

TOOTSIE ROLL INDUSTRIES INC

Form 10-Q

August 09, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 1-1361

Tootsie Roll Industries, Inc.

(Exact Name of Registrant as Specified in its Charter)

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VIRGINIA
(State of Incorporation)

22-1318955
(I.R.S. Employer Identification No.)

7401 South Cicero Avenue, Chicago, Illinois
(Address of Principal Executive Offices)

60629
(Zip Code)

773-838-3400

(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 No

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date (June 30, 2012).

Class	Outstanding
Common Stock, \$.69 4/9 par value	37,273,346
Class B Common Stock, \$.69 4/9 par value	21,640,941

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

June 30, 2012

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This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. See Forward-Looking Statements under Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands) (UNAUDITED)

	June 30, 2012	December 31, 2011	July 2, 2011
ASSETS			
<u>CURRENT ASSETS</u>			
Cash & cash equivalents	\$ 66,617	\$ 78,612	\$ 41,282
Investments	12,820	10,895	10,324
Trade accounts receivable, Less allowances of \$1,502, \$1,731 & \$1,661	26,010	41,895	26,862
Other receivables	3,654	3,391	7,043
Inventories, at cost			
Finished goods & work in process	62,867	42,676	74,506
Raw material & supplies	33,112	29,084	30,784
Prepaid expenses	5,777	5,070	8,103
Deferred income taxes	578	578	682
Total current assets	211,435	212,201	199,586
<u>PROPERTY, PLANT & EQUIPMENT, at cost</u>			
Land	21,653	21,939	21,659
Buildings	107,891	107,567	103,002
Machinery & equipment	323,046	322,993	307,325
Construction in progress	7,940	2,598	15,221
	460,530	455,097	447,207
Less-accumulated depreciation	252,784	242,935	234,714
Net property, plant and equipment	207,746	212,162	212,493
<u>OTHER ASSETS</u>			
Goodwill	73,237	73,237	73,237
Trademarks	175,024	175,024	175,024
Investments	114,889	96,161	103,835
Split dollar officer life insurance	70,549	74,209	74,441
Prepaid expenses	1,564	3,212	5,034
Equity method investment	3,270	3,935	4,751
Deferred income taxes	7,723	7,715	9,106
Total other assets	446,256	433,493	445,428
Total assets	\$ 865,437	\$ 857,856	\$ 857,507

(The accompanying notes are an integral part of these statements.)

Table of Contents(in thousands except per share data) **(UNAUDITED)**

	June 30, 2012	December 31, 2011	July 2, 2011
<u>LIABILITIES AND SHAREHOLDERS EQUITY</u>			
<u>CURRENT LIABILITIES</u>			
Accounts payable	\$ 14,374	\$ 10,683	\$ 13,869
Dividends payable	4,714	4,603	4,635
Accrued liabilities	42,889	43,069	41,197
Total current liabilities	61,977	58,355	59,701
<u>NONCURRENT LIABILITIES</u>			
Deferred income taxes	43,311	43,521	46,651
Postretirement health care and life insurance benefits	27,625	26,108	21,709
Industrial development bonds	7,500	7,500	7,500
Liability for uncertain tax positions	7,580	8,345	10,074
Deferred compensation and other liabilities	51,644	48,092	48,866
Total noncurrent liabilities	137,660	133,566	134,800
<u>SHAREHOLDERS EQUITY</u>			
Common stock, \$.69-4/9 par value- 120,000 shares authorized; 37,273, 36,479 & 36,890, respectively, issued	25,884	25,333	25,618
Class B common stock, \$.69-4/9 par value- 40,000 shares authorized; 21,641, 21,025 & 21,040, respectively, issued	15,028	14,601	14,611
Capital in excess of par value	563,859	533,677	543,503
Retained earnings	82,931	114,269	94,366
Accumulated other comprehensive loss	(19,910)	(19,953)	(13,100)
Treasury stock (at cost)- 73, 71 & 71 shares, respectively	(1,992)	(1,992)	(1,992)
Total shareholders equity	665,800	665,935	663,006
Total liabilities and shareholders equity	\$ 865,437	\$ 857,856	\$ 857,507

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF
EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS
(in thousands except per share amounts) **(UNAUDITED)**

	Quarter Ended	
	June 30, 2012	July 2, 2011
Net product sales	\$ 108,156	\$ 104,884
Rental and royalty revenue	983	936
Total revenue	109,139	105,820
Product cost of goods sold	72,858	70,986
Rental and royalty cost	250	238
Total costs	73,108	71,224
Product gross margin	35,298	33,898
Rental and royalty gross margin	733	698
Total gross margin	36,031	34,596
Selling, marketing and administrative expenses	25,022	26,171
Earnings from operations	11,009	8,425
Other income (expense), net	(444)	1,001
Earnings before income taxes	10,565	9,426
Provision for income taxes	3,054	2,940
Net earnings	7,511	6,486
Net earnings per share	\$ 0.13	\$ 0.11
Dividends per share *	\$ 0.08	\$ 0.08
Average number of shares outstanding	58,911	59,725
Other comprehensive income (loss), before tax		
Foreign currency translation adjustments	(1,510)	448
Unrealized gains for the period on investments	514	1,965
Less: reclassification adjustment for gains in net earnings		
Unrealized gains on investments	514	1,965
Unrealized losses for the period on derivatives	(699)	
Less: reclassification adjustment for losses in net earnings	(115)	(1,607)
Unrealized losses on derivatives	(814)	(1,607)
Total other comprehensive income (loss), before tax	(1,810)	806

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Income tax benefit (expense) related to items of other comprehensive income		181		(174)
Comprehensive earnings	\$	5,882	\$	7,118
Retained earnings at beginning of period	\$	80,128	\$	92,509
Net earnings		7,511		6,486
Cash dividends		(4,708)		(4,629)
Stock dividends				
Retained earnings at end of period	\$	82,931	\$	94,366

*Does not include 3% stock dividend to shareholders of record on 3/6/12 and 3/8/11.

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF
EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS
(in thousands except per share amounts) **(UNAUDITED)**

	Year to Date Ended	
	June 30, 2012	July 2, 2011
Net product sales	\$ 217,919	\$ 213,207
Rental and royalty revenue	2,040	2,008
Total revenue	219,959	215,215
Product cost of goods sold	147,763	144,510
Rental and royalty cost	507	508
Total costs	148,270	145,018
Product gross margin	70,156	68,697
Rental and royalty gross margin	1,533	1,500
Total gross margin	71,689	70,197
Selling, marketing and administrative expenses	52,261	52,135
Earnings from operations	19,428	18,062
Other income, net	2,891	3,993
Earnings before income taxes	22,319	22,055
Provision for income taxes	6,034	7,239
Net earnings	16,285	14,816
Net earnings per share	\$ 0.28	\$ 0.25
Dividends per share *	\$ 0.16	\$ 0.16
Average number of shares outstanding	58,987	59,764
Other comprehensive income (loss), before tax		
Foreign currency translation adjustments	341	1,450
Unrealized gains (losses) for the period on investments	(32)	1,776
Less: reclassification adjustment for gains (losses) in net earnings		
Unrealized gains (losses) on investments	(32)	1,776
Unrealized losses for the period on derivatives	(193)	(859)
Less: reclassification adjustment for losses in net earnings	(282)	(6,001)
Unrealized losses on derivatives	(475)	(6,860)
Total other comprehensive loss, before tax	(166)	(3,634)

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Income tax benefit related to items of other comprehensive income		209		1,747
Comprehensive earnings	\$	16,328	\$	12,929
Retained earnings at beginning of period	\$	114,269	\$	135,866
Net earnings		16,285		14,816
Cash dividends		(9,289)		(9,141)
Stock dividends		(38,334)		(47,175)
Retained earnings at end of period	\$	82,931	\$	94,366

*Does not include 3% stock dividend to shareholders of record on 3/6/12 and 3/8/11.

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands) (UNAUDITED)

	Year to Date Ended	
	June 30, 2012	July 2, 2011
<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>		
Net earnings	\$ 16,285	\$ 14,816
Adjustments to reconcile net earnings to net cash from (used in) operating activities:		
Depreciation and amortization	9,844	9,255
(Gain) loss from equity method investment	589	(133)
Amortization of marketable security premiums	765	513
Changes in operating assets and liabilities:		
Accounts receivable	15,954	10,765
Other receivables	(738)	710
Inventories	(24,114)	(48,340)
Prepaid expenses and other assets	5,406	84
Accounts payable and accrued liabilities	3,467	995
Income taxes payable and deferred	(1,548)	(3,708)
Postretirement health care and life insurance benefits	1,517	1,020
Deferred compensation and other liabilities	1,235	828
Other	212	385
Net cash from (used in) operating activities	28,874	(12,810)
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Capital expenditures	(5,373)	(6,067)
Net purchases of trading securities	(2,167)	(2,724)
Purchase of available for sale securities	(20,071)	(37,142)
Sale and maturity of available for sale securities	3,094	1,275
Net cash used in investing activities	(24,517)	(44,658)
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Shares purchased and retired	(7,076)	(8,069)
Dividends paid in cash	(9,276)	(9,157)
Net cash used in financing activities	(16,352)	(17,226)
Decrease in cash and cash equivalents	(11,995)	(74,694)
Cash and cash equivalents at beginning of year	78,612	115,976
Cash and cash equivalents at end of quarter	\$ 66,617	\$ 41,282
Supplemental cash flow information:		
Income taxes paid, net	\$ 8,550	\$ 7,941
Interest paid	\$ 20	\$ 29
Stock dividend issued	\$ 38,237	\$ 47,053

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2012

(in thousands except per share amounts) (UNAUDITED)

Note 1 Significant Accounting Policies

General Information

Foregoing data has been prepared from the unaudited financial records of Tootsie Roll Industries, Inc. and Subsidiaries (the Company) and in the opinion of management all adjustments necessary for a fair statement of the results for the interim period have been reflected. All adjustments were of a normal and recurring nature. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's 2011 Annual Report on Form 10-K.

Results of operations for the period ended June 30, 2012 are not necessarily indicative of results to be expected for the year to end December 31, 2012 because of the seasonal nature of the Company's operations. Historically, the third quarter has been the Company's largest sales quarter due to Halloween sales.

Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued new accounting rules related to fair value measurements. The new accounting rules clarify some existing concepts, eliminate wording differences between Generally Accepted Accounting Principles in the United States of America (GAAP) and International Financial Reporting Standards (IFRS), and in some limited cases, change some principles to achieve convergence between GAAP and IFRS. The new accounting rules result in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and IFRS. The new accounting rules also expand the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. The adoption of the new accounting rules did not have a material effect on the Company's financial condition, results of operations or cash flows.

In June 2011, the FASB issued new accounting rules that require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. The new accounting rules eliminate the option to present components of other comprehensive income as part of the statement of equity. The adoption of the new accounting rules did not have a material effect on the Company's financial condition, results of operations or cash flows.

In December 2011, the FASB issued new accounting rules which deferred certain provisions of the rules issued in June 2011 that required entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. Accordingly, this requirement is indefinitely deferred.

In September 2011, the FASB issued new accounting rules related to testing goodwill for impairment. The new accounting rules permit an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the two-step goodwill impairment test prescribed under current accounting rules. Otherwise, the two-step goodwill impairment test is not required. The adoption of the new accounting rules did not have a material effect on the Company's financial condition, results of operations or cash flows.

Note 2 Average Shares Outstanding

Average shares outstanding for the period ended June 30, 2012 reflect stock purchases of 306 shares for \$7,076 and a 3% stock dividend distributed on April 5, 2012. Average shares outstanding for the period ended July 2, 2011 reflect stock purchases of 283 shares for \$8,069 and a 3% stock dividend distributed on April 7, 2011.

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The Company is subject to taxation in the U.S. and various state and foreign jurisdictions. The Company remains subject to examination by U.S. federal and state and foreign tax authorities for the years 2008 through 2011. Certain foreign jurisdictions are subject to examinations for the years 2005 through 2011. The Company effectively settled a state tax examination and recovered foreign income taxes from prior years resulting in a reduction in the provision for income taxes and an increase in net earnings of \$1,301 during the first half 2012.

Note 4 Fair Value Measurements

Current accounting guidance defines fair value as the price that would be received in the sale of an asset, or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Guidance requires disclosure of the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. Guidance establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date. Level 1 inputs include quoted prices for identical instruments and are the most observable. Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity rates and yield curves. Level 3 inputs are not observable in the market and include management's own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the table below.

As of June 30, 2012, December 31, 2011 and July 2, 2011, the Company held certain financial assets that are required to be measured at fair value on a recurring basis. These included derivative hedging instruments related to the purchase of certain raw materials and foreign currencies, investments in trading securities and available for sale securities, including an auction rate security. The Company's available-for-sale and trading securities principally consist of municipal bonds and mutual funds that are publicly traded.

The following table presents information about the Company's financial assets and liabilities measured at fair value as of June 30, 2012, December 31, 2011 and July 2, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

	Total Fair Value	Estimated Fair Value June 30, 2012 Input Levels Used		
		Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 66,617	\$ 66,617	\$	\$
Auction rate security	7,453			7,453
Available-for-sale securities excluding the auction rate security	74,016		74,016	
Foreign currency forward contracts	70		70	
Commodity futures contracts	(132)	(132)		
Commodity options contracts	(18)	(18)		
Trading securities	46,240	46,240		
Total assets measured at fair value	\$ 194,246	\$ 112,707	\$ 74,086	\$ 7,453

	Total Fair Value	Estimated Fair Value December 31, 2011 Input Levels Used		
		Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 78,612	\$ 78,612	\$	\$
Auction rate security	7,453			7,453
Available-for-sale securities excluding the auction rate security	57,835		57,835	
Foreign currency forward contracts	205		205	
Commodity futures contracts	203	203		
Commodity options contracts				
Trading securities	41,768	41,768		
Total assets measured at fair value	\$ 186,076	\$ 120,583	\$ 58,040	\$ 7,453

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	Total Fair Value	Estimated Fair Value July 2, 2011		
		Level 1	Input Levels Used Level 2	Level 3
Cash and cash equivalents	\$ 41,282	\$ 41,282	\$	\$
Auction rate security	8,130			8,130
Available-for-sale securities excluding the auction rate security	62,953		62,953	
Foreign currency forward contracts	368		368	
Commodity futures contracts	573	573		
Commodity options contracts	565	565		
Trading securities	43,076	43,076		
Total assets measured at fair value	\$ 156,947	\$ 85,496	\$ 63,321	\$ 8,130

As of June 30, 2012, the Company's long term investments included an auction rate security, Jefferson County Alabama Sewer Revenue Refunding Warrants, reported at a fair value of \$7,453 after reflecting a \$5,140 other than temporary impairment and a \$957 temporary decline in market value against its \$13,550 par value and original cost. This other-than-temporary impairment was recorded in other income (expense), net in 2008. In 2008, this auction rate security was determined to be other-than-temporarily impaired due to the duration and severity of the decline in fair value. At June 30, 2012, the Company estimated the fair value of this auction rate security utilizing market comparable bonds. The significant unobservable inputs used in the fair value measurement of the reporting entity's auction rate securities are the market prices on fixed income securities with terms similar to those of the auction rate securities. Significant increases or decreases in these inputs in isolation would result in a significantly lower or higher fair value measurement. The trading range of these inputs was between 54% and 64%, with a weighted average of 60%, of the original par value. The Company classified this auction rate security as non-current and has included it in long term investments on the Condensed Consolidated Statements of Financial Position at June 30, 2012, December 31, 2011 and July 2, 2011 because the Company believes that the current condition of the auction rate security market may take more than twelve months to improve. Jefferson County is in bankruptcy and has asked the bankruptcy court judge to divert some money to municipal sewer repairs that would have otherwise gone to pay debtholders and other creditors. A ruling in favor of the county could further reduce the market value of this auction rate security resulting in an additional other-than-temporary impairments and charges to net earnings. The Company is not currently able to determine the outcome of this bankruptcy, or the amount and timing of the ultimate net proceeds that it may recover. See also Management's Discussion and Analysis of Financial Condition and Results of Operations regarding Jefferson County auction rate security.

The following table presents additional information about the Company's financial instruments (an auction rate security) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2012 and July 2, 2011:

	2012	2011
Balance at January 1	\$ 7,453	\$ 6,775
Unrealized gain in other comprehensive earnings		1,355
Balance at June 30 and July 2, respectively	\$ 7,453	\$ 8,130

Management believes that the economic situation in Spain is likely to result in additional equity method operating losses in the foreseeable future, and consequently, the Company's equity investment (current carrying value is \$3,270) may suffer an other than temporary decline in value at a future date. Should such a decline in value occur, the Company may be required to recognize a partial or full impairment of this investment asset.

The \$7,500 carrying amount of the Company's industrial revenue development bonds at June 30, 2012 and July 2, 2011 approximates its estimated fair value as the bonds have a floating interest rate.

Note 5 Derivative Instruments and Hedging Activities

From time to time, the Company uses derivative instruments, including foreign currency forward contracts, commodity futures contracts and commodity option contracts, to manage its exposures to foreign exchange and commodity prices. Commodity futures contracts and most commodity option contracts are intended and effective as hedges of market price risks associated with the anticipated purchase of certain raw materials (primarily sugar). Foreign currency forward contracts are intended and effective as hedges of the Company's exposure to the variability of cash flows, primarily related to the foreign

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exchange rate changes of products manufactured in Canada and sold in the United States, and periodic equipment purchases from foreign suppliers denominated in a foreign currency. The Company does not engage in trading or other speculative use of derivative instruments.

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the Condensed Consolidated Statement of Financial Position. Derivative assets are recorded in other receivables and derivative liabilities are recorded in accrued liabilities. The Company uses either hedge accounting or mark-to-market accounting for its derivative instruments. Derivatives that qualify for hedge accounting are designated as cash flow hedges by formally documenting the hedge relationships, including identification of the hedging instruments, the hedged items and other critical terms, as well as the Company's risk management objectives and strategies for undertaking the hedge transaction.

Changes in the fair value of the Company's cash flow hedges are recorded in accumulated other comprehensive loss, net of tax, and are reclassified to earnings in the periods in which earnings are affected by the hedged item. Substantially all amounts reported in accumulated other comprehensive loss for commodity derivatives are expected to be reclassified to cost of goods sold. Substantially all amounts reported in accumulated other comprehensive loss for foreign currency derivatives are expected to be reclassified to other income, net.

The following table summarizes the Company's outstanding derivative contracts and their effects on its Condensed Consolidated Statements of Financial Position at June 30, 2012, December 31, 2011 and July 2, 2011:

	Notional Amounts	June 30, 2012	
		Assets	Liabilities
Derivatives designated as hedging instruments:			
Foreign currency forward contracts	\$ 4,350	\$ 70	\$
Commodity futures contracts	3,738	56	(188)
Commodity option contracts	171	1	
Total derivatives designated as hedges		127	(188)
Derivatives not designated as hedging instruments:			
Commodity futures contracts	1,290	14	(33)
Total derivatives not designated as hedges		14	(33)
Total derivatives		\$ 141	\$ (221)

	Notional Amounts	December 31, 2011	
		Assets	Liabilities
Derivatives designated as hedging instruments:			
Foreign currency forward contracts	\$ 13,044	\$ 205	\$
Commodity futures contracts	4,557	341	(138)
Commodity option contracts			
Total derivatives		\$ 546	\$ (138)

July 2, 2011

**Notional
Amounts**