Pillsbury Annual Report -- 1985
America's Corporate Foundation; 1985; ProQuest Historical Annual Reports
pg. 1

Pillsbury

Annual Report

1985

Financial Highlights

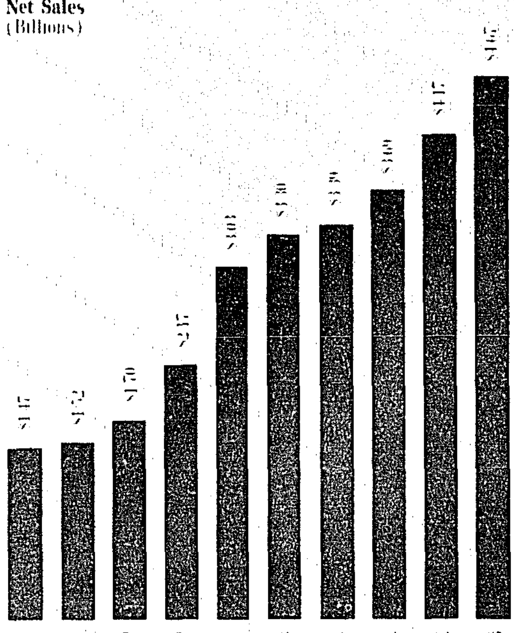
For the Year:	Year Ended May 31 1985	1984	Increase
	(In millions)		
Net Sales	**$4,670.6**	$4,172.3	12%
Net Earnings	**191.8**	169.8	13
Cash Dividends	**65.8**	58.9	12
Capital Expenditures	**327.1**	282.4	16

Per Share:	Year Ended May 31 1985	1984	Increase
Net Earnings	**$4.42**	$3.91	13%
Cash Dividends	**1.52**	1.36	12
Stockholders' Equity	**26.87**	24.22	11
Closing Price of Common Stock	**54⅝**	37⅞	44

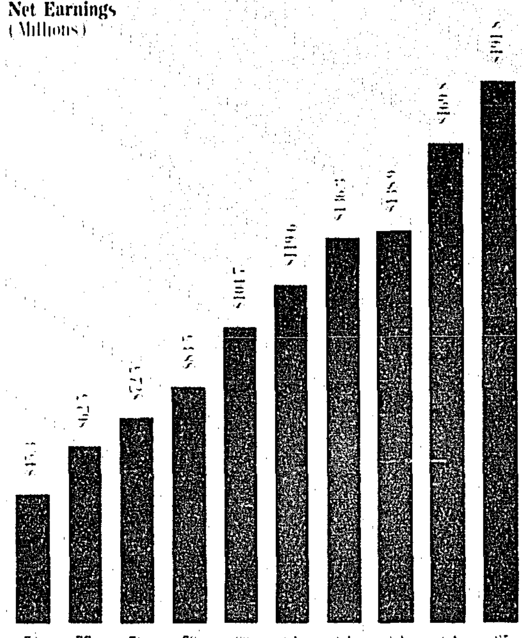
At Year-End:	1985	1984	Increase
Total Assets	**2,778.5**	2,608.3	7
Stockholders' Equity	**1,165.4**	1,046.2	11

Performance Measures:	1985	1984
Net Earnings as a Percent of Sales	**4.1%**	4.1%
Return on Average Stockholders' Equity	**17.3**	17.0
Return on Average Invested Capital	**12.0**	12.1

Net Sales
(Billions)



Net Earnings
(Millions)



William H. Spoor (left), Chairman of the Board, and John M. Stafford, President and Chief Executive Officer.

Performance. . .Progress. . .Potential. These three words sum up Pillsbury's efforts during Fiscal 1985.

Performance included a 12 percent increase in sales and a 13 percent increase in net earnings, making the 14th consecutive year in which we have set new records in each category. We achieved our highest return on stockholders' equity. Cash dividends were increased for the 27th consecutive year and we closed the year on May 31 with the highest stock price in our history.

Progress was evident throughout our Consumer Foods and Restaurants operations as new products, new menus and new restaurant openings brought more consumers to the quality taste and experience of Pillsbury products and services. We increased investments in advertising and promotion to maintain the vitality of our brands and in capital expenditures to expand our manufacturing and marketing capabilities. Acquisitions significantly broadened our portfolio in both the food-at-home and food-away-from-home markets.

Potential for continued growth is excellent. Fiscal 1985 was also a year to prepare for the future, which we believe will bring even better results. New leadership was installed at both the corporate and operating levels. We also took time to reevaluate who we are, who we want to be and what priorities we should set to achieve our goals. These efforts resulted in a "Mission and Values" statement defining our corporate conduct, which is reprinted on page 5 of this report.

The year did have its disappointments. Losses in Commodity Marketing, two costly new product disappointments in Consumer Foods and heavy concept development spending in Restaurants kept operating profits below hoped for levels. These issues are being addressed and will be resolved.

As we look with confidence toward the future, we point with pride to these specific accomplishments of the past year:

Sales of $4.67 billion were up 12 percent from the $4.17 billion of Fiscal 1984. Sales have more than doubled since 1979 and tripled since 1976.

Net earnings of $191.8 million, or $4.42 per share, were 13 percent higher than the $169.8 million, or $3.91 per share of Fiscal 1984. Earnings growth has exceeded that of sales, rising 2.3 times since 1979 and quadrupling since 1976.

A 17.3 percent return on stockholders' equity was the highest in our history and a full percentage point above our average return for the past 10 years.

With a closing stock price of $54⅞, our stockholders enjoyed a 44 percent market appreciation for the year. Our stock price has doubled in a little over two years.

Cash dividends of $1.52 per share were 12 percent higher than the $1.36 of a year ago. Over the past decade, Pillsbury has paid out approximately 33 percent of its earnings in dividends.

New investments, including capital expenditures and acquisitions, were a record $481 million, up 31 percent from Fiscal 1984. Over the past five years, nearly $1.6 billion has been invested in the growth of the Company.

In strategic moves to reposition our Consumer Foods portfolio, we acquired Van de Kamp's, a national leader in frozen fish and ethnic entrees, and sold the American Beauty pasta division for a substantial after tax gain.

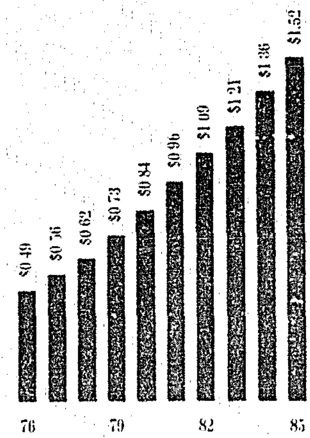
In May, we initiated the largest acquisition in our history with a $390 million tender offer for Diversifoods Inc., Burger King's largest franchisee and the operator of several other restaurant concepts. The acquisition was completed in early Fiscal 1986.

John M. Stafford was elected Chief Executive Officer in May, succeeding William H. Spoor, who has directed the Company's growth since 1973.

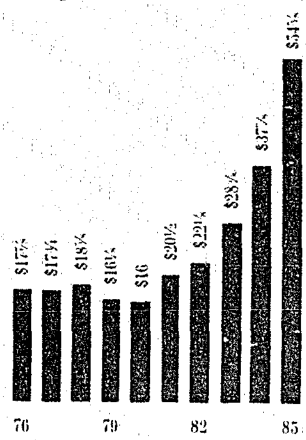
A number of other key executive changes added depth to our management and leadership for our future. Named Executive Vice Presidents were J. Jeffrey Campbell, Chairman and Chief Executive Officer of Burger King Corporation, and Jerry W. Levin, formerly Senior Vice President, Corporate Development and Treasurer. In the Consumer Foods Group, Thomas R. McBurney was named President of U.S. Foods and John L. Morrison was named President of International Foods.

J. Michael Jenkins was elected Chief Executive Officer of the S&A Restaurant Corp, while Jay O. Darling became President of Burger King U.S.A.

Cash Dividends Per Share



Closing Price Of Stock



Each of our employees is important and their contribution over the past year is greatly appreciated. We also thank our customers, suppliers and stockholders for their loyalty and continued support.

Our business impacts—and is impacted by—others who share the communities where we live and work. Pillsbury is committed to being an involved corporate citizen and willingly gives of its good fortune to help improve the quality of life of those around us. During Fiscal 1985, a record $6 million was donated to educational, cultural, civic, and health and welfare organizations, with emphasis placed on programs dealing with hunger and youth.

We are pleased with our progress and believe our story is an exciting one. We invite you to review the details of our business in the pages which follow. Stockholders are also cordially invited to attend the Annual Meeting of The Pillsbury Company to be held at the Guthrie Theatre in Minneapolis at 2 p.m. on Tuesday, September 10.

Respectfully submitted,

William H. Spoor

William H. Spoor
Chairman of the Board

John M. Stafford

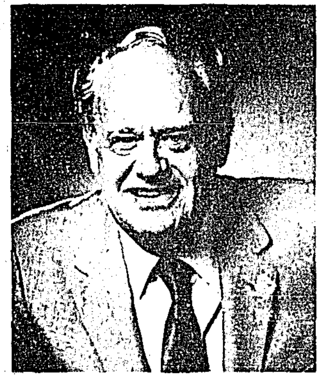
John M. Stafford
President and
Chief Executive Officer

July 17, 1985

Winston R. Wallin, who provided 37 years of dedicated service to The Pillsbury Company, retired as Vice Chairman and a Director in July 1985, to become President and Chief Executive Officer of Medtronic, Inc., a Minneapolis manufacturer of heart pacemakers and other implantable medical devices.

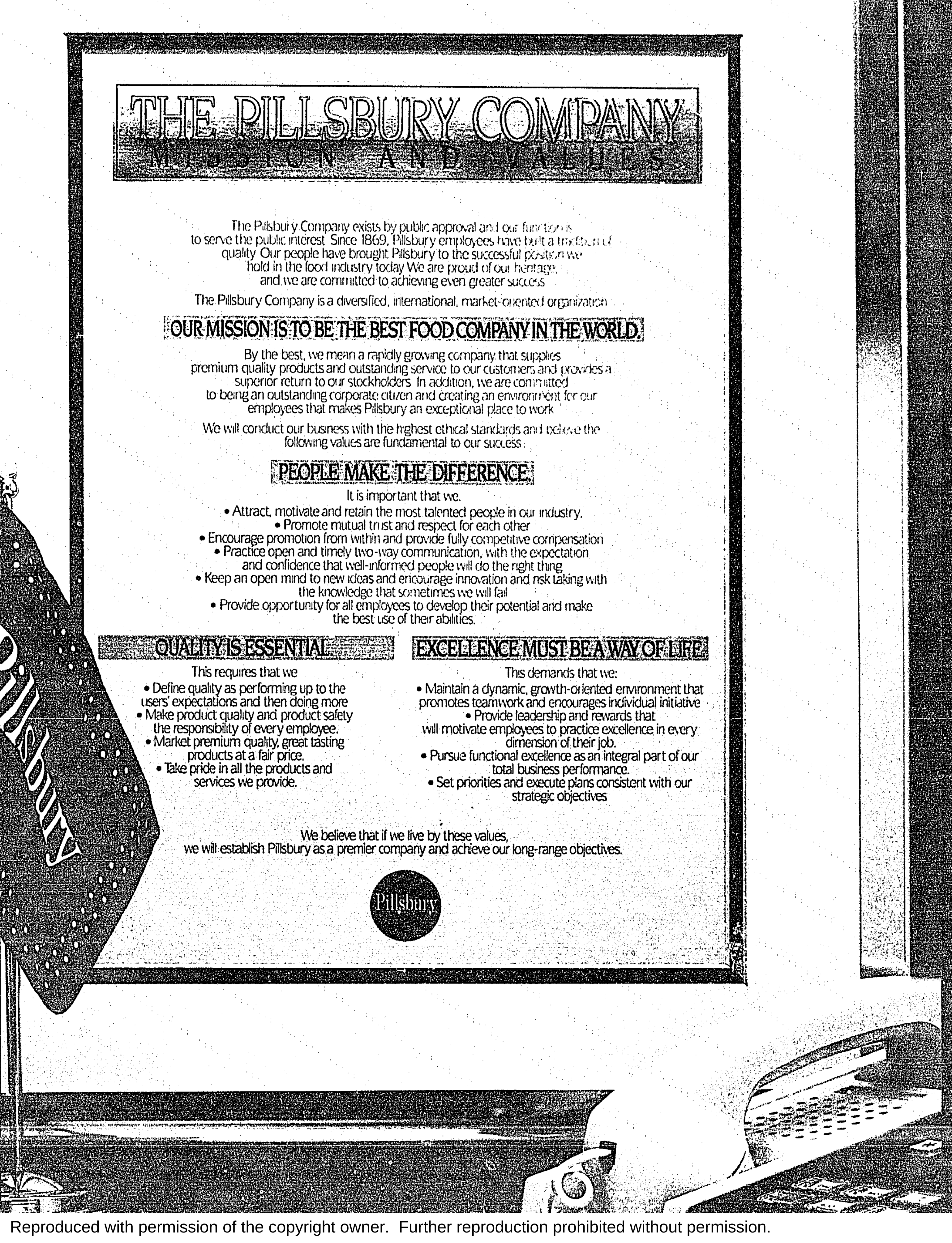
As Vice President and General Manager of Agri-Products and later as President and Chief Operating Officer, Win was importantly responsible for Pillsbury's success in Agri-Products during the 1970's and for the growth of our Restaurants business in the 1980's. We are grateful for his many contributions to Pillsbury and wish him success in his new endeavor.

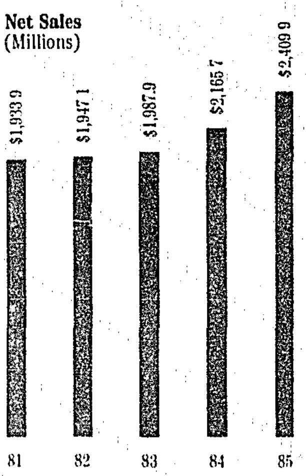
We also congratulate John C. Whitehead, who was appointed U.S. Deputy Secretary of State in July 1985. John served as a member of our Board of Directors since 1970 and was Chairman of the International Advisory Board of Goldman, Sachs & Co. His counsel will be missed.

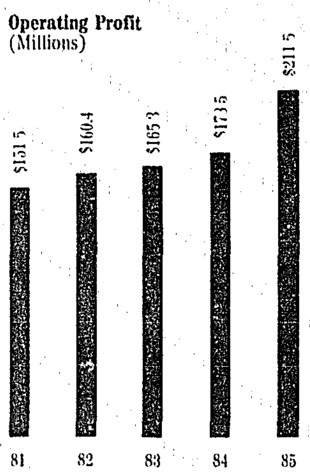


Winston R. Wallin

John C. Whitehead


THE PILLSBURY COMPANY
MISSION AND VALUES
The Pillsbury Company exists by public approval and our function is to serve the public interest. Since 1869, Pillsbury employees have built a tradition of quality. Our people have brought Pillsbury to the successful position we hold in the food industry today. We are proud of our heritage, and we are committed to achieving even greater success.
The Pillsbury Company is a diversified, international, market-oriented organization.
OUR MISSION IS TO BE THE BEST FOOD COMPANY IN THE WORLD.
By the best, we mean a rapidly growing company that supplies premium quality products and outstanding service to our customers and provides a superior return to our stockholders. In addition, we are committed to being an outstanding corporate citizen and creating an environment for our employees that makes Pillsbury an exceptional place to work.
We will conduct our business with the highest ethical standards and believe the following values are fundamental to our success.
PEOPLE MAKE THE DIFFERENCE.
It is important that we.
• Attract, motivate and retain the most talented people in our industry.
• Promote mutual trust and respect for each other.
• Encourage promotion from within and provide fully competitive compensation.
• Practice open and timely two-way communication, with the expectation and confidence that well-informed people will do the right thing.
• Keep an open mind to new ideas and encourage innovation and risk taking with the knowledge that sometimes we will fail.
• Provide opportunity for all employees to develop their potential and make the best use of their abilities.
QUALITY IS ESSENTIAL.
This requires that we
• Define quality as performing up to the users' expectations and then doing more.
• Make product quality and product safety the responsibility of every employee.
• Market premium quality, great tasting products at a fair price.
• Take pride in all the products and services we provide.
EXCELLENCE MUST BE A WAY OF LIFE.
This demands that we:
• Maintain a dynamic, growth-oriented environment that promotes teamwork and encourages individual initiative.
• Provide leadership and rewards that will motivate employees to practice excellence in every dimension of their job.
• Pursue functional excellence as an integral part of our total business performance.
• Set priorities and execute plans consistent with our strategic objectives.
We believe that if we live by these values, we will establish Pillsbury as a premier company and achieve our long-range objectives.
Pillsbury
Pillsbury





In Fiscal 1985, Pillsbury's Consumer Foods Group:

- Posted a 22 percent gain to $211.5 million in operating profit, including $34.9 million in unusual items primarily from the sale of the American Beauty pasta division.
- Achieved an 11 percent increase in sales to $2.41 billion on a nine percent increase in unit volume despite essentially flat industry sales and intense competition.
- Accelerated the momentum of new product development with the introduction of nine major items generating first-year sales of $160 million.
- Entered the important frozen fish business through the acquisition of nationally recognized Van de Kamp's.
- Expanded Pillsbury's international presence through nine acquisitions or joint ventures in Europe, Canada, Mexico and the Far East.
- Reorganized the business to facilitate and accelerate the entry into more contemporary, growth-oriented categories.

Overall, despite some disappointments and lower than expected profit performance, it was a good year. With the exception of family flour and dessert baking mixes, where industry volume is eroding, strong gains in volume and market share were recorded across Pillsbury's product lines. To help achieve this growth, advertising and promotional spending was increased 25 percent to $365 million.

Pillsbury's strength lies in its product quality and strong brand franchises, including such familiar names as Pillsbury®, Green Giant®, Le Sueur®, Hungry Jack®, Totino's®, Van de Kamp's® and Häagen-Dazs® in the United States and Green's, *Hammonds, Gringoire-Brossard,* Erasco, Milani and Mac'Ma internationally.

Through new product development and acquisitions, the Company has grown considerably faster in recent years than the food industry as a whole.

Pillsbury expects the Consumer Foods Group to grow five percent per year in volume and 10 to 12 percent in operating profit. In Fiscal 1985, 34 percent of U.S. Consumer Foods' sales came from products not in the Company's portfolio five years ago, with about half of these coming from internal development and half from acquisitions. Outside the U.S., growth continues to come primarily from acquisitions.

Worldwide, the Company invested $142 million in strategic food acquisitions or joint ventures during the year, while research and development expenditures for new products rose seven percent to $30.5 million.

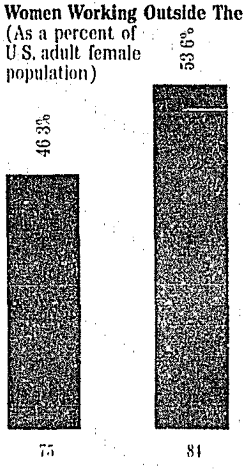
Highlighting the year's successful new product offerings were Toaster Strudel™, Microwave Pizza, *Soft Breadsticks, Pudding Pockets and a new line* of Green Giant frozen vegetables in polybag packages. Disappointing, however, were Milk Break™ Bar and Yeast Bread.

Although productivity improvement continues to be a priority, becoming the industry's low-cost producer is no longer sufficient. Thus, Pillsbury is also concentrating on becoming both the low-cost and preferred supplier to the grocery trade by offering products of outstanding quality and consumer acceptance backed by a sales and distribution organization committed to consistently superior customer service.

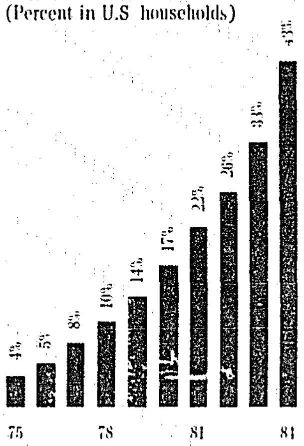
To help enforce its quality standards, retain customer loyalty and answer consumer questions on product usage, availability and recipes, the Company encourages an open dialogue with the *consuming public. A toll-free '800' telephone* number is printed on most Pillsbury packages. In Fiscal 1985, trained home economists responded to more than 80,000 calls and answered another 90,000 letters.


New
STRUDEL
Pastries
Dear Mom
I love you

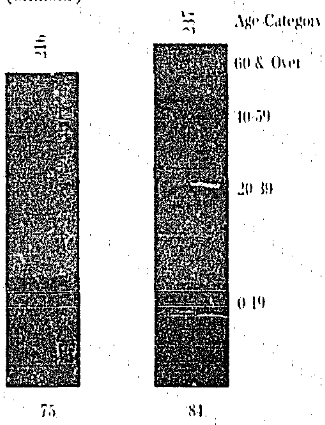
Women Working Outside The Home
(As a percent of U.S. adult female population)



Microwave Ovens
(Percent in U.S. households)



U.S. Population
(Millions)



An exciting new "Vision" for the Consumer Foods Group was launched in Fiscal 1985 to help achieve the Company's mission of becoming the best food company in the world. The effort sets clearly defined priorities for growth, opens new avenues for innovation and provides an operating framework more responsive to changing consumer tastes and lifestyles. As a result, Pillsbury is now managing its domestic operations in terms of meal occasions and contemporary food usage rather than distribution channels. The Company's former Dry, Refrigerated and Frozen divisions have been regrouped around such concepts as Meals and Snacks, Vegetables and Side Dishes, Breads and Baking Products, and Ice Cream.

Meals and Snacks

Fiscal 1985 sales $372 million, up 46 percent.

Pillsbury has targeted the $4 billion-a-year frozen main meal market and the rapidly expanding market in light meals and snacks as vital to its future. The nation's eating habits are changing in response to such demographic influences as smaller families, an aging population and an increase in dual-income families with more disposable income but less disposable time. To remain contemporary, Pillsbury's focus is shifting from supplying food ingredients, such as flour and baking mixes, to producing more ready-to-eat, convenient, portion-control foods that offer premium quality and good value.

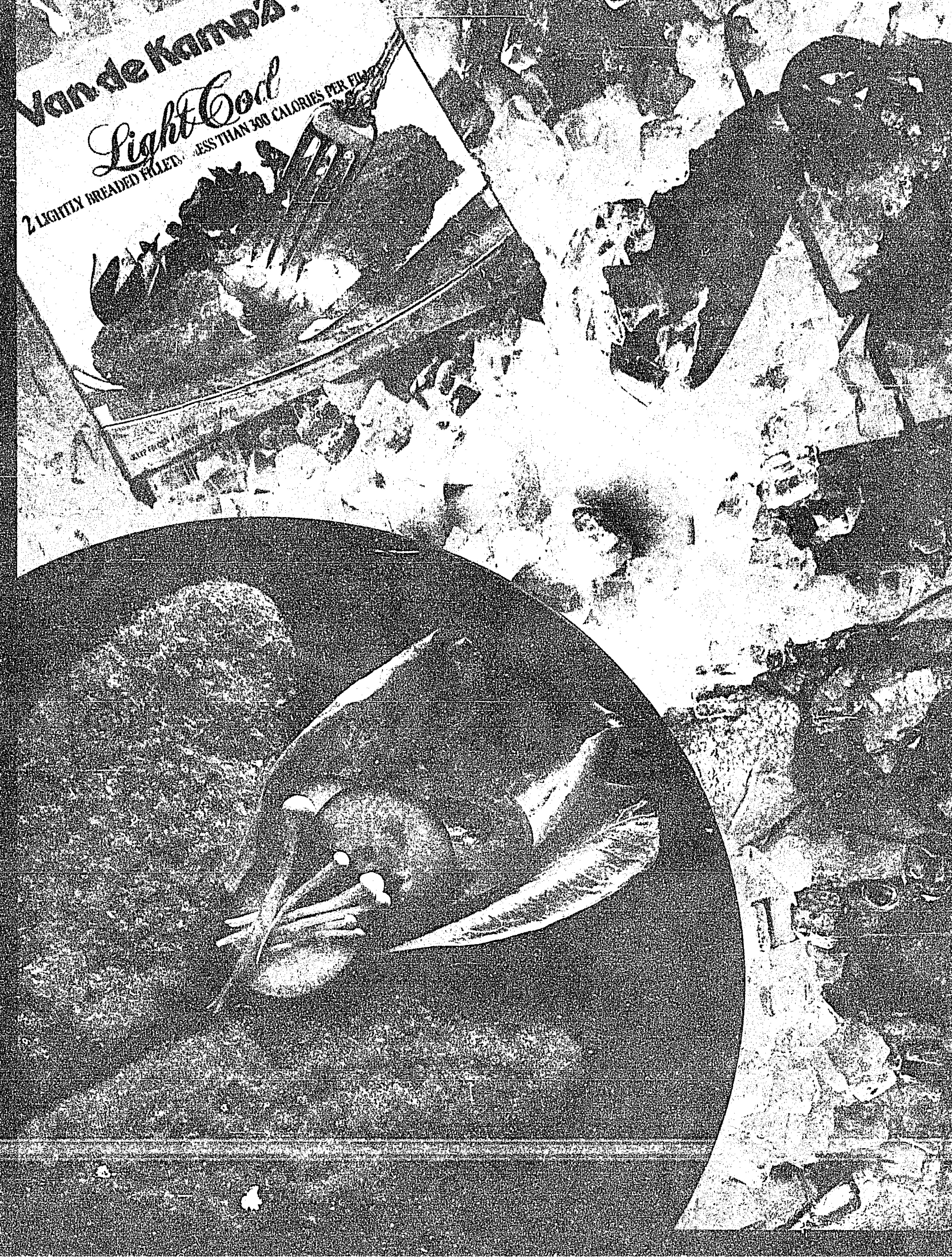
The $102 million acquisition in November 1984 of Van de Kamp's, a market leader in frozen seafood and ethnic entrees, gives significant thrust to this strategy.

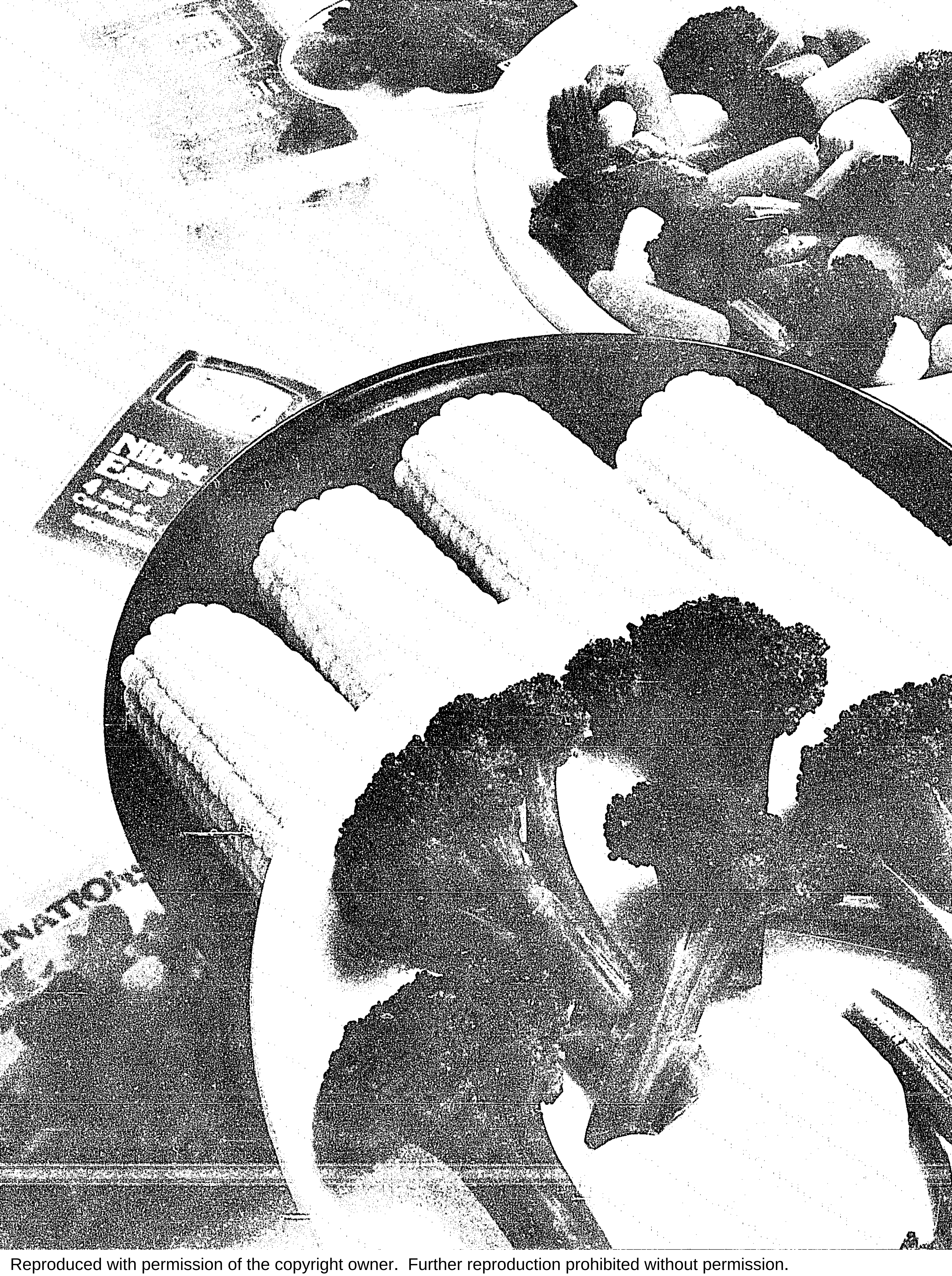
In response to growing consumer interest in lower calorie foods, Van de Kamp's added new "Light" and uncoated "Today's Catch"™ lines of sole, cod, perch and flounder filets to its popular breaded and battered lines. New national advertising called attention to Van de Kamp's reputation for freshness, consistent quality and good tasting products. Van de Kamp's became the number one seller of frozen Mexican meals during the year and expanded its lines of other frozen ethnic dinners, helping to offset weakness in the Green Giant frozen entree business.

In the breakfast category, Pillsbury introduced Toaster Strudel after several years of research and development. A unique frozen pastry that pops from the toaster bakery-fresh, Toaster Strudel is one of Pillsbury's most exciting new product lines in years. Extensive market tests showed excellent consumer appeal with some of the highest repeat-purchase scores in the Company's history. Backed by strong advertising support, its national roll-out in April is exceeding sales expectations.

Pillsbury is also seeking to establish a line of light meals and snacks especially formulated for the more than 40 percent of American homes equipped with microwave ovens. Microwave Pizza, which utilizes a specially-developed process for a crisp crust, was an instant success. More than 20 million were sold during the first year. Microwave Pancakes, which combine excellent taste with convenience, found an equally receptive market. Sales of frozen Microwave Popcorn increased six percent. In total, Pillsbury's microwave products exceeded $58 million in sales in Fiscal 1985 and are expected to continue their strong growth.

To maintain the number one position in frozen pizza, substantial investments were made in quality improvements and marketing support for the Totino's and Fox Deluxe® brands. New flavors, thicker sauces and improved toppings were added, and Pizza Slices in portion-control packages were introduced. Totino's volume increased four percent and, combined with Microwave Pizza, Pillsbury sold more than one-third of the 550 million frozen pizzas consumed in the U.S. last year.


Van de Kamp's
Light Cod
2 LIGHTLY BREADED FILLETS



Vegetables and Side Dishes

Fiscal 1985 sales $434 million, up 12 percent.

The Valley of the Jolly Green Giant once again produced an abundance of America's best liked, finest-quality vegetables. Volumes in canned and frozen products increased five and 15 percent, respectively, despite a five percent decline in industry-wide sales of canned vegetables and only a two percent growth in the total vegetable market.

The national introduction of Green Giant frozen vegetables in polybags, which facilitates portion-control, was a major success during Fiscal 1985. Green Giant also maintained its leadership position in frozen prepared vegetables and, with its Le Sueur and B 'n B® labels, retained its number one position in canned asparagus, peas and mushrooms and strengthened its number two position in canned corn and beans. In May, test marketing began on a new line of nine imported Oriental vegetables and mushrooms in glass jars.

Green Giant's return on invested capital reached an all-time high. Both canned and frozen vegetables benefited from productivity improvements initiated over the past few years, including the foreign sourcing of some labor-intensive crops. Further operating efficiencies are anticipated from the combination of the canned and frozen vegetable operations.

Breads and Baking Products

Fiscal 1985 sales $1.21 billion, up one percent.

For the fifth consecutive year, Poppin' Fresh®, the Pillsbury Doughboy, chalked up increased sales and volume as a number of innovative new refrigerated dough products stimulated interest in the dairy case. Unit volume rose four percent as specialty products, biscuits, sweet rolls and dinner rolls recorded increased sales.

Soft Breadsticks, a refrigerated product that uses Pillsbury's yeast-dough technology to produce bakery-fresh flavor, achieved outstanding first-year sales. New Pillsbury's BEST™ Apple Danish and Cinnamon Rolls also attained high volume levels, while All Ready Pie Crust, introduced in Fiscal 1983, continued to gain sales momentum.

Pillsbury's challenge in the mature family flour and cake mix area is to develop more contemporary products to offset the decline in home baking. Results in Fiscal 1985 were largely disappointing as industry volume continued to decline following 1984's ethylene dibromide (EDB) scare, despite increased promotional spending. Although profits declined sharply, Pillsbury was able to maintain market share in this important, $3 billion-a-year business.

Pudding Pockets, a unique pudding-filled cupcake, was introduced in April and appears to be one of the Company's more successful new dessert mixes in years. However, two other new products, Milk Break Bar, an attempt to enter the expanding cereal bar market, and dry mix Yeast Bread were poorly received.

In the industrial market, Pillsbury is a major supplier of flour and specialty products to the bakery industry. Although per capita flour consumption rose about two percent in the U.S. last year, industry volume declined slightly due to the absence of the government's flour export program to Egypt, which stimulated sales in Fiscal 1984.

In March, Pillsbury acquired California Milling Corporation, a Los Angeles manufacturer of wheat flour; bakery mixes, fillings and toppings; and masa corn flour, significantly strengthening its presence in the growing Southwest markets.

U.S. Foods

President
Thomas R. McBurney

Executive Vice President
Kent C. Larson

Senior Vice President, Operations and Technology
James R. Behnke

Group Vice President, Industrial Foods
Robbie M. Westmoreland

Vice Presidents
John W. Argent
Howard E. Bauman
John R. Cox
John E. Dixon
Diana L. Doshan
L. Thomas Gartner
William W. Hay
Edward A. Januschka
Mary Ellen Jenks
Gary F. Klingl
Robert L. Lindsay, Jr.
Daniel J. Locke
Lloyd V. Lofgren
Warren G. Malkerson
W. Richard Nickel, III
Donald A. Osell
Steven H. Pokress
Kenneth A. Pond
Kenneth J. Reis
Anthony L. Scherber
Jimmy A. Shadler
Jolyon A. Stein
Michael Symeonides
Rose W. Totino
Kenneth J. Valentas
Virginia L. Ward
Thomas N. Wilkolak
Lawrence P. Youngblood


Natural Chocolate Flavored

Ice Cream

Fiscal 1985 sales $130 million, up 34 percent.

The strategic decision two years ago to enter the frozen dessert category through the acquisition of Haagen-Dazs, the nation's leading manufacturer of super-premium ice cream, has been highly successful. Häagen-Dazs had an outstanding year in Fiscal 1985 with volume up 20 percent despite a slight decline in total U.S. ice cream consumption. In April, Häagen-Dazs opened its second plant, in Tulare, California, increasing capacity by 50 percent and broadening its national market penetration

While Häagen-Dazs products are sold primarily through supermarkets, the company also franchises more than 300 ice cream parlors throughout the U.S. and in Singapore, Hong Kong, Japan and Puerto Rico. Through new product introductions and better franchisee relations, efforts are underway to improve the profitability of the Häagen-Dazs Shoppes, which frequently provide consumers with their first taste of super-premium ice cream.

In 1984, Häagen-Dazs became the national distributor of Tofutti, a low-calorie, nondairy frozen product, and LeSorbet, a frozen French ice made with real fruit. First-year sales of both were excellent as they opened the frozen dessert market to 30 million Americans who for health or religious reasons must abstain from dairy products. In May, a new line of orange, boysenberry and raspberry "Sorbet and Cream" was launched, combining the cool taste of fruit ice with Häagen-Dazs rich vanilla ice cream.

Sedutto Ice Cream Corporation, a New York-based producer of specialty ice cream products for the restaurant and food service industry, was acquired during the year. In addition, a new joint venture was formed with Suntory Limited to market Häagen-Dazs ice cream in Japan. Both are showing good results as they extend Pillsbury's ice cream penetration beyond the domestic retail market.

International Foods

Fiscal 1985 sales $342 million, up six percent.

Unit volume from Pillsbury's international businesses rose 12 percent during Fiscal 1985. Including joint ventures, which broaden Pillsbury's foreign penetration, sales approached $500 million. Operating profit in local currencies was up substantially as all countries reported increases. However, the gains were more than offset by the continued strength of the dollar and operating profit in U.S. dollars fell three percent.

Pillsbury is committed to expanding its international presence and views the strong dollar as an opportunity to acquire premier companies at attractive prices. Nine acquisitions and joint ventures were completed in Fiscal 1985 at a cost of $30 million, positioning the Company in significant growth areas of the food industry in the United Kingdom, West Germany, Belgium, Canada, Mexico, Australia and Taiwan.

In Europe, which accounts for half of Pillsbury's international sales, excellent growth was recorded, particularly in West Germany and France. Backfrost and Hofmann Menu, producers of frozen specialty sandwiches and prepared meals in West Germany, continued volume growth and a third frozen foods concern, Goldstein, a maker of specialty cakes, was acquired. Erasco and Jokisch, makers of canned meals for the German market, outpaced their record profit performance of Fiscal 1984. Gringoire-Brossard, a maker of premium cookies in France and Belgium, posted a 17 percent increase in volume, mainly due to the acquisition of Boone Cakes in Belgium.

In May, Pillsbury acquired Fiesta Foods, the U.K.'s number two producer of frozen mousse desserts and the number three brand of take-home ice cream. The acquisition provides a base for expanding into other frozen foods and includes a broad distribution system which can benefit Pillsbury's other businesses in the country—Green's cake mixes, Hammonds' sauces and Green Giant canned corn.

International Foods and Ice Cream

President
John L. Morrison

International Foods

Vice Presidents
Jock A. Flournoy
Grahame R. Francis
John C. Lenker
Donald E. Loadman
James T. Petersen

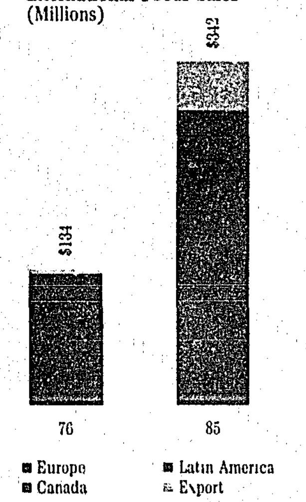
Country Managers
William G. Bullis, Jamaica
Rocky Chen, Taiwan
Hans-Joachim Denecke, West Germany
Michael S. Dingee, Venezuela
Yves Dumont, (Green Giant) Europe
J. Thomas Kirchner, Mexico
Chris Leong, Hong Kong
Don Moraza, Philippines
Bruce A. Noble, United Kingdom
Gerald O'Connor, Guatemala
Richard Peddie, Canada
Victor Scherrer, France

Ice Cream

President, The Häagen-Dazs Company, Inc.
Mark L. Stevens

President, The Häagen-Dazs Shoppe Company, Inc.
Charles Kanan

International Foods Sales
(Millions)



A record year was posted by Pillsbury's Canadian operations as frozen and canned Green Giant vegetables recorded sizable volume gains and Totino's pizza and Clark's canned stews and meat sauces maintained their vitality. Brights and Martins, quality producers of fruit and vegetable juices, were acquired in August 1984.

Mac'Ma, the leading baker of premium cookies in Mexico, was acquired by Grupo Olazabal/Pillsbury, the Company's flour and pasta joint venture. In Venezuela, flour sales increased but pasta volume declined in the face of increased competition and overcapacity. An expansion program to double flour capacity in Jamaica was completed during the year leading to a 65 percent increase in volume.

A joint venture with Allied Mills Ltd., Australia's market leader in branded flour, mayonnaise and nuts and a major producer of salad dressings, cake mixes, peanut butter, pasta and frozen foods, was announced in March. Renamed ETA Foods, for Allied's major brand, the new venture gives Pillsbury an excellent opportunity to expand in the growing Asia/Pacific region. A second new joint venture in the region, Great Wall in Taiwan, gives Pillsbury an entry into that growing market.

For years, Pillsbury has been the world's largest exporter of canned corn. Other Pillsbury products are exported to more than 50 countries abroad. In Fiscal 1985, as a strategic move to recognize the strength of the dollar, the Company also began importing into the U.S. products from its foreign subsidiaries and other producers. Tournai cookies and cakes from Gringoire-Brossard in Europe and sauces from Amoy Canning in Hong Kong were the first to enter the domestic market.

Declining exports and an overcapacity in grain storage and transportation facilities plagued the nation's agricultural economy during Fiscal 1985. The performance of Pillsbury's Commodity Marketing Group suffered accordingly. Shipments fell 20 percent to eight million tons, sales dropped 13 percent to $207 million and an operating loss of $14.9 million was incurred, compared with a year-earlier profit of $7.8 million

Nevertheless, Pillsbury fared better than most in the industry as its feed ingredient business continued to generate good earnings and the rice and edible dry bean businesses, where Pillsbury's Jack Rabbit® brand is the industry leader, improved their performance. In addition, the grain merchandising division scaled back its operations as its focus shifted from a reliance on exports to meeting internal and domestic requirements.

The world's grain markets have undergone significant changes over the past decade. In the peak 1979-1980 crop year, the United States accounted for nearly 60 percent of the world's wheat and coarse grain trade. Government and economic forecasters expected farm exports to continue to rise. Instead, exports have declined as the strength of the dollar and high government price supports have rendered U.S. agricultural products uncompetitive in world markets. With increased grain production in Europe and such countries as Argentina, Australia and China, the U.S. share of the world export market fell to 48 percent in 1984-1985

Pillsbury began restructuring its Commodity Marketing operations in Fiscal 1983. By year-end Fiscal 1985, it had sold or closed 22 of its 102 grain and edible bean elevators and reduced storage capacity to 88 million bushels from 112 million. In Fiscal 1985, a $10.7 million provision was made to reflect the permanent impairment of the barge transportation business. Thus at May 31, only $223 million, representing eight percent of Pillsbury's total identifiable assets, were employed in Commodity Marketing. Efforts to reduce participation in these businesses continue.

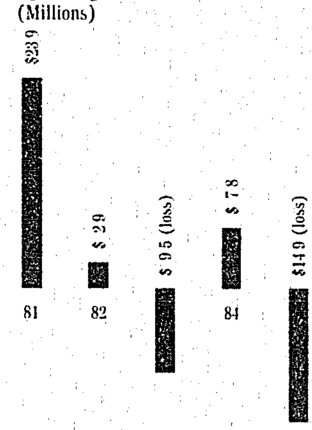
Commodity Marketing

Group Vice President, Grain Merchandising
Russell J. Bragg

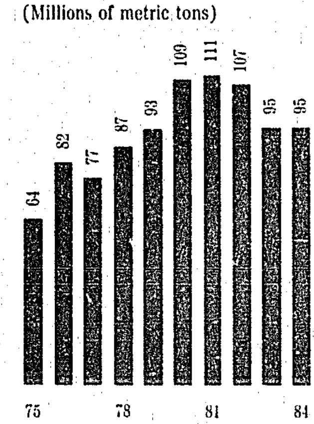
Group Vice President, Specialty Commodities
Philip J. Lindau

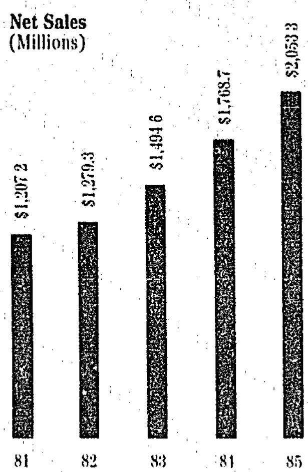
Vice Presidents
Donald E. Brummer
David W. Dean
James A. Woerner

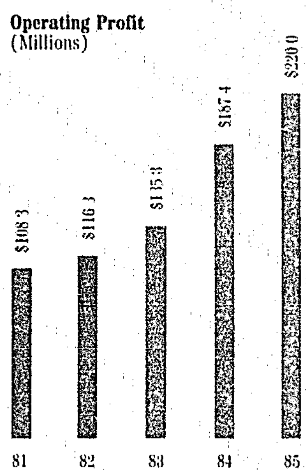
Operating Profit
(Millions)

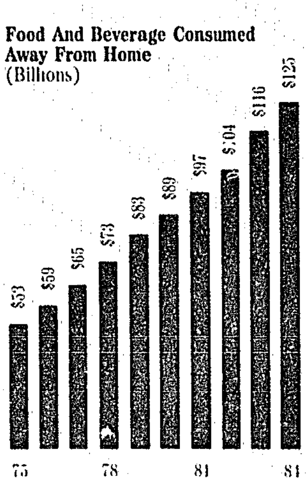


U.S. Exports Of Wheat And Coarse Grain
(Millions of metric tons)









Fiscal 1985 was a year of dramatic growth and achievement for Pillsbury's Restaurants Group. Comprised of Burger King Corporation and the S&A Restaurant Corp, the Group:

Achieved record sales and earnings, with sales up 16 percent to $2.05 billion and operating profit up 17 percent to $220 million.

Opened 477 new restaurants, the most ever in a single year, bringing the total to 4,601.

Developed exciting new menu items at Burger King®, Steak and Ale® and Bennigan's®.

Launched "Image '87," a program to upgrade the appearance and quality of service at Burger King units over the next several years, while the renovation of the Steak and Ale chain neared completion.

Installed new leadership and depth of management throughout the Group in order to maintain vitality into the 1990s.

In May 1985, Pillsbury announced an agreement to acquire Diversifoods Inc., the largest franchise operator of Burger King restaurants—with 377 units—and the parent of several other restaurant concepts such as Godfather's Pizza®, Luther's® Bar-B-Q, The Chart House® dinnerhouses and Moxie's® Deluxe Grille.

Completed in early Fiscal 1986, the $390 million cash acqusition adds significantly to Burger King's company-operated store base and will open for further development important markets in the Chicago and New Orleans areas where Diversifoods previously held exclusive territorial rights. By consolidating its ownership position in Burger King and revitalizing or divesting Diversifoods' 1,000 non-Burger King restaurants, Pillsbury believes the acquisition holds the potential for superior long-term earnings growth with minimal or no first-year dilution.

During Fiscal 1986, the Company will also be evaluating two other new restaurant concepts—Bay Street®, a fresh seafood dinnerhouse operated by S&A, and Quik Wok®, an Oriental fast-food chain to be managed by Burger King.

Already the largest multi-concept restaurant organization in the world, serving more than 40 million meals a week, Pillsbury's strategy is to extend its leadership in both the fast-food and full-service segments of the $125 billion-a-year restaurant industry. By emphasizing quality, service and convenience, and by strategically focusing on restaurant concepts with broad consumer appeal, Pillsbury's Restaurants Group has grown considerably faster than the industry as a whole over the past five years.

The challenge for the future is to maintain that vitality at a time when growth is becoming more difficult. Despite the outlook for slower economic growth in the United States and increased competition within the restaurant industry, consumers are still spending nearly 30 cents of every food dollar on meals away from home. Thus, the Company believes there is ample growth opportunity for a well disciplined organization with product superiority.


BURGER KING
BURGER KING
BURGER KING
BURGER KING

Burger King Corporation

Fiscal 1985 sales $1.41 billion, up 18 percent.

Records are made to be broken and Burger King did exactly that in Fiscal 1985. Operating profit rose 23 percent as the company benefited from higher sales at company-operated stores and greater volume at Distron, Burger King's distribution division, which supplies more than 70 percent of the domestic system. Increased royalties and rents from franchised units also boosted sales and operating profit.

Systemwide sales, which include sales by franchised units, rose 16 percent to $3.99 billion. On top of two years of double-digit growth, average sales per domestic unit increased another seven percent to top $1 million for the first time.

A record 430 new units were opened during the year, 74 more than in Fiscal 1984, lifting the system total to 4,225 worldwide. Company operated stores accounted for 74 new openings, while a record 314 units were built by franchisees with their own financing —a strong endorsement of the vitality of the Burger King system. Approximately 400 additional units will be opened in Fiscal 1986.

Burger King seeks to maintain a healthy mix of franchised and company-operated restaurants in order to achieve market penetration. Favorable franchise terms and good franchisee relations, in which the company and its investors are partners in enhancing value, are key components of Burger King's strategy for growth.

At the same time, in order to provide demonstrated leadership for the system and to enjoy the greater profitability that comes from direct store management, Burger King has sought to increase its 15 percent domestic company-operated store base to 20 percent. Through the acquisition of Diversifoods, Burger King will reach that percentage in Fiscal 1986.

New product introductions aggressively backed by network television advertising are also key to Burger King's success. In Fiscal 1985, the Croissan'wich, a croissant breakfast sandwich, went nationwide after a successful introduction in 1984. As a result, breakfast's contribution to unit sales rose to nearly 12 percent from eight percent a year ago.

The Whopper®, Burger King's most popular sandwich, was beefed up in June of 1985 with a meatier 4.2 ounce patty and a taste-pleasing kaiser-cut bun. Bigger than competing quarter-pound hamburgers and enhanced by the unique flavor of flame broiling, the Whopper continued to outdistance the competition in national taste tests.

"Image '87," a major program to improve the visual appeal of the stores in keeping with consumer desires, was introduced during the year and will involve the renovation of most company operated restaurants over the next three years. A new exterior design will be accompanied by upgraded interiors featuring atriums, more wood and an improved system for taking and filling customer orders. Response to the new units has been marked by a sizable increase in traffic and sales. Franchise operators are being encouraged to upgrade their units as well.

Burger King is committed to being the best restaurant operator in terms of quality, service and cleanliness. To help achieve that goal, extra managers were added to its company-operated stores in order to improve the quality of service, the cleanliness of facilities, the freshness of salad bars and to better train new employees.

Burger King Corporation

Chairman and Chief Executive Officer
J. Jeffrey Campbell

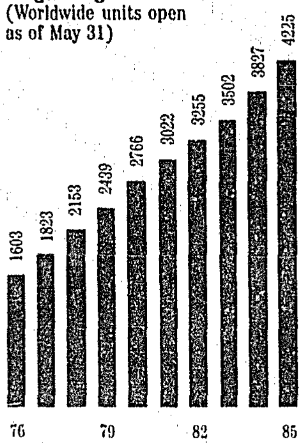
President, Burger King U.S.A.
Jay O. Darling

Executive Vice Presidents
Peter J. Campisi
William T. de Laet
C. Donald Dempsey
Glenn W. Jeffrey
William E. Prather
Tony B. Rolland
Allen G. Shuh

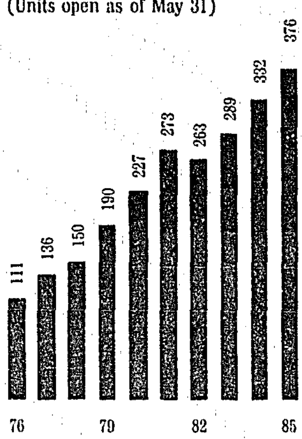
Senior Vice Presidents
William J. Gill
Robert H. Sorensen
Joel J. Weiss
Richard P. White

Vice Presidents
Joseph P. Bisignano
Oliver P. Brown
Joseph E. Burkhart
Ronald S. Busch
Herman Cain
Robert B. Cathcart
Alan B. Fabricant
Matthew J. Fairbairn
Eugene D. Feola
Stephen A. Finn
Suzanne Fox
Paul R. Gershen
Jerilee Goodman
Robert A. Gumm
Robert S. Hill
John H. Kemp, III
William H. Lee, Jr.
Gary C. List
Paul R. Lovin, Jr.
Donald G. Manson
Michael H. McCaffrey
Michael A. Moskowits
Charles S. Olcott
Charles R. Petty
Mitchel E. Rhoads
Wayne A. Saunders
Douglas R. Schrank
Jeffrey T. Seeberger
Richard T. Snead
Roger Stephen Sparling
James D. Stoops
Paul T. Sutherland
Richard J. Trutz
Marc Weinstein

Burger King
(Worldwide units open as of May 31)



S&A Restaurant Corp
(Units open as of May 31)



For the first time in its history, Burger King is developing a second restaurant concept. In June 1985, after a year-long search for a viable new fast-food concept, the Company acquired Quik Wok, a nine-unit Chinese restaurant chain based in San Antonio, Texas. By combining a high quality ethnic food organization with Burger King's marketing and franchising skills, the Company expects to expand Quik Wok rapidly.

Internationally, Burger King is poised for a major expansion program over the next two years after utilizing Fiscal 1985 to install new management and improve operating controls. The company has 334 stores outside the U.S., mostly in Canada, Puerto Rico, Europe and Australia. While Canadian operations have been profitable, European operations have had to cope with excessively high occupancy and labor costs and have generated losses for several years. Burger King's strategy is to build up a sufficient store base in selected enclaves to support local advertising campaigns and win consumer acceptance.

As an adjunct to its domestic and international expansion, Burger King has an agreement with the Army and Air Force Exchange Service to open 185 restaurants on U.S. Army and Air Force bases over the next five years. The first nine units were opened during Fiscal 1985, including six in the U.S., two in West Germany and one in South Korea. Each is doing more than $2 million in annualized sales, or twice the domestic system average. Approximately 50 more of these units will be opened during Fiscal 1986.

S&A Restaurant Corp

Fiscal 1985 sales $641 million, up 15 percent.

Unit expansion and concept evolution were the major themes of Fiscal 1985 as S&A's operating profit increased eight percent. The company opened 47 new restaurants and placed renewed emphasis on menu development and quality meals offered at superior price/values. As the operator of two dinnerhouse and two casual-dining concepts, S&A is tapping the strength in financial resources and personnel of its mature concepts to stimulate the expansion of its developing concepts.

Steak and Ale, the nation's premier dinnerhouse chain, recorded its 19th consecutive year of sales and earnings gains, with average store sales rising two percent to $1.5 million. By keeping pace with the changing tastes of its mostly 30-to-44 year-old clientele and maintaining consistent quality and service, Steak and Ale has achieved a 50 percent increase in unit sales in the past five years with only a 12 percent increase in menu prices.

Six new restaurants were opened during the year, bringing the chain to 181 units, located mostly in the South and East. Since 1982, nearly all of the restaurants have been remodeled, while menus have been expanded to include more seafood and specialty dishes.


Philadelphia Cheese Steak
Let freedom ring in your mouth with our juicy, thin-sliced beef, grilled onions, mushrooms and melted cheese on a Philly roll $5.45
Monte Cristo
The classic we've perfected! A triple treat of lean ham, tender turkey breast and mild cheeses hand battered (so we can show off!) and fried 'til golden.

Bennigan's, the nation's largest casual-dining chain, reemphasized its quality food with the introduction of an expanded 75-item menu with the theme, "Serious Food Served with a Side of Fun." Freshly prepared foods; shared appetizers, snacks and finger foods; and special offerings such as Cajun dishes have been introduced to broaden the focus and appeal of the Bennigan's experience. Six appealing nonalcoholic cocktails are also offered.

This change in focus, as well as Bennigan's role as an industry leader in promoting responsible liquor management, is in response to the national trend toward more moderate alcohol consumption. Liquor sales at Bennigan's dropped to 39 percent of total sales from 41 percent in Fiscal 1984 and a peak of 43 percent in Fiscal 1983. As a result, average restaurant sales declined five percent last year to $2.2 million.

Nevertheless, the concept continues to have tremendous appeal among young adults and remains a growth concept for Pillsbury. During Fiscal 1985, S&A opened 28 new Bennigan's, increasing the chain to 177. An additional 25 to 30 units are planned for this year.

	Average Annual Restaurant Sales Per Unit	
	Amount (Thousands)	Percent increase from prior year
Burger King:		
Company-operated	$1,086	4
Franchised	996	7
Total domestic	1,009	7
International	879	0
Total system	999	6
Steak and Ale	1,518	2
Bennigan's	2,206	(5)

S&A is developing two new concepts to address the varied tastes and changing needs of the dining-out public not currently served by Pillsbury's existing restaurants. J.J. Muggs, a casual-dining concept, is targeting an audience that wants high quality, moderately priced foods served quickly in a friendly atmosphere. J.J. Muggs offers a 35-item menu of soups, salads, gourmet hamburgers and favorite American dishes such as chicken and steak. As in other S&A restaurants, it also features table service and full beverage service. During Fiscal 1985, J.J. Muggs grew from five to 17 units averaging $1.3 million in annualized sales.

A second dinnerhouse concept, Bay Street, was introduced in Fiscal 1985 featuring a changing fresh seafood menu. Two restaurants are currently in operation in the Dallas area and four more are planned for this year.

S&A Restaurant Corp

Chairman and Chief Executive Officer
J. Michael Jenkins

President and Chief Operating Officer
Kyle T. Craig

Executive Vice President
Marvin T. Braddock

Senior Vice Presidents
Allen G. Anz
Richard B. Berman
Terry W. Bowmaster
John G. Cook
Michael T. Donovan
Jeffry J. Shearer
Roger F. Thomson

Vice Presidents
Scott W. Burcham
F. Lane Cardwell
Levy H. Curry
Dennis L. Hood
Donald J. Slater
George Van Derven

Controller
Vanda M. Davey

Treasurer
David F. Smith


Dear Sara & Adam,
I'll be home at
5:00. Here's a
treat.
Love, Mom

Citizenship and Community Involvement

Pillsbury is active in the communities where its employees live and work. Charitable contributions by the Company and The Pillsbury Company Foundation were increased significantly during Fiscal 1985. Cash grants of $6 million exceeded those of the prior year by $1.5 million and were supplemented by donations of more than two million pounds of Pillsbury products.

As one of the world's leading food companies and the nation's second largest employer of young people, Pillsbury is focusing its charitable efforts on the needs of hunger and youth. At the same time, Pillsbury sees an important role for employee volunteerism, product donations and in-kind contributions as a way to extend its dollar contributions to help meet community needs.

During Fiscal 1985, Pillsbury:

Served as catalyst in creating programs to help children who are home alone after school because of working parents. The Company sponsored a "Latchkey Resource Fair" in Minneapolis to advise parents of the numerous agencies serving such children. A national survey was commissioned to determine what parents believe their unattended children need in after-school activities, and support was given for a telephone hot line to help "latchkey" children worried about everything from minor spills to intruders.

Through the Burger King Corporation, gave $718,000 to fund higher education grants for employees, support curriculum development in Washington D.C., and begin an annual recognition and professional development conference for outstanding teachers and principals. Burger King also gave $50,000 toward construction of the James W. McLamore Children's Center for abused and neglected children in Miami.

Donated more than two million pounds of Pillsbury food products to Second Harvest, the nation-wide food surplus network, the Minnesota Food Bank and to unemployed families on northeastern Minnesota's Iron Range.

Matched $815,000 in employee contributions to United Way organizations in more than 50 communities and 377 gifts by employees and directors to colleges and universities.

Supported numerous cultural organizations, including The Minnesota Orchestra, The Children's Theater, The Saint Paul Chamber Orchestra, The Minneapolis Society of Fine Arts, the Guthrie Theater and the Walker Art Center.

Human Resources

Pillsbury is committed to the principle that people make the difference. Accordingly, leadership, affirmative action, industrial relations and programs aimed at employee development, morale and fitness received considerable emphasis.

Fiscal 1985 was a year of transition in the leadership of the Company and its key operating units. Management is proud of the fact that its succession planning is effective and that its internal development efforts have produced talented people to fill senior-level positions.

Steps were taken to ensure open and timely communications at all levels, including attitude surveys that assessed feelings about the Company. Follow-up discussions with management included recommendations for further action. To give employees further opportunity to develop their potential, a new learning and health center was opened at Pillsbury's World Headquarters Building.

Renewed efforts were made to improve the Company's performance in meeting affirmative action goals in communication, recruitment, retention and development. The Company continued its successful Motivation and Performance Seminar, helping minority employees develop their potential, and helped launch "Project Destiny" to prepare young minorities in Minneapolis for employment. Aggressive efforts are continuing to increase the percentage of minorities in all levels of management as well as purchases from minority vendors. Burger King's commitment to equal opportunity has resulted in achieving a 36 percent minority employment level in the United States, compared with 26 percent two years ago, when its current program began.

Pillsbury's philosophy of consistency and fair treatment in industrial relations resulted in a continuation of cooperative efforts between employees, management and union leadership during Fiscal 1985 as 19 contract settlements were made in the U.S. and Canada without a work stoppage.

Pillsbury Leadership Awards

Four outstanding employees were recognized during 1985 for their extraordinary achievement of excellence. Recipients of the second annual Pillsbury Leadership Awards were:

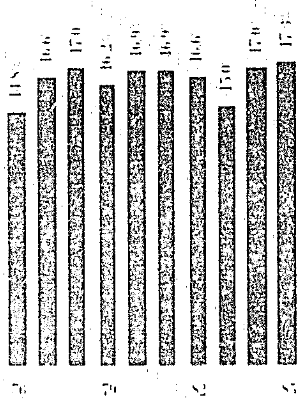
Dick I. Chung, Director of Asia-Pacific operations in Hong Kong, who created a financing plan for mushroom production in the Orient that will save working capital, improve profits and increase return on invested capital.

Jay O. Darling, President of Burger King U.S.A., whose successful leadership resulted in the new Whopper and a new restaurant design.

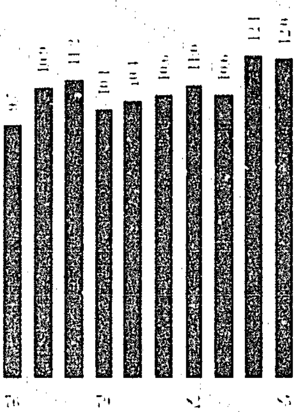
Rose Totino, Vice President of U.S. Foods, who has provided a decade of leadership. Since Pillsbury's acquisition of Totino's Finer Foods, the Company has become number one in frozen pizza sales in the U.S.

Virginia L. Ward, Vice President of Human Resources for U.S. Foods, who guided the development of the Company's "Mission and Values" statement which articulates Pillsbury's commitment to excellence.

Return On Equity
(Goal 18%)



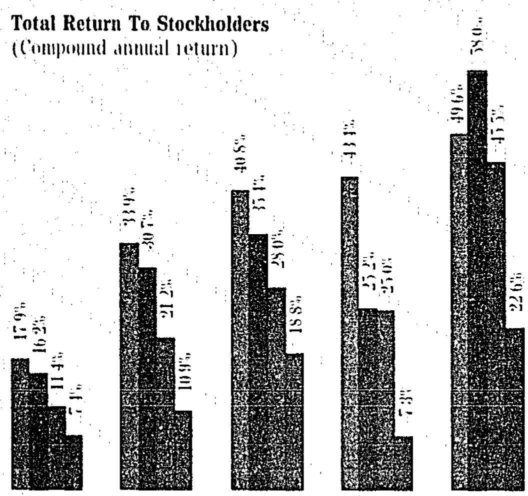
Return On Invested Capital
(Goal 13%)



Pillsbury's financial goals are based on measures of superior competitive performance and are used by management as guidelines for the development of business plans and the evaluation of performance over time. The primary goal is to increase the value of stockholders' investment in The Pillsbury Company in a manner consistent with responsible business practices and prudent investment risks. This includes achieving a predictable, steady growth in earnings and dividends through the ongoing development of quality reinvestment opportunities. Management strives to perform consistently in the upper third of competitor companies in terms of total return to stockholders.

In Fiscal 1985, dividends and capital appreciation provided stockholders with a total return of nearly 50 percent. The graph below also shows the total return to stockholders for periods of two, three, five and 10 years. Pillsbury's annual compound return was 34 percent over the past five years, assuming dividends were reinvested in Pillsbury stock. The Company's performance has consistently exceeded the compound returns that could have been realized from an investment in the equity market as a whole or in any of the composite indices for competitor companies reported by Standard & Poor's (S&P).

Total Return To Stockholders
(Compound annual return)



Stock held on May 31, 1985 for periods of:
10 years 5 years 3 years 2 years 1 year

■ Pillsbury ■ S&P Restaurants ■ S&P Foods ■ S&P 400

To achieve its goals and maintain its growth, management has developed the following set of financial objectives:

- Achieve an 18 percent return on stockholders' equity.
- Earn a 13 percent after tax return on invested capital.
- Maintain a consistent 12-to-15 percent growth in earnings per share.
- Retain a strong "A" credit rating on senior debt and maintain a long-term debt-to-capitalization ratio of 40 percent or less.

The rationale for these goals and Pillsbury's performance against them are discussed below.

18 Percent Return on Equity

Return on equity (ROE) relates net earnings to average stockholders' equity during the year. This is a key measure of management's ability to effectively utilize the stockholders' investment in the Company. In order to be recognized as a premier performer within the food and restaurant industries, Pillsbury has established an ROE objective of 18 percent.

Stockholders' equity in the Company has more than tripled over the past 10 years, and increased 11 percent during Fiscal 1985 to $1.17 billion. Returns on that investment have been improving for several years, and in Fiscal 1985, ROE reached 17.3 percent, the highest in the Company's history.

13 Percent Return on Invested Capital

Return on Invested Capital (ROIC) is the ratio of net earnings before interest expense on long-term debt to average invested capital. Invested capital is the permanent capital invested in the business and is equal to total assets less current liabilities. Thus, ROIC measures the total earning power of the Company's assets, while ROE indicates the extent to which leverage is being employed to benefit the stockholders. Consistent with Pillsbury's debt capacity, a 13 percent ROIC (25 percent pretax) is required to meet management's ROE objective. Over the past 10 years, ROIC has improved from the 9-to-10 percent range to 12 percent.

12-to-15 Percent Growth in Earnings Per Share

Management's ROE and ROIC objectives are dependent on achieving over time a 12-to-15 percent annual increase in earnings per share from operations. Unusual items can significantly add to or subtract from total earnings in any one year, but these are unpredictable and are not included in management's earnings objective. Adjusted for inflation, a 6-to-10 percent real growth in earnings is sought. Over the past 10 years, Pillsbury has achieved a 13 percent compound annual growth in earnings per share (five percent after inflation). Last year, Pillsbury's earnings increased nine percent before unusual items (five percent after inflation) in an extremely competitive environment.

Strong "A" Credit Rating on Senior Debt

A key aspect of Pillsbury's financing strategy is the ability to maintain adequate financial flexibility to take advantage of investment opportunities as they arise. Pillsbury's financing flexibility is primarily a function of having adequate cash flow and a strong "A" credit rating on senior debt, which allows timely access to the debt markets at favorable interest rates. This implies that long-term debt, excluding the current portion, not exceed 40 percent of total capitalization.

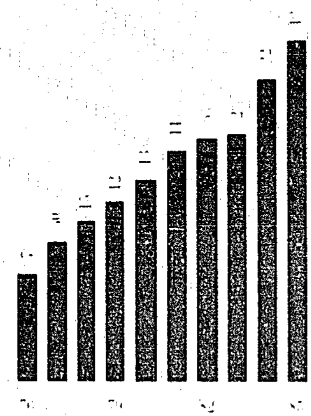
Pillsbury's long-term debt-to-capitalization ratio declined steadily from 43 percent in Fiscal 1979 to 29 percent in Fiscal 1984. The ratio increased to 32 percent in Fiscal 1985 as heavy capital spending in the Restaurants segment plus a number of acquisitions generated a need for additional financing. With the completion of the Diversifoods acquisition in early Fiscal 1986, the Company's long-term debt-to-capitalization ratio will exceed 40 percent, and then decline as portions of Diversifoods' non-Burger King assets are sold.

Financial Statement Responsibility

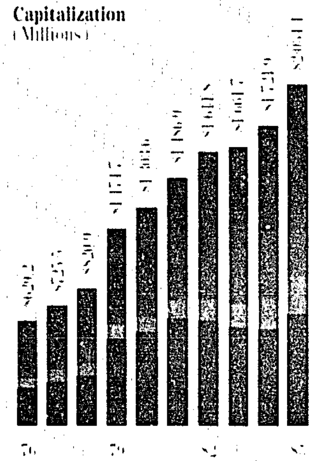
Pillsbury management is responsible for the preparation, presentation, objectivity and integrity of the financial statements and related financial information contained in this report. The financial statements have been prepared in accordance with generally accepted accounting principles and all financial information is consistent with such statements.

The Company and its subsidiaries develop and maintain internal financial control systems and procedures which provide reasonable assurance that assets are adequately safeguarded, prescribed policies are effectively pursued and transactions are properly recorded. A comprehensive program of internal audits provides management with a review and monitoring process which augments the system of internal financial controls.

Earnings Per Share
(Percent increase)



Capitalization
(Millions)



■ Long-term debt ■ Deferrals ■ Equity

The Pillsbury Company and Subsidiaries
Consolidated Statements of Earnings

	Year ended May 31		
	1985	1984	1983
	(In millions except per share amounts)		
Net sales	**$4,670.6**	$4,172.3	$3,685.9
Costs and expenses:			
Cost of sales	**3,292.7**	2,952.5	2,589.5
Selling, general and administrative expenses	**984.7**	871.9	826.8
Interest expense, net	**53.0**	44.2	39.4
	4,330.4	3,868.6	3,455.7
Earnings before taxes on income	**340.2**	303.7	230.2
Taxes on income	**148.4**	133.9	91.3
Net earnings	**$ 191.8**	$ 169.8	$ 138.9
Average number of shares outstanding	**43.4**	43.5	43.5
Net earnings per share	**$ 4.42**	$ 3.91	$ 3.20

Notes to Consolidated Financial Statements are an integral part of this statement

Discussion

Pillsbury's financial performance of record sales and earnings for 14 consecutive years has stemmed from a combined effort to expand market penetration for its products and services while containing costs.

Net sales in Fiscal 1985 were nearly $500 million greater than in Fiscal 1984 and $1 billion higher than in Fiscal 1983. Last year's 12 percent increase compares with a compound annual growth rate of 13 percent over the past 10 years.

In 1985's low inflationary economy, only one percent of the year's sales was attributable to higher prices compared with a three percent price increase in Fiscal 1984. Over the past 10 years, when inflation was more of a factor, price increases accounted for less than one-third of the overall increase in sales. Higher unit volume in Consumer Foods and expansion in Restaurants have been the dominant forces in the Company's sales growth. Both internal development and acquisitions have been important in driving sales momentum.

Continued efforts to improve operating efficiency have been vital to Pillsbury's earnings growth. In Fiscal 1985, the cost of sales increased less than the increase in sales and as a result, the Company's gross profit margin improved slightly to 29.5 percent of sales from 29.2 percent a year earlier. Pillsbury's gross margin has remained remarkably stable, ranging between 27.7 and 29.7 percent of sales during the past 10 years despite wide fluctuations in the economy and inflation rates.

Selling, general and administrative expenses include the cost of advertising and promotion, research and development and corporate overhead. Advertising and promotion expenses have been the most significant of these costs in recent years, increasing 21 percent in Fiscal 1985 to $474 million as the Company responded to greater competition within Consumer Foods by increasing its support of brand franchises and promoting new product introductions. Advertising and promotion expense had increased only three percent during Fiscal 1984.

Net interest expense rose 20 percent during Fiscal 1985 as Pillsbury drew down its cash portfolio and increased borrowings to finance acquisitions and the growth in Restaurants.

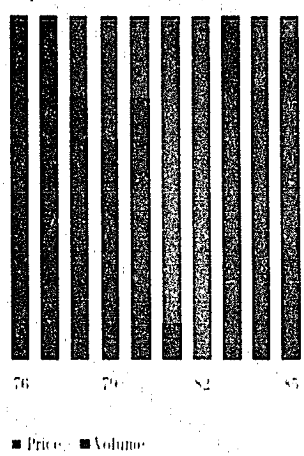
Taxes on income rose 11 percent during Fiscal 1985. The Company's effective tax rate declined slightly to 43.6 percent from 44.1 percent. Over the past five years, Pillsbury's combined federal, state and foreign income taxes have ranged between 40 and 45 percent of pretax earnings.

Net earnings increased 13 percent during Fiscal 1985 and 22 percent during Fiscal 1984. Net earnings have totaled $500 million over the past three years and, over the past 10 years, have grown at a compound annual rate of 17 percent. To put this growth into perspective, the $53 million increase in net earnings between Fiscal 1983 and Fiscal 1985 exceeds Pillsbury's total earnings in Fiscal 1976.

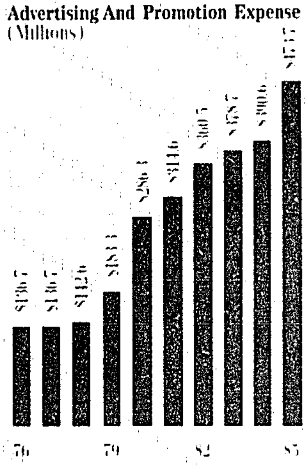
Unusual items have benefited net earnings in each of the past three years ($16.9 million in Fiscal 1985, $9.2 million in Fiscal 1984 and $7.9 million in Fiscal 1983), accounting for approximately seven percent of total earnings over the period. The most significant item was a gain from the sale of the American Beauty pasta division in Fiscal 1985. Asset management, tax planning and provisions to recognize permanent changes in the Company's operating environment are important aspects of management's efforts to build stockholder value.

During the year, the Company purchased 600,000 shares of its common stock to cover requirements associated with employee benefit plans.

Net Sales Analysis
(Percent of annual change due to price and volume)



Advertising And Promotion Expense
(Millions)



The Pillsbury Company and Subsidiaries

Consolidated Balance Sheets

	May 31 1985	May 31 1984
	(In millions)	
Assets		
Current assets:		
Cash and equivalents	$ 59.7	$ 142.5
Receivables, less allowances of $10.6 million and $11.5 million, respectively	383.5	355.8
Inventories	432.8	440.2
Advances on purchases	18.7	107.7
Prepaid expenses	26.8	25.6
Total current assets	921.5	1,071.8
Property, plant and equipment	1,403.0	1,193.0
Net investment in direct financing leases	189.3	184.0
Intangibles	163.2	83.2
Investments and other assets	101.5	76.3
	$2,778.5	$2,608.3
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable	$ 11.3	$ 17.3
Current portion of long-term debt	40.8	94.3
Trade accounts payable	347.2	369.2
Advances on sales	34.4	136.0
Employee compensation	76.1	83.8
Taxes on income	28.4	16.5
Other liabilities	205.9	169.3
Total current liabilities	744.1	886.4
Long-term debt, noncurrent portion	647.7	503.1
Deferred taxes on income	192.4	149.3
Other deferrals	28.9	23.3
Stockholders' equity:		
Preferred stock, without par value, authorized 500,000 shares, no shares issued		
Common stock, without par value, authorized 80,000,000 shares, issued 43,991,279 shares and 43,516,019 shares, respectively	324.9	306.2
Common stock in treasury at cost, 610,874 shares and 322,785 shares, respectively	(23.3)	(11.7)
Accumulated earnings	916.5	792.4
Accumulated foreign currency translation	(52.7)	(40.7)
Total stockholders' equity	1,165.4	1,046.2
	$2,778.5	$2,608.3

Notes to Consolidated Financial Statements are an integral part of this statement.

Discussion

In managing for growth, Pillsbury has achieved a compound annual increase of 16 percent in stockholders' equity and 14 percent in invested capital over the past 10 years through the effective utilization of existing assets and the reinvestment of earnings in businesses with above average profit potential.

Management strives to increase returns from the Company's productive assets, such as property, plant and equipment (PP&E), while keeping current, or liquid assets, such as cash, inventories and receivables, at the minimum level necessary to operate the business efficiently. The Company also capitalizes intangibles, such as the goodwill associated with the strong brand franchises of acquired companies, which are expected to continue to produce earnings growth.

During Fiscal 1985, asset turnover (sales in relation to total assets), a measure of effective asset utilization, reached a 10-year high of 1.7, up from 1.6 in Fiscal 1984 and an average of 1.5 since Fiscal 1976. PP&E increased 18 percent during Fiscal 1985 and intangibles doubled, largely as a result of the Van de Kamp's acquisition, while current assets were reduced by 14 percent. Despite rapid growth, Pillsbury has been able to operate with the same level of current assets as five years ago and the same level of working capital (current assets less current liabilities) as 10 years ago. This reflects the shift in the Company's business mix from Commodity Marketing, which requires high levels of working capital, to Restaurants, which have low inventories and receivables.

The major changes in working capital during the year included an $83 million reduction in cash and marketable securities and a $60 million reduction in notes payable and current portion of long term debt. Large, but substantially offsetting, reductions in advances on purchases and advances on sales reflected the reduced scale of the Company's grain merchandising activities. Receivables, which primarily relate to the Consumer Foods business, are considered excellent from the perspective of credit worthiness, delinquency amounts and days outstanding.

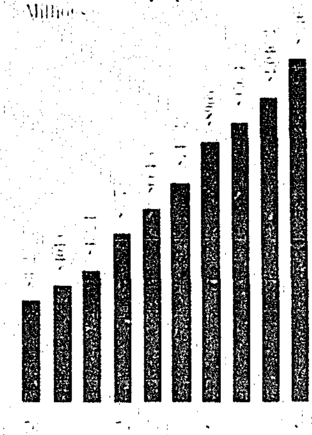
Pillsbury's balance sheet is characterized by strength and flexibility. A current ratio (current assets to current liabilities) of 1.2-to-1, while lower than in prior years, is adequate to meet the Company's liquidity needs and ensure a strong credit rating, particularly when coupled with improving interest and fixed charge coverage ratios. The latter ratio relates pretax earnings to interest costs and rent requirements.

Pillsbury's financing strategy is designed to minimize borrowing costs while maintaining flexibility to meet the growth requirements of its businesses. Fundamental to that strategy, the Company seeks to:

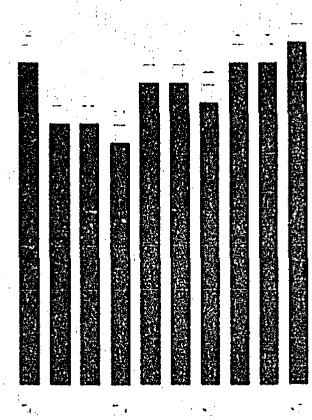
- Finance investments with long-term debt or equity, while utilizing the commercial paper markets to meet short-term and seasonal fluctuations in working capital requirements. During the year, average short-term notes and commercial paper outstanding increased $39 million to $177 million with an average interest cost of 10.8 percent, up from 9.5 percent in Fiscal 1984. The use of short-term financing doubled between Fiscal 1983 and Fiscal 1985.
- Borrow only when needed. $219 million in long-term debt was issued during the year, primarily consisting of $100 million in November to finance the Van de Kamp's acquisition and $100 million in April to finance capital expenditures and other general corporate requirements.
- Maintain timing flexibility to take advantage of opportunities in interest rates. The average interest rate on long-term debt issued in Fiscal 1985 was approximately 12 percent.
- Stagger maturities so that there are no unduly large refinancing requirements in any single future year. Maturities over the next five years average $36 million per year.

During the past two years, the Company restructured its long-term debt in order to implement a consolidated financing strategy. Prior to Fiscal 1984, Restaurant subsidiaries were financed on a separate credit basis to facilitate the heavy funding requirements needed to meet their growth projections. Pillsbury has moved to consolidate its financing in order to take advantage of its lower overall borrowing rates. As part of the restructuring, the Company provided for the early redemption during Fiscal 1985 of older debentures containing unduly restrictive covenants.

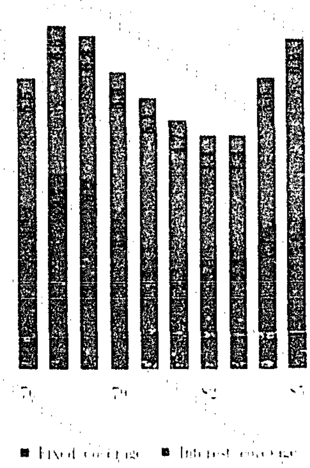
Stockholders' Equity



Asset Turnover



Coverage Ratios



The Pillsbury Company and Subsidiaries
Consolidated Statements of Changes in Financial Position

	Year ended May 31		
	1985	1984	1983
		(In millions)	
Funds provided from operations:			
Net earnings	**$191.8**	$169.8	$138.9
Charges to income not requiring working capital:			
Depreciation	**133.9**	114.6	105.5
Amortization of intangibles	**8.8**	6.2	3.3
Deferred taxes on income	**26.1**	21.9	(4.3)
	360.6	312.5	243.4
Funds from (used for) changes in working capital employed:			
(Increase) decrease in receivables	**(27.7)**	(5.2)	22.9
(Increase) decrease in inventories	**7.4**	(49.5)	(1.0)
(Increase) decrease in other current assets	**87.8**	17.4	39.5
Increase (decrease) in trade accounts payable	**(22.0)**	89.6	(18.5)
Increase (decrease) in advances on sales	**(101.6)**	(.7)	(51.3)
Increase (decrease) in taxes on income	**11.9**	(4.3)	(30.6)
Increase (decrease) in other current liabilities	**28.9**	28.6	16.5
	(15.3)	75.9	(22.5)
Funds from conversion of noncurrent assets:			
Disposals of property, plant and equipment	**33.1**	30.9	66.5
Proceeds from sale of notes with recourse	**22.3**	33.7	
Other proceeds from investments and other assets	**21.9**	22.2	25.4
Other, net	**11.5**	4.5	16.6
	88.8	91.3	108.5
Total funds generated internally	**434.1**	479.7	329.4
Funds utilized for investment activities:			
Capital expenditures	**(327.1)**	(282.4)	(243.9)
Additions to other noncurrent assets	**(78.0)**	(50.7)	(36.0)
Noncurrent assets of acquired companies:			
Property, plant and equipment	**(67.6)**	(23.9)	
Intangibles	**(86.6)**	(61.0)	
	(559.3)	(418.0)	(279.9)
Net funds generated (used) before financing activities	**(125.2)**	61.7	49.5
Funds from (used for) financing activities:			
Issuance of long-term debt	**219.3**	54.2	30.2
Long-term debt of acquired companies	**5.2**	3.6	
Retirement of long-term debt	**(132.5)**	(65.1)	(73.7)
Increase (decrease) in notes payable	**(6.0)**	6.8	(9.6)
Investment in tax lease			(24.7)
Income tax benefits from tax lease	**17.0**	19.0	33.6
Issuance (purchase) of common stock, net	**5.2**	(8.4)	(2.8)
Cash dividends	**(65.8)**	(58.9)	(52.5)
	42.4	(48.8)	(99.5)
Increase (decrease) in cash and equivalents	**$(82.8)**	$ 12.9	$(50.0)

Notes to Consolidated Financial Statements are an integral part of this statement.

Discussion

Pillsbury's unique business portfolio, with almost equal balance in Consumer Foods and Restaurants, provides both a high level of internal cash generation and superior reinvestment opportunities. Funds generated internally have totaled $1.25 billion over the past three years, providing reinvestment capital equal to two-and-a-half times reported net earnings.

Funds from operations continue to be the primary source of the Company's financial strength. Operating cash flow increased 15 percent in Fiscal 1985 following a 28 percent increase in Fiscal 1984 as higher net earnings were supplemented by increased depreciation and amortization on the Company's expanded asset base.

Prudent asset management and the conversion of noncurrent assets are key aspects of Pillsbury's financial strategy. The sale or disposal of inefficient or unneeded assets has been an important source of cash flow over the years. The sale of the American Beauty pasta division was the primary asset conversion in Fiscal 1985, while Poppin Fresh Pies, a restaurant subsidiary, was sold in Fiscal 1983.

Funds utilized for investment activities, primarily capital expenditures and acquisitions, are vital to the Company's growth and are its principal use of funds. New capital projects and acquisitions are carefully screened to ensure that their projected cash flows generate a return which exceeds the Company's cost of capital and enhances its overall return on invested capital.

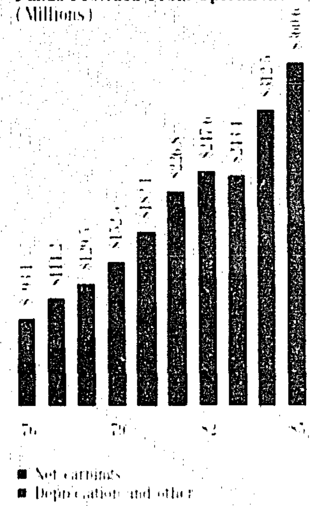
Capital expenditures have been concentrated in the Restaurants Group over the past several years as both Burger King and S&A have substantially expanded their operations. During Fiscal 1985, capital expenditures were 16 percent higher than in Fiscal 1984 and nearly 35 percent higher than the Company's average spending level over the past five years.

Acquisitions required $154 million during the year as Van de Kamp's and California Milling were added to the U.S. Foods Group, and International Foods expanded its base with nine acquisitions or joint ventures. In Fiscal 1984, the Company invested $85 million in acquired companies, principally Häagen-Dazs.

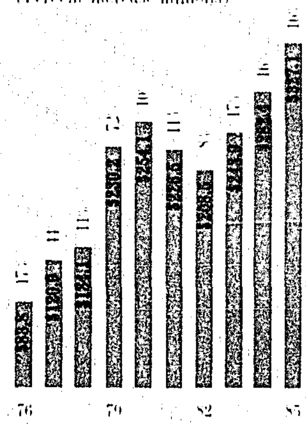
Financing activity centers around the issuance and retirement of debt and payment of dividends. Dividends have been increased in each of the past 27 years as Pillsbury has sought to balance the expectations of its stockholders with the Company's cash requirements for reinvestment and growth. Pillsbury has paid out approximately 33 percent of its earnings in dividends over the past 10 years.

Although cash was reduced at year-end, Pillsbury had approximately $650 million in various bank credit lines as well as access to debt markets. Management believes that these sources plus its strong internally generated cash flow will be sufficient to meet projected internal investment requirements of approximately $400 million in Fiscal 1986 plus the acquisition of Diversifoods Inc. Pillsbury has an "A" credit rating on its senior debt and an "A1/P1" rating on its commercial paper.

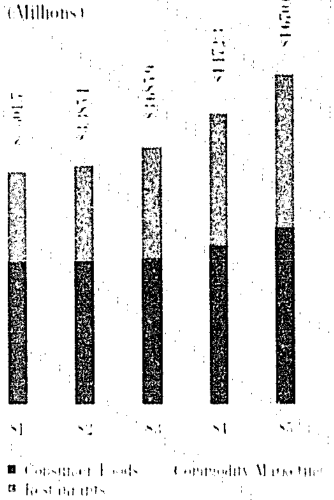
Funds Provided From Operations
(Millions)



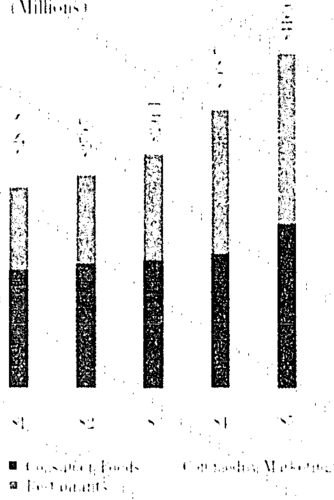
Capital Expenditures
(Percent increase-millions)



Net Sales
(Millions)



Operating Profit
(Millions)



Pillsbury is a diversified international food company operating in the Consumer Foods, Restaurants and Commodity Marketing segments of the industry. Management's strategy is centered around a commitment to remain in the food industry, to maintain a reasonable balance between Consumer Foods and Restaurants without artificially constraining the growth of either, and to de-emphasize Commodity Marketing.

The Company's performance in recent years has been led by Restaurants where sales have doubled over the past five years and profits doubled over the past four years. In Fiscal 1985, Restaurants accounted for 44 percent of sales, 47 percent of identifiable assets and 53 percent of operating profit.

The following summarizes the contribution of each segment to the Company's performance:

Net Sales

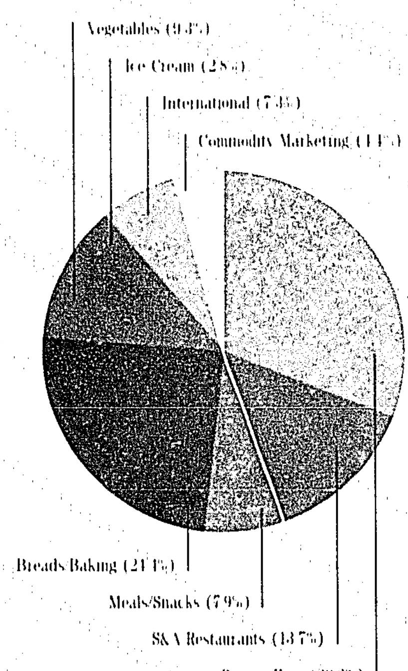
Net Sales of $4.67 billion in Fiscal 1985 were 12 percent greater than in Fiscal 1984 and 27 percent greater than in Fiscal 1983. Restaurant sales over the two years increased by nearly $560 million, or 37 percent, while Consumer Foods added more than $420 million for an increase of 21 percent. Commodity Marketing accounted for only four percent of Fiscal 1985 sales, compared with six percent in each of the prior two years.

Within Restaurants, Burger King's Fiscal 1985 net sales of $1.41 billion accounted for more than two-thirds of the segment total and 30 percent of Pillsbury's entire sales. Burger King's 18 percent increase in sales last year came on top of a 20 percent increase in Fiscal 1984. This growth is attributable to the net addition of nearly 725 restaurants over the past two years as well as an increase in average sales per domestic unit of $170,000, or 20 percent.

Sales for S&A Restaurant Corp rose 15 percent during Fiscal 1985 and 44 percent over the past two years in response to unit expansion, particularly within the Bennigan's concept. While declining liquor sales have contributed to a seven percent drop in average unit sales at Bennigan's since Fiscal 1983, good sales momentum continued at Steak and Ale.

Approximately three-fourths of the sales growth within the Consumer Foods segment over the past two years is attributable to acquisitions, primarily Van de Kamp's in Fiscal 1985 and Häagen-Dazs in Fiscal 1984. Within the United States, new products, such as Microwave Pizza, and strong sales in refrigerated dough products and canned and frozen vegetables more than offset declining sales in family flour and dessert mixes. Internationally, a 26 percent sales increase in Canada last year more than offset declines in Latin America.

The Pillsbury Company
Fiscal 1985 Net Sales



Operating Profit

Operating profit of $417 million in Fiscal 1985 represented a 13 percent increase from Fiscal 1984 and a 43 percent increase from Fiscal 1983. Restaurants contributed two-thirds of the increase, generating $85 million more in operating profit in Fiscal 1985 than in Fiscal 1983.

Burger King's contribution to operating profit increased 23 percent during Fiscal 1985, compared with a 60 percent increase during Fiscal 1984. Favorable franchise activity including higher royalty payments and refranchising benefited Fiscal 1985. The profit contribution from company-operated stores declined to 15.2 percent of sales from 16.7 percent a year earlier as additional managers were hired to improve service and quality. S&A's operating profit, which rose 16 percent during Fiscal 1984, increased at half that rate during Fiscal 1985 as concept development costs at J.J. Muggs and reduced liquor sales held down earnings.

Consumer Foods increased operating profit $46 million between Fiscal 1983 and 1985, representing a gain of 28 percent. However, nearly $35 million of Fiscal 1985's profit related to unusual items, primarily the sale of the American Beauty pasta division. Without this gain, the two-year increase was seven percent. A 25 percent increase in advertising and promotion expense during Fiscal 1985 and the costly introduction of several new products adversely affected performance, particularly in the Breads and Baking Products and Meals and Snacks categories.

Commodity Marketing had a small profit in Fiscal 1984, but had losses in both Fiscal 1985 and 1983 reflecting the deteriorating condition of the export grain market. Last year's loss was magnified by a $10.7 million provision to recognize the permanent impairment of the barge transportation business.

General Corporate Expense, Net

General corporate expense increased $2.6 million, or 12 percent, during Fiscal 1985. Fiscal 1984 included nearly $12 million in nonrecurring gains from the sale of an investment in Stokely-Van Camp common stock and an exchange of cash and common stock for certain debt. Equity in net profits of unconsolidated affiliates was $2.4 million in Fiscal 1985, compared with losses of $3.7 million and $2.4 million in the prior two years, principally from Midwest Processing Company. Other corporate costs were reduced by 15 percent during Fiscal 1985.

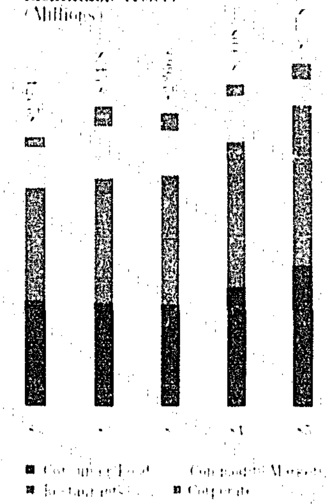
Capital Expenditures

Capital expenditures rose 16 percent in each of the past two years, with Restaurants requiring an increasingly large proportion of each year's total funding. More than $600 million, or 70 percent of total capital expenditures, have been invested in the expansion of the Restaurants business since the beginning of Fiscal 1983.

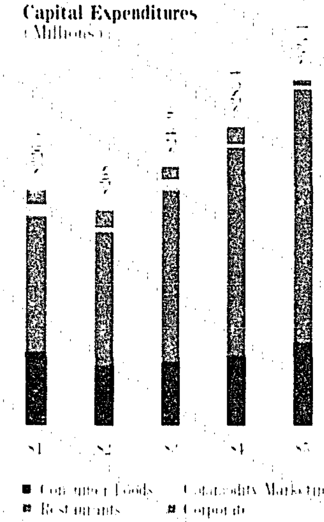
During Fiscal 1985, Burger King invested $158 million, including funds to build 74 company-operated stores, finance the construction of 42 additional units for franchisees and carry-out a major company-operated store remodeling program. S&A invested $82 million to construct 47 new restaurants and remodel others.

The largest single project in the Consumer Foods segment last year was the construction of a second manufacturing plant for Häagen-Dazs ice cream. Improvements were also made to the Company's pizza, canned and frozen vegetables and industrial foods facilities.

Identifiable Assets
(Millions)



Capital Expenditures
(Millions)



During Fiscal 1985, the Company realigned its operations resulting in the transfer of the Industrial Foods (flour milling and baking mixes) Division to Consumer Foods from the previous Agri-Products segment (now identified as Commodity Marketing). Prior year amounts have been restated to conform to the Fiscal 1985 segment presentation.

Operating profit of reportable segments is net sales less operating expenses. Operating expenses include gain or loss on disposal of, or provision for writedown of, identifiable assets as well as all other expenses related to segment operations. General corporate expense includes unallocated corporate items and equity in net earnings (losses) of unconsolidated affiliates.

Summary by Industry Segment

	Year ended May 31		
	1985	1984	1983
		(In millions)	
Net sales:			
Consumer Foods	**$2,409.9**	$2,165.7	$1,987.8
Restaurants	**2,053.3**	1,768.7	1,494.6
Commodity Marketing	**207.4**	237.9	203.5
Total	**4,670.6**	4,172.3	3,685.9
Operating profit:			
Consumer Foods	**211.5**	173.5	165.3
Restaurants	**220.0**	187.4	135.3
Commodity Marketing	**(14.9)**	7.8	(9.5)
Total	**416.6**	368.7	291.1
General corporate expense, net	**(23.4)**	(20.8)	(21.5)
Interest expense, net	**(53.0)**	(44.2)	(39.4)
Earnings before taxes on income	**340.2**	303.7	230.2
Identifiable assets:			
Consumer Foods	**1,122.6**	957.4	843.6
Restaurants	**1,316.1**	1,191.2	1,025.7
Commodity Marketing	**223.2**	377.1	367.9
Corporate	**116.6**	82.6	129.4
Total	**2,778.5**	2,608.3	2,366.6
Capital expenditures:			
Consumer Foods	**77.2**	67.0	59.5
Restaurants	**240.2**	197.4	164.0
Commodity Marketing	**4.5**	6.2	10.1
Corporate	**5.2**	11.8	10.3
Total	**327.1**	282.4	243.9
Depreciation expense:			
Consumer Foods	**47.5**	40.8	37.0
Restaurants	**71.7**	59.5	54.7
Commodity Marketing	**9.2**	9.5	9.6
Corporate	**5.5**	4.8	4.2
Total	**133.9**	114.6	105.5
Foreign operations included in the above categories are as follows:			
Net sales	**381.0**	355.5	360.1
Operating profit	**22.7**	16.2	18.0
Identifiable assets	**264.1**	241.8	212.8
Capital expenditures	**17.4**	20.4	16.3
Depreciation expense	**10.7**	9.7	10.3

Footnotes to Summary by Quarter on the following page are an integral part of this statement

Summary by Quarter (Unaudited)

	Net sales	Gross margin	Earnings before taxes on income	Net earnings	Per share: Net earnings	Per share: Cash dividends	Market price: High	Market price: Low	Market price: Close
			(In millions)						
Fiscal 1985:									
First quarter	$1,023.5	$ 278.8	$ 70.8	$ 38.9	$ .90	$ .35	$40⅛	$34½	$38
Second quarter(a,b)	1,256.5	387.5	113.0	66.1	1.52	.39	44⅞	36⅞	40¼
Third quarter(b)	1,171.2	344.9	68.7	39.5	.91	.39	46½	38¼	46⅛
Fourth quarter(b)	1,219.4	366.7	87.7	47.3	1.09	.39	55	44¼	54⅞
Annual	$4,670.6	$1,377.9	$340.2	$191.8	$4.42	$1.52			
Fiscal 1984:									
First quarter	$ 929.4	$ 263.5	$ 62.7	$ 34.8	$ .80	$ .31	$32	$27¼	$31¼
Second quarter(c)	1,124.5	348.7	93.8	52.1	1.20	.35	38	31⅞	37¼
Third quarter	1,035.3	298.5	66.2	36.2	.83	.35	39	34¼	35⅞
Fourth quarter(d)	1,083.1	309.1	81.0	46.7	1.08	.35	41½	33	37⅞
Annual	$4,172.3	$1,219.8	$303.7	$169.8	$3.91	$1.36			
Fiscal 1983:									
First quarter	$ 806.0	$ 221.6	$ 47.3	$ 25.6	$ .59	$ .28	$23⅛	$18½	$21⅝
Second quarter(e)	985.7	307.0	58.5	30.7	.71	.31	25⅞	20¼	25
Third quarter	903.9	272.0	54.0	29.1	.67	.31	27½	23⅜	24¼
Fourth quarter(f,g)	990.3	295.8	70.4	53.5	1.23	.31	30⅞	24¼	28⅞
Annual	$3,685.9	$1,096.4	$230.2	$138.9	$3.20	$1.21			

Earnings before taxes on income include:

(a) $38.9 million (Consumer Foods) gain from the sale of the American Beauty pasta division [$24.3 million net earnings — 56¢ per share].
$16.9 million ($10.7 million Commodity Marketing and $6.2 million Consumer Foods) provision to reflect a permanent impairment of the barge transportation business and the restructure of certain other businesses [$8.6 million net earnings—20¢ per share].

(b) Effects of a change in accounting for inventories to the LIFO method:
$2.6 million provision in the second quarter [$1.3 million net earnings—3¢ per share].
$1.2 million provision in the third quarter [$.6 million net earnings—1¢ per share].
$6.1 million gain in the fourth quarter [$3.1 million net earnings—7¢ per share].
$2.3 million ($2.2 million Consumer Foods and $.1 million Restaurants) gain in the year [$1.2 million net earnings—3¢ per share].

(c) $5.4 million (General corporate expense, net) gain from sale of an investment in Stokely-VanCamp common stock [$2.7 million net earnings—6¢ per share].

(d) $6.5 million (General corporate expense, net) gain relating to an agreement to exchange cash and common stock for certain long-term debt [$6.5 million net earnings—15¢ per share].

(e) $11.9 million (Restaurants) provision for writedown of Burger King's assets [$8.2 million net earnings—19¢ per share].

(f) $4.1 million (Restaurants) gain on sale of Burger King's office building [$4.1 million net earnings—9¢ per share].

Net earnings also include:

(g) A tax reduction of $12.0 million [28¢ per share] related to a permanent tax deferral of earnings from certain subsidiaries, of which approximately $8.2 million [19¢ per share] was applicable to the first nine months of the Fiscal year.

1. Accounting policies:

Consolidation
The consolidated financial statements include the accounts of the parent company and all of its majority-owned domestic and foreign subsidiaries after elimination of intercompany balances and transactions. The fiscal year of foreign subsidiaries generally ends April 30 to facilitate timely reporting.

Sales
Trading margins from merchandising of grain, feed ingredients and export flour, rather than total sales, are included in net sales.

Pensions
The Company and its subsidiaries have retirement plans covering substantially all salaried and full-time hourly employees. Costs and expenses include provisions for retirement benefits, interest on unfunded prior service costs and, on certain plans, amortization of prior service costs over periods of up to 30 years. The Company funds pension costs as accrued.

Taxes on income
Investment tax credits are reflected as reductions in federal income taxes in the year eligible purchases are placed in service. Federal income taxes are provided on unremitted earnings of subsidiaries which are not reinvested indefinitely.

Earnings per share
Net earnings per share are computed using the weighted average number of common shares, including common share equivalents of stock options, outstanding during each year. Net earnings per share assuming full dilution would be substantially the same.

Foreign exchange
Foreign currency balance sheets (local currencies, except in Mexico, have been determined to be functional currencies) are translated at the end-of-period exchange rates and earnings statements are translated at the average exchange rate for each period. The resulting translation gains or losses are recorded in the "Accumulated Foreign Currency Translation" caption within stockholders' equity. Because of its hyperinflationary economy, Mexican translation adjustments are recognized immediately in earnings.

Inventories
Inventories are valued at the lower of cost or market, except grain inventories which are stated on the basis of market prices at May 31, including adjustment to market of open contracts for grain purchases and sales.

During Fiscal 1985, the Company changed its method of determining cost for substantially all domestic inventories, except grain inventories, from the first-in, first-out (FIFO) method to the last-in, first-out (LIFO) method. The Company believes LIFO results in a better matching of current costs and revenues.

This accounting change increased inventories at May 31, 1985 and earnings before taxes on income in Fiscal 1985 by $2.3 million ($1.2 million net earnings—3¢ per share). The adoption of LIFO did not affect prior years' financial results because it does not change the opening inventory valuation.

Property, plant and equipment
Owned property, plant and equipment is stated at cost. Depreciation is computed using the straight-line method for financial statement purposes and accelerated methods for tax purposes. Estimated useful lives are: buildings and improvements, 3 to 40 years; machinery and equipment, 3 to 30 years.

Assets under capital leases are capitalized at the present value of future minimum lease payments and are depreciated using the straight-line method over the related lease terms as follows: buildings, 15 to 30 years; equipment, 2 to 15 years.

Intangibles
Intangible assets consist primarily of goodwill, reacquired franchise rights, trademarks and patents and are carried at purchased cost less accumulated amortization. Goodwill represents the excess of cost over the market value of identified net assets of businesses purchased. Costs are amortized evenly over their estimated useful lives or periods benefited (not in excess of 40 years).

2. Acquisitions and dispositions:
Effective November 4, 1984, the Company purchased the net assets of Van de Kamp's, a producer of frozen fish products and ethnic entrees, for $102 million in cash. The acquisition was accounted for as a purchase. Accordingly, the purchase price was allocated to the acquired assets and liabilities based upon their estimated fair market value at the date of acquisition, including $67 million of intangibles. The results of operations of Van de Kamp's (included since date of acquisition) were not material to the Fiscal 1985 consolidated statement of earnings.

In November 1984, the Company sold the identifiable assets of the American Beauty pasta division for $56 million in cash resulting in a net gain of $38.9 million ($24.3 million net earnings—56¢ per share).

Effective July 1, 1983, the Company purchased the net assets of Häagen-Dazs companies, a manufacturer, distributor and franchisor of super-premium ice cream, for $76 million in cash and notes. The acquisition was accounted for as a purchase with the purchase price allocated to the acquired assets and liabilities based upon their estimated fair market value at the date of acquisition, including $53 million of intangibles. The results of operations of Häagen-Dazs (included since date of acquisition) were not material to the consolidated statements of earnings.

In addition, during the three-year period ended May 31, 1985 the Company acquired or disposed of other businesses, none of which were material.

3. Subsequent event:

Subsequent to May 31, 1985, the Company acquired substantially all of the outstanding common stock of Diversifoods Inc. for cash. Diversifoods is a broad-based restaurant management company and the largest franchisee of Burger King restaurants.

The cost of the acquisition will approximate $390 million and will be accounted for as a purchase. Accordingly, the purchase price will be allocated to the acquired assets and liabilities based on their estimated fair market value at the date of acquisition, including approximately $165 million of intangibles. The results of operations of Diversifoods will be included in the consolidated statements of earnings from July 1, 1985. Diversifoods had net sales of $556 million and net earnings from continuing operations of $14.2 million for the twelve months ended March 31, 1985.

The following unaudited pro forma combined results of operations are adjusted for the amortization of estimated excess purchase price and interest on debt incurred in connection with the acquisition, as though the acquisition had occurred June 1, 1984.

	Year ended May 31 1985 (In millions except per share amount)
Net sales	$5,219.3
Net earnings	183.4
Net earnings per share	4.23

The pro forma financial information is not necessarily indicative either of results of operations that would have occurred had the merger been effected at June 1, 1984 or of future results of operations of the combined companies. The pro forma financial information has been prepared in accordance with Accounting Principles Board Opinion No. 16 and is based upon the hypothetical assumption that the purchase price would have been the same at the beginning of the period presented and the interest rate on money borrowed would have been the same throughout the period presented.

4. Foreign operations:

The consolidated financial statements include amounts for foreign subsidiaries (substantially all are wholly owned) as of and for the years ended May 31, as follows:

	1985	1984	1983
		(In millions)	
Net sales	**$381.0**	$355.5	$360.1
Net earnings	**19.3**	3.9	8.2
Total assets	**273.1**	251.1	220.5
Net tangible assets	**132.5**	103.0	114.0
Excess of investments over equity in net tangible assets	**11.9**	7.8	6.0

Net foreign currency transaction losses for 1985, 1984 and 1983 were not material.

5. Inventories:

The components of inventories are as follows:

	May 31 **1985**	May 31 1984
	(In millions)	
Grain	**$ 43.5**	$ 75.5
Finished products	**232.0**	214.1
Raw materials, containers and supplies	**157.3**	150.6
	$ 432.8	$ 440.2

6. Property, plant and equipment:

The components of property, plant and equipment are as follows:

	May 31 **1985**	May 31 1984
	(In millions)	
Land and improvements	**$ 236.5**	$ 199.2
Buildings and improvements	**1,026.2**	885.1
Machinery and equipment	**801.5**	692.5
	2,064.2	1,776.8
Less accumulated depreciation	**(661.2)**	(583.8)
	$1,403.0	$1,193.0

Property, plant and equipment includes assets under capital leases, as well as assets leased to restaurant franchisees under operating leases, at May 31 as follows:

	Assets under capital leases **1985**	Assets under capital leases 1984	Assets leased to restaurant franchisees **1985**	Assets leased to restaurant franchisees 1984
	(In millions)			
Land and improvements			**$ 80.8**	$ 82.5
Buildings and improvements	**$ 50.7**	$ 44.9	**48.2**	47.0
Machinery and equipment	**15.9**	18.1	**2.8**	5.1
	66.6	63.0	**131.8**	134.6
Less accumulated depreciation	**(31.4)**	(30.2)	**(27.8)**	(25.0)
	$ 35.2	$ 32.8	**$104.0**	$109.6
Depreciation expense	**$ 5.1**	$ 5.0		

7. Long-term debt:

	May 31 1985	May 31 1984
	(In millions)	
12% extendible notes due 1999	**$100.0**	
11½% notes due 1995	**100.0**	
14% notes due 1991	**50.0**	$ 50.0
5¼% sinking fund debentures due 1987		2.3
8¼% sinking fund debentures due 1996		11.2
8⅛% notes due 1999		36.7
4¼% convertible subordinated debentures due 1993	**1.2**	1.6
Zero coupon notes, $30.5 million due in 1985 (yield 10.25%) and $30.5 million in 2015 (yield 12.5%)	**1.0**	30.7
Restaurant subsidiaries' installment notes at 5.75% to 16%:		
Unsecured	**263.5**	279.3
Secured (real estate of $108.1 million pledged as collateral)	**63.3**	68.0
Other notes at 6.2% to 11% (real estate of $29.8 million pledged as collateral)	**53.1**	60.3
Capital lease obligations	**56.4**	57.3
	688.5	597.4
Less current portion	**(40.8)**	(94.3)
	$647.7	$503.1

In Fiscal 1985, the Company satisfied the requirements of the 5¼% and 8¼% sinking fund debentures through the deposit of United States Government securities into an irrevocable trust. The effect of these transactions on Fiscal 1985 net earnings was not material.

In May 1984, investment bankers exercised their option to exchange the entire $43.8 million principal amount then outstanding of the Company's 8⅛% notes due 1999 for $36.7 million plus accrued interest and expenses of the exchange. The $6.5 million gain ($6.5 million net earnings—15¢ per share) on this exchange agreement was recorded in Fiscal 1984. Upon settlement in September 1984, the Company paid one-half in cash and one-half in common stock, with 471,532 shares issued based upon the per share market value on the date of exchange.

Certain debt agreements contain restrictions relating to the payment of dividends and the purchase by the Company of its common stock. Under the most restrictive of these provisions, approximately $156 million of accumulated earnings at May 31, 1985 were not restricted.

The 4¼% convertible surbordinated debentures are convertible into one share of the Company's common stock for each $24.90 principal amount of debentures. At May 31, 1985, approximately 60,000 shares of common stock were reserved for issuance upon conversion of the debentures.

Maturities of long-term debt, excluding capital lease obligations, for the five fiscal years subsequent to May 31, 1985 are:

1986	$35.1 million
1987	45.5 million
1988	40.0 million
1989	30.6 million
1990	28.8 million

8. Financing commitments:

Notes payable at year-end consist primarily of foreign subsidiaries' bank notes. During each year, notes payable also includes borrowings by the Company through issuance of commercial paper.

Selected information on notes payable is as follows:

	1985	1984	1983
		(In millions)	
Balance at May 31:			
Amount	**$ 11.3**	$ 17.3	$ 10.5
Interest rate	**11.5%**	9.6%	11.2%
Largest month-end balance	**$370.2**	$223.6	$180.0
Weighted average balance	**177.4**	138.0	81.0
Average interest rate	**10.8%**	9.5%	10.9%

Bank lines of credit, which may be used for direct borrowing or to support commercial paper, are reviewed on an annual basis and may be withdrawn at the banks' option. Interest on borrowings is at the prevailing prime rates. At May 31, 1985, the Company had bank lines of credit of $147.0 million against which $8.4 million of foreign subsidiaries' borrowings were outstanding. The Company either pays a commitment fee of .25% on the unused portion or maintains compensating balances generating an earnings equivalent. Compensating balances are not legally restricted.

In addition, the Company has a $500 million, four-year revolving credit agreement with several banks. No borrowings were outstanding at May 31, 1985. Interest on borrowings is at the prevailing prime rate or other similar rates. The Company pays a commitment fee of .25% on the unused portion.

9. Interest expense, net:

	Year ended May 31		
	1985	1984	1983
	(In millions)		
Interest expense on:			
Long-term obligations	**$ 62.3**	$ 63.0	$ 63.4
Capital lease obligations	**5.9**	6.2	6.7
Short-term obligations	**24.0**	16.6	12.1
Capitalized interest	**(2.4)**	(2.3)	(1.9)
Interest income	**(14.3)**	(18.4)	(21.1)
Amortization of unearned income on direct financing leases	**(22.5)**	(20.9)	(19.8)
	$ 53.0	$ 44.2	$ 39.4

10. Commitments as lessee:

Capital leases cover restaurant buildings and transportation, computer and manufacturing equipment.

Operating leases cover land; manufacturing, warehousing and administrative facilities; grain handling and storage facilities; and manufacturing and transportation equipment.

Minimum future obligations on leases with an initial term greater than one year for the fiscal years ending May 31	Capital leases	Operating leases (a)
	(In millions)	
1986	$ 11.6	$ 53.4
1987	10.3	48.7
1988	9.0	44.7
1989	8.3	43.1
1990	7.8	37.5
Later	52.8	418.7
Total minimum obligations (b)	99.8	646.1
Executory costs	(1.0)	(6.3)
Net minimum obligations	98.8	$639.8(c)
Amount representing interest	(42.4)	
Present value of net minimum obligations	$ 56.4	
Current portion	$ 5.7	

(a) Does not include obligations under term freight agreements for 1,920 barge loads in Fiscal 1986, decreasing to 1,360 in Fiscal 1989 and ending in Fiscal 1991.
(b) Minimum lease obligations have not been reduced by minimum sublease rentals. In addition to minimum obligations, contingent rentals may be paid under certain restaurant and grain facility leases on the basis of percentage of sales and volume, respectively.
(c) The present value of the net minimum future obligations under operating leases, calculated using the Company's incremental borrowing rate at the inception of the leases, is $290.6 million.

Rental expense	Year ended May 31		
	1985	*1984*	*1983*
	(In millions)		
Minimum rental expense (a)	**$89.0**	$82.9	$88.6
Contingent rental expense	**9.1**	8.1	6.0
Transportation equipment sublease income	**(6.7)**	(7.9)	(7.5)
	$91.4	$83.1	$87.1

(a) Includes rentals under leases with terms of one year or less. Payments under term freight agreements of $21.3 million, $26.1 million and $21.0 million for Fiscal 1985, 1984 and 1983 respectively, are not included.

11. Investments as lessor:

Restaurant subsidiaries lease restaurant buildings and land to franchisees. The building portions of the leases are direct financing leases while the land portions are operating leases. Substantially all leases are for 15 to 20 years, provide for minimum and contingent rentals, and require the franchisee to pay executory costs.

Minimum future lease payments to be received during the fiscal years ending May 31	Direct financing leases	Operating leases
	(In millions)	
1986	$ 27.5	$ 23.8
1987	27.9	23.9
1988	28.3	23.7
1989	28.8	23.5
1990	28.8	23.5
Later	279.6	237.2
	$420.9	$355.6

Net investment in direct financing leases at May 31	**1985**	1984
	(In millions)	
Minimum lease payments receivable	**$420.9**	$414.7
Allowance for uncollectables	**(4.0)**	(3.9)
Estimated unguaranteed residual value	**3.8**	4.0
Unearned amount representing interest	**(226.9)**	(226.1)
Net investment	**193.8**	188.7
Current portion included in receivables	**(4.5)**	(4.7)
Net investment in direct financing leases	**$189.3**	$184.0

Rental income	Year ended May 31		
	1985	1984	1983
	(In millions)		
Minimum rental income	**$26.6**	$23.9	$21.5
Contingent rental income (a)	**32.8**	27.9	20.2
	$59.4	$51.8	$41.7

(a) Includes contingent rentals on both owned and leased property under direct financing and operating leases.

12. Taxes on income:

	Year ended May 31		
	1985	1984	1983
		(In millions)	
Earnings before taxes on income consists of:			
Domestic	**$318.8**	$288.1	$213.1
Foreign	**21.4**	15.6	17.1
	$340.2	$303.7	$230.2
Income tax expense consists of:			
Current:			
Federal	**$113.8**	$ 97.4	$ 82.6
Investment tax credit	**(9.0)**	(11.8)	(9.3)
	104.8	85.6	73.3
State	**16.8**	15.2	14.2
Foreign	**1.5**	9.7	8.3
	123.1	110.5	95.8
Deferred:			
Federal	**22.3**	19.4	(4.5)
State	**2.4**	2.0	(.6)
Foreign	**.6**	2.0	.6
	25.3	23.4	(4.5)
	$148.4	$133.9	$ 91.3

In Fiscal 1983, the Company entered into a tax benefit lease as a purchaser of equipment. The transaction does not affect current or deferred income tax expense. The income tax benefits related to this purchase decreased the current liability for taxes on income by $15.5 million, $17.5 million and $33.6 million and increased the deferred liability for taxes on income by $17.0 million, $19.0 million and $8.9 million in Fiscal 1985, 1984 and 1983, respectively.

Reconciliation between the expected federal tax rate and the actual effective rate is as follows:

	1985	1984	1983
Expected federal tax rate	**46.0%**	46.0%	46.0%
State income taxes, net of federal income tax benefit	**3.1**	3.1	3.2
Investment tax credit	**(2.6)**	(3.9)	(4.0)
Reversal of provision on unremitted earnings of subsidiaries deemed to be permanently reinvested		(1.6)	(5.7)
Other, net	**(2.9)**	.5	.2
	43.6%	44.1%	39.7%

Deferred taxes result from timing differences in the recognition of revenue and expense for tax and financial statement purposes. Tax effects of those differences are as follows:

	Year ended May 31		
	1985	1984	1983
		(In millions)	
Excess of tax over book depreciation	**$38.3**	$15.4	$23.3
Change in reserves not currently deductible for taxes	**(11.6)**	3.4	(7.7)
Installment sales	**(5.3)**	1.1	(.4)
Interest on zero coupon notes	**7.0**		
Earnings of Domestic International Sales Corporations		(2.5)	(17.8)
Unremitted earnings of consolidated foreign subsidiaries (a)			(2.0)
Other, net	**(3.1)**	6.0	.1
	$25.3	$23.4	$ (4.5)

(a) At May 31, 1985, federal taxes are not provided on approximately $76 million of unremitted earnings of foreign subsidiaries which management intends to reinvest indefinitely.

13. Stockholders' equity:

	Shares of common stock outstanding (In millions)	Common stock	Treasury stock	Accumulated earnings (In millions)	Accumulated foreign currency translation	Total
Balances at May 31, 1982	21.7	$282.0		$618.8	$(10.8)	$ 890.0
Net earnings				138.9		138.9
Translation adjustment					(17.2)	(17.2)
Cash dividends				(52.5)		(52.5)
Purchase of treasury stock	(.1)		$ (6.1)			(6.1)
Stock issued for:						
Conversion of subordinated debentures		1.3				1.3
Stock option and performance unit plans		.8	1.5	(.3)		2.0
Balances at May 31, 1983	21.6	284.1	(4.6)	704.9	(28.0)	956.4
Stock split effected by means of a 100% stock dividend	21.7	21.7		(21.7)		
Net earnings				169.8		169.8
Translation adjustment					(12.7)	(12.7)
Cash dividends				(58.9)		(58.9)
Purchase of treasury stock	(.6)		(19.7)			(19.7)
Stock issued for:						
Conversion of subordinated debentures		.4				.4
Stock option and performance unit plans	.5		12.6	(1.7)		10.9
Balances at May 31, 1984	43.2	306.2	(11.7)	792.4	(40.7)	1,046.2
Net earnings				191.8		191.8
Translation adjustment					(12.0)	(12.0)
Cash dividends				(65.8)		(65.8)
Purchase of treasury stock	(.6)		(22.6)			(22.6)
Stock issued for:						
Conversion of subordinated debentures and 8¾% notes	.5	18.6				18.6
Stock option and performance unit plans	.3	.1	11.0	(1.9)		9.2
Balances at May 31, 1985	43.4	$324.9	$(23.3)	$916.5	$(52.7)	$1,165.4

14. Stock options:

Stock options may currently be granted under the Company's 1982 Stock Option Plan. Under this plan, options to purchase in the aggregate 1,500,000 shares of the Company's common stock may be granted to officers and key employees. Options outstanding under this and predecessor option plans are either nonqualified or incentive stock options granted at 100% of the fair market value at date of grant and expire 10 years thereafter. Nonqualified stock options become exercisable in cumulative annual installments of 25% beginning one year after date of grant and incentive stock options become fully exercisable one year after date of grant.

	Option shares		
	Outstanding	Exercisable	Price range
Balances at May 31, 1982	938,892	399,672	$ 8-23
Granted	275,400		21-25
Becoming exercisable		187,320	16-23
Exercised	(70,486)	(70,486)	11-23
Cancelled	(149,888)	(80,788)	
Balances at May 31, 1983	993,918	435,718	8-25
Granted	265,900		29-37
Becoming exercisable		414,950	16-25
Exercised	(424,311)	(424,311)	9-22
Cancelled	(53,750)	(32,700)	
Balances at May 31, 1984	781,757	393,657	8-37
Granted	215,500		38-47
Becoming exercisable		316,450	18-35
Exercised	(256,908)	(256,908)	8-35
Cancelled	(45,050)	(31,150)	
Balance at May 31, 1985	695,299	422,049	9-47

An additional 1,050,600 shares are available for grant through Fiscal 1988. Shares of common stock reserved for options at May 31, 1985 were 1,745,899. Option shares outstanding at May 31, 1985 were granted in Fiscal 1981 and prior years (102,774); 1982 (143,100); 1983 (81,515); 1984 (156,310) and 1985 (211,600). Unexercisable option shares outstanding at May 31, 1985 become exercisable in Fiscal 1986 (257,062); 1987 (5,528); 1988 (5,327) and 1989 (5,333).

15. Compensation plans:

Certain employees of the Company participate in compensation programs which include a base salary plus incentive payments. They are in managerial, sales and other areas in which it is deemed appropriate to reward employees on the basis of individual and/or group performance. Incentive payments are calculated based upon the level of operating earnings, as defined by the executive compensation committee of the board of directors.

Additionally, under a 1981 Performance Unit Plan, officers and key employees may be awarded performance units valued at the fair market value of an equivalent number of shares of the Company's common stock at time of award. The value at time of payment cannot be greater than 200% of the award value. The Company's cumulative annual growth in earnings per share over the four-year period following the award is the basis for payment. No payments may be made if annual growth is less than 6%. Awards of 250,500 performance units were outstanding at May 31, 1985 at a weighted average award value of $28.07 each. An additional 949,500 units are available for grant through Fiscal 1988.

Eligible employees may elect, under the Company's Stock Purchase and Investment Plan or Deferred Incentive Plan, to make deposits of up to 10% of the employees' profit sharing earnings with the Company matching 50% of the deposits up to the first 4% of profit sharing earnings.

Expenses incurred under the above compensation plans (excluding base salary) were approximately $27.7 million in each of Fiscal 1985 and 1984 and $19.2 million in Fiscal 1983.

16. Retirement plans:
Noncontributory retirement plans are provided for both salaried and hourly employees of the Company and certain subsidiaries. Benefits for salaried employees are based on final average compensation, including certain incentive compensation, and years of credited service. The hourly plans include various monthly amounts for each year of credited service. All retirement plans conform with the provisions of the Employee Retirement Income Security Act of 1974.

Expenses incurred for retirement plans were $7.8 million, $13.2 million and $14.1 million in Fiscal 1985, 1984 and 1983, respectively.

The accumulated plan benefits and net assets for all retirement plans are:

	May 31	
	1985	1984
	(In millions)	
Actuarial present value of accumulated plan benefits:		
Vested	**$163.5**	$160.3
Nonvested	**18.0**	23.2
	$181.5	$183.5
Net assets available for benefits	**$298.2**	$251.1

The rate of return used in determining the actuarial present value of accumulated plan benefits was 9% in Fiscal 1985 and 8% in Fiscal 1984, except for those benefits at May 31, 1985 and 1984 which are matched to a dedicated bond portfolio yielding 15.25%. The effect of the change in the rate of return assumption was to reduce Fiscal 1985 pension expense by approximately $7 million.

In addition to providing retirement income benefits, the Company and certain subsidiaries offer limited health care and life insurance benefits for eligible retired employees. Currently, the Company's health care and life insurance benefit plans permit employees to receive those benefits if they reach normal retirement age while still working for the Company. The cost of such benefits is recognized as expense as claims are paid, which totaled approximately $4 million in Fiscal 1985.

17. Other commitments and contingent liabilities:
The Company and certain of its subsidiaries are parties to legal proceedings and guarantees of debt arising in the conduct of business. In addition, the Company and certain of its subsidiaries have sold, with recourse, notes receivable with remaining uncollected balances at May 31, 1985 of approximately $53 million. In the opinion of management, disposition of these matters will not materially affect the Company's consolidated financial position.

18. Industry segment data:
A summary by industry segment is included on page 36.

19. Interim results of operations (unaudited):
A summary by quarter is included on page 37.

20. Information on effects of changing prices and inflation (unaudited):
Financial statements are prepared using historical costs as required by generally accepted accounting principles. As a result, these financial statements may not reflect the full impact of specific price changes (current cost) and general inflation.

The following supplementary disclosures attempt to remeasure certain historical financial information to recognize the effects of changes in specific prices using current cost indices. For comparative purposes, the current cost information is then expressed in average Fiscal 1985 dollars to reflect the effects of general inflation based on the U.S. Consumer Price Index. This involves the use of assumptions and estimates, and therefore should not be interpreted as a highly reliable indicator of the effects of inflation. Furthermore, comparisons between companies may not be valid.

Net earnings has only been adjusted for remeasured depreciation expense in Fiscal 1985. Because the Company now uses the LIFO method for valuing substantially all U.S inventories, except grain inventories which are stated on the basis of market prices, the Fiscal 1985 cost of sales is already reported in current costs. Prior to Fiscal 1985, an adjustment to historical FIFO basis cost of sales under the current cost method was also required. No adjustments have been made to net sales, other operating expenses or the provisions for income taxes. The effective tax rates are therefore higher than reported in the primary financial statements. If taxes on income were adjusted (using the primary statement effective tax rate of 43.6 percent), net earnings would increase $10.6 million (25¢ per share) under current cost remeasurement.

The difference between current cost net earnings from that reported in the primary statements of $24.4 million affects industry segment operating profit as follows: Consumer Foods, $10.6 million; Restaurants, $11.3 million; Commodity Marketing, $1 6 million and Corporate, $0.9 million.

Consolidated statement of earnings adjusted for changing prices	Year ended May 31, 1985 (In millions)
Net earnings as reported in the primary statements	$191.8
Adjustment to reflect the current cost impact on depreciation expense	(24.4)
Net earnings as adjusted for changes in current cost (specific prices)	$167.4
Gain from decline in purchasing power of net amounts owed	$ 30.4
Increase in current cost (specific prices) of inventory and property, plant and equipment held during the year	28.5
Effect of increase in general inflation	68.4
Excess of increase in general inflation over increase in current cost	39.9
Foreign currency translation adjustment	(9.5)

At May 31, 1985, current cost of inventory is $430.5 million and property, plant and equipment, net is $1,657.9 million.

Five-year comparison of selected financial data adjusted for changing prices (Average Fiscal 1985 dollars)	Year Ended May 31 **1985**	1984	1983	1982	1981
	(In millions except per share amounts)				
Net sales	**$4,670.6**	$4,335.7	$3,967.3	$3,813.8	$4,049.2
Net earnings	**167.4**	121.8	95.7	91.6	58.3
Gain from decline in purchasing power of net amounts owed	**30.4**	29.4	22.3	47.2	76.4
Excess (deficit) of increase in general inflation over increase in current cost	**39.9**	7.1	(60.4)	47.9	31.6
Foreign currency translation adjustment	**(9.5)**	(9.2)	(12.9)	(5.2)	
Net assets at year-end	**1,434.1**	1,396.0	1,343.5	1,331.7	1,245.3
Per share information:					
Net earnings	**3.86**	2.81	2.21	2.11	1.45
Cash dividends	**1.52**	1.41	1.30	1.23	1.19
Market price at year-end	**53¾**	38⅝	30⅛	24⅛	24
Average consumer price index	**315.8**	303.9	293.4	280.3	257.5

Accountants' Report

Minneapolis, Minnesota
June 28, 1985

Stockholders and
Board of Directors
The Pillsbury Company

We have examined the consolidated balance sheets of The Pillsbury Company and subsidiaries as of May 31, 1985 and 1984, and the related statements of earnings and changes in financial position for each of the three years in the period ended May 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above (pages 28, 30, 32, and 36 to 46) present fairly the financial position of The Pillsbury Company and subsidiaries at May 31, 1985 and 1984, and the results of their operations and the changes in their financial position for each of the three years in the period ended May 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants

Ten Year Summary

Annual Growth Rate 10-Yr. 1975-1985	5-Yr. 1980-1985	1-Yr. 1984-1985		1985
			Operating results:	
13%	9%	12%	Net sales	$4,670.6
16	10	13	Gross margin	1,377.9
15	11	17	Depreciation	133.9
17	14	7	Research and development	37.1
15	11	21	Advertising and promotion	473.7
9	(2)	20	Interest, net	53.0
15	12	12	Earnings before taxes on income	340.2
17	13	13	Net earnings	191.8
4	2	–	Average common shares outstanding	43.4
13	11	13	Net earnings per common share	$ 4.42
			Changes in financial position:	
16	15	15	Funds provided from operations	$ 360.6
13	5	16	New investments–capital expenditures	327.1
			–acquisitions	154.2
			Issuance of long-term debt	219.3
			Retirement of long-term debt	132.5
20	14	12	Cash dividends	65.8
13	13	12	Cash dividends per common share	1.52
			Financial position:	
9	–	(14)	Current assets	$ 921.5
15	10	18	Property, plant and equipment, net	1,403.0
13	7	7	Total assets	2,778.5
11	2	(16)	Current liabilities	744.1
14	9	18	Invested capital	2,034.4
10	3	29	Long-term debt	647.7
16	12	11	Stockholders' equity	1,165.4
12	10	11	Equity per common share	26.87
			Statistics and ratios:	
			Gross margin to net sales	29.5%
			Net earnings to net sales	4.1%
			Pretax interest and rent coverage	2.8
			Pretax long-term interest coverage	6.2
			Long-term debt to total capitalization	31.8%
			Dividend payout	34.3%
			Return on average equity	17.3%
			Return on average invested capital–pretax	21.6%
			–after tax	12.0%
			Market price of common stock–high	$ 55
			–low	34½
			–close	54⅝
			Stockholders of record*	20,900
			Employees:	
			Restaurants subsidiaries	74,400
			Pillsbury and other domestic subsidiaries	14,200
			Foreign subsidiaries	4,300
			Total	92,900

*Does not reflect the large number of employees (17,100 at May 31, 1985) holding stock through Company benefit plans.

Year ended May 31

1984	1983	1982	1981	1980	1979	1978	1977	1976
(Amounts in millions except per share, stockholders and employees)								
$4,172.3	$3,685.9	$3,385.1	$3,301.7	$3,032.0	$2,166.0	$1,704.9	$1,521.5	$1,466.1
1,219.8	1,096.4	995.4	914.2	850.3	627.8	497.8	443.9	408.8
114.6	105.5	92.8	89.4	78.4	55.2	44.4	40.4	38.9
34.7	29.8	25.9	21.3	19.4	17.3	14.5	14.3	10.3
390.6	378.7	360.5	314.6	286.3	183.3	142.6	136.7	136.7
44.2	39.4	39.3	65.6	58.2	26.5	19.0	16.2	15.7
303.7	230.2	228.0	201.9	191.8	160.3	142.1	123.8	107.4
169.8	138.9	136.3	119.6	104.7	83.5	72.5	62.5	45.3
43.5	43.5	43.3	40.2	40.1	36.2	35.1	34.8	32.8
$ 3.91	$ 3.20	$ 3.14	$ 2.98	$ 2.61	$ 2.31	$ 2.07	$ 1.80	$ 1.38
$ 312.5	$ 243.4	$ 247.6	$ 226.8	$ 182.1	$ 152.5	$ 129.5	$ 114.2	$ 93.1
282.4	243.9	208.5	226.5	254.1	230.2	134.1	120.9	83.8
84.9	–	22.5	25.2	5.4	135.8	–	–	–
51.2	30.2	35.2	98.3	79.3	154.8	63.3	63.8	42.7
65.1	73.7	47.7	37.9	28.7	15.8	30.9	27.4	32.1
58.9	52.5	47.2	38.7	33.5	26.4	21.4	18.7	13.4
1.36	1.21	1.09	.96	.84	.73	.62	.56	.49
$1,071.8	$1,021.6	$1,133.0	$ 989.9	$ 938.8	$ 906.6	$ 680.6	$ 624.9	$ 506.7
1,193.0	1,053.2	1,009.0	950.6	857.4	741.5	486.5	428.8	366.4
2,608.3	2,366.6	2,428.3	2,174.5	1,983.7	1,804.5	1,282.8	1,139.1	947.3
886.4	704.9	816.5	687.6	680.1	629.8	461.9	413.6	318.1
1,721.9	1,661.7	1,611.8	1,486.9	1,303.6	1,174.7	820.9	725.5	629.2
503.1	572.4	597.1	631.0	552.0	509.2	298.0	267.2	228.1
1,046.2	956.4	890.0	747.2	664.5	577.7	452.1	401.6	352.7
24.22	22.10	20.51	18.60	16.58	14.75	12.92	11.48	10.25
29.2%	29.7%	29.4%	27.7%	28.0%	29.0%	29.2%	29.2%	27.9%
4.1%	3.8%	4.0%	3.6%	3.5%	3.9%	4.3%	4.1%	3.1%
2.7	2.3	2.3	2.2	2.3	3.0	3.6	3.7	3.1
5.5	4.4	4.4	4.7	5.1	5.6	6.3	6.5	5.5
29.2%	34.4%	37.0%	42.4%	42.3%	43.3%	36.3%	36.8%	36.3%
34.7%	37.8%	34.6%	32.4%	32.0%	31.6%	30.0%	29.9%	29.6%
17.0%	15.0%	16.6%	16.9%	16.9%	16.2%	17.0%	16.6%	14.8%
21.9%	18.2%	19.0%	18.4%	19.3%	19.6%	22.2%	21.6%	19.4%
12.1%	10.6%	11.0%	10.6%	10.4%	10.1%	11.2%	10.9%	9.5%
$ 41½	$ 30⅞	$ 23⅞	$ 23	$ 20⅞	$ 23⅞	$ 20⅝	$ 22¼	$ 21¾
27¼	18½	17½	15⅞	13½	16	16¼	17¼	15½
37⅞	28⅝	22⅛	20½	16	16⅛	18⅞	17¼	17⅞
20,800	19,100	20,200	20,700	21,200	20,000	14,300	14,300	13,900
61,400	41,500	40,400	44,100	42,200	42,000	31,900	29,200	26,400
14,200	11,200	11,400	12,800	13,900	12,800	9,400	8,200	8,100
3,800	3,500	3,400	3,100	3,400	3,300	3,000	3,000	3,100
79,400	56,200	55,200	60,000	59,500	58,100	44,300	40,400	37,600

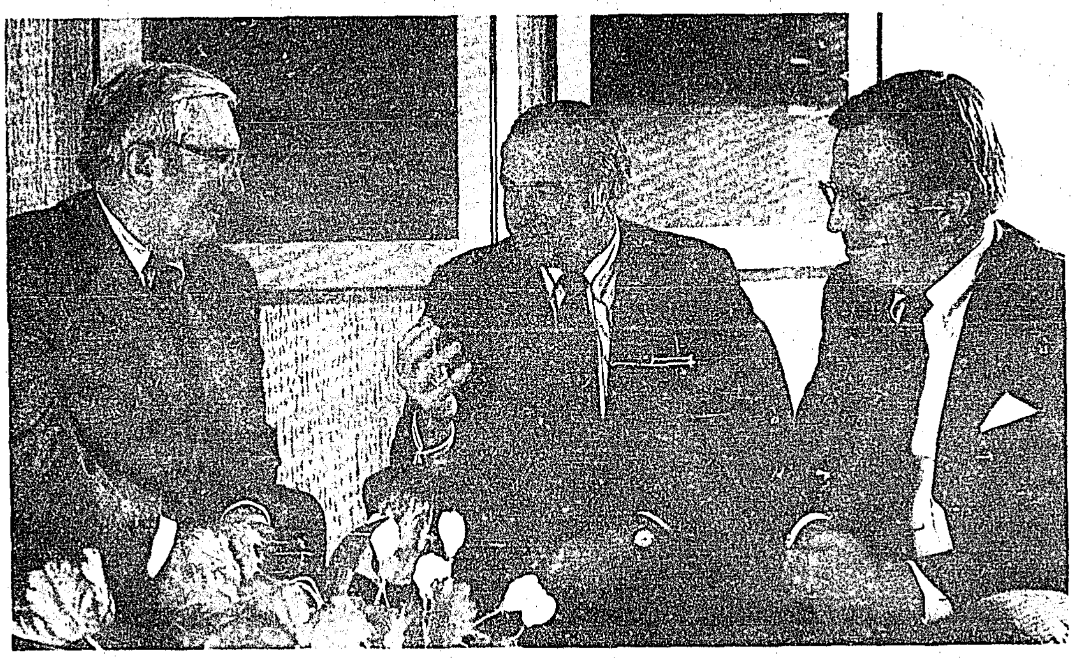
Board of Directors

(Left to right)

Willys H. Monroe, *1, 4, 5, 6*
President, Willys H. Monroe, Inc. (management consulting), Chicago, Ill.

George J. Sella, Jr., *2, 4, 5*
Chairman, President and Chief Executive Officer, American Cyanamid Company (agricultural, chemical, consumer and medical products), Wayne, N.J.

Peter G. Wray, *3, 4*
Chairman, The Victorio Company (ranching, farming and related activities), Phoenix, Ariz.



W. Michael Blumenthal, *2, 4*
Chairman and Chief Executive Officer, Burroughs Corporation (computer systems), Detroit, Mich.

Robert A. Schoellhorn, *2, 4, 5*
Chairman and Chief Executive Officer, Abbott Laboratories (health care products), Chicago, Ill.

Caro E. Luhrs, M.D., *3, 4, 6*
Physician and Consultant, Washington, D.C.

George S. Pillsbury, *1, 3, 4*
President, Sargent Management Company (investment advisors), Minneapolis, Minn.

Committees of the Board
1. Executive
2. Finance
*3. Audit**
*4. Nominating**
*5. Executive Compensation**
6. Public Responsibilities

**Composed entirely of non employee Board members*

(Left to right)

James W. McLamore, *3, 4, 6*
Chairman Emeritus, Burger King Corporation, Miami, Fla.

John C. Whitehead, (Resigned from Board effective July 8, 1985.)

John H. Perkins, *3, 4, 6*
Consultant, Retired President, Continental Illinois Corporation and Continental Illinois National Bank and Trust Company, Chicago, Ill.

Allen F. Jacobson, *1, 2, 4*
President, U.S. Operations, Minnesota Mining and Manufacturing Company (diversified manufacturer), St. Paul, Minn.

Donald F. Craib, Jr., *2, 4, 5*
Chairman and Chief Executive Officer, Allstate Insurance Group (property/casualty and life insurer), Northbrook, Ill.

Kenneth A. Macke, *1, 4, 5*
Chairman and Chief Executive Officer, Dayton Hudson Corporation (diversified retailing), Minneapolis, Minn.

William H. Spoor, *1, 2*
Chairman
(photo, page two)

John M. Stafford, *1, 2, 6*
President and Chief Executive Officer
(photo, page two)

Paul S. Gerot,
Chairman Emeritus

Corporate Data

General Offices
Pillsbury Center
200 South Sixth Street
Minneapolis, MN 55402
Telephone (612) 330-4966
Cable address: PILLS MPLS.

Transfer Agent and Registrar
First National Bank
of Minneapolis
120 South Sixth Street
Minneapolis, MN 55480

Annual Meeting
The annual meeting will be held at the Guthrie Theater, 725 Vineland Place, Minneapolis, Minnesota at 2 p.m. Central Daylight Time, Tuesday, September 10, 1985.

Stockholder Inquiries
Stockholders interested in the current progress of the Company are invited to telephone Investor Relations at (612) 330 8686.

Stock Listing
Pillsbury common stock is listed on the New York Stock Exchange, the Midwest Stock Exchange and the London Stock Exchange under the symbol PSY.

Dividend Reinvestment
The Automatic Dividend Reinvestment Plan permits stockholders to reinvest their dividends in Pillsbury common stock automatically, regularly and conveniently-without service charges or brokerage fees. In addition, participating stockholders may make limited periodic cash investments for the purchase of additional Pillsbury common stock on the same fee-free basis. The Plan is voluntary. Stockholders may join or withdraw at any time. Full details about the Plan are available by writing to First National Bank of Minneapolis, Attention: Dividend Reinvestment Department, P.O. Box A799, Minneapolis, MN 55480.

Availability of Reports
Stockholders may obtain, without charge and exclusive of exhibits, a copy of the 1985 Form 10K Annual Report, which is an annual filing with the Securities and Exchange Commission, by writing to Investor Relations, The Pillsbury Company, Pillsbury Center, 200 South Sixth Street, Minneapolis, MN 55402.

A Community Relations Annual Report on the Company's contributions and gift-giving policy is available from The Pillsbury Company Foundation at the above address.