Pillsbury Annual Report -- 1986
America's Corporate Foundation; 1986; ProQuest Historical Annual Reports
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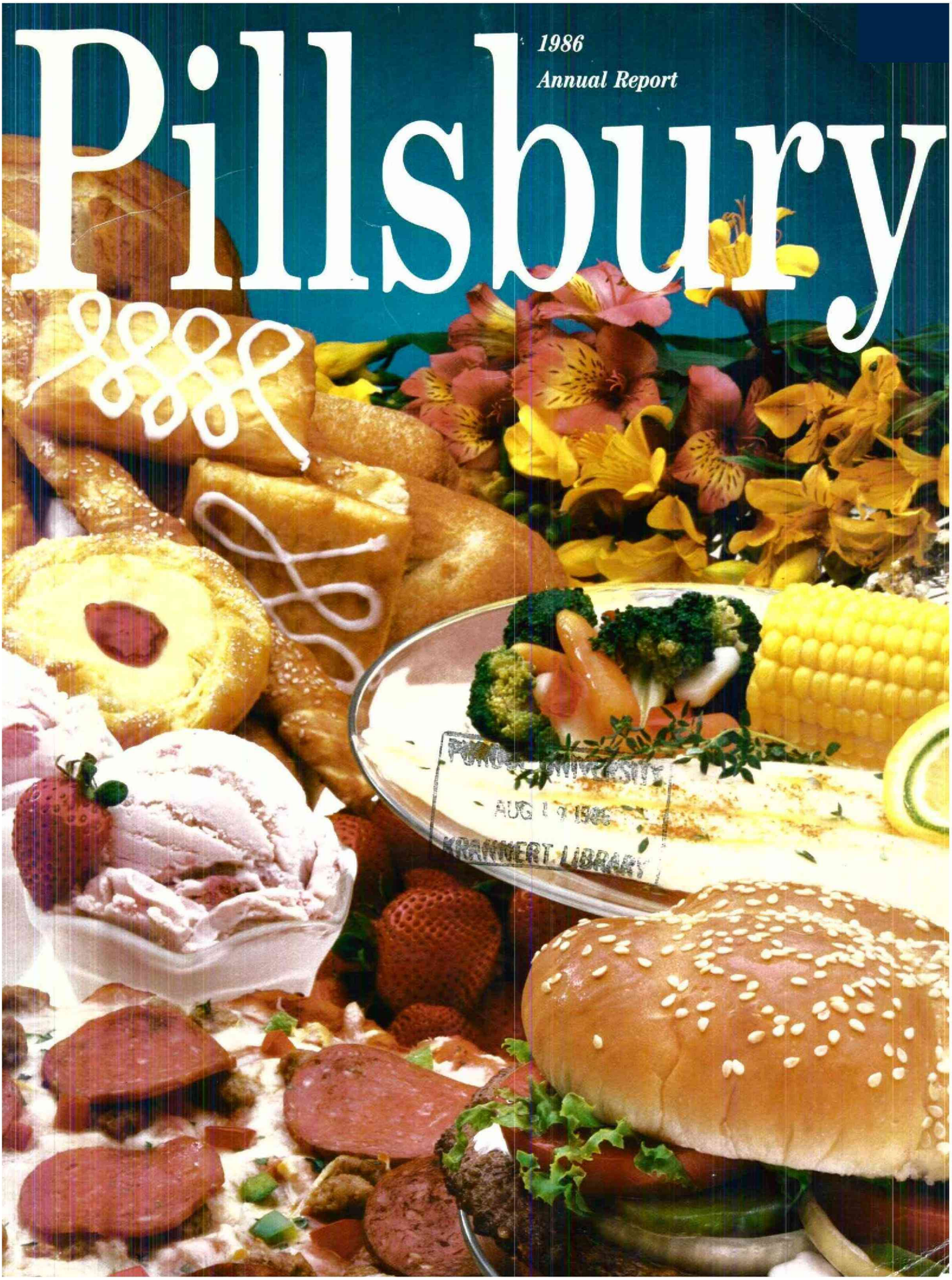
Pillsbury

1986
Annual Report



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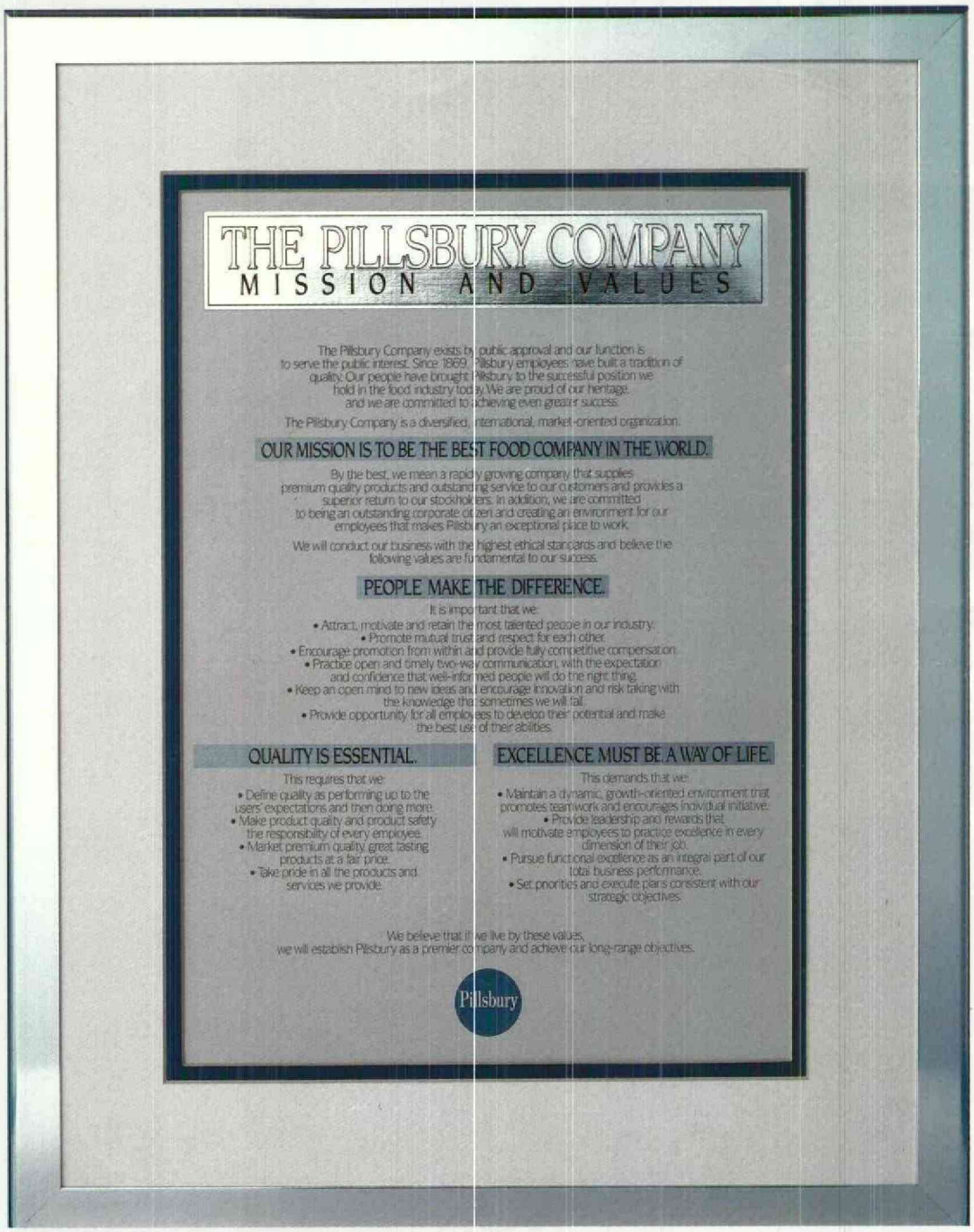
Pillsbury Profile

The Pillsbury Company, as the cover of this year's annual report depicts, is a total food company—a diversified, international food company uniquely positioned to serve existing and emerging needs in the food-at-home and food-away-from-home markets. From its heritage in flour and baking products to its more contemporary lines of frozen fish, vegetables, pizza and ice cream, the Company is a leading producer of many of the best known consumer foods. Its restaurants serve approximately 40 million meals a week, and are quality leaders in the fast food, casual dining and dinnerhouse areas.

In all that it does, Pillsbury's mission is to be the best food company in the world while adhering to the highest standard of values. The Company's Mission and Values Statement is proudly reprinted here.



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

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Financial Highlights

For the Year:	Year Ended May 31 1986	1985	Increase
	(In millions)		
Net Sales*	**$5,848**	$4,843	21%
Net Earnings	**208**	192	8
Cash Dividends	**73**	66	11
New Investments	**1,118**	559	100

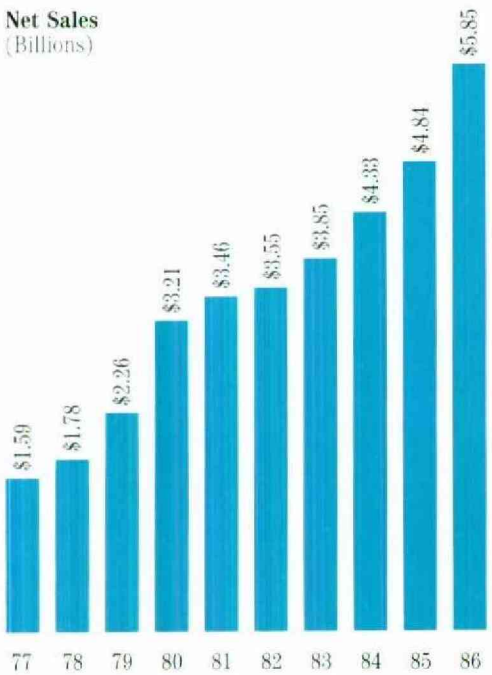
Per Share:	Year Ended May 31 1986	1985	Increase
Net Earnings	**$4.77**	$4.42	8%
Cash Dividends	**1.68**	1.52	11
Shareholders' Equity	**30.24**	26.87	13
Closing Price of Common Stock	**80¼**	54⅝	47

At Year-End:			
Total Assets	**3,659**	2,779	32
Long-Term Debt	**1,025**	689	49
Shareholders' Equity	**1,314**	1,165	13

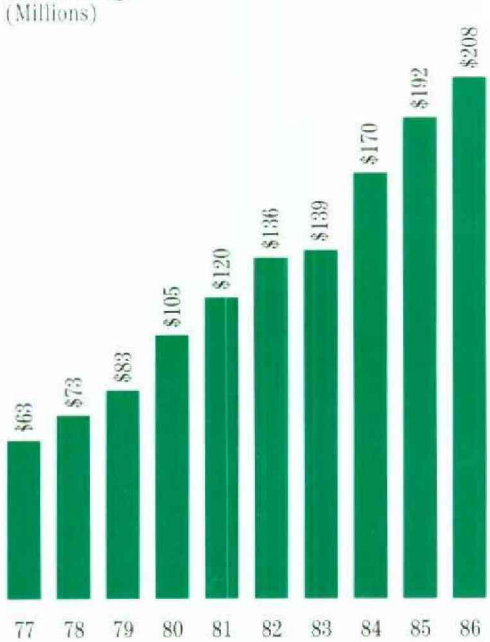
Performance Measures:		
Net Earnings as a Percent of Sales*	**3.6%**	4.0%
Return on Average Shareholders' Equity	**16.8**	17.3
Return on Average Invested Capital*	**12.7**	12.9

*Restated

Net Sales
(Billions)



Net Earnings
(Millions)



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To Our Shareholders

Fiscal 1986 was a good year for The Pillsbury Company. We are pleased with the results. Our financial performance was satisfactory and we made several significant new investments which position us well for the future.

Sales, net earnings and earnings per share attained record levels for the 15th consecutive year. Dividends were increased for the 28th consecutive year and our shareholders enjoyed another sizable increase in the value of Pillsbury stock.

Progress was made throughout the Company implementing Pillsbury's "Mission and Values." A copy of that statement, which defines our goals for the future and our conduct toward others, is reprinted on the inside front cover of this report.

We did encounter some problems. A slowdown in the fast food industry resulted in sales and profits at Burger King that were below our expectations. We also recognized that JJ. Muggs was not a viable restaurant concept and wrote down our investment in those units. In addition, our new investments diluted the year's earnings by approximately 30 cents per share. As a result, our return on shareholders' equity declined slightly.

Progress, however, clearly outweighed the problems and we are pleased to highlight the following accomplishments:

- Sales of $5.85 billion were 21 percent and $1 billion higher than Fiscal 1985's $4.84 billion. The size of this sales increase is placed in better perspective when realized that it wasn't until 1974—105 years after the Company was founded—that The Pillsbury Company first achieved a billion dollars in annual sales.
- Net earnings of $208 million, or $4.77 per share, were eight percent above the $192 million, or $4.42 per share, earned in Fiscal 1985. Net earnings from operations, excluding gains and losses from the sale of certain assets, increased ten percent.
- Cash dividends of $1.68 per share were 11 percent higher than the $1.52 per share paid in

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Fiscal 1985. Our stock closed the year at just over $80 per share, giving shareholders a total return of 51 percent on their investment.

- We invested a record $1.12 billion to expand our growth opportunities in the food-at-home and food-away-from-home markets. The acquisition of Diversifoods increased our base of Company-operated Burger King restaurants and put us into the pizza restaurant business with Godfather's Pizza. Through Quik Wok, we entered the oriental fast food business. Four acquisitions in Consumer Foods—Jeno's frozen pizza, Joan of Arc canned vegetables, French's potatoes and Tennant & Hoyt flour milling—strengthened existing product lines. In addition, more than 600 new restaurants were added to our fast food and full service systems.
- To help finance this growth, we created the Burger King Investors Master Limited Partnership and listed its units on the New York Stock Exchange. The partnership acquired the real estate assets and the right to future rental income of 128 franchised restaurant properties, while Pillsbury received $69 million in net cash proceeds.
- We divested several businesses that did not represent a good strategic fit or hold the promise for satisfactory long-term financial returns. These included the Edible Protein (dry beans) and Pioneer Foods (rice milling) portions of our Commodity Marketing business, The Chart House and Luther's Bar-B-Q restaurant chains acquired with Diversifoods, and Apollo Foods, a regional producer of fillo dough.
- A number of key executive changes were made to strengthen our leadership. Thomas R. McBurney and Kent C. Larson were elevated to Chairman and President, respectively, of U.S. Foods. Kyle T. Craig was named Chief Executive Officer of the S&A Restaurant Corp. James R. Behnke was elected Senior Vice President, Growth and Technology. Herman Cain was named President of Godfather's Pizza. Timothy C. Sullivan was elected Senior Vice President, Human Resources.

On a personal note, the Chief Executive Officer transition was accomplished quickly and smoothly. My special thanks to Bill Spoor for his wisdom, support and guidance. We are pleased that Bill will continue as a member of Pillsbury's Board of Directors.

We appreciate the contributions of our directors, officers and over 108,000 employees around the world. Each, in their own way, helped carry Pillsbury to new heights of success and achievement.

As we look ahead, the prospects for Fiscal 1987 are excellent. We will benefit from continued growth in our existing businesses and from last year's new investments. We also hope to see passage of a major federal tax reform bill which could significantly benefit Pillsbury and our shareholders in Fiscal 1988 and beyond. As a representative of one of the most heavily taxed industries in the country, we have taken a leadership role in supporting the new tax legislation.

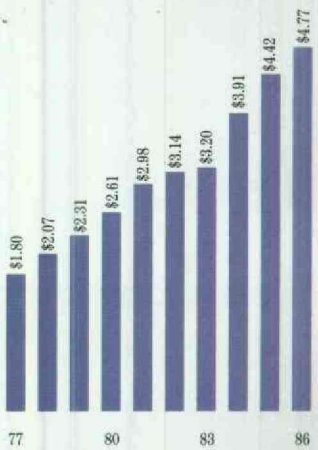
We invite you to read the balance of this report and share in the enthusiasm we hold for the Company. Shareholders are also cordially invited to attend the Annual Meeting of The Pillsbury Company to be held at The Guthrie Theater in Minneapolis at 2:00 p.m. on Tuesday, September 9, 1986.

Respectfully submitted,

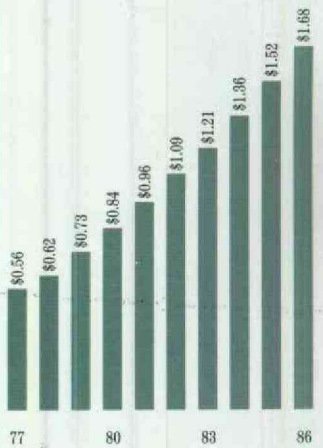
John M. Stafford
Chairman of the Board,
President and
Chief Executive Officer

July 16, 1986

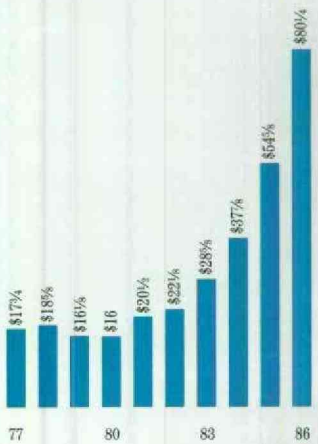
Earnings Per Share



Cash Dividends Per Share



Closing Price Of Stock



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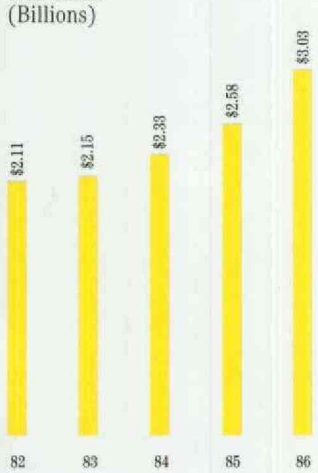
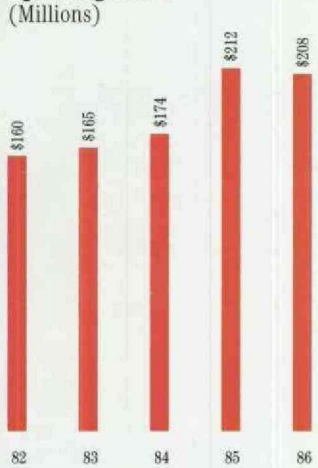
Consumer Foods

Net Sales
(Billions)



Operating Profit
(Millions)



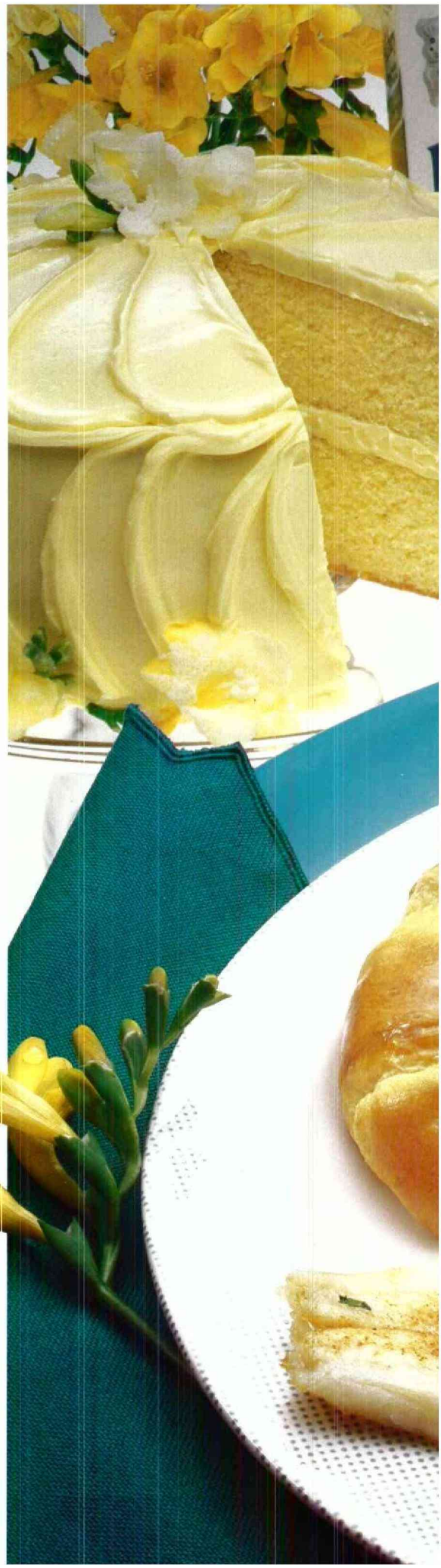
Identifiable Assets
(Millions)

Fiscal 1986 was an outstanding year for Pillsbury's Consumer Foods Group. Sales rose 17 percent to $3.03 billion, and operating profit was $208.3 million. This compares with $211.5 million in Fiscal 1985, when a $38.9 million gain was recorded on the sale of the Company's pasta business. Excluding that gain, as well as small restructuring charges in each year, Fiscal 1986 profits rose 20 percent.

Unit volume, the true test of consumer acceptance, grew by 16 percent as market share gains were recorded in half of the Company's domestic product categories. With such familiar brand names as Pillsbury, Green Giant®, Hungry Jack®, Totino's®, Häagen-Dazs® and Van de Kamp's®, 79 percent of the Company's domestic volume came from businesses in which it has the number one share position, and another 11 percent from areas where it is number two. Overseas, Gringoire-Brossard cookies in France, Green's cake mixes in the United Kingdom, and Erasco canned meals in Germany, also led their respective markets.

Four acquisitions during the year — Jeno's® pizza, Joan of Arc® canned vegetables, French's® box prepared and fresh potatoes, and Tennant & Hoyt flour milling — strengthened the Company's position in important markets. These businesses accounted for approximately half of the gain in unit volume and sales for the year, and one-quarter of the increase in operating profit. Integration is proceeding rapidly to achieve further economies of scale. Apollo Foods, a regional producer of fillo dough, was sold at a small loss in the fourth quarter.

New products continued to win consumer approval as the Company introduced a variety of great tasting items that offer advantages in quality and convenience over competing products. Häagen-Dazs ice cream bars, Green Giant Valley Combinations™ frozen vegetables and new Pillsbury microwave, toaster and prepared dough products came to market, and a line of superior-quality refrigerated



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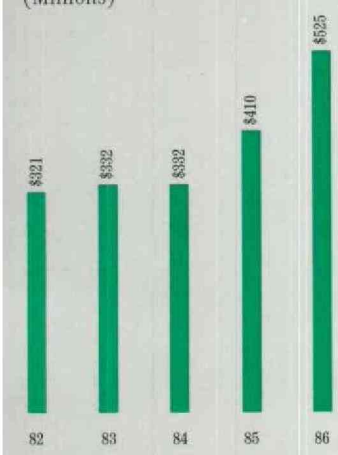
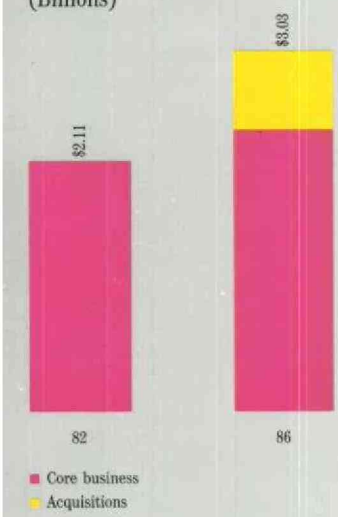
Advertising And Promotion
(Millions)



Sales Growth Analysis
(Billions)



Mexican items was introduced in test markets under the Azteca® label.

To support this effort, research and development spending was increased 16 percent to $35 million, while advertising and promotional spending rose 28 percent to $525 million.

In an industry characterized by limited growth, Pillsbury is successfully pursuing a high-growth strategy by building a diversified portfolio of premium quality, nutritious foods which meet the lifestyle needs of today's convenience-oriented consumers. With one-third of its volume in the United States coming from products either acquired or internally developed within the past five years, the Company believes there is ample opportunity for continued growth, despite increased competition and consolidation within the $300-billion-a-year food-at-home market. Foreign markets offer even greater expansion prospects.

Becoming a low-cost and more effective competitor carries a high priority in today's low-inflationary environment. Pillsbury's efforts were focused in several specific areas during Fiscal 1986. A program to become the preferred supplier to the grocery trade resulted in improving service in such areas as on-time delivery, order processing and attention to customer needs. An effort to improve productivity at the Company's 47 manufacturing plants and processing facilities across the U.S. was also initiated. In addition, a reorganization of staff responsibilities coupled with a voluntary early retirement program resulted in a reduction in headquarters positions.

Lower ingredient costs for such key commodities as flour, sugar, shortening and vegetables benefited both Pillsbury and the public during the year. Stable food prices are again forecast for Fiscal 1987.

Meals and Snacks

Fiscal 1986 sales $562 million, up 43 percent.

The consumer's dramatically changing expectations for food quality and convenience are being met with an exciting array of new Pillsbury products, many especially formulated for microwave and toaster preparation. From a strong leadership base in frozen pizza, Pillsbury is building a reputation as an innovative producer of excellent tasting light meals and snacks, while growth in frozen main meals is being built around Van de Kamp's fish and Mexican lines.

The acquisition of Jeno's was the highlight of the year. The combination adds important market depth to Pillsbury's pizza business, with opportunities for brand differentiation, product quality improvements, and operating efficiencies. Jeno's also provides an entry into a new product category: hot snack rolls. With such brand names as Totino's, Jeno's, Pillsbury Microwave, My Classic™, Mr. P's®, Fox Deluxe® and Chef Saluto®, pizza has become one of the highest volume products in Pillsbury's Consumer Foods portfolio.

The $1-billion-a-year frozen pizza market expanded seven percent in volume last year, despite increased competition from supermarket delicatessens and home delivery. Bolstered by the success of Microwave Pizza, Pillsbury's volume rose eight percent excluding the Jeno's acquisition.

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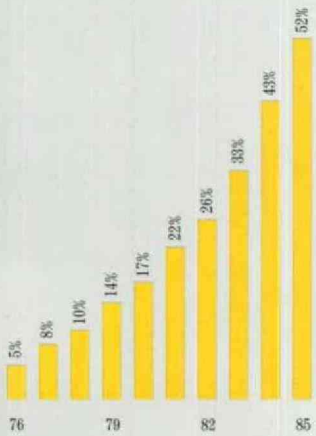
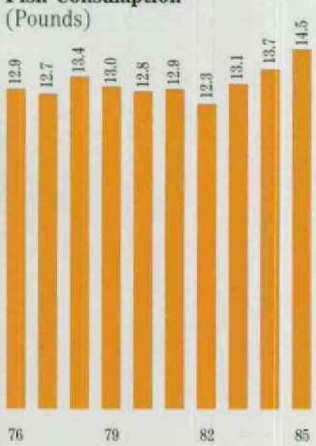
Microwave Ovens
(Percent of U.S. households)



Annual Per Capita Fish Consumption
(Pounds)



A French Bread Pizza that cooks crisp and delicious in just five minutes is the latest addition to Pillsbury's expanding line of quality microwave products. Also introduced this spring were microwave Classic™ Casseroles—three single dish meals of choice meats and fresh vegetables topped with flaky pastry crust. Meanwhile, Microwave Pancakes set sales records as new packaging offered better shelf life and visibility.

Toaster Muffins™ breakfast muffins, with real fruit, fiber and natural flavors, are making their appearance in grocery freezer cases this summer alongside Toaster Strudel™ pastries, Fiscal 1985's most successful new product. More than just a breakfast treat, fruit or cinnamon-filled Toaster Strudel™ pastries make a mouth-watering dessert when topped with Häagen-Dazs ice cream.

Encouraging early test market results are being achieved by the Azteca line of Mexican products. Involving 11 items, the refrigerated tacos, tortillas, taco salad shells and sauces establish a new level of freshness and quality in the $1.3 billion-a-year Mexican foods arena.

In frozen fish, Van de Kamp's is challenging the market leaders by its adherence to freshness, packaging innovation and the industry's largest advertising campaign. Volume increased ten percent, led by the "Light" line of low-calorie fillets and the fresh-frozen "Today's Catch"® line, which features a triple-wrapped package to seal in the flavor. Strong relationships with suppliers worldwide assure Van de Kamp's of the oceans' choicest offerings as seafood popularity grows in response to lighter, more healthful eating trends.

Vegetables and Side Dishes

Fiscal 1986 sales $701 million, up 39 percent.

Two acquisitions and the launching of two new lines of Green Giant frozen vegetables clearly established Pillsbury as the number one producer of quality branded vegetables in the U.S.

New Valley Combinations frozen vegetables, 11 varieties in box and polybag packaging, helped Green Giant increase frozen volume seven percent last year. Testing also began on a unique Special Additions line, combining premium quality vegetables with a variety of separately packaged toppings, to provide a side dish with outstanding flavor.

Benefiting from a bountiful harvest, Green Giant also increased canned vegetable volume 13 percent. Already the number one seller of canned peas, corn, mushrooms and asparagus, Pillsbury increased its canned product line by one-third with the acquisition of Joan of Arc, which added such specialty items as kidney beans, yams and vegetable salads.

A second acquisition, French's potatoes, complements Pillsbury's Hungry Jack brand of instant mashed potatoes, and gives the Company a strong position in specialty boxed potatoes, such as scalloped and au gratin.

The $13-billion-a-year fresh produce market accounts for more than 70 percent of total vegetable consumption in the U.S. With an entry into fresh potatoes through French's, and initial sales of Green Giant asparagus, broccoli and cauliflower, Pillsbury has a small, but growing presence in this market.

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Breads and Baking Products

Fiscal 1986 sales $1.21 billion, up 2 percent.

A significant profit rebound headlined the performance of this large and important segment of the business. Market share gains in dessert mixes, the fifth consecutive year of volume growth in prepared dough products, and lower ingredient costs benefited Fiscal 1986. A year ago, the residual effects of an industry-wide pesticide scare and the costly introduction of two unsuccessful new products penalized results.

Pillsbury's challenge in these mature markets is to generate fresh new product ideas to stimulate consumer interest, while striving to make at-home baking more convenient and contemporary.

Prepared dough, Pillsbury's largest product category, posted a three percent increase in volume with the introduction of a new Crusty French Loaf and four varieties of Pillsbury's BEST® soft, spoonable cookies. Early in Fiscal 1987, Pillsbury will add All Ready Pizza Crust—just unroll, top and bake—to a refrigerated product line already distinguished by such recent innovative product successes as All Ready Pie Crusts and Soft Breadsticks.

Unit volume in cake mixes, brownies and frostings increased six percent, despite a two percent decline in the overall dessert mix market, as continued emphasis was placed on quality, superior price/value and aggressive national advertising. Figurines®, a nutritious and tasty diet bar, was reintroduced in a low 100-calorie format.

With per capita flour consumption in the U.S. up four percent to 123 pounds last year, Pillsbury expanded its penetration in the flour and bakery products market. The Company is the leading supplier of quality mixes to the baking industry, with a variety of doughnut, muffin, croissant, bread and cake offerings. Its biscuit and pizza mixes, also judged the hallmark of quality, are used by a number of leading restaurant chains.

In the past two years, the Company has acquired two flour mills, lifting its milling capacity by 15 percent to 14 million pounds per day. A significant portion of this output is sold as family flour under the Pillsbury's BEST® label, or is used in the manufacture of the Company's cake mixes, prepared dough products and pizza crusts.

Ice Cream

Fiscal 1986 sales $157 million, up 14 percent.

For Häagen-Dazs, Fiscal 1986 was a year of transition, linking its past growth with a future of exciting promise. Having achieved national presence and brand recognition as *the* luxury ice cream, Häagen-Dazs devoted the past year to building a professional management team, and developing a more cohesive network of Company-owned and independent distributors.

Unquestionably, Pillsbury's most indulgent new product of the year was the Häagen-Dazs ice cream bar. Rich vanilla and chocolate ice cream covered with thick layers of imported Belgian milk or dark chocolate, the bars are the perfect marriage of the world's best ice cream and the world's best chocolate. Although currently available only in the New York, Chicago, Atlanta and California markets, the bars will reach ice cream lovers elsewhere as additional manufacturing lines are opened.

Other accomplishments included the successful opening of Häagen-Dazs' second manufacturing plant, which achieved unsurpassed marks for product quality, and the introduction of its first national print advertising campaign. Volume for the year rose eight percent, compared with two percent for the $4.1 billion ice cream industry as a whole.

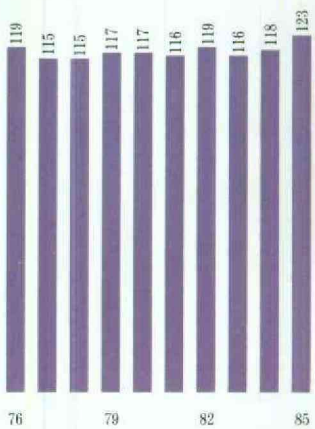
U.S. Foods

Chairman
Thomas R. McBurney

President
Kent C. Larson

Vice Presidents
John W. Argent
Daniel C. Barnett
Howard E. Bauman
John E. Dixon
Diana L. Doshan
Gary M. Eastburn
L. Thomas Gartner
William W. Hay
William D. Howe
Mary Ellen Jenks
Gary F. Klingl
Robert L. Lindsay, Jr.
Daniel J. Locke
Lloyd V. Lofgren
Warren G. Malkerson
Russell S. Mentzer
W. Richard Nickel, III
Donald A. Osell
Michael J. Paxton
Kenneth A. Pond
Anthony L. Scherber
Jimmy A. Shadler
Jolyon A. Stein
Rose W. Totino
Kenneth J. Valentas
Virginia L. Ward
Robbie M. Westmoreland
Thomas N. Wilkolak
Carl Wilson
Lawrence P. Youngblood

Annual Per Capita Flour Consumption
(Pounds)



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In addition to its high volume supermarket sales, Häagen-Dazs franchises or operates 325 ice cream shoppes. Intense competition in the U.S. has resulted in declining sales and disappointing results for the past two years, while the introduction of Häagen-Dazs shoppes in Japan is setting sales records. New products and marketing programs are being introduced in the U.S. to help shoppe owners increase traffic and build sales. Home delivery service, party/event catering and dessert catering to restaurants and hotels are also being tested. Three new flavors, Cappuccino, Key Lime Sorbet & Cream and Peanut Vanilla, are being introduced in the shoppes this summer with the support of a national print ad campaign.

International Foods

Fiscal 1986 sales $434 million, up 18 percent.

Pillsbury's international business continued to show excellent growth with unit volume up 14 percent. Including unconsolidated affiliate companies, total sales exceeded $600 million. Operating profit improved in all regions. Although aided by the decline in the value of the dollar, profits were adversely impacted by the cost of integrating several acquisitions completed during Fiscal 1985.

Continued international expansion is a strategic priority for Pillsbury. Profits are expected to improve significantly as recent acquisitions achieve their potential, new businesses are added to the portfolio, and the Company expands its development of branded global products, such as Green Giant vegetables and Häagen-Dazs ice cream.

European operations turned in a strong performance and accounted for over half of Pillsbury's international sales. Gringoire-Brossard, a producer of premium cookies and cakes in France and Belgium, achieved record profits and introduced several new ready-to-eat products. In June 1986, two additional ready-to-eat cake companies, Biscuiterie Vinchon-Jeannette in France and Brockmans in Belgium, were acquired. Green Giant completed the second year of a three-year program to expand canned corn capacity in France.

In West Germany, Pillsbury strengthened its leadership in canned and frozen meals under the Erasco and Jokisch labels. However, two recent acquisitions, Goldstein and Backfrost, makers of frozen cakes, specialty sandwiches and prepared meals, performed below expectations. They have been repositioned for future growth with a variety of new products scheduled for introduction this year. Sales in the United Kingdom increased by more than 80 percent with the acquisition of Fiesta Foods, a leading producer of frozen desserts and ice cream.

Canadian operations achieved record results with major gains in Green Giant frozen vegetables and the Brights and Martins juice business. In Latin America, Pillsbury's flour and pasta businesses set new records in Venezuela and Jamaica, but were depressed in Mexico due to that country's difficult economy. Mac'Ma, the leading baker of premium cookies in Mexico, however, performed exceptionally well.

The Asia/Pacific region represents significant growth potential for Pillsbury. Häagen-Dazs Japan, a newly formed joint venture with Suntory Limited, had an outstanding year. Sales reached $12 million as quality-conscious consumers established sales records at Japan's 11 Häagen-Dazs shoppes. ETA Foods, a diversified consumer foods joint venture in Australia, was formed in June 1985, giving Pillsbury a solid entry into this important region.

The declining dollar, recent Pillsbury acquisitions and the U.S. government's Export Enhancement Program resulted in record export volumes. Canned corn, Pillsbury's primary export product, continued to expand its market, as the Green Giant was present in more than 40 countries. The recent acquisitions of Van de Kamp's fish, French's potatoes and Jeno's pizza added to Pillsbury's array of high quality exports. Government programs aided the export of bakery flour.

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

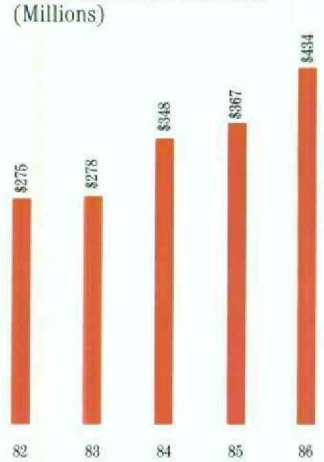
Country Managers
William G. Bullis, Jamaica
Calvin Chang, Hong Kong
Rocky W. Chen, Taiwan
Hans-Joachim Denecke, West Germany
Michael S. Dingee, Venezuela
J. Thomas Kirchner, Mexico
Don Moraza, Philippines
Bruce A. Noble, United Kingdom
Gerald A. O'Connor, Guatemala
Richard A. Peddie, Canada
Victor Scherrer, France/Belgium
David Stuart, Australia

Ice Cream

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

Häagen-Dazs Shoppes
President, Charles V. Kanan

International Foods Sales
(Millions)



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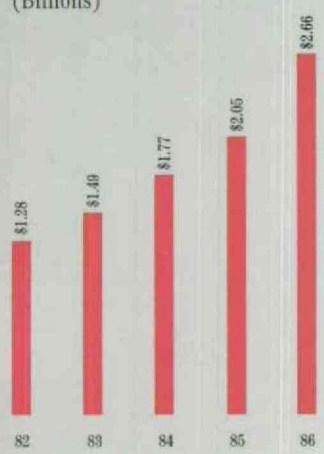
Net Sales
(Billions)



Operating Profit
(Millions)

Identifiable Assets
(Millions)

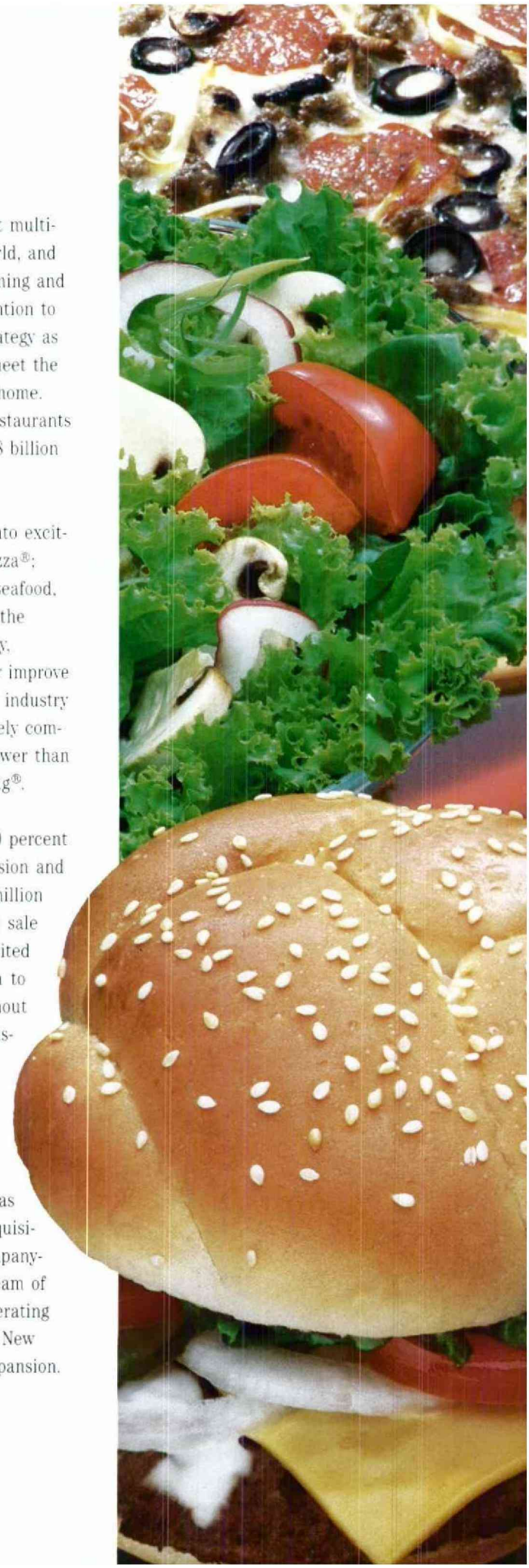
Restaurants

Pillsbury's Restaurants Group is the largest multi-concept restaurant organization in the world, and a quality leader in the fast food, casual dining and full service areas. Diversity and close attention to consumer needs are keys to Pillsbury's strategy as they strengthen the Company's ability to meet the public's changing taste in food away from home. The Group operated or franchised 5,831 restaurants at year-end, with systemwide sales of $5.48 billion for the year.

During Fiscal 1986, the Group expanded into exciting new areas — pizza, with Godfather's Pizza®; oriental food, with Quik Wok®; and fresh seafood, with Bay Street®. In addition, it absorbed the largest acquisition in the Company's history, Diversifoods, and took steps to significantly improve its future return on assets. However, weak industry growth patterns, particularly in the intensely competitive hamburger segment, resulted in lower than anticipated sales and profits at Burger King®.

Sales, including franchise revenue, rose 30 percent to $2.66 billion, primarily from unit expansion and acquisitions. Operating profit of $304.7 million included a $32.2 million net gain from the sale of Burger King properties to a Master Limited Partnership, offset partially by a provision to discontinue the JJ. Muggs® concept. Without this gain, but including increased refranchising at Burger King, operating profit rose 24 percent.

The acquisition and integration of Diversifoods, previously the largest franchisee in the Burger King system with 377 units, was the year's major accomplishment. The acquisition increased Burger King's base of Company-operated restaurants, turned a limited stream of royalty income into much greater store operating profit, and opened the important Chicago, New Orleans and Norfolk markets for future expansion.



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To better coordinate the Company's expanding restaurant operations, ground was broken during the year for contemporary new headquarters buildings for both the fast food and full service organizations. Burger King Corporation's world headquarters is being constructed on a campus-like setting south of Miami, while the S&A Restaurant Corp. is building in North Dallas.

Despite a cyclical downturn affecting much of the restaurant industry, the food-away-from-home market remains a dynamic $125-billion-a-year business, accounting for nearly one-third of every food dollar spent in the United States. Pillsbury believes there is ample opportunity for continued growth, both at home and abroad. Its strategy for success is built on continued unit expansion and concept development, backed by the introduction of quality new products, superior operations and strong marketing support.

Fast Food

Fiscal 1986 sales $1.97 billion, up 39 percent.

The flame-broiled hamburger, garnished "your way" is the principal reason for Burger King's continuing success and last year's record number of new store openings. At the same time, Pillsbury is forging new growth opportunities for its fast food operations by expanding into other popular concepts, such as pizza and oriental food, and by selectively broadening its product offerings to include the industry's best chicken, salads and breakfast items.

Systemwide sales for Burger King, which include sales by franchisees, rose 13 percent to $4.5 billion. Sales per domestic restaurant exceeded $1 million for the second consecutive year. However, after three years of spectacular growth, year-to-year sales per restaurant increased only slightly as the growth in consumer spending weakened throughout the industry and competition intensified.

With approximately 17 percent of the domestic hamburger market, Burger King has increased its market share over the past six years. Its formula for continued growth includes a new national advertising campaign strongly supporting its reputation for superior-tasting, flame-broiled hamburgers; new product development to meet the consumer's desire for quality, convenient and nutritious foods, and a further expansion of nonconventional sites to reach consumers where they live and work.

Advertising spending by the Company and its franchisees during the year exceeded $190 million, or 4.6 percent of domestic system sales. Fiscal 1987 opened with the launching of a new advertising campaign under the umbrella theme, "This is a **Burger King**® town. We know how burgers should be."℠ which builds on more than 30 years of history in supplying America's best loved burger, the Whopper® sandwich.

Chicken Tenders, finger-size pieces of 100 percent chicken breast, is one of the most successful new products in the Company's history. Deliciously different and with nutritional advantages over competing products, it exceeded ten percent of total sales during its introductory month, April. National roll-out of a new A.M. Express™ line of portable, breakfast-to-go items, including French Toast Sticks and Great Danish, will supplement the popular Croissan'wich breakfast sandwich in early Fiscal 1987. In response to growing health consciousness among consumers, Burger King led the industry in converting to vegetable shortening for all frying except French fries.

Unconventional locations are becoming increasingly important as competition for prime sites intensifies. Military bases, toll roads, shopping malls and specially equipped mobile units are rapidly becoming the "Home of the Whopper."® During Fiscal 1986, eight Burger King Express mobile restaurants were put into service at college campuses, small towns and recreational areas. Additional Express units will be rolled out this year.

Burger King Corporation

Chairman and Chief Executive Officer
J. Jeffrey Campbell

President
Jay O. Darling

Executive Vice Presidents
Peter J. Campisi
William J. Gill
Glenn W. Jeffrey
Charles R. Petty
Tony B. Rolland
Allen G. Shuh

Senior Vice Presidents
James R. Britt
Wayne A. Saunders
Richard T. Snead
Robert H. Sorensen
Joel J. Weiss

Region Vice Presidents
Ronald S. Busch
Matthew J. Fairbairn
Robert A. Gumm
John H. Kemp, III
Paul R. Lovin, Jr.
Kevin K. Moriarty
Charles S. Olcott
Christy A. Placzek
Mitchel E. Rhoads
James D. Stoops
Richard J. Trutz
Columbus E. Vines

Distron

President
Alan B. Fabricant

Senior Vice Presidents
Donald G. Manson
Roger Stephen Sparling

Godfather's Pizza, Inc.

President
Herman Cain

Executive Vice Presidents
Ronald B. Gartlan
David C. Huether

Quik Wok, Inc.

Senior Vice President/ General Mgr.
Marc Weinstein

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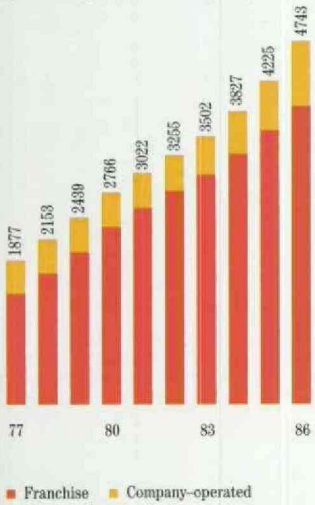
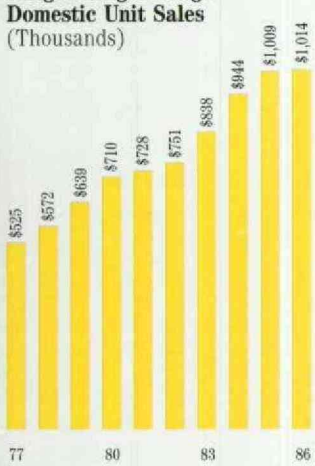
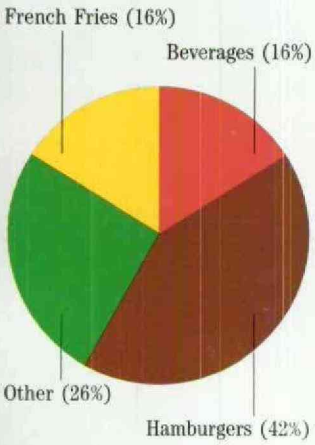
Burger King Restaurants
(Units open as of May 31)



Burger King Average Domestic Unit Sales
(Thousands)



Burger King Menu Mix
Fiscal 1986



In total, 546 new Burger King restaurants were opened during Fiscal 1986, bringing the system to 4,743 stores worldwide. Company-operated stores accounted for 77 of the openings. The rest were opened by franchisees, who are a vital part of the Burger King system. These independent investors provide the entrepreneurial leadership to make Burger King a success in their local communities.

By increasing the base of Company-operated stores, the Diversifoods acquisition provided a unique opportunity for a realignment of corporate assets. A careful review of properties resulted in refranchising 204 Company-operated units and the purchase of 56 other units. The refranchised units had lower returns or were located in markets where economic or demographic profiles favor franchised management, while those bought were in markets where the Company could obtain sufficient scale for managerial, distribution and advertising impact. At year-end, Burger King operated 838 restaurants, representing 18 percent of the total system, up from 635 stores and 15 percent of the system at the end of Fiscal 1985. With the realignment, store operating profit is expected to improve from the average of 15.2 percent of sales achieved in both Fiscal 1986 and 1985.

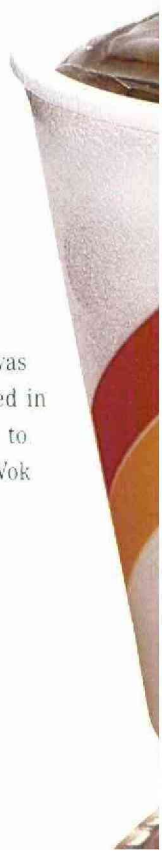
International operations were profitable for the first time in years as 71 restaurants were opened, primarily in Canada, Germany, the United Kingdom, France and Australia. The highest volume restaurant in the system, doing $5 million in annual sales, is located on the Champs Elysees in Paris. With 402 restaurants in 25 countries, Burger King is undertaking an aggressive expansion program abroad.

Store remodeling continues to be a priority as Burger King seeks to keep its restaurants contemporary, appealing and productive. With nearly 65 percent of sales taken off-premises, emphasis was placed on double drive-thru windows to speed delivery, while improved front counter arrangements with self-serve drink dispensers improved in-store service.

Recognizing its responsibility as a first employer, Burger King is providing leadership in improving the working conditions and environment for its largely teenage workforce. A Crew Education Assistance program, with tuition payments of up to $2,000 for post-secondary education, was made available in nearly all Company restaurants to improve crew recruitment and retention rates. New crew and manager uniforms are also being introduced to improve the self-image of employees and make a positive, professional impression on customers.

Fiscal 1986 was a year of transition and development at both Quik Wok and Godfather's Pizza. New management teams were put in place, strategies were formulated, and implementation begun. Although both concepts reported small losses for the year, Pillsbury is excited about their future prospects.

From a beginning of nine units in San Antonio, Quik Wok expanded to 13 units during the year. Plans call for 30 additional units to be opened in Texas and Louisiana this year. A new store design was developed and home delivery was initiated in April. The home delivery market appears to present exciting opportunities for Quik Wok and will be tested during Fiscal 1987.



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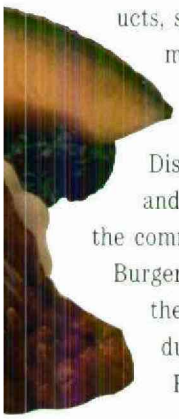
With a limited menu of nine authentic Chinese entrees, Quik Wok is developing a loyal following for the taste and quality of its food. Average store sales during its first year with Pillsbury were $635,000, with newer units doing considerably better.

At Godfather's Pizza, consolidation, rather than expansion, has been the first order of business. Acquired as part of Diversifoods, Godfather's was retained for its good potential and synergy with Pillsbury's pizza technology. Despite a reputation for superior-tasting pizza with generous toppings, Godfather's has experienced poor sales performance for the past three years. High management turnover and strained franchisee relations have taken their toll in a very competitive market. Average restaurant sales slipped another seven percent to $351,000 during Fiscal 1986, although the rate of decline is slowing.

As part of a restructuring program to cut costs and improve profits, the number of restaurants has been pared to 671 from 873. Company-operated stores totaled 163 at year-end. Weaker franchisees have left the system and several lawsuits, which predated Pillsbury's purchase, were resolved. Strong support and commitment by remaining franchisees add confidence to Pillsbury's turnaround strategy. A major move into the rapidly growing home delivery market in selected cities and quality new products, such as Stuffed Pizza now in test market, are key elements of that strategy.



Distron, a highly efficient procurement and distribution system, which supplies the commissary needs of Company-operated Burger King restaurants and 74 percent of the franchised stores, expanded its role during Fiscal 1986 to include other Pillsbury restaurant concepts.

Full Service

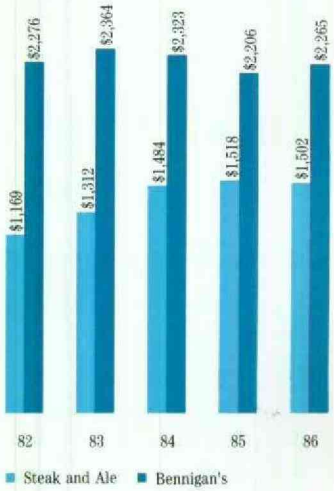
Fiscal 1986 sales $722 million, up 13 percent.

Pillsbury's full service restaurants, operated by S&A Restaurant Corp., turned in another good year as the revitalized Bennigan's®, repositioned Steak and Ale®, and exciting new Bay Street® concepts proved the validity of the Company's diversification strategy. Operating profit rose 13 percent before charges to discontinue the 17-unit JJ. Muggs gourmet hamburger chain.

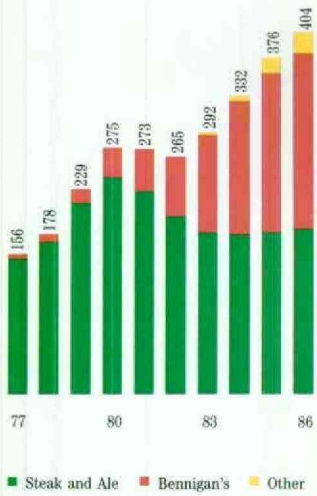
To satisfy the consumer's changing taste for good food served in pleasant and fun environments, S&A strives to provide a balanced portfolio of unique restaurant concepts in various stages of development. As concepts mature, new ones are introduced to provide continued vitality to the system. A new casual dining theme restaurant will be introduced this year to tap new markets.

Bennigan's regained its momentum as the nation's leading casual dining concept. A successful new menu changing the focus to food from liquor helped lift sales and operating profit. After two years of declining restaurant sales linked to lower liquor consumption, average annual sales per unit climbed three percent to $2.3 million. Liquor sales declined slightly during the year to 37 percent of total sales.

Full Service Restaurants Average Unit Sales
(Thousands)



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



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Commodity Marketing

The new 100-item menu is geared to young adults and a grazing-style of eating. It features an interesting array of appetizers, freshly prepared items and non-alcoholic cocktails, and is updated several times a year to provide continuing excitement. Current favorites include Cajun and pasta specialties, Mexican entrees, salads and croissant sandwiches.

Bennigan's opened 20 restaurants during the year, bringing the total to 196. Expansion at the same pace is expected for the next several years.

The most significant menu repositioning in the 20-year history of Steak and Ale was also initiated in an effort to contemporize the popular dinnerhouse concept. A daily variety of fresh seafood is being flown from the coasts to each of the 185 restaurants. New chicken items and an upgraded wine selection were also added. Attention to customer service with all the amenities full service implies continues to distinguish Steak and Ale from other dinnerhouses.

Steak and Ale's average annual sales slipped one percent to $1.5 million per restaurant. Eleven restaurants were added during the year, and seven units were sold.

Bay Street, S&A's newest full service concept, won excellent acceptance during its first year, with average restaurant sales exceeding $2 million. Featuring a wide variety of fresh seafood prepared with differing cooking techniques, the chain is developing the casual, yet elegant, ambiance of a New England fisherman's wharf. Six restaurants in Dallas and Atlanta were open at year-end, and ten more are planned this year as the concept expands into New Jersey, Florida and Illinois.

Pillsbury has moved rapidly to reduce its exposure in the troubled agricultural markets while improving productivity in selected areas where its expertise can be profitably marketed. With the sale of its edible dry bean and rice milling businesses during Fiscal 1986, the Company's Commodity Marketing operations center on an efficient river-based storage and transportation system for grain and bulk commodities, and a feed ingredient business.

A loss of $1.4 million on sales of $156 million represented a significant improvement over Fiscal 1985's loss of $14.9 million on sales of $210 million. The losses include provisions of $7.4 million in Fiscal 1986 and $10.7 million in Fiscal 1985, reflecting the permanent impairment of the barge transportation business.

Over the past three years, Pillsbury's grain merchandising division reduced the size of its system by one-third, while adhering to quality customer service. Today, it is a strategically positioned handler and merchandiser of grain and bulk commodities throughout the upper Midwest and Mississippi River Valley. Utilizing storage capacity for 75 million bushels of grain and a system of 200 barges and seven towboats, Pillsbury handled 225 million bushels of grain and four million tons of other commodities during the year. Decentralized operations, a sophisticated computerized logistics system and a focus on domestic markets has enabled the division to achieve one of the best operating records in the industry.

The feed ingredient business also performed well, despite the weakening farm environment. By providing a market for the by-products of Pillsbury's flour mills, as well as distributing feed to farmers and raw materials to feed manufacturers, Pillsbury has become the nation's largest trader of processed feed ingredients. With its adherence to service and an excellent agricultural credit department which minimizes the impact of the farm debt crisis, it has consistently earned high returns.

S&A Restaurant Corp.

President and Chief Executive Officer
Kyle T. Craig

Executive Vice Presidents
Richard B. Berman
Roger F. Thomson

Senior Vice Presidents
Allen G. Anz
Terry W. Bowmaster
F. Lane Cardwell
John G. Cook
Michael T. Donovan
Dennis L. Hood
Donald J. Slater

Vice Presidents
Scott W. Burcham
Levy H. Curry
Vanda M. Davey
Robert M. Hartnett
Gary A. Link
Alan R. Palmieri
Dennis W. Phillips
Roy E. Study
Robert S. Svehlak
George R. Van Derven

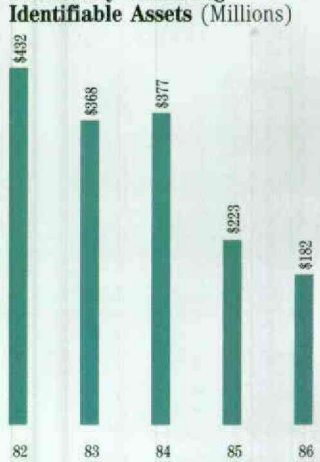
Commodity Marketing

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

Commodity Marketing Identifiable Assets (Millions)



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Corporate Responsibility

Pillsbury's corporate conduct is guided by a belief that people make the difference, quality is essential and excellence must be a way of life. These values determine how the Company relates to the various publics it serves — its customers, employees, communities and society as a whole.

Pillsbury is proud of its heritage and is committed to conducting its business in keeping with the highest ethical standards. Uncompromising product quality and safety are rigidly enforced. As one of the nation's largest advertisers, the Company also adheres to strict standards of integrity and good taste in its promotional material. The Company screens all television programs on which its commercials are to appear, and withdraws from those judged to be unfit for family viewing or which fail to respect religious, ethnic or human values.

To achieve its goals, Pillsbury seeks to attract, motivate and retain the most talented people in industry. Through fully competitive compensation, a practice of open and timely two-way communication, and efforts to foster innovation and risk taking, the Company encourages and rewards the pursuit of excellence, as attested by the Leadership Award winners shown on this page.

With 108,100 employees worldwide, Pillsbury is committed to equal employment opportunity, effective employee development, internal promotion and thoughtful successor planning. In a significant move last year, the criteria for officer incentive awards was changed to require specific progress toward these human resource goals.

At year-end, 17,500 employees held 1.6 million shares of Pillsbury stock under various Company-sponsored investment plans. The Company encourages stock ownership by employees in order to foster a commonality of interest with shareholders and to provide employees with an opportunity to share in the rewards of their efforts.

Pillsbury has a rich history of community involvement and philanthropic giving which was further enhanced during Fiscal 1986 by a variety of programs focused in the areas of youth and hunger. Cash contributions of $6.7 million were supplemented by a $750,000 land grant to the National Park Service by Burger King, the donation of more than three million pounds of Pillsbury products to a nationwide surplus food program, and the time and technical expertise of hundreds of employee volunteers.

To help alleviate hunger and malnutrition, the Company promoted public education programs through national grants to organizations promoting utilization of the Federal Food Stamp program by eligible non-users. A Presidential Award for Private Sector Initiatives was received for two programs linking contribution dollars with the efforts of employee volunteers. One provided the financial and technical support for an applied nutrition program in Bolivia in cooperation with the Meals for Millions/Freedom From Hunger Foundation. The other, Pillsbury's Project Destiny, works with the Survival Skills Institute in Minneapolis to prepare minority students for employment.

In an effort to increase good citizenship among low income and minority youth in Minneapolis, Pillsbury was a catalyst and underwriter for the Youth Volunteerism Program. Known as "Fresh Force," the program has enrolled 1,000 junior high school students to create and carry out a variety of neighborhood volunteer programs ranging from painting houses for the elderly, to cleaning parks and assisting the needy.

The Pillsbury Company Foundation supported numerous cultural, civic and health and welfare organizations, and matched nearly $1 million in employee gifts to United Way organizations, colleges and universities nationwide. The Company's restaurant subsidiaries contributed to a number of educational programs, provided scholarships for law enforcement officers, and funded programs dealing with domestic violence and suicide prevention. Burger King also made a $360,000 grant to the James W. McLamore Children's Center for abused and neglected children in Miami.

Pillsbury Leadership Awards

Special recognition was given in 1986 to five outstanding employees whose significant accomplishments truly made a difference in the Company's performance and who exemplify its Mission and Values. Recipients of Leadership Awards were:

- Robert L. Lindsay, Jr., Vice President of U.S. Foods, whose innovative leadership in the prepared dough business brought productivity, vitality and new product success to one of the Company's most important business areas.
- Ronald E. Lund, Vice President and Associate General Counsel, whose creative problem-solving skills and team-building efforts helped resolve numerous complex legal and business issues and contributed to many new profit opportunities.
- Charles H. McGill, III, Vice President, Mergers and Acquisitions, who helped lead the Company through the most active year of acquisitions and divestments in its history, and whose efforts were especially critical in the acquisition of Jeno's, Inc.
- Donald Joseph Slater, Senior Vice President of the S&A Restaurant Corp. and general manager of Bennigan's, whose management skills and menu creativity rejuvenated this popular casual dining chain.
- Henry C. Wendler, Director of Business Development for Häagen-Dazs in Japan, whose single-handed efforts established Häagen-Dazs ice cream as one of the most successful new products in that country.

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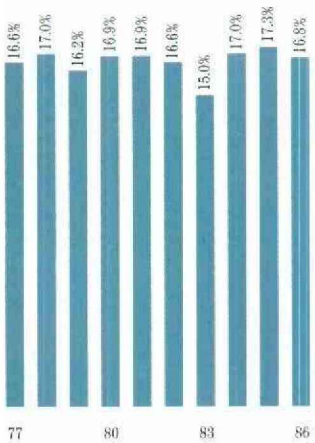
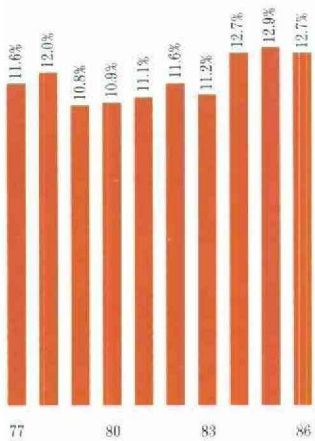
Financial Review

Return On Equity



Return On Invested Capital



Pillsbury's primary goal is to increase the value of its shareholders' investment through a combination of rising dividends and market appreciation of its common stock. In order to be regarded as a premier company, management strives to provide shareholders with a total return that is in the upper third of competitor companies, exceeds the general stock market averages and provides a real return after inflation.

In progressing toward that goal, management has set specific financial objectives which it uses as guidelines for the development and execution of business plans and the evaluation of performance over time. These objectives are to achieve:

- Predictable growth in earnings per share of 12 to 15 percent per year.
- Superior quality earnings with an after-tax return on invested capital of at least 13 percent and a return on shareholders' equity of 18 percent.
- Continued financial flexibility with an "A" credit rating and long-term debt to total capital of approximately 40 percent.

Progress against these objectives often involves tradeoffs and a balancing of priorities. In recent years, management has emphasized growth over current returns. Through the development of profitable investment opportunities, Pillsbury has grown faster than most of its competitors, but has generated lower returns than those companies managing more mature assets. By significantly increasing its investments over the past two years, management accepted some penalty in current earnings to build the base for greater returns in future years. Results for Fiscal 1986 are reported below.

Objective: Predictable Earnings Growth

Over the past ten years, net earnings have grown at a compound annual rate of 16 percent and earnings per share have increased 13 percent. Earnings per share of $4.77 during Fiscal 1986 were eight percent higher than Fiscal 1985's $4.42. The shortfall from the Company's growth objective can be largely accounted for by a 30-cent-per-share dilution from acquisitions during the year, primarily Diversifoods. A strategically important investment, Diversifoods is expected to significantly strengthen the Company's fast food operations and future earnings.

Objective: Superior Quality Earnings

Return on average invested capital (RIC) measures the earning power of the permanent funds invested in the Company, while return on average shareholders' equity (ROE) measures management's ability to use leverage to benefit its shareholders. An after-tax RIC of 12.7 percent and an ROE of 16.8 percent during Fiscal 1986 compare with returns of 12.9 and 17.3 percent—the highest returns in the Company's history—for Fiscal 1985.

Asset management and the sale of low-return businesses have had a favorable impact on both RIC and ROE. During Fiscal 1986, the Company sold The Chart House restaurant chain that had been acquired with Diversifoods, as well as selected Burger King properties to a Master Limited Partnership.

With this report, Pillsbury has revised its definition of capitalization to exclude deferrals, largely deferred taxes, and to include the current portion of long-term debt. The change better portrays the permanent funds invested in the Company and conforms to the definition used by a majority of competitor companies. After-tax RIC increased by approximately one percentage point as a result of this change. Prior year numbers have been restated. ROE is unaffected by the change.

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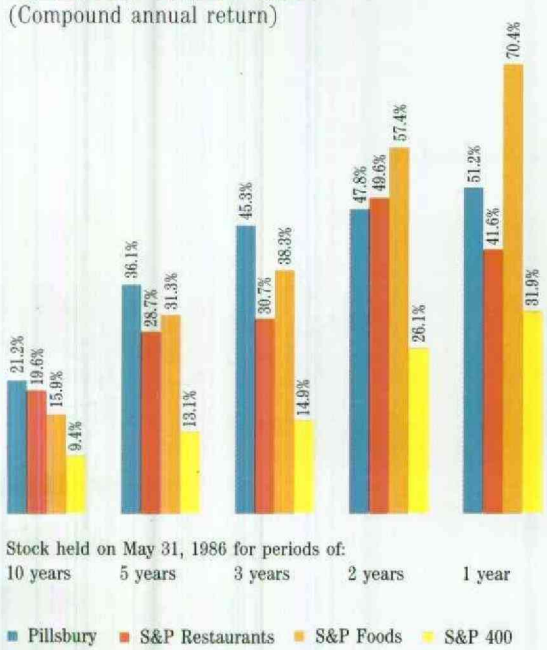
Objective: Financial Flexibility

A strong credit rating is essential to obtaining timely access to the debt markets at favorable interest rates. The Company retained its "A" credit rating on senior debt during Fiscal 1986, despite an increase of $336 million in long-term debt to $1.03 billion. Although a record $1.12 billion was spent for new investments, a 20 percent increase in operating cash flow and the ability to raise more than $300 million from asset sales reduced the need for external financing.

Pillsbury's long-term debt to total capital of 43.8 percent at year-end was the highest in five years, and compares with a restated 37.1 percent for Fiscal 1985. The change in definition of capitalization to be more consistent with rating agency methodology and competitor reporting increased the debt ratio by approximately five percentage points in each year. Prior year numbers have been restated.

Total Return To Shareholders
(Compound annual return)



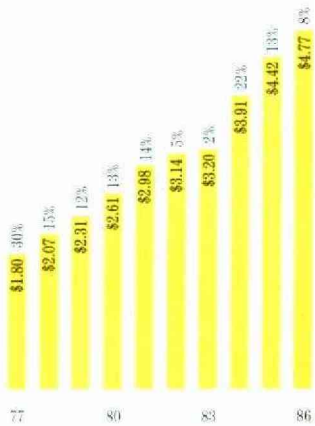
Goal: Superior Total Return to Shareholders

Fiscal 1986 represented another year of excellent returns for Pillsbury shareholders. It was the 28th consecutive year in which the Company has paid higher dividends. Dividends were increased 11 percent to $1.68 per share, and represented 35 percent of total earnings. Historically, the Company has paid out approximately one-third of its annual earnings in dividends. In addition, Pillsbury's stock rose 47 percent. A rising stock market and greater investor recognition of the food and restaurant industries benefited the Company and others in its competitor group.

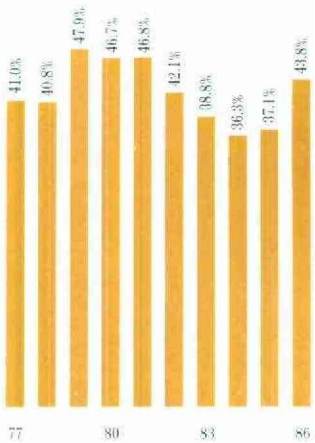
Assuming the reinvestment of dividends, shareholders for the full year earned a total return in excess of 51 percent on their investment. The graph below also shows the total return to shareholders for periods of two, three, five and ten years. Pillsbury's performance has consistently exceeded the rate of inflation, which grew by three percent last year and seven percent on a compound basis over the past ten years. It has also exceeded the compound returns that could have been realized from an investment in the stock market as a whole, as measured by Standard & Poor's (S&P), and has compared favorably with the S&P composite indicies of competitor companies.

At year-end, the total market value of the Company's common stock was $3.49 billion.

Earnings Per Share
(Annual Increase)



Long-Term Debt To Total Capital



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The Pillsbury Company and Subsidiaries

Consolidated Statements of Earnings

	Year ended May 31		
	1986	1985	1984
	(In millions except per share amounts)		
Net sales	**$5,847.9**	$4,843.4	$4,334.8
Costs and expenses:			
Cost of sales	**4,102.6**	3,465.5	3,115.0
Selling, general and administrative expenses	**1,270.9**	984.7	871.9
Interest expense, net	**97.3**	53.0	44.2
	5,470.8	4,503.2	4,031.1
Earnings before taxes on income	**377.1**	340.2	303.7
Taxes on income	**169.0**	148.4	133.9
Net earnings	**$ 208.1**	$ 191.8	$ 169.8
Average number of shares outstanding	**43.7**	43.4	43.5
Net earnings per share	**$ 4.77**	$ 4.42	$ 3.91

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

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Discussion of Earnings

Pillsbury's record of 15 consecutive years of increased sales and earnings has been built on a foundation of strong internal growth and complementary acquisitions. Over the past eight years, beginning with the acquisition of the Green Giant Company, the Company has acquired businesses that added $1.7 billion to Fiscal 1986 sales, or approximately 40 percent of the increase in sales over that period. Higher unit volume in Consumer Foods, aided by new products and strong advertising support, and expansion in Restaurants have been the principal factors accounting for the sales momentum. Price increases have accounted for only one-quarter of the sales growth over the past decade.

During Fiscal 1986, sales increased by $1 billion, or 21 percent, of which half is attributable to acquisitions during the year. One-third of the $500 million, or 12 percent, increase in sales during Fiscal 1985 came from acquisitions that year. Price increases added nominally to sales in the past three years.

Lower commodity costs for most food ingredients resulted in the cost of sales rising less rapidly than sales during Fiscal 1986. The Company's gross margin improved to 30 percent of sales, a ten-year high, from 28 percent in each of the prior two years. Selling, general and administrative expenses, however, rose more rapidly than sales as the Company significantly increased its spending for advertising and promotion. New product introductions, increased competition and a commitment to support its national brand franchises resulted in a 30 percent increase in advertising and promotion to $618 million following a 21 percent increase in Fiscal 1985. Advertising and promotion equated to 35 percent of gross margin, compared with 34 percent in Fiscal 1985 and 32 percent in Fiscal 1984.

Net interest expense rose 84 percent as debt was increased to finance a major investment program, including several large acquisitions. First year operating profits from the acquired businesses did not cover the increased interest cost, resulting in a dilution to earnings and a reduction in the pretax profit margin to 6.4 percent of sales from 7.0 percent in each of the prior two years.

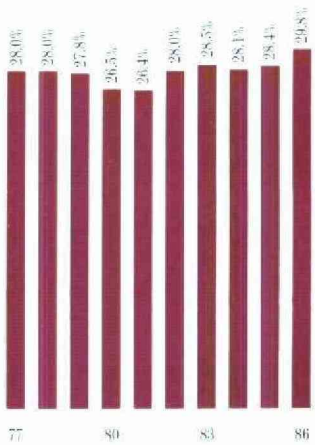
Taxes on income rose 14 percent as the effective federal, state and foreign tax rate climbed to 44.8 percent from 43.6 percent in Fiscal 1985. Excluding asset redeployment gains, which benefit from long-term capital gain treatment, taxes on operations amounted to 46.3 percent of the year's pretax earnings, the highest level in recent years.

Net earnings increased eight percent during Fiscal 1986 and 13 percent during Fiscal 1985. With a lower pretax profit margin and higher taxes, net earnings as a percent of sales slipped to 3.6 percent from 4.0 percent in Fiscal 1985 and 3.9 percent in Fiscal 1984.

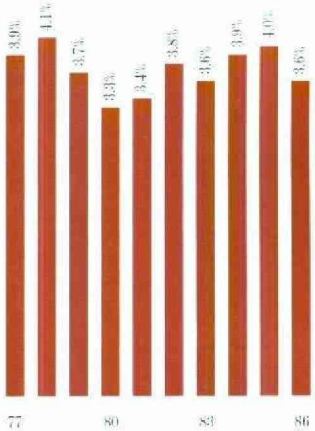
Asset redeployment gains, including the sale of properties and provisions for business restructuring, added seven percent to net earnings over the past three years. Included were $14.9 million in Fiscal 1986, primarily from the sale of Burger King properties to a Master Limited Partnership; $15.7 million in Fiscal 1985, primarily from the sale of the American Beauty pasta business; and $9.2 million in Fiscal 1984 from the sale of investments. In addition, two accounting principle and estimate changes during Fiscal 1986 added $11.5 million to net earnings. These resulted from the adoption of Financial Accounting Standard No. 87 regarding the calculation of pension costs, and the recognition of longer service lives for Burger King buildings and equipment which more closely conform to current industry practice.

Net earnings per share excluding asset redeployments were $4.43, $4.06 and $3.70 for the three years shown. Included in operating earnings for Fiscal 1986 were accounting principle and estimate changes of 27 cents per share and the dilution from acquisitions of 30 cents per share.

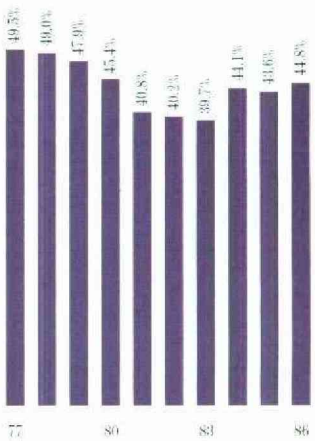
Gross Margin



Net Earnings To Net Sales



Effective Tax Rate



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The Pillsbury Company and Subsidiaries

Consolidated Statements of Changes in Financial Position

	Year ended May 31		
	1986	1985	1984
		(In millions)	
Funds provided from operations:			
Net earnings	**$ 208.1**	$191.8	$169.8
Charges to income not requiring working capital:			
Depreciation	**175.3**	133.9	114.6
Amortization of intangibles	**20.2**	8.8	6.2
Deferred taxes on income	**28.9**	26.1	21.9
	432.5	360.6	312.5
Funds from (used for) changes in working capital employed:			
(Increase) decrease in receivables	**(109.2)**	(27.7)	(5.2)
(Increase) decrease in inventories	**(57.4)**	7.4	(49.5)
(Increase) decrease in other current assets	**(34.2)**	87.8	17.4
Increase (decrease) in accounts and drafts payable	**166.4**	(22.0)	89.6
Increase (decrease) in advances on sales	**57.0**	(101.6)	(.7)
Increase (decrease) in taxes on income	**21.4**	11.9	(4.3)
Increase (decrease) in other current liabilities	**124.5**	28.9	28.6
	168.5	(15.3)	75.9
Funds from conversion of noncurrent assets:			
Disposals of property, plant and equipment	**125.3**	33.1	30.9
Proceeds from sale of notes with recourse	**24.2**	22.3	33.7
Proceeds from disposal of other assets	**134.6**	21.9	22.2
Other, net	**21.5**	11.5	4.5
	305.6	88.8	91.3
Total funds generated internally	**906.6**	434.1	479.7
Funds utilized for investment activities:			
Capital expenditures	**(308.5)**	(327.1)	(282.4)
Additions to other noncurrent assets	**(51.8)**	(78.0)	(50.7)
Noncurrent assets of acquired companies:			
Property, plant and equipment	**(333.1)**	(67.6)	(23.9)
Intangibles	**(272.9)**	(86.6)	(61.0)
Other assets	**(151.3)**		
	(1,117.6)	(559.3)	(418.0)
Net funds generated (used) before financing activities	**(211.0)**	(125.2)	61.7
Funds from (used for) financing activities:			
Issuance of long-term debt	**454.5**	219.3	54.2
Long-term debt of acquired companies	**155.3**	5.2	3.6
Retirements of long-term debt	**(282.8)**	(132.5)	(65.1)
Increase (decrease) in notes payable	**10.8**	(6.0)	6.8
Income tax cash flows from tax lease	**(15.0)**	17.0	19.0
Issuance (purchase) of common stock, net	**(2.0)**	5.2	(8.4)
Cash dividends	**(73.0)**	(65.8)	(58.9)
	247.8	42.4	(48.8)
Increase (decrease) in cash and equivalents	**$ 36.8**	$(82.8)	$ 12.9

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

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Discussion of Changes in Financial Position

Fiscal 1986 was a year of major investment in the Company's future. A record $1.12 billion was invested in acquisitions, capital expenditures and other activities to expand the Company's participation in the food-at-home and food-away-from-home markets. That was twice the level of Fiscal 1985's investment spending, and equal to 60 percent of Pillsbury's total invested capital at the beginning of the year.

More than $757 million was invested in acquisitions, compared with $154 million a year earlier. Diversifoods, a broad-based restaurant management company, and Jeno's, a manufacturer of frozen pizza, were the two largest investments of the year and were acquired for a total of $503 million in cash and notes plus $123 million in assumed debt. Five other businesses were also acquired. Included in the year's acquisition activity was $151 million in noncurrent assets, primarily restaurant properties from Diversifoods that did not meet Pillsbury's investment criteria and are being sold. During Fiscal 1985, the Company acquired Van de Kamp's frozen fish business, while the Häagen-Dazs ice cream companies were purchased in Fiscal 1984.

Internal investments, primarily capital expenditures, totaled $360 million, 12 percent less than in Fiscal 1985, as Burger King reduced spending to concentrate on integrating units acquired from Diversifoods. Still, Burger King accounted for approximately half of all capital expenditures for the year. Nearly three-quarters of the $918 million invested in capital projects over the past three years has gone toward expansion within the Restaurants Group. A new Häagen-Dazs plant, the largest project in Consumer Foods in recent years, was completed in Fiscal 1985.

To finance this growth, Pillsbury drew heavily on both internal and external sources of funds. Internal funding consists of operating cash flow, changes in working capital employed and asset redeployment. Internal funds more than doubled to $907 million and generated 81 percent of the year's funding requirements. Historically, internal cash generation meets at least 80 percent of the Company's funding needs.

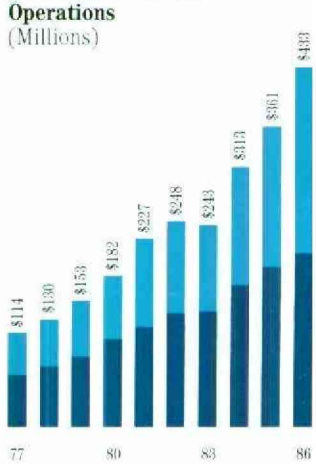
Funds provided from operations are the primary source of the Company's financial strength. Operating cash flow increased 20 percent to $432 million during the year as higher net earnings were supplemented by a 37 percent increase in depreciation and amortization on the Company's expanded asset base. Including deferred taxes, noncash charges exceeded net earnings for the first time in ten years.

A concentrated effort to minimize the use of long-term debt as well as the short-term funding requirements of the businesses resulted in a $169 million reduction in working capital employed.

The sale of underperforming assets is fundamental to Pillsbury's financing philosophy. During Fiscal 1986, more than $300 million was raised through the sale of assets. A number of properties acquired with Diversifoods, including the 54-unit Chart House restaurant chain and Luther's Bar-B-Q restaurants, were sold, as were the rice milling and edible dry bean portions of Commodity Marketing and a small fillo dough business. In addition, the real estate underlying 128 franchised Burger King restaurants was sold to a Master Limited Partnership, and 204 other Company-operated Burger King restaurants were refranchised. During Fiscal 1985, the Company sold the American Beauty pasta business.

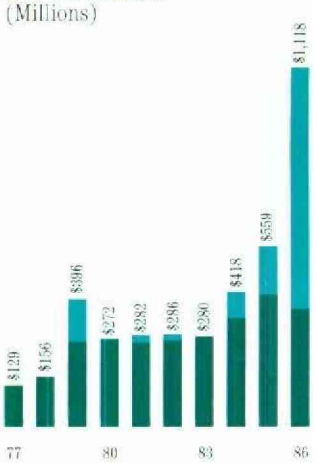
Including the debt of acquired companies, Pillsbury increased its long-term debt by $336 million during the year. Three bond issues totaling the U.S. dollar equivalent of $325 million were issued at interest rates ranging from 6⅝ to 11⅛ percent. Pillsbury paid dividends of $73 million in Fiscal 1986, a 24 percent increase from Fiscal 1984.

Funds Provided From Operations
(Millions)



■ Net Earnings ■ Depreciation and other

New Investments
(Millions)



■ Capital expenditures / other
■ Acquisitions

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The Pillsbury Company and Subsidiaries
Consolidated Balance Sheets

	May 31 1986	May 31 1985
	(In millions)	
Assets		
Current assets:		
Cash and equivalents	**$ 96.5**	$ 59.7
Receivables, less allowances of $15.3 million and $10.6 million, respectively	**492.7**	383.5
Inventories	**490.2**	432.8
Advances on purchases	**30.0**	18.7
Prepaid expenses	**49.7**	26.8
Total current assets	**1,159.1**	921.5
Property, plant and equipment	**1,763.2**	1,403.0
Net investment in direct financing leases	**193.3**	189.3
Intangibles	**421.6**	163.2
Other assets	**121.6**	101.5
	$3,658.8	$2,778.5
Liabilities and Shareholders' Equity		
Current liabilities:		
Notes payable	**$ 22.1**	$ 11.3
Long-term debt, current portion	**52.1**	40.8
Accounts and drafts payable	**513.6**	347.2
Advances on sales	**91.4**	34.4
Employee compensation	**118.6**	76.1
Taxes on income	**49.8**	28.4
Other liabilities	**287.9**	205.9
Total current liabilities	**1,135.5**	744.1
Long-term debt, noncurrent portion	**972.9**	647.7
Deferred taxes on income	**202.5**	192.4
Other deferrals	**33.7**	28.9
Shareholders' equity:		
Preferred stock, without par value, authorized 500,000 shares, no shares issued		
Common stock, without par value, authorized 80,000,000 shares, issued 43,998,859 shares and 43,991,279 shares, respectively	**325.2**	324.9
Common stock in treasury at cost, 534,194 shares and 610,874 shares, respectively	**(24.4)**	(23.3)
Accumulated earnings	**1,050.4**	916.5
Accumulated foreign currency translation	**(37.0)**	(52.7)
Total shareholders' equity	**1,314.2**	1,165.4
	$3,658.8	$2,778.5

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

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Discussion of Balance Sheets

Pillsbury's Balance Sheet for Fiscal 1986 reflects the financing and asset redeployment measures taken to accommodate the largest investment program in the Company's history. While quite strong, as demonstrated by a 13 percent increase in shareholders' equity, it is less liquid than in prior years as long-term debt was increased and working capital reduced.

Increases in both current assets and current liabilities reflect the assumption of receivables and payables of acquired companies, as well as the overall growth of the business. Inventories increased primarily because of a larger vegetable pack in Fiscal 1986. Better management of working capital requirements and the continuing shift in the mix of the Company's businesses toward restaurants, which typically require low inventories and have no receivables, enabled a reduction in working capital to $24 million from $177 million at year-end Fiscal 1985. The ratio of current assets to current liabilities of 1-to-1 was the lowest in years and compared with a ratio of 1.2-to-1 in the prior two years, and 1.4-to-1 for most of the past decade.

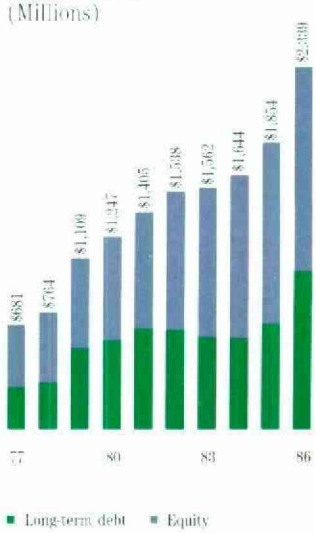
Total assets increased by nearly one-third, or $880 million, during the year as a result of acquisitions and capital expenditures. Additions to property, plant and equipment and current assets accounted for almost $600 million of the increase. Intangibles of acquired companies accounted for the balance, and increased by more than 150 percent.

During the year, asset turnover, which measures sales in relation to total assets, remained unchanged at 1.8, a ten-year high.

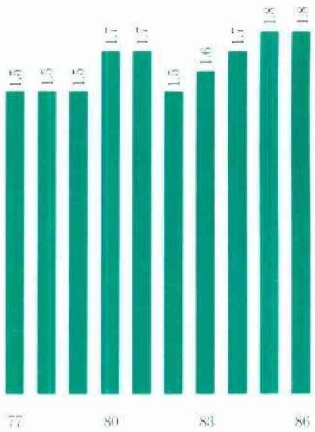
Long-term debt, including the current portion, increased almost 50 percent and represented 44 percent of total capitalization. With an 84 percent increase in interest cost, the Company's pretax fixed coverage ratio, which measures the ability to pay interest and rental charges, declined to 2.4 from 2.8 in Fiscal 1985. Pretax interest coverage of 4.3 was the lowest in a number of years, and compares with a coverage of 6.2 a year ago.

However, with an "A" credit rating and approximately $475 million in various bank credit lines available, management believes it has adequate financing flexibility to meet external funding requirements in Fiscal 1987. Strong cash flow from operations, supplemented by further asset sales, is expected to meet projected internal funding requirements, including capital expenditures, of approximately $450 million during the coming year.

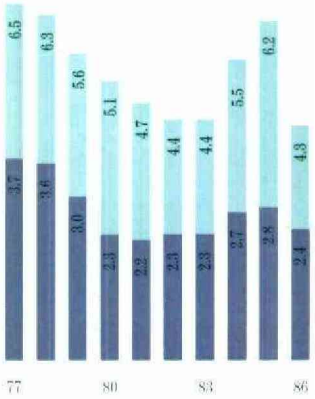
Capitalization
(Millions)



Asset Turnover



Coverage Ratios



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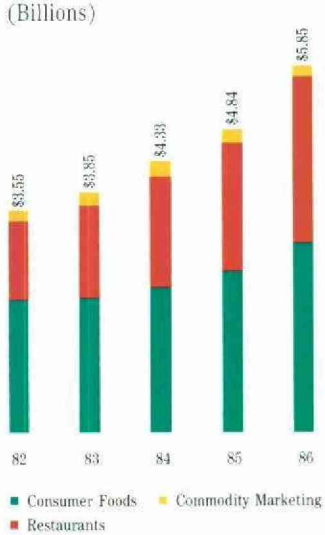
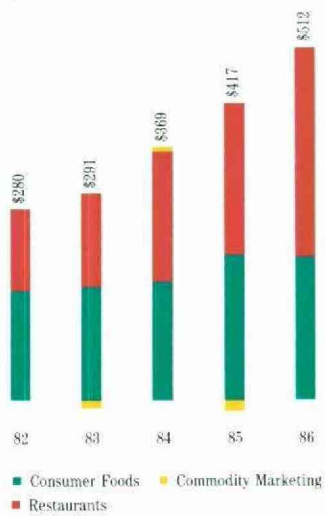
Segment Analysis

Net Sales
(Billions)



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.

This strategy has resulted in a significant increase in investments in Restaurants in recent years and a corresponding increase in that segment's contribution to sales and operating profit. During Fiscal 1986, Restaurants accounted for 46 percent of sales and 60 percent (55 percent excluding asset redeployment gains) of operating profit. Five years ago, Restaurants were 36 percent of sales and 38 percent of operating profit.

Consumer Foods has generated more than 50 percent of total sales in each of the past five years. Its contribution to operating profit, however, declined to 41 percent (44 percent excluding asset redeployment gains) in Fiscal 1986 from 53 percent five years earlier.

Identifiable assets in Commodity Marketing have been reduced by half in the past two years, and currently represent five percent of the Company's total. The segment accounted for only three percent of sales in Fiscal 1986 and incurred a small loss.

The following summarizes the Company's operating results for the past two years by business segment.

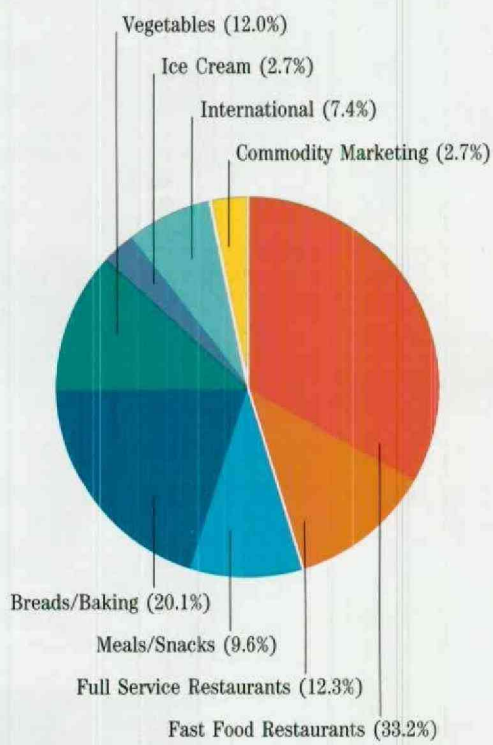
Net Sales

Net sales of $5.85 billion were 21 percent higher than in Fiscal 1985 and 35 percent greater than in Fiscal 1984. Restaurants sales increased by almost $900 million, or 51 percent, over the two years, while Consumer Foods posted a $700 million, or 30 percent, increase. Commodity Marketing sales declined as portions of that business have been sold.

Half of the increase in sales for Consumer Foods during Fiscal 1986 resulted from acquisitions. New products and volume increases in existing businesses contributed to significant sales increases in all areas except family flour and dessert mixes in each of the past two years. Excluding acquisitions, volume grew seven percent in the United States in Fiscal 1986 and five percent in Fiscal 1985. International sales rose sharply in Europe, where several recent acquisitions have added scale to the business, but declined for the second year in a row in Latin America. Higher exports of flour and canned corn also benefited sales. Prices were increased an average of 1.6 percent last year and 1.1 percent in Fiscal 1985.

The acquisition of Diversifoods accounted for more than half of the 30 percent increase in Restaurants sales in Fiscal 1986. Nearly 1,000 Burger King restaurants have been opened by the Company and its franchisees during the past two years, and sales per restaurant, while essentially flat in Fiscal 1986, have risen seven percent since Fiscal 1984. More than 80 full service restaurants also were opened in the past two years, mostly in the Bennigan's concept. Bennigan's average restaurant sales increased three percent during Fiscal 1986, but have not fully recovered from a drop in liquor sales which began in Fiscal 1984. Pillsbury's average restaurant prices increased 3.5 percent in Fiscal 1986 and 1.7 percent in Fiscal 1985.

Fiscal 1986 Net Sales



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Operating Profit

Segment operating profit rose 23 percent to $511.6 million in Fiscal 1986 and has increased 39 percent during the past two years. Acquisitions accounted for 30 percent of last year's increase. An additional 19 percent of the year's improvement, and half of that for Fiscal 1985, came from asset redeployment gains. Accounting principle and estimate changes adopted in Fiscal 1986 represented another 22 percent of the year's profit growth.

Consumer Foods had an exceptionally strong year, despite a one percent decline in reported profit. A $38.9 million gain on the sale of the American Beauty pasta business in Fiscal 1985, and minor restructuring changes in each of the past two years, obscured actual operating trends. Excluding these asset redeployment effects, operating profit rose 20 percent to $215.5 million, compared with a year-earlier gain of three percent.

One-third of this improvement came from acquisitions. Market share gains in most product lines, several new products and lower ingredient costs were the principal factors contributing to the year's success. In Fiscal 1985, the breads and baking products area was penalized by the lingering impact of a pesticide scare and costs associated with two disappointing new products.

Operating profit for Restaurants rose 38 percent last year and increased 63 percent since Fiscal 1984. Included in Fiscal 1986 was a gain of $32.2 million from the sale of Burger King real estate to a Master Limited Partnership and a provision to discontinue the JJ. Muggs restaurant concept.

Excluding this gain, operating profit of $272.5 million was 24 percent higher than a year earlier. An extension of the depreciable lives of Burger King properties, refranchising gains at Burger King and unit expansion accounted for the growth. Industry softness prevented Burger King from increasing either its sales per unit or its operating profit margin at Company restaurants. Both Godfather's Pizza and Quik Wok posted small losses for the year. Full service restaurants benefited from unit expansion and a new menu at Bennigan's, while Steak and Ale's profits declined slightly.

Losses in Commodity Marketing in each of the past two years reflect provisions totaling $17.8 million to recognize a permanent impairment of the barge transportation business. Excluding those losses, operating profit of $5.3 million was earned on increased grain storage revenue during Fiscal 1986, representing a recovery from a year-earlier loss.

General Corporate and Interest Expense

General corporate expense increased 59 percent to $37.2 million in Fiscal 1986 on top of a 12 percent increase the year before. Higher insurance, management information systems and early retirement costs were largely responsible. Net interest expense rose 84 percent to $97.3 million for the year and was 120 percent higher than in Fiscal 1984. The increase in each of the past two years is attributable to acquisitions.

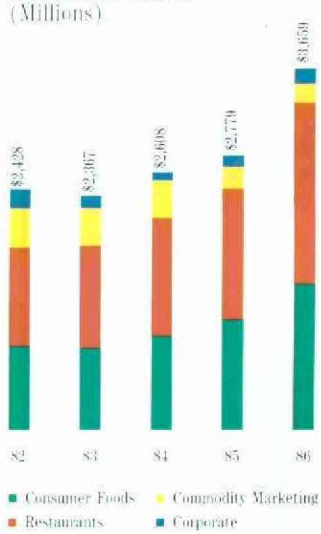
Capital Expenditures

Capital expenditures of $308.5 million were six percent below those of Fiscal 1985, but nine percent higher than in Fiscal 1984. Restaurants accounted for nearly three-fourths of the expenditures in each year. During Fiscal 1986, 121 Company-operated restaurants were opened, the same as in Fiscal 1985. Burger King also participated in financing 26 restaurants for franchisees during the year, down from 42 the year before.

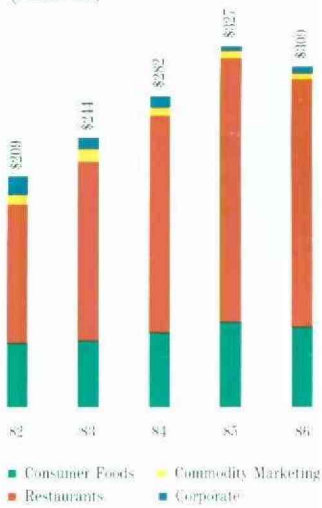
Foreign Operations

Foreign operations accounted for eight percent of sales and five percent of operating profit in Fiscal 1986. Sales have grown by nearly $100 million since Fiscal 1984 and operating profit has increased 70 percent to $27.6 million. Nine percent of the Company's total identifiable assets are invested abroad. Consumer Foods accounts for approximately 85 percent of foreign sales and most of the operating profit. Foreign operations of Burger King are largely franchised.

Identifiable Assets
(Millions)



Capital Expenditures
(Millions)



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Summary by Industry Segment	Year ended May 31		
	1986	1985	1984
		(In millions)	
Net sales:			
Consumer Foods	**$3,029.0**	$2,580.0	$2,325.3
Restaurants	**2,663.2**	2,053.3	1,768.7
Commodity Marketing	**155.7**	210.1	240.8
Total	**5,847.9**	4,843.4	4,334.8
Operating profit:			
Consumer Foods	**208.3**	211.5	173.5
Restaurants	**304.7**	220.0	187.4
Commodity Marketing	**(1.4)**	(14.9)	7.8
Total	**511.6**	416.6	368.7
General corporate expense, net	**(37.2)**	(23.4)	(20.8)
Interest expense, net	**(97.3)**	(53.0)	(44.2)
Earnings before taxes on income	**377.1**	340.2	303.7
Identifiable assets:			
Consumer Foods	**1,477.9**	1,122.6	957.4
Restaurants	**1,841.1**	1,316.1	1,191.2
Commodity Marketing	**182.0**	223.2	377.1
Corporate	**157.8**	116.6	82.6
Total	**3,658.8**	2,778.5	2,608.3
Capital expenditures:			
Consumer Foods	**72.3**	77.2	67.0
Restaurants	**225.3**	240.2	197.4
Commodity Marketing	**3.2**	4.5	6.2
Corporate	**7.7**	5.2	11.8
Total	**308.5**	327.1	282.4
Depreciation expense:			
Consumer Foods	**60.6**	47.5	40.8
Restaurants	**99.9**	71.7	59.5
Commodity Marketing	**8.3**	9.2	9.5
Corporate	**6.5**	5.5	4.8
Total	**175.3**	133.9	114.6
Foreign operations included in the above categories are as follows:			
Net sales	**474.2**	401.2	375.9
Operating profit	**27.6**	22.7	16.2
Identifiable assets	**347.0**	264.1	241.8
Capital expenditures	**30.8**	17.4	20.4
Depreciation expense	**11.7**	10.7	9.7

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. See footnotes to Summary by Quarter on the following page.

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Summary by Quarter (Unaudited)

	Net sales*	Gross margin	Earnings before taxes on income	Net earnings	Per share: Net earnings	Per share: Cash dividends	Per share: Market price High	Per share: Market price Low	Per share: Market price Close
	(In millions)								
Fiscal 1986:									
First quarter(a)	$1,263.3	$ 347.1	$ 82.3	$ 44.2	$1.01	$ .39	$56⅝	$48	$51⅝
Second quarter(a)	1,583.0	482.1	105.1	56.6	1.30	.43	63½	51¼	61
Third quarter(a,b)	1,456.7	430.9	92.5	55.4	1.27	.43	71	58⅜	69⅛
Fourth quarter(a,c)	1,544.9	485.2	97.2	51.9	1.19	.43	80¾	65¾	80¼
Annual(a)	$5,847.9	$1,745.3	$377.1	$208.1	$4.77	$1.68			
Fiscal 1985:									
First quarter	$1,057.1	$ 278.8	$ 70.8	$ 38.9	$ .90	$ .35	$40⅜	$34½	$38
Second quarter(d)	1,304.0	387.5	113.0	66.1	1.52	.39	44⅝	36⅝	40¼
Third quarter	1,213.2	344.9	68.7	39.5	.91	.39	46½	38¾	46⅜
Fourth quarter	1,269.1	366.7	87.7	47.3	1.09	.39	55	44¾	54⅝
Annual	$4,843.4	$1,377.9	$340.2	$191.8	$4.42	$1.52			
Fiscal 1984:									
First quarter	$ 966.8	$ 263.5	$ 62.7	$ 34.8	$ .80	$ .31	$32	$27¾	$31¾
Second quarter(e)	1,172.2	348.7	93.8	52.1	1.20	.35	38	31⅞	37¾
Third quarter	1,073.9	298.5	66.2	36.2	.83	.35	39	34¾	35⅝
Fourth quarter(f)	1,121.9	309.1	81.0	46.7	1.08	.35	41½	33	37⅞
Annual	$4,334.8	$1,219.8	$303.7	$169.8	$3.91	$1.36			

* Net sales have been restated from amounts previously reported as described in Notes to Consolidated Financial Statements.

Earnings before taxes on income include:

(a) Effects of a change in accounting policy for adoption of Statement of Financial Accounting Standards No. 87 "Employers Accounting for Pensions":

$3.1 million gain in each of the restated first three quarters and in the fourth quarter.

$12.4 million gain in the year ($6.7 million Consumer Foods, $3.3 million Restaurants, $.6 million Commodity Marketing and $1.8 million General corporate expense, net) [$6.3 million net earnings—15¢ per share].

(b) $41.0 million gain (Restaurants) from the sale of 128 Burger King real estate properties to a Master Limited Partnership [$28.4 million net earnings—65¢ per share].

$22.5 million provision ($5.2 million Consumer Foods, $8.8 million Restaurants, $7.4 million Commodity Marketing and $1.1 million General corporate expense, net) for discontinuation of JJ. Muggs Restaurant concept, a further impairment of the barge transportation business and a headquarters early retirement program [$12.3 million net earnings—28¢ per share].

(c) $10.2 million benefit (Restaurants) from the lengthening of depreciable lives of Burger King restaurant properties, effective June 1, 1985 [$5.2 million net earnings—12¢ per share].

$1.3 million loss consisting of a $2.0 million loss (Consumer Foods) on the sale of Apollo Foods and a $.7 million gain (Commodity Marketing) on the sale of Pioneer Rice [$1.2 million net earnings—3¢ per share].

(d) $38.9 million gain (Consumer Foods) from the sale of the American Beauty pasta division [$24.3 million net earnings—56¢ per share].

$16.9 million provision ($6.2 million Consumer Foods and $10.7 million Commodity Marketing) 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].

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

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

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1. Accounting policies

Consolidation
The consolidated financial statements include the accounts of the parent company and 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 grain, feed ingredients and export flour, rather than total sales, are included in net sales. Restaurants net sales include franchise fees, royalties and operating lease rentals.

Net sales have been restated for all periods presented to reflect the reclassification of finished goods transportation and warehousing costs as an element of cost of sales instead of a deduction from sales, as previously reported, to conform more closely with industry practice. The impact of this reclassification was to increase both net sales and cost of sales by $201.8 million, $172.8 million and $162.5 million for the years ended May 31, 1986, 1985 and 1984, respectively. There is no impact on previously reported earnings.

Pensions
The Company and its subsidiaries have defined benefit retirement plans covering substantially all salaried and full-time hourly employees. The Company adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" effective June 1, 1985. The impact of this change on Fiscal 1986 earnings is discussed in Note 16.

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 foreign subsidiaries which are not reinvested indefinitely. At May 31, 1986, federal taxes were not provided on approximately $92 million of unremitted earnings of foreign subsidiaries which management intends to reinvest 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 are translated at the end-of-period exchange rates and earnings statements are translated at the average exchange rates for each period. Local currencies, except in Mexico, have been determined to be functional currencies. The resulting translation gains or losses are recorded in the "Accumulated Foreign Currency Translation" caption within shareholders' equity. Because of its hyperinflationary economy, Mexican translation adjustments are recognized immediately in earnings.

Inventories
Grain inventories are stated on the basis of market prices at May 31, including adjustment to market of open grain contracts for purchases and sales. Other domestic inventories are valued at the lower of cost, determined on a last-in, first-out (LIFO) method, or market. Prior to Fiscal 1985, cost was determined by the first-in, first-out (FIFO) method. If the FIFO method had been used at May 31, 1986 and 1985, inventories would have been lower by $10.8 million and $2.3 million, respectively.

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. Effective June 1, 1985, Burger King lengthened the depreciable lives of certain properties. The change increased earnings before taxes on income by $10.2 million.

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

2. Acquisitions and dispositions

Effective July 1, 1985, the Company acquired the outstanding common stock of Diversifoods Inc. for $392 million in cash. Diversifoods, a broad-based restaurant management company, was the largest franchisee of Burger King restaurants. 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 $201.9 million of intangibles and $122.5 million of net assets held for disposal, primarily the Chart House restaurant concept which was sold for $83.0 million in November 1985.

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Pro forma combined results of operations for Fiscal 1985 adjusted for the amortization of excess purchase price and interest on debt incurred in connection with the acquisition, as though the acquisition had occurred June 1, 1984 are: net sales, $5,219.3 million, net earnings, $183.4 million and net earnings per share, $4.23. The pro forma 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.

Effective December 9, 1985, the Company purchased the net assets of Jeno's Inc., a producer of frozen pizzas and hot snack products, for $147.2 million in cash and assumed debt. The acquisition, accounted for as a purchase, included $45.6 million of intangibles.

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 $100.5 million in cash. The acquisition, accounted for as a purchase, included $64.5 million of intangibles.

The results of operations of Jeno's and Van de Kamp's, (included since their respective dates of acquisition) were not material to the consolidated statement of earnings.

In February 1986, the Company sold 128 Burger King real estate properties to a Master Limited Partnership for $84.3 million in cash resulting in a gain of $41.0 million ($28.4 million net earnings—65 cents per share).

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

In addition, during the three-year period ended May 31, 1986 the Company acquired or disposed of other businesses, none of which were material.

3. Inventories

	May 31	
	1986	1985
	(In millions)	
Finished products	**$306.7**	$ 232.0
Raw materials, containers and supplies	**170.3**	157.3
Grain	**13.2**	43.5
	$490.2	$ 432.8

4. Property, plant and equipment

	May 31	
	1986	1985
	(In millions)	
Land and improvements	**$ 245.6**	$ 236.5
Buildings and improvements	**1,324.5**	1,026.2
Machinery and equipment	**975.7**	801.5
	2,545.8	2,064.2
Less accumulated depreciation	**(782.6)**	(661.2)
	$1,763.2	$1,403.0

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		Assets leased to restaurant franchisees	
	1986	1985	**1986**	1985
	(In millions)			
Land and improvements			**$ 85.5**	$ 80.8
Buildings and improvements	**$ 68.7**	$ 50.7	**61.1**	48.2
Machinery and equipment	**20.9**	15.9	**4.0**	2.8
	89.6	66.6	**150.6**	131.8
Less accumulated depreciation	**(38.0)**	(31.4)	**(31.2)**	(27.8)
	$ 51.6	$ 35.2	**$119.4**	$104.0

5. Interest expense, net

	Year ended May 31		
	1986	1985	1984
	(In millions)		
Interest expense on:			
Long-term obligations	**$108.7**	$ 62.3	$ 63.0
Capital lease obligations	**8.6**	5.9	6.2
Short-term obligations	**20.4**	24.0	16.6
Capitalized interest	**(3.9)**	(2.4)	(2.3)
Interest income	**(11.1)**	(14.3)	(18.4)
Amortization of unearned income on direct financing leases	**(25.4)**	(22.5)	(20.9)
	$ 97.3	$ 53.0	$ 44.2

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6. Long-term debt

	May 31 1986	1985
	(In millions)	
11⅛% sinking fund debentures due 2015	**$ 150.0**	
10¼% Euro bonds due 1993	**100.0**	
6⅝% Deutsche Mark bonds due 1992	**75.0**	
12% extendible notes due 1999	**100.0**	$100.0
11½% notes due 1995	**100.0**	100.0
14% notes due 1991	**50.0**	50.0
Restaurant subsidiaries installment notes at 5½% to 16%:		
Unsecured	**245.5**	263.5
Secured (real estate of $82.1 million pledged as collateral)	**53.0**	63.3
Other notes at 6⅝% to 12⅝% (real estate of $91.2 million pledged as collateral)	**74.3**	55.3
Capital lease obligations	**77.2**	56.4
	1,025.0	688.5
Less current portion	**(52.1)**	(40.8)
	$ 972.9	$647.7

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 $159 million of accumulated earnings at May 31, 1986 was available for dividends and the purchase of common stock of the Company.

Maturities of long-term debt, excluding capital lease obligations, for the five fiscal years subsequent to May 31, 1986 are: 1987 ($44.9 million); 1988 ($43.0 million); 1989 ($35.9 million); 1990 ($32.0 million); and 1991 ($89.5 million).

7. Financing commitments

Notes payable at year-end consists of foreign subsidiaries' 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:

	1986	1985	1984
		(In millions)	
Balance at May 31:			
Amount	**$ 22.1**	$ 11.3	$ 17.3
Interest rate	**10.8%**	11.5%	9.6%
Largest month-end balance	**$314.5**	$370.2	$223.6
Weighted average balance	**179.8**	177.4	138.0
Average interest rate	**8.0%**	10.8%	9.5%

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 prevailing market rates. At May 31, 1986, the Company had bank lines of credit of $169.9 million against which $6.4 million of foreign subsidiaries' borrowings were outstanding. Certain bank lines require compensating balances which are not legally restricted.

In addition, the Company has two seven-year revolving credit agreements with several banks totaling $300 million. No borrowings were outstanding under these agreements at May 31, 1986. Interest on borrowings is at the prevailing prime rate or other market rates. The Company pays commitment fees on the unused portions of the commitments.

8. Investments as lessor

Restaurant subsidiaries lease 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)	
1987	$ 29.7	$ 29.7
1988	30.2	28.9
1989	31.0	28.5
1990	31.0	27.0
1991	30.7	26.4
Later	307.3	275.0
	$459.9	$415.5

Net investment in direct financing leases at May 31:	1986	1985
	(In millions)	
Minimum lease payments receivable	**$ 459.9**	$420.9
Allowance for uncollectables	**(4.4)**	(4.0)
Estimated unguaranteed residual value	**3.8**	3.8
Unearned amount representing interest	**(261.4)**	(226.9)
Net investment	**197.9**	193.8
Current portion included in receivables	**(4.6)**	(4.5)
Net investment in direct financing leases	**$193.3**	$189.3

Rental income:	Year ended May 31 1986	1985	1984
		(In millions)	
Minimum rental income	**$31.7**	$26.6	$23.9
Contingent rental income (a)	**32.3**	32.8	27.9
	$64.0	$59.4	$51.8

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

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9. 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)	
1987	$ 15.7	$ 69.1
1988	14.2	62.5
1989	13.1	59.4
1990	12.2	54.9
1991	11.6	49.3
Later	71.8	488.9
Total minimum obligations (b)	138.6	784.1
Executory costs	(.8)	(6.3)
Net minimum obligations	137.8	$777.8(c)
Amount representing interest	(60.6)	
Present value of net minimum obligations	$ 77.2	
Current portion	$ 7.2	

(a) Does not include obligations under term freight agreements for 1,860 barge loads in Fiscal 1987, 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 $362.9 million.

Rental expense:	Year ended May 31		
	1986	1985	1984
		(In millions)	
Minimum rental expense (a)	**$112.2**	$89.0	$82.9
Contingent rental expense (b)	**12.0**	9.1	8.1
Transportation equipment sublease income	**(5.9)**	(6.7)	(7.9)
	$118.3	$91.4	$83.1

(a) Includes rentals under leases with terms of one year or less. Payments under term freight agreements of $15.6 million, $21.3 million, and $26.1 million for Fiscal 1986, 1985 and 1984, respectively, are not included.
(b) Includes contingent rental expense under both capital and operating leases.

10. Taxes on income

	Year ended May 31		
	1986	1985	1984
		(In millions)	
Earnings before taxes on income consists of:			
Domestic	**$349.6**	$318.8	$288.1
Foreign	**27.5**	21.4	15.6
	$377.1	$340.2	$303.7
Taxes on income consists of:			
Current:			
Federal	**$127.4**	$113.8	$ 97.4
Investment tax credit	**(8.2)**	(9.0)	(11.8)
	119.2	104.8	85.6
State	**19.4**	16.8	15.2
Foreign	**6.9**	1.5	9.7
	145.5	123.1	110.5
Deferred:			
Federal	**16.8**	22.3	19.4
State	**2.7**	2.4	2.0
Foreign	**4.0**	.6	2.0
	23.5	25.3	23.4
	$169.0	$148.4	$133.9

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

Expected federal tax rate	**46.0%**	46.0%	46.0%
State income taxes, net of federal income tax benefit	**3.2**	3.1	3.1
Investment tax credit	**(2.2)**	(2.6)	(3.9)
Other, net	**(2.2)**	(2.9)	(1.1)
	44.8%	43.6%	44.1%

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:

Excess of tax over book depreciation	**$32.0**	$38.3	$15.4
Change in reserves not currently deductible for taxes	**(7.2)**	(11.6)	3.4
Installment sales	**1.2**	(5.3)	1.1
Interest on zero coupon notes	**(1.0)**	7.0	
Other, net	**(1.5)**	(3.1)	3.5
	$23.5	$25.3	$23.4

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11. Shareholders' equity

	Shares of common stock outstanding	Common stock	Treasury stock	Accumulated earnings	Accumulated foreign currency translation	Total
	(In millions)			(In millions)		
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 8⅜% 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
Net earnings				208.1		208.1
Translation adjustment					15.7	15.7
Cash dividends				(73.0)		(73.0)
Purchase of treasury stock	(.2)		(14.0)			(14.0)
Stock issued for:						
Conversion of subordinated debentures		.2				.2
Stock option and performance unit plans	.3	.1	12.9	(1.2)		11.8
Balances at May 31, 1986	43.5	$325.2	$(24.4)	$1,050.4	$(37.0)	$1,314.2

At May 31, 1986, there were outstanding 43,464,665 rights to purchase Series C Junior participating preferred stock. The rights were issued as a dividend on January 21, 1986 at the rate of one right for each outstanding share of common stock. Each right entitles the holder to purchase from the Company a unit (one two-hundredth of a share) of Series C Junior participating preferred stock without par value at $200 per unit. The rights are not exercisable or transferable apart from the common stock until ten days after a person or group has acquired 20 percent or more, or makes a tender offer for 30 percent or more, of the Company's common stock. The Series C Junior participating preferred stock will entitle the holder, under certain circumstances (a merger, acquisition of 50 percent or more of the common stock of the Company by an acquiring person or sale of 50 percent or more of the Company's assets or earning power), to acquire, at half their value, either common stock or other securities of the Company or common stock of the acquiring person. Any such event would also result in any rights owned beneficially by the acquiring person or its affiliates becoming null and void. The rights expire on January 21, 1996 and are redeemable for a limited time after an acquiring person has acquired 20 percent or more of the Company's common stock at one cent per right.

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12. 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 percent of the fair market value at date of grant and expire ten years thereafter. Nonqualified stock options become exercisable in cumulative annual installments of 25 percent 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, 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)	
Balances at May 31, 1985	695,299	422,049	9-47
Granted	275,750		53-76
Becoming exercisable		255,362	18-47
Exercised	(290,394)	(290,394)	9-47
Cancelled	(42,021)	(25,545)	
Balances at May 31, 1986	638,634	361,472	10-76

An additional 812,321 shares are available for grant through Fiscal 1988. Shares of common stock reserved for options at May 31, 1986 were 1,450,955. Option shares outstanding at May 31, 1986 were granted in Fiscal 1982 and prior years (144,414); 1983 (37,006); 1984 (66,150) 1985 (127,564) and 1986 (263,500). Unexercisable option shares outstanding at May 31, 1986 become exercisable in Fiscal 1987 (251,480); 1988 (10,055); 1989 (10,058) and 1990 (5,569).

13. 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 limited recourse, notes receivable with remaining uncollected balances at May 31, 1986 of approximately $53 million. In the opinion of management, disposition of these matters will not materially affect the Company's consolidated financial position.

14. 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 percent 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 percent. Awards of 207,784 performance units were outstanding at May 31, 1986 at a weighted average award value of $31.17 each. An additional 955,216 units are available for awarding through Fiscal 1989.

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

Expenses incurred under the above compensation plans (excluding base salary) were approximately $33.9 million in Fiscal 1986, and $27.7 million in each of Fiscal 1985 and 1984.

15. 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:

	1986	1985	1984
		(In millions)	
Net sales	**$474.2**	$401.2	$375.9
Net earnings	**16.6**	19.3	3.9
Total assets	**358.0**	273.1	251.1
Net tangible assets	**172.8**	132.5	103.0
Excess of investments over equity in net tangible assets	**12.5**	11.9	7.8

Net foreign currency transaction losses were not material in any of the years.

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16. Retirement plans

The Company and its subsidiaries have noncontributory defined benefit retirement plans covering substantially all salaried and full-time hourly employees. Benefits for salaried employees are based on final average compensation. The hourly plans include various monthly amounts for each year of credited service. Substantially all of the plans are funded by annual contributions to tax exempt trusts. The Company's funding policy is consistent with the funding requirements of federal law and regulations. Plan assets consist principally of listed equity securities and corporate obligations and U.S. government bonds.

In Fiscal 1986, the Company adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (SFAS 87), retroactive to June 1, 1985. Pension cost and related disclosures are determined under the provisions of SFAS 87 for Fiscal 1986 and under the provisions of previous accounting principles for Fiscal 1985 and 1984. The effect of the change was to reduce pension expense in Fiscal 1986 by $12.4 million.

Net pension cost consists of the following:

	Year ended May 31, 1986 (In millions)
Service cost—benefits earned during the year	$ 7.2
Interest cost on projected benefit obligation	23.9
Actual return on plan assets	(96.3)
Deferred gain	66.8
Amortization of transition asset	(7.8)
Net pension credit	$ (6.2)

The Company and its subsidiaries are also participants in multiemployer defined benefit pension plans covering a small number of hourly employees. The pension cost for multiemployer pension plans in Fiscal 1986 was $1.1 million.

At May 31, 1986, the weighted average discount rate and rate of increase in future compensation used in determining the actuarial present value of the projected benefit obligation were nine percent and six percent, respectively. The expected long-term rate of return on plan assets was ten percent.

The funded status of the plans and the amount recognized on the balance sheet are as follows:

	May 31, 1986 (In millions)
Actuarial present value of benefit obligation:	
Vested benefits	$(202.2)
Nonvested benefits	(21.2)
Accumulated benefit obligation	(223.4)
Effect of projected future compensation increases	(69.7)
Projected benefit obligation	(293.1)
Plan assets at fair value	389.6
Plan assets in excess of projected benefit obligation	96.5
Unrecognized prior service cost	.7
Unrecognized net gain	(18.5)
Unrecognized transition asset	(74.8)
Prepaid pension asset	$ 3.9

Pension expense for Fiscal 1985 and 1984 was $7.8 million and $13.2 million, respectively. The reduction in Fiscal 1985 pension expense is due primarily to a one percentage point increase in the rate of return assumption. The actuarial present value of accumulated plan benefits at May 31, 1985 was $181.5 million (of which $18.0 million was nonvested), compared with net assets available for benefits of $298.2 million. The assumed average rate of return used in determining the actuarial present value of benefits for Fiscal 1985 was nine percent, except for those benefits at May 31, 1985 which were matched to a dedicated bond portfolio yielding 15.25 percent.

In addition to providing retirement income benefits, the Company and certain subsidiaries provide 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 retirement age while still working for the Company. The cost of such benefits is recognized as expense as claims are paid, which totaled approximately $4.6 million in Fiscal 1986 and $4.0 million in each of Fiscal 1985 and 1984.

17. Industry segment data

A summary by industry segment is included on page 36.

18. Interim results of operations (unaudited)

A summary by quarter is included on page 37.

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19. Information on effects of changing prices and inflation (unaudited)

Financial statements, prepared using historical costs as required by generally accepted accounting principles, may not reflect the full impact of current costs and general inflation.

The following supplementary disclosures attempt to remeasure certain historical financial information to recognize the effects of changes in current costs using specific price indices. The current cost information is then expressed in average Fiscal 1986 dollars to reflect the effects of general inflation based on the U.S. Consumer Price Index. These procedures involve 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 in Fiscal 1986 and 1985 have been adjusted only for remeasured depreciation expense. The Company adopted the LIFO method for valuing substantially all U.S inventories in Fiscal 1985, therefore, cost of sales are 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 rate is therefore higher than reported in the primary financial statements. If taxes on income were adjusted (using the primary statement effective tax rate of 44.8 percent), net earnings would increase $9.7 million (22 cents per share) under current cost remeasurement.

The adjustment to reflect the current cost impact on depreciation expense would reduce industry segment operating profit as follows: Consumer Foods, $9.1 million; Restaurants, $10.1 million; Commodity Marketing, $1.6 million and General corporate expense, net, $.9 million.

Consolidated statement of earnings adjusted for changing prices:	Year ended May 31, 1986 (In millions)
Net earnings as reported in the primary statements	$208.1
Adjustment to reflect the current cost impact on depreciation expense	(21.7)
Net earnings as adjusted for changes in current cost	$186.4
Gain from decline in purchasing power of net amounts owed	$ 15.8
Increase in current cost of inventory and property, plant and equipment held during the year	18.4
Effect of increase in general inflation	61.4
Excess of increase in general inflation over increase in current cost	43.0
Foreign currency translation adjustment	19.5

At May 31, 1986, current cost of inventory was $479.4 million and property, plant, and equipment, net was $2,005.2 million.

Five-year comparison of selected financial data adjusted for changing prices (Average Fiscal 1986 dollars):	Year Ended May 31				
	1986	1985	1984	1983	1982
	(In millions except per share amounts)				
Net sales	$5,847.9	$4,992.2	$4,642.9	$4,271.8	$4,122.1
Net earnings	186.4	172.5	125.5	98.6	94.4
Gain from decline in purchasing power of net amounts owed	15.8	31.3	30.3	23.0	48.7
Excess (deficit) of increase in general inflation over increase in current cost	43.0	41.1	7.3	(62.2)	49.4
Foreign currency translation adjustment	19.5	(9.8)	(9.5)	(13.3)	(5.3)
Net assets at year-end	1,549.0	1,478.6	1,438.9	1,384.8	1,372.6
Per share information:					
Net earnings	4.27	3.98	2.89	2.27	2.17
Cash dividends	1.68	1.57	1.46	1.34	1.27
Market price at year-end	80⅛	55¼	39¾	31⅜	25¼
Average consumer price index	325.5	315.8	303.9	293.4	280.3

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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.

Accountants' Report

Minneapolis, Minnesota
June 25, 1986

Shareholders and Board of Directors
The Pillsbury Company

We have examined the consolidated balance sheets of The Pillsbury Company and subsidiaries as of May 31, 1986 and 1985, and the related statements of earnings and changes in financial position for each of the three years in the period ended May 31, 1986. 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 45) present fairly the financial position of The Pillsbury Company and subsidiaries at May 31, 1986 and 1985, 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, 1986, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in the method of accounting for pensions as described in Note 16 to the consolidated financial statements.

Touche Ross & Co.

Certified Public Accountants

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Statistical Summary

Restaurants	Year ended May 31 1986	1985	1984	1983	1982
Systemwide Sales (Billions) (Including sales by franchisees)	**$ 5.5**	$ 4.6	$ 4.0	$ 3.3	$ 2.8
Average Unit Sales (Thousands)					
Fast Food					
Burger King (Domestic)	**$1,014**	$1,009	$ 944	$ 838	$ 751
Godfather's	**351**				
Quik Wok	**635**				
Full Service					
Steak and Ale	**1,502**	1,518	1,484	1,312	1,169
Bennigan's	**2,265**	2,206	2,323	2,364	2,276
Bay Street	**2,141**				
Number of Units					
Fast Food					
Burger King	**4,743**	4,225	3,827	3,502	3,255
Godfather's	**671**				
Quik Wok	**13**				
Full Service					
Steak and Ale	**185**	181	179	181	199
Bennigan's	**196**	177	148	109	66
Bay Street	**6**	1			
Other	**17**	17	5	2	
Total	**5,831**	4,601	4,159	3,794	3,520
Store Operating Profit (Company Stores)					
Burger King (Domestic)	**15.2%**	15.2%	16.7%	15.2%	13.3%
Full Service Restaurants	**21.6%**	20.1%	19.9%	21.1%	20.4%
Consumer Foods					
Unit Volume Change	**+16%**	+9%	+9%	−1%	+1%
Advertising and Promotion (Millions)	**$525**	$410	$332	$332	$321
Research and Development (Millions)	**$ 35**	$ 31	$ 28	$ 25	$ 22
Ingredient Cost Index* (1980 = 100)	**92**	101	105	100	102
Pretax Operating Margins**	**7.1%**	6.9%	7.5%	7.7%	7.0%

* U.S. Government Producer Price Index for Foodstuffs

**Without Unusuals

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Eleven Year Summary

Annual Growth Rates 10-Yr. 1976-1986	5-Yr. 1981-1986	1-Yr. 1985-1986		1986	1985
			Operating results:		
14%	11%	21%	Net sales (a)	**$ 5,847.9**	$4,843.4
16	14	27	Gross margin	**1,745.3**	1,377.9
16	14	31	Depreciation	**175.3**	133.9
15	14	12	Research and development	**41.4**	37.1
16	14	30	Advertising and promotion	**617.8**	473.7
20	8	84	Interest, net	**97.3**	53.0
13	13	11	Earnings before taxes on income	**377.1**	340.2
16	12	8	Net earnings	**208.1**	191.8
3	2	1	Average common shares outstanding	**43.7**	43.4
13	10	8	Net earnings per common share	**$ 4.77**	$ 4.42
			Changes in financial position:		
17	14	20	Funds provided from operations	**$ 432.5**	$ 360.6
			New investments–acquisitions	**757.3**	154.2
14	6	(6)	–capital expenditures	**308.5**	327.1
			–other	**51.8**	78.0
			Issuance of long-term debt	**454.5**	219.3
			Retirement of long-term debt	**282.8**	132.5
18	14	11	Cash dividends	**73.0**	65.8
13	12	11	Cash dividends per common share	**1.68**	1.52
			Financial position:		
9	3	26	Current assets	**$ 1,159.1**	$ 921.5
17	13	26	Property, plant and equipment, net	**1,763.2**	1,403.0
14	11	32	Total assets	**3,658.8**	2,778.5
14	11	53	Current liabilities	**1,135.5**	744.1
15	11	26	Invested capital (b)	**2,339.2**	1,853.9
15	9	49	Long-term debt, including current portion (b)	**1,025.0**	688.5
14	12	13	Shareholders' equity	**1,314.2**	1,165.4
11	10	13	Equity per common share	**30.24**	26.87
			Statistics and ratios:		
			Gross margin to net sales (a)	**29.8%**	28.4%
			Net earnings to net sales (a)	**3.6%**	4.0%
			Pretax interest and rent coverage	**2.4**	2.8
			Pretax long-term interest coverage	**4.3**	6.2
			Long-term debt to total capitalization (b)	**43.8%**	37.1%
			Dividend payout	**35.1%**	34.3%
			Return on average equity	**16.8%**	17.3%
			Return on average invested capital (b)	**12.7%**	12.9%
			Market price of common stock–high	**$ 80¾**	$ 55
			–low	**48**	34½
			–close	**80¼**	54⅝
			Shareholders of record (c)	**21,300**	20,900
			Employees:		
			Restaurant subsidiaries	**87,800**	74,400
			Pillsbury and other domestic subsidiaries	**15,800**	14,200
			Foreign subsidiaries	**4,500**	4,300
			Total	**108,100**	92,900

(a) Net sales and related ratios have been restated as described in Notes to Consolidated Financial Statements.

(b) Invested capital, long-term debt, and related ratios have been restated to conform with current year's classification as described in the Financial Review.

(c) Does not reflect the large number of employees (17,500 at May 31, 1986) individually holding and voting shares through Company benefit plans.

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Year ended May 31

1984	1983	1982	1981	1980	1979	1978	1977	1976
(Amounts in millions except per share, shareholders and employees)								
$4,334.8	$3,850.5	$3,549.7	$3,463.6	$3,207.2	$2,259.6	$1,776.7	$1,585.1	$1,525.8
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
84.9	–	22.5	25.2	5.4	135.8	–	–	–
282.4	243.9	208.5	226.5	254.1	230.2	134.1	120.9	83.8
50.7	36.1	54.8	30.6	12.6	29.5	21.7	8.2	1.2
54.2	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
1,643.6	1,561.6	1,538.0	1,404.9	1,246.8	1,109.3	763.8	680.9	595.6
597.4	605.2	648.0	657.7	582.3	531.6	311.7	279.3	242.9
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
28.1%	28.5%	28.0%	26.4%	26.5%	27.8%	28.0%	28.0%	26.8%
3.9%	3.6%	3.8%	3.4%	3.3%	3.7%	4.1%	3.9%	3.0%
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
36.3%	38.8%	42.1%	46.8%	46.7%	47.9%	40.8%	41.0%	40.8%
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%
12.7%	11.2%	11.6%	11.1%	10.9%	10.8%	12.0%	11.6%	10.0%
$ 41½	$ 30⅝	$ 23⅜	$ 23	$ 20⅝	$ 23⅞	$ 20⅝	$ 22¼	$ 21¾
27¾	18½	17½	15⅝	13½	16	16¾	17¼	15½
37⅞	28⅝	22⅛	20½	16	16⅛	18⅝	17¾	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

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Board of Directors

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

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

Allen F. Jacobson, *1, 2, 4*
Chairman of the Board and Chief Executive Officer, Minnesota Mining and Manufacturing Company (diversified manufacturer), St. Paul, Minn.

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

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

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

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

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

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

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

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

William H. Spoor, *1, 2, 4*
Chairman Emeritus, The Pillsbury Company

John M. Stafford, *1, 2*
Chairman of the Board, President and Chief Executive Officer

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

Paul S. Gerot,
Chairman Emeritus

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.*

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John M. Stafford

Allen F. Jacobson

William H. Spoor

George S. Pillsbury

W. Michael Blumenthal

George J. Sella, Jr.

Kenneth A. Macke

Robert A. Schoellhorn

Caro E. Luhrs, M.D.

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Officers

Corporate Officers

John M. Stafford
Chairman of the Board, President and Chief Executive Officer

J. Jeffrey Campbell
Executive Vice President and Chairman of the Board and Chief Executive Officer, Burger King Corporation

Roger L. Headrick
Executive Vice President and Chief Financial Officer

Jerry W. Levin
Executive Vice President, Corporate Development and Treasurer

Edward C. Stringer
Executive Vice President, General Counsel, Chief Administrative Officer and Secretary

James R. Behnke
Senior Vice President, Growth and Technology

Richard T. Crowder
Senior Vice President, Strategic Planning and Corporate Risk Officer

Herbert D. Ihle
Senior Vice President and Controller

Timothy C. Sullivan
Senior Vice President, Human Resources

Kyle T. Craig
Vice President and President and Chief Executive Officer, S&A Restaurant Corp.

Kent C. Larson
Vice President and President, U.S. Foods

Thomas R. McBurney
Vice President and Chairman, U.S. Foods

John L. Morrison
Vice President and President, International Foods and Ice Cream

Gerald L. Olson
Vice President, Government Relations

Staff Officers

John E. Bohan
Vice President, Pension Investments

Michael D. Ellwein
Vice President and Assistant General Counsel

Allan E. Fonfara
Vice President, Accounting and Control and Assistant Controller

Jerry L. Ford
Vice President, Administrative Services

John M. Hammitt
Vice President, Information Management

Kenneth A. Johnson
Vice President and Tax Counsel

Gerald T. Knight
Vice President and Deputy Controller

Ronald E. Lund
Vice President, Associate General Counsel and Assistant Secretary

Charles H. McGill
Vice President, Mergers and Acquisitions

Jack H. Morris
Vice President, Investor Relations

Dan C. Rengers
Vice President, Industrial Relations

Mahlon C. Schneider
Vice President and Assistant General Counsel

Johnny W. Thompson
Vice President, Public Relations

Ralph O. Thrane
Vice President, International Acquisitions

Carol B. Truesdell
Vice President, Community Relations

Robert G. Walker
Vice President, Engineering

Barbara E. Buisman
Assistant Secretary

Kim E. Cornell
Assistant Treasurer

Charles H. Gauck
Assistant Secretary

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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 Trust Company, Inc.
Third Floor, First Trust Center
180 East Fifth Street
St. Paul, MN 55101

Annual Meeting
The annual meeting will be held at the Guthrie Theater, 725 Vineland Place, Minneapolis, Minnesota at 2:00 p.m. Central Daylight Time, Tuesday, September 9, 1986.

All shareholders are invited to attend. Those unable to do so may listen to the proceedings by calling 1-900-410-3663 between the hours of 2:00 and 3:00 p.m. This is not a toll free number and persons using the service will be charged 50 cents for the first minute and 35 cents for each additional minute. The service provides one-way communication only; callers can listen but cannot be heard.

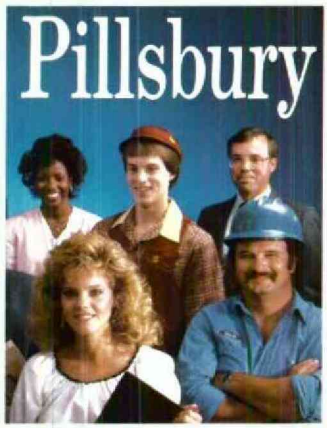
Shareholder Inquiries
Shareholders interested in the current progress of the Company are invited to telephone Investor Relations at (612) 330-8686.

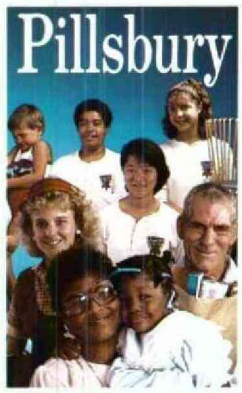
Stock Listing
Pillsbury common stock is listed on the New York, Pacific, Midwest and London Stock Exchanges under the symbol PSY.

Dividend Reinvestment
An Automatic Dividend Reinvestment Plan permits shareholders to reinvest their dividends in Pillsbury common stock automatically and conveniently without service charges or brokerage fees. In addition, participating shareholders may make limited periodic cash investments for the purchase of additional Pillsbury common stock on the same basis. The Plan is voluntary and shareholders may join or withdraw at any time. Full details about the Plan are available by writing to
First Trust Company, Inc.
Attn: Dividend Reinvestment Dept.
Third Floor, First Trust Center
180 East Fifth Street
St. Paul, MN 55101

Other Available Reports
Additional reports on The Pillsbury Company and its activities are available to shareholders without charge by writing to Investor Relations at the Company's general offices. The reports available are:

- Form 10K, an annual report filed with the Securities and Exchange Commission.
- Making the Difference, People of Pillsbury 1986, an employee annual report.
- Community Relations Annual Report covering the Company's contributions and gift-giving policy.





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