 2005 to October 2005, and President and Chief Operating Officer from July 2004 to February 2005. She has served as a director of Sara Lee since July 2004. Ms. Barnes served as the Interim President of Starwood Hotels and Resorts from November 1999 to March 2000, and President and Chief Executive Officer of PepsiCo North America from 1996 until 1998. Prior to that she held various positions with several divisions of PepsiCo, Inc. from 1976 to 1996. Ms. Barnes also served as an adjunct professor at the Kellogg Graduate School of Business and at North Central College in 2002. Ms. Barnes is a member of the Board of Directors of The New York Times Company and Staples, Inc. She also serves on the Board of Trustees of Augustana College and is a member of the Steering Committee of the Kellogg Center for Executive Women.

Diana S. Ferguson, Age 43. Senior Vice President of Sara Lee Corporation since January 2004 and Chief Financial Officer of Sara Lee Foodservice from June 2006. Ms. Ferguson served as Senior Vice President, Strategy and Corporate Development from February 2005 to June 2006, and Treasurer from January 2001 to February 2004. She was elected a Vice President of Sara Lee in January 2001. Prior to joining Sara Lee in 2001, Ms. Ferguson served as Vice President and Treasurer of Fort James Corporation, held a variety of treasury management positions at Eaton Corporation, and served in various financial positions at Fannie Mae, the First National Bank of Chicago and IBM. Ms. Ferguson serves as a member of the Board of Directors of Franklin Electric Co., Inc. and People's Energy Corporation.

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Christopher J. (CJ) Fraleigh, Age 43. Senior Vice President of Sara Lee Corporation and Chief Executive Officer of Sara Lee Food & Beverage since January 2005. Prior to joining Sara Lee, Mr. Fraleigh was employed

by General Motors Corporation (automobile manufacturer) as general manager of its GMC-Buick-Pontiac division during 2004 and as Executive Director of Advertising and Corporate Marketing from 2001 to 2004. Mr. Fraleigh also served as Vice President, Colas from 1999 to 2001, and Director Brand *Pepsi* from 1997 to 1999 for PepsiCo, Inc.

L.M. (Theo) de Kool, Age 53. Executive Vice President and Chief Financial and Administrative Officer of Sara Lee since February 2005; Executive Vice President and Chief Financial Officer of Sara Lee from January 2002 to February 2005. Mr. de Kool began his career with Sara Lee in 1990, serving as Vice President of Finance for the Household and Personal Care division of Sara Lee/DE N.V., a Dutch subsidiary of Sara Lee, from 1990 to 1993. From 1993 to 1995, he served as Chief Financial Officer of the Blokker retail chain. Mr. de Kool rejoined Sara Lee/DE in 1995 as its Chief Financial Officer and as a member of its Board of Management. Mr. de Kool was named a Vice President of Sara Lee in 1996 and a Senior Vice President