GENERAL MILLS INC
Form 10-K
July 26, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED MAY 27, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ________TO_________

Commission File Number 001-01185

GENERAL MILLS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**41-0274440**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
Number One General Mills Boulevard	
Minneapolis, Minnesota	**55426**
(Mail: P.O. Box 1113)	**(Mail: 55440)**
(Address of principal executive offices)	(Zip Code)

(763) 764-7600
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.10 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

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

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

Aggregate market value of Common Stock held by non-affiliates of the registrant, based on the closing price of $56.65 per share as reported on the New York Stock Exchange on November 24, 2006 (the last business day of the registrant s most recently completed second fiscal quarter): $19,451 million.

Number of shares of Common Stock outstanding as of July 13, 2007: 330,188,079 (excluding 172,118,585 shares held in the treasury).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its 2007 Annual Meeting of Stockholders are incorporated by reference into Part III.

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PART I

ITEM 1 Business

COMPANY OVERVIEW

General Mills, Inc. is a leading global manufacturer and marketer of branded, packaged, consumer foods and operates in the consumer foods industry. We are also a leading supplier of branded and unbranded food products to the foodservice and commercial baking industries. As of May 27, 2007, these products are manufactured by us in 18 countries and marketed in more than 100 countries. Our joint ventures manufacture and market products in more than 130 countries and republics worldwide.

General Mills, Inc. was incorporated in Delaware in 1928. The terms General Mills, Company, registrant, we, u and our mean General Mills, Inc. and all subsidiaries included in the Consolidated Financial Statements included in this report unless the context indicates otherwise.

Certain terms used throughout this document are defined in a glossary on page 71 of this report.

PRINCIPAL PRODUCTS

Our major product categories in the United States are ready-to-eat cereals, refrigerated yogurt, ready-to-serve soup, dry dinners, shelf stable and frozen vegetables, refrigerated and frozen dough products, dessert and baking mixes, frozen pizza and pizza snacks, grain, fruit, and savory snacks, microwave popcorn, and a wide variety of organic products including soup, granola bars, and cereal.

In Canada, our major product categories are ready-to-eat cereals, shelf stable and frozen vegetables, dry dinners, refrigerated and frozen dough products, dessert and baking mixes, frozen pizza snacks, and grain, fruit and savory snacks.

In markets outside the United States and Canada, our major product categories include super-premium ice cream, grain snacks, shelf stable and frozen vegetables, refrigerated and frozen dough products, and dry dinners.

TRADEMARKS AND PATENTS

Our products are marketed under trademarks and service marks that are owned by or licensed to us. The most significant trademarks and service marks used in our businesses are set forth in *italics* in this report. Some of the important trademarks used in our global operations include:

Ready-to-eat cereals	*Cheerios, Wheaties, Lucky Charms, Total, Trix, Golden Grahams, Chex, Kix, Fiber One, Reese s Puffs, Cocoa Puffs, Nature Valley, Cookie Crisp, Cinnamon Toast Crunch, Clusters, Oatmeal Crisp, Uncle Tobys*, and *Basic 4*
Refrigerated yogurt	*Yoplait, Trix, Yoplait Kids, Go-GURT, Yoplait Whips!,* and *Colombo*
Refrigerated and frozen dough products	*Pillsbury,* the *Pillsbury Doughboy* character, *Grands!, Golden Layers, Big Deluxe Classics, Toaster Strudel, Toaster Scrambles, Perfect Portions, Jus-Rol, Forno de Minas, Latina, Wanchai Ferry, Saxby s, La Salteña,* and *Frescarini*
Dry dinners and shelf stable and frozen vegetable products	*Betty Crocker, Hamburger Helper, Tuna Helper, Chicken Helper, Old El Paso, Green Giant, Potato Buds, Suddenly Salad, Bac*O s, Betty Crocker Bowl Appetit!, Betty Crocker Complete Meals, Valley Selections, Simply Steam, Wanchai Ferry,* and *Diablitos*
Grain, fruit, and savory snacks	*Nature Valley, Fiber One, Betty Crocker, Fruit Roll-Ups, Fruit By The Foot, Gushers, Chex Mix, Gardetto s,* and *Bugles*
Dessert and baking mixes	*Betty Crocker, SuperMoist, Warm Delights, Bisquick, Gold Medal,* and *Creamy Deluxe*
Ready-to-serve soup	*Progresso*
Ice cream and frozen desserts	*Häagen-Dazs*
	Totino s, Jeno s, Pizza Rolls, Pillsbury Pizza Pops, and *Pillsbury Pizza Minis*

Frozen pizza and pizza snacks	
Microwave popcorn	*Pop Secret*
Organic products	*Cascadian Farm* and *Muir Glen*

Trademarks are vital to our businesses. To protect our ownership and rights, we register our trademarks with the Patent and Trademark Office in the United States, and we file similar registrations in foreign jurisdictions. Trademark registrations in the United States are generally for a term of 10 years, renewable every 10 years as long as the trademark is used in the regular course of trade.

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Some of our products are marketed under or in combination with trademarks that have been licensed from others, including:

Yoplait for yogurt in the United States;

Dora the Explorer for yogurt, cereal, and vegetables;

Curves for snack bars and cereal;

Caribou Coffee and *Second Cup* for snack bars;

Reese s Puffs and certain *Disney* characters for cereal;

Hershey s chocolate for a variety of products;

Weight Watchers as an endorsement for soup;

Best Life Diet for a variety of products;

Mario Batali for dry dinners;

Sunkist for baking products and fruit snacks;

Cinnabon for refrigerated dough, frozen pastries and baking products;

Bailey s for super-premium ice cream; and

a variety of characters and brands for fruit snacks, including *Tonka, My Little Pony*, *Animal Planet*, *Care Bears*, *Teenage Mutant Ninja Turtles*, *Polly Pocket*, *Spiderman,* and various Warner Bros. characters.

We license all of our cereal trademarks to Cereal Partners Worldwide (CPW), our joint venture with Nestlé S.A. (Nestlé). Nestlé similarly licenses certain of its trademarks to CPW, including the *Nestlé* and *Uncle Tobys* trademarks. We also license our *Green Giant* trademark to a third party for use in connection with its sale of fresh produce in the United States. We own the *Häagen-Dazs* trademark and have the right to use the trademark outside of the United States and Canada. Nestlé has an exclusive royalty-free license to use the *Häagen-Dazs* trademark in the United States and Canada on ice cream and other frozen dessert products. We also license this trademark to our joint ventures in Japan, Korea, and Thailand. The J. M. Smucker Company holds an exclusive royalty-free license to use the *Pillsbury* brand and the *Pillsbury Doughboy* character in the dessert mix and baking mix categories in the United States and under limited circumstances in Canada and Mexico.

Given our focus on developing and marketing innovative, proprietary products, we consider the collective rights under our various patents, which expire from time to time, a valuable asset, but we do not believe that our businesses are materially dependent upon any single patent or group of related patents.

RAW MATERIALS AND SUPPLIES

The principal raw materials that we use are grains (wheat, oats, and corn), sugar, dairy products, vegetables, fruits, meats, vegetable oils, and other agricultural products. We also use substantial quantities of carton board, corrugated and plastic packaging materials, operating supplies and energy. Most of these inputs for our domestic and Canadian operations are purchased from suppliers in the United States. In our international operations, inputs that are not locally available in adequate supply may be imported from other countries. The cost of these inputs may fluctuate widely due to government policy and regulation, weather conditions, or other unforeseen circumstances. We have some long-term fixed price contracts, but the majority of our inputs are purchased on the open market. We believe that we will be able to obtain an adequate supply of needed inputs. Occasionally and where possible, we make advance purchases of items significant to our business in order to ensure continuity of operations. Our objective is to procure materials meeting both our quality standards and our production needs at price levels that allow a targeted profit margin. Since these inputs generally represent the largest variable cost in manufacturing our products, to the extent possible, we hedge the risk associated with adverse price movements for some inputs using a variety of risk management strategies. We also have a grain merchandising operation that provides us efficient access to, and more informed knowledge of, various commodity markets. This operation holds physical inventories that are carried at fair market value and uses derivatives to hedge its net inventory position and minimize its market exposures. See Note 7 to the Consolidated Financial Statements on pages 51 through 54 in Item 8 of this report and Item 7A on pages 35 through 36 of this report.

RESEARCH AND DEVELOPMENT

Our principal research and development facilities are located in Minneapolis, Minnesota. Our research and development resources are focused on new product development, product improvement, process design and improvement, packaging, and exploratory research in new business areas. Research and development expenditures were $191 million in fiscal 2007, $178 million in fiscal 2006, and $165 million in fiscal 2005.

FINANCIAL INFORMATION ABOUT SEGMENTS

We review the financial results of our business under three operating segments U.S. Retail, International, and Bakeries and Foodservice. See pages 17 through 20 in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) for a description of our segments. For financial information by segment and geographic area, refer to Note 16 to the Consolidated Financial Statements on pages 67 through 68 in Item 8 of this report.

JOINT VENTURES

In addition to our consolidated operations, we manufacture and sell our products through several joint ventures. See

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page 21 in MD&A for a description of our joint ventures. For financial information on our joint ventures, refer to Note 5 to the Consolidated Financial Statements on pages 49 through 50 in Item 8 of this report.

CUSTOMERS

Our primary customers are grocery stores, mass merchandisers, membership stores, natural food chains, drug, dollar and discount chains, commercial and noncommercial foodservice distributors and operators, and convenience stores. We generally sell to these customers for resale to consumers through our direct sales force. We use broker and distribution arrangements for certain products or to serve certain types of customers. We also use these types of arrangements in less developed markets internationally.

During fiscal 2007, Wal-Mart Stores, Inc. and its affiliates (Wal-Mart), accounted for 20 percent of our consolidated net sales and 27 percent of our net sales in the U.S. Retail segment. No other customer accounted for 10 percent or more of our consolidated net sales. Wal-Mart also represented 5 percent of our net sales in the International segment and 6 percent of our net sales in the Bakeries and Foodservice segment. As of May 27, 2007, Wal-Mart accounted for 20 percent of our receivables invoiced in the U.S. Retail segment, 3 percent of our receivables invoiced in the International segment and 3 percent of our receivables invoiced in the Bakeries and Foodservice segment. There has been significant worldwide consolidation in the food retailing industry in recent years, and we believe that this trend is likely to continue. The 5 largest customers in our U.S. Retail segment accounted for 54 percent of its fiscal 2007 net sales, the 5 largest customers in our International segment accounted for 41 percent of its fiscal 2007 net sales, and the 5 largest customers in our Bakeries and Foodservice segment accounted for 40 percent of its fiscal 2007 net sales. Although the loss of any large customer for an extended length of time could negatively impact our sales and profits, we do not anticipate that this will occur to a significant extent due to the consumer demand for our products and our relationships with our customers. For further information on our customer credit and product return practices please refer to Note 2 to the Consolidated Financial Statements on pages 43 through 47 in Item 8 of this report.

COMPETITION

The consumer foods industry is highly competitive, with numerous manufacturers of varying sizes in the United States and throughout the world. The food categories in which we participate are very competitive. Our principal competitors in these categories all have substantial financial, marketing, and other resources. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity, and the ability to identify and satisfy consumer preferences. Our principal strategies for competing in each of our segments include superior product quality, innovative advertising, product promotion, product innovation, and price. In most product categories, we compete not only with other widely advertised branded products, but also with generic and private label products, that are generally sold at lower prices. Internationally, we compete with both multi-national and local manufacturers, and each country includes a unique group of competitors.

SEASONALITY

In general, demand for our products is evenly balanced throughout the year. However, within our U.S. Retail segment demand for refrigerated dough, frozen baked goods, and baking products is stronger in the fourth calendar quarter. Demand for *Progresso* soup and *Green Giant* canned and frozen vegetables is higher during the fall and winter months. Internationally, demand for *Häagen-Dazs* ice cream is higher during the summer months and demand for baking mix and dough products increases during winter months. Due to the offsetting impact of these demand trends, as well as the different seasons in the northern and southern hemispheres, our international net sales are generally evenly balanced throughout the year.

BACKLOG

Orders are generally filled within a few days of receipt and are subject to cancellation at any time prior to shipment. The backlog of any unfilled orders as of May 27, 2007, was not material.

CAPITAL EXPENDITURES

During fiscal 2007, our aggregate capital expenditures for land, buildings and equipment were $460 million.

EMPLOYEES

As of May 27, 2007, we had approximately 28,500 full- and part-time employees.

FOOD QUALITY AND SAFETY REGULATION

The manufacture and sale of consumer food products is highly regulated. In the United States, our activities are subject to regulation by various federal government agencies, including the Food and Drug Administration, Department of Agriculture, Federal Trade Commission, Department of Commerce and Environmental Protection

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Agency, as well as various state and local agencies. Our business is also regulated by similar agencies outside of the United States.

ENVIRONMENTAL MATTERS

As of May 27, 2007, we were involved with four active cleanup sites associated with the alleged or threatened release of hazardous substances or wastes located in: Minneapolis, Minnesota; Sauget, Illinois; Moonachie, New Jersey; and Doolittle, Missouri. These matters involve several different actions, including administrative proceedings commenced by regulatory agencies and demand letters by regulatory agencies and private parties.

We recognize that our potential exposure with respect to any of these sites may be joint and several, but have concluded that our probable aggregate exposure is not material to our consolidated financial position or cash flows from operations. This conclusion is based upon, among other things: our payments and accruals with respect to each site; the number, ranking and financial strength of other potentially responsible parties identified at each of the sites; the status of the proceedings, including various settlement agreements, consent decrees or court orders; allocations of volumetric waste contributions and allocations of relative responsibility among potentially responsible parties developed by regulatory agencies and by private parties; remediation cost estimates prepared by governmental authorities or private technical consultants; and our historical experience in negotiating and settling disputes with respect to similar sites.

Our operations are subject to the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, Comprehensive Environmental Response, Compensation and Liability Act, and the Federal Insecticide, Fungicide and Rodenticide Act, and all similar state, local, and foreign environmental laws and regulations applicable to the jurisdictions in which we operate.

Based on current facts and circumstances, we believe that neither the results of our environmental proceedings nor our compliance in general with environmental laws or regulations will have a material adverse effect upon our capital expenditures, earnings or competitive position.

EXECUTIVE OFFICERS

The section below provides information regarding our executive officers as of July 13, 2007:

Y. Marc Belton, age 48, is Executive Vice President, Worldwide Health, Brand and New Business Development. Mr. Belton joined General Mills in 1983 and has held various positions, including President of Snacks Unlimited from 1994 to 1997, New Ventures from 1997 to 1999 and Big G cereals from 1999 to 2002. He had oversight responsibility for Yoplait, General Mills Canada and New Business Development from 2002 to May 2005, and has had oversight responsibility for Worldwide Health, Brand and New Business Development since May 2005. Mr. Belton was elected a Vice President of General Mills in 1991, a Senior Vice President in 1994, and an Executive Vice President in June 2006. He is a director of Navistar International Corporation.

Randy G. Darcy, age 56, is Executive Vice President, Worldwide Operations and Technology. Mr. Darcy joined General Mills in 1987, was named Vice President, Director of Manufacturing, Technology and Operations in 1989, served as Senior Vice President, Supply Chain from 1994 to 2003, and as Senior Vice President, Chief Technical Officer with responsibilities for Supply Chain, Research and Development, and Quality and Regulatory Operations from 2003 to 2005. He was named to his present position in May 2005. Mr. Darcy was employed by The Procter & Gamble Company from 1973 to 1987, serving in a variety of management positions.

Ian R. Friendly, age 47, is Executive Vice President and Chief Operating Officer, U.S. Retail. Mr. Friendly joined General Mills in 1983 and held various positions before becoming Vice President of Cereal Partners Worldwide in 1994, President of Yoplait in 1998, Senior Vice President of General Mills in 2000, and President of the Big G cereals division in 2002. In May 2004, he was named Chief Executive Officer of Cereal Partners Worldwide. Mr. Friendly was named to his present position in June 2006.

James A. Lawrence, age 54, is Vice Chairman and Chief Financial Officer. Mr. Lawrence joined General Mills as Chief Financial Officer in 1998 from Northwest Airlines where he was Executive Vice President, Chief Financial Officer. Prior to joining Northwest Airlines in 1996, he was at Pepsi-Cola International, serving as President and Chief Executive Officer for its operations in Asia, the Middle East, and Africa. Mr. Lawrence was elected Vice Chairman of General Mills in June 2006. He is a director of Avnet, Inc., British Airways Plc, and Physicians Formula Holdings, Inc.

Siri S. Marshall, age 59, is Senior Vice President, General Counsel, Chief Governance and Compliance Officer and Secretary. Ms. Marshall joined General Mills in 1994 as Senior Vice President, General Counsel and Secretary from Avon Products, Inc. where she spent 15 years, last serving as Senior Vice President, General Counsel and Secretary. She was named Chief Governance and Compliance Officer in May 2005. Ms. Marshall is a director of Ameriprise Financial, Inc. and Equifax Inc.

Donal L. Mulligan, age 46, is Senior Vice President, Financial Operations. Mr. Mulligan joined General Mills in 2001 from The Pillsbury Company. He served as Vice President, Financial Operations, for our International division until 2004, when he was named Vice President, Financial

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Operations for Operations and Technology. Mr. Mulligan was appointed Vice President and Treasurer of General Mills in January 2006 and was elected to his present position in July 2007. From 1987 to 1998, he was at PepsiCo, Inc. and YUM! Brands, Inc. holding several international positions.

Christopher D. O Leary, age 48, is Executive Vice President and Chief Operating Officer, International. Mr. O Leary joined General Mills in 1997 as Vice President, Corporate Growth. He was elected a Senior Vice President in 1999 and President of the Meals division in 2001. Mr. O Leary was named to his present position in June 2006. Prior to joining General Mills, he spent 17 years at PepsiCo, Inc., last serving as President and Chief Executive Officer of the Hostess Frito-Lay business in Canada. Mr. O Leary is a director of Telephone & Data Systems, Inc.

Michael A. Peel, age 57, is Senior Vice President, Human Resources and Corporate Services. Mr. Peel joined General Mills in this position in 1991 from PepsiCo, Inc. where he spent 14 years, last serving as Senior Vice President, Human Resources, responsible for PepsiCo Worldwide Foods. He is a director of Select Comfort Corporation.

Kendall J. Powell, age 53, is President, Chief Operating Officer and a director of General Mills. Mr. Powell joined General Mills in 1979 and held various positions before becoming Vice President, Marketing Director of Cereal Partners Worldwide in 1990. He was named President of Yoplait in 1996, President of the Big G cereals division in 1997, and Senior Vice President of General Mills in 1998. From 1999 to 2004, Mr. Powell was Chief Executive Officer of Cereal Partners Worldwide. He was elected Executive Vice President of General Mills in 2004 with responsibility for our Meals, Pillsbury USA, Baking Products, and Bakeries and Foodservice divisions. He was named Executive Vice President and Chief Operating Officer, U.S. Retail in May 2005, and was named to his present position in June 2006. Mr. Powell is a director of Medtronic, Inc.

Jeffrey J. Rotsch, age 56, is Executive Vice President, Worldwide Sales and Channel Development. Mr. Rotsch joined General Mills in 1974 and served as the President of several divisions, including Betty Crocker and Big G cereals. He served as Senior Vice President from 1993 to 2005 and as President, Consumer Foods Sales from 1997 to 2005. Mr. Rotsch was named to his present position in May 2005.

Stephen W. Sanger, age 61, has been Chairman of the Board and Chief Executive Officer of General Mills since 1995. Mr. Sanger joined General Mills in 1974 and served as the head of several divisions, including Yoplait and Big G cereals. He was elected a Senior Vice President in 1989, an Executive Vice President in 1991, Vice Chairman in 1992, and President in 1993. Mr. Sanger is a director of Target Corporation and Wells Fargo & Company.

Christina L. Shea, age 54, is Senior Vice President, External Relations and President, General Mills Foundation. Ms. Shea joined General Mills in 1977 and has held various positions in the Big G cereals, Yoplait, Gold Medal, Snacks, and Betty Crocker divisions. From 1994 to 1999, she was President of the Betty Crocker division and was named a Senior Vice President of General Mills in 1998. Ms. Shea became President of General Mills Community Action and the General Mills Foundation in 2002 and was named to her current position in May 2005.

Kenneth L. Thome, age 59, is Senior Vice President, Financial Operations. Mr. Thome joined General Mills in 1969 and was named Vice President, Controller for the Convenience and International Foods Group in 1985. He became Vice President, Controller for International Foods in 1989, Vice President, Director of Information Systems in 1991, and was elected to his present position in 1993.

AVAILABLE INFORMATION

AVAILABILITY OF REPORTS We are a reporting company under the Securities Exchange Act of 1934, as amended (1934 Act), and file reports, proxy statements, and other information with the Securities and Exchange Commission (SEC). The public may read and copy any of our filings at the SEC s Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (800) 732-0330. Because we submit filings to the SEC electronically, you may access this information at the SEC s internet website: *www.sec.gov.* This site contains reports, proxies, and information statements and other information regarding issuers that file electronically with the SEC.

WEBSITE ACCESS Our website is *www.generalmills.com.* We make available, free of charge in the Investors portion of this website, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the 1934 Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Reports of beneficial ownership filed pursuant to Section 16(a) of the 1934 Act are also available on our website.

ITEM 1A Risk Factors

Various risks and uncertainties could affect our business. Any of the risks described below or elsewhere in this report or our other filings with the SEC could materially adversely affect our business, financial condition, and results of operations. It is not possible to predict or identify all risk factors.

Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial also may adversely affect our business, financial condition, and results of operations in the future. Therefore, the following is not intended to be a complete discussion of all potential risks or uncertainties.

The food categories in which we participate are very competitive, and if we are not able to compete effectively, our results of operations could be adversely affected.

The food categories in which we participate are very competitive. Our principal competitors in these categories all have substantial financial, marketing, and other resources. In most product categories, we compete not only with other widely advertised branded products, but also with generic and private label products that are generally sold at lower prices. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity, and the ability to identify and satisfy consumer preferences. If our large competitors were to decrease their pricing or were to increase their promotional spending, we could choose to do the same, which could adversely affect our margins and profitability. If we did not do the same, our revenues and market share could be adversely affected. Our market share and revenue growth could also be adversely impacted if we are not successful in introducing innovative products in response to changing consumer demands or by new product introductions of our competitors. If we are unable to build and sustain brand equity by offering recognizably superior product quality, we may be unable to maintain premium pricing over generic and private label products.

We may be unable to maintain our profit margins in the face of a consolidating retail environment.

The 5 largest customers in our U.S. Retail segment accounted for 54 percent of its fiscal 2007 net sales, the 5 largest customers in our International segment accounted for 41 percent of its net sales for fiscal 2007, and the 5 largest customers in our Bakeries and Foodservice segment accounted for 40 percent of its net sales for fiscal 2007. The loss of any large customer for an extended length of time could adversely affect our sales and profits. There has been significant worldwide consolidation in the grocery industry in recent years and we believe that this trend is likely to continue. As the retail grocery trade continues to consolidate and mass market retailers become larger, our large retail customers may seek to use their position to improve their profitability through improved efficiency, lower pricing, and increased promotional programs. If we are unable to use our scale, marketing expertise, product innovation, and category leadership positions to respond to these demands, our profitability or volume growth could be negatively impacted.

Price changes for the commodities we depend on for raw materials, packaging, and energy may adversely affect our profitability.

The principal raw materials that we use are grains (wheat, oats, and corn), sugar, dairy products, vegetables, fruits, meats, vegetable oils, and other agricultural products. We also use substantial quantities of carton board, corrugated and plastic packaging materials, operating supplies, and energy. These items are largely commodities that experience price volatility caused by external conditions such as weather and product scarcity, commodity market fluctuations, currency fluctuations, and changes in governmental agricultural programs. Commodity price changes may result in unexpected increases in raw material, packaging, and energy costs. If we are unable to increase productivity to offset these increased costs or increase our prices as a result of consumer sensitivity to pricing or otherwise, we may experience reduced margins and profitability. We do not fully hedge against changes in commodity prices, and the hedging procedures that we do use may not always work as we intend.

If we are not efficient in our production, our profitability could suffer as a result of the highly competitive environment in which we operate.

Our future success and earnings growth depends in part on our ability to be efficient in the production and manufacture of our products in highly competitive markets. Our ability to gain additional efficiencies may become more difficult over time as we take advantage of existing opportunities. Our failure to reduce costs through productivity gains or by eliminating redundant costs resulting from acquisitions could adversely affect our profitability and weaken our competitive position. Further, many productivity initiatives involve complex reorganization of manufacturing facilities and production lines. Such manufacturing realignment may result in the interruption of production which may negatively impact product volume and margins.

Disruption of our supply chain could adversely affect our business.

Our ability to make, move, and sell products is critical to our success. Damage or disruption to raw material supplies or our manufacturing or distribution capabilities due to weather, natural disaster, fire, terrorism, pandemic, strikes, or other reasons could impair our ability to manufacture or sell our products. Failure to take adequate steps to mitigate the likelihood or potential impact of such events, or to effectively manage such events if they occur, particularly when a

product is sourced from a single location, could adversely affect our business and results of operations, as well as require additional resources to restore our supply chain.

We may be unable to anticipate changes in consumer preferences and trends, which may result in decreased demand for our products.

Our success depends in part on our ability to anticipate the tastes and eating habits of consumers and to offer products that appeal to their preferences. Consumer preferences change from time to time and can be affected by a number of different trends. Our failure to anticipate, identify or react to these changes and trends, or to introduce new and improved products on a timely basis, could result in reduced demand for our products, which would in turn cause our revenues and profitability to suffer. Similarly, demand for our products could be affected by consumer concerns regarding the health effects of ingredients such as trans fats, sugar, processed wheat, or other product ingredients or attributes.

We may be unable to grow our market share or add products that are in faster growing and more profitable categories.

The food industry s growth potential is constrained by population growth. Our success depends in part on our ability to grow our business faster than populations are growing in the markets that we serve. One way to achieve that growth is to enhance our portfolio by adding innovative new products in faster growing and more profitable categories. Our future results will also depend on our ability to increase market share in our existing product categories. If we do not succeed in developing innovative products for new and existing categories, our growth may slow, which could adversely affect our profitability.

Customer demand for our products may be limited in future periods as a result of increased purchases in response to promotional activity.

Our unit volume in the last week of each quarter can be higher than the average for the preceding weeks of the quarter in certain circumstances. In comparison to the average daily shipments in the first 12 weeks of a quarter, the final week of each quarter may have as much as two to four days worth of incremental shipments (based on a five-day week), reflecting increased promotional activity at the end of the quarter. This increased activity includes promotions to assure that our customers have sufficient inventory on hand to support major marketing events or increased seasonal demand early in the next quarter, as well as promotions intended to help achieve interim unit volume targets. If, due to quarter-end promotions or other reasons, our customers purchase more product in any reporting period than end-consumer demand will require in future periods, our sales level in future reporting periods could be adversely affected.

Economic downturns could cause consumers to shift their food purchases from our higher priced premium products to lower priced items, which could adversely affect our results of operations.

The willingness of consumers to purchase premium branded food products depends in part on local economic conditions. In periods of economic uncertainty, consumers tend to purchase more generic, private label, and other economy brands. In those circumstances, we could experience a reduction in sales of higher margin products or a shift in our product mix to lower margin offerings. In addition, as a result of economic conditions or otherwise, we may be unable to raise our prices due to increased consumer sensitivity to pricing. Any of these events could have an adverse effect on our results of operations.

Volatility in the market value of derivatives we use to hedge exposures to fluctuations in commodity prices will cause volatility in our gross margins and net earnings.

We utilize derivatives to hedge price risk for various raw materials and energy input costs, including grains (wheat, oats, and corn), oils (principally soybean), non-fat dry milk, natural gas, and diesel fuel. Application of hedge accounting under Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, (SFAS 133) requires significant resources, record keeping, and analytical systems. As a result of the rising compliance costs and the complexity associated with the application of hedge accounting, effective as of the beginning of fiscal 2008 we will no longer be documenting our commodity derivatives as hedges of our commodity price risk. Accordingly, the changes in the values of these derivatives will be recorded in earnings currently, resulting in volatility in both gross margin and net earnings. These gains and losses will be reported in cost of sales in our Consolidated Statements of Earnings and in unallocated corporate expenses in our segment operating results. This volatility could cause results reported in any period to differ from our expectations. Our net earnings over the life of the derivative contracts remain unchanged.

Our international operations are subject to political and economic risks.

In fiscal 2007, 17 percent of our consolidated net sales were generated outside of the United States. We are accordingly

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subject to a number of risks relating to doing business internationally, any of which could significantly harm our business. These risks include:

- political and economic instability;
- exchange controls and currency exchange rates;
- foreign tax treaties and policies; and
- restrictions on the transfer of funds to and from foreign countries.

Our financial performance on a U.S. dollar denominated basis is subject to fluctuations in currency exchange rates. These fluctuations could cause material variations in our results of operations. Our principal exposures are to the Australian dollar, British pound sterling, Canadian dollar, Euro, and Mexican peso. From time to time, we enter into agreements that are intended to reduce the effects of our exposure to currency fluctuations, but these agreements may not be effective in significantly reducing our exposure.

Concerns with the safety and quality of food products could cause consumers to avoid certain food products or ingredients.

We could be adversely affected if consumers in our principal markets lose confidence in the safety and quality of certain food products or ingredients. Adverse publicity about these types of concerns, whether or not valid, may discourage consumers from buying our products or cause production and delivery disruptions.

If our food products become adulterated or misbranded, we might need to recall those items and may experience product liability claims if consumers are injured.

We may need to recall some of our products if they become adulterated or misbranded. We may also be liable if the consumption of any of our products causes injury. A widespread product recall could result in significant losses due to the costs of a recall, the destruction of product inventory, and lost sales due to the unavailability of product for a period of time. We could also suffer losses from a significant product liability judgment against us. A significant product recall or product liability case could also result in adverse publicity, damage to our reputation, and a loss of consumer confidence in our food products, which could have a material adverse effect on our business results and the value of our brands.

New regulations or regulatory-based claims could adversely affect our business.

Food production and marketing are highly regulated by a variety of federal, state, local, and foreign agencies. Changes in laws or regulations that impose additional regulatory requirements on us could increase our cost of doing business or restrict our actions, causing our results of operations to be adversely affected. In addition, we advertise our products and could be the target of claims relating to false or deceptive advertising under federal, state, and foreign laws and regulations.

We have a substantial amount of indebtedness, which could limit financing and other options and in some cases adversely affect our ability to pay dividends.

As of May 27, 2007, we had total debt and minority interests of $7.3 billion. The agreements under which we have issued indebtedness do not prevent us from incurring additional unsecured indebtedness in the future. Our level of indebtedness may limit our:

- ability to obtain additional financing for working capital, capital expenditures, or general corporate purposes, particularly if the ratings assigned to our debt securities by rating organizations were revised downward; and
- flexibility to adjust to changing business and market conditions and may make us more vulnerable to a downturn in general economic conditions.

There are various financial covenants and other restrictions in our debt instruments and minority interests. If we fail to comply with any of these requirements, the related indebtedness (and other unrelated indebtedness) could become due and payable prior to its stated maturity, and our ability to obtain additional or alternative financing may also be adversely affected.

If our subsidiary General Mills Cereals, LLC (GMC) fails to make required distributions to the holders of its Series B-1 preferred membership interests, we will be restricted from paying any dividends (other than dividends in the form of shares of common stock) or other distributions on shares of our common stock and may not repurchase shares of our common stock until such distributions are paid.

Our ability to make scheduled payments on or to refinance our debt and other obligations will depend on our operating and financial performance, which in turn is subject to prevailing economic conditions and to financial, business, and other factors beyond our control.

Volatility in the securities markets, interest rates, and other factors or changes in our employee base could substantially increase our defined benefit pension, other postretirement, and postemployment benefit costs.

We sponsor a number of defined benefit plans for employees in the United States, Canada, and various foreign locations, including defined benefit pension, retiree health and welfare,

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severance, and other postemployment benefit plans. Our major defined benefit pension plans are funded with trust assets invested in a globally diversified portfolio of securities and other investments. Changes in interest rates, mortality rates, health care costs, early retirement rates, investment returns, and the market value of plan assets can affect the funded status of our defined benefit pension, other postretirement, and postemployment benefit plans and cause volatility in the net periodic benefit cost and future funding requirements of the plans. Although the aggregate fair value of our defined benefit pension, other postretirement, and postemployment benefit plan assets exceeded the aggregate defined benefit pension, other postretirement, and postemployment benefit obligations as of May 27, 2007, a significant increase in our obligations or future funding requirements could have a negative impact on our results of operations and cash flows from operations.

Our business operations could be disrupted if our information technology systems fail to perform adequately.

The efficient operation of our business depends on our information technology systems. We rely on our information technology systems to effectively manage our business data, communications, supply chain, order entry and fulfillment, and other business processes. The failure of our information technology systems to perform as we anticipate could disrupt our business and could result in transaction errors, processing inefficiencies, and the loss of sales and customers, causing our business and results of operations to suffer. In addition, our information technology systems may be vulnerable to damage or interruption from circumstances beyond our control, including fire, natural disasters, systems failures, security breaches, and viruses. Any such damage or interruption could have a material adverse effect on our business.

If other potentially responsible parties (PRPs) are unable to contribute to remediation costs at certain contaminated sites, our costs for remediation could be material.

We are subject to various federal, state, local, and foreign environmental and health and safety laws and regulations. Under certain of these laws, namely the Comprehensive Environmental Response, Compensation and Liability Act and its state counterparts, liability for investigation and remediation of hazardous substance contamination at currently or formerly owned or operated facilities or at third-party waste disposal sites is joint and several. We currently are involved in active remediation efforts at certain sites where we have been named a PRP. If other PRPs at these sites are unable to contribute to remediation costs, we could be held responsible for all or their portion of the remediation costs, and those costs could be material. We cannot assure that our costs in relation to these environmental matters or compliance with environmental laws in general will not exceed our reserves or otherwise have an adverse effect on our business and results of operations.

An impairment in the carrying value of goodwill could negatively affect our consolidated results of operations and net worth.

Goodwill represents the difference between the purchase price of acquired companies and the related fair values of net assets acquired. Goodwill is not subject to amortization and is tested for impairment annually and whenever events or changes in circumstances indicate that impairment may have occurred. Impairment testing is performed for each of our reporting units. We compare the carrying value of a reporting unit, including goodwill, to the fair value of the unit. Carrying value is based on the assets and liabilities associated with the operations of that reporting unit, which often requires allocation of shared or corporate items among reporting units. If the carrying amount of a reporting unit exceeds its fair value, we revalue all of the assets and liabilities of the reporting unit, excluding goodwill, to determine if the fair value of the net assets is greater than the net assets including goodwill. If the fair value of the net assets is less than the net assets including goodwill, impairment has occurred. Our estimates of fair value are determined based on a discounted cash flow model. Growth rates for sales and profits are determined using inputs from our annual long-range planning process. We also make estimates of discount rates, perpetuity growth assumptions, market comparables, and other factors. We periodically engage third-party valuation consultants to assist in this process. All our reporting units have fair values in excess of their carrying values by at least 20 percent.

As of May 27, 2007, we had $6.8 billion of goodwill. While we currently believe that the fair value of goodwill exceeds its carrying value, materially different assumptions regarding future performance of our businesses could result in significant impairment losses.

An impairment in the carrying value of, or a change in the useful life of, our indefinite-lived intangible assets could negatively affect our consolidated results of operations and net worth.

We evaluate the useful lives of our intangible assets, primarily intangible assets associated with the *Pillsbury*, *Totino s*, *Progresso*, *Green Giant*, *Old El Paso*, and *Häagen-Dazs* brands to determine if they are finite or indefinite-lived. Reaching a determination on useful life requires significant judgments and assumptions regarding the future effects of obsolescence, demand, competition, other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing

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regulatory environment, and expected changes in distribution channels), the level of required maintenance expenditures, and the expected lives of other related groups of assets.

Our indefinite-lived intangible assets are also tested for impairment annually and whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Our estimate of the fair value of the brands is based on a discounted cash flow model using inputs including: projected revenues from our annual long-range plan; assumed royalty rates which could be payable if we did not own the brands; and a discount rate. We periodically engage third-party valuation consultants to assist in this process.

As of May 27, 2007, we had $3.7 billion of indefinite-lived intangible assets. While we currently believe that the fair value of each indefinite-lived intangible asset exceeds its carrying value and that those intangibles so classified will contribute indefinitely to our cash flows, materially different assumptions regarding future performance of our businesses could result in significant impairment losses and amortization expense.

Resolution of uncertain income tax matters could adversely affect our results of operations or cash flows from operations.

Our consolidated effective income tax rate is influenced by tax planning opportunities available to us in the various jurisdictions in which we operate. Management judgment is involved in determining our effective tax rate and in evaluating the ultimate resolution of any uncertain tax positions. We are periodically under examination or engaged in a tax controversy. We establish reserves in a variety of taxing jurisdictions when, despite our belief that our tax return positions are supportable, we believe that certain positions may be challenged and may need to be revised. We adjust these reserves in light of changing facts and circumstances, such as the progress of a tax audit. Our effective income tax rate includes the impact of reserve provisions and changes to those reserves. We also provide interest on these reserves at the appropriate statutory interest rate. These interest charges are also included in our effective tax rate. As of May 27, 2007, our income tax and related interest reserves recorded in other current liabilities were slightly more than $700 million. Reserve adjustments for individual issues have generally not exceeded 1 percent of earnings before income taxes and after-tax earnings from joint ventures annually. Nevertheless, the accumulation of individually insignificant discrete adjustments throughout a particular year has historically impacted our consolidated effective income tax rate by up to 80 basis points.

The Internal Revenue Service (IRS) recently concluded field examinations for our 2002 and 2003 federal tax years. These examinations included review of our determinations of cost basis, capital losses, and the depreciation of tangible assets and amortization of intangible assets arising from our acquisition of Pillsbury and the sale of minority interests in our GMC subsidiary. The IRS has proposed adjustments related to a majority of the tax benefits associated with these items. We believe we have meritorious defenses and intend to vigorously defend our positions. Our potential liability for this matter is significant and, notwithstanding our reserves against this potential liability, an unfavorable resolution could have a material adverse impact on our results of operations or cash flows from operations.

ITEM 1B Unresolved Staff Comments

None.

ITEM 2 Properties

We own our principal executive offices and main research facilities, which are located in the Minneapolis, Minnesota metropolitan area. We operate numerous manufacturing facilities and maintain many sales and administrative offices and warehouses, mainly in the United States. Other facilities are operated in Canada and elsewhere around the world.

As of May 27, 2007, we operated 83 facilities for the production of a wide variety of food products. Of these facilities, 51 are located in the United States (1 of which is leased), 15 in the Asia/Pacific region (10 of which are leased), 6 in Canada (2 of which are leased), 5 in Europe (1 of which is leased), 5 in Latin America and Mexico, and 1 in South Africa. The following is a list of the locations of our principal production facilities, which primarily support the segment noted:

U.S. Retail

Carson, California

Lodi, California

Covington, Georgia

Belvidere, Illinois

West Chicago, Illinois

New Albany, Indiana

Carlisle, Iowa

Cedar Rapids, Iowa

Reed City, Michigan

Hannibal, Missouri

Kansas City, Missouri

Great Falls, Montana

Vineland, New Jersey

Albuquerque, New Mexico

Buffalo, New York

Wellston, Ohio

Murfreesboro, Tennessee

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Milwaukee, Wisconsin

Irapuato, Mexico

International

Rooty Hill, Australia

Guangzhou, China

Arras, France

San Adrian, Spain

Berwick, United Kingdom

Cagua, Venezuela

Bakeries and Foodservice

Chanhassen, Minnesota

Joplin, Missouri

Martel, Ohio

Trenton, Ontario

We also own or lease warehouse space totaling 12.7 million square feet, of which 9.6 million square feet are leased, that primarily supports our U.S. Retail segment. We own and lease a number of sales and administrative offices in the United States, Canada and elsewhere around the world, totaling 2.7 million square feet (600,000 square feet of which are leased).

As part of our Häagen-Dazs business in our International segment, we operate 149 and franchise 356 branded ice-cream parlors in various countries around the world, all outside of the United States and Canada. All shops we operate are leased, totaling 150,000 square feet.

ITEM 3 Legal Proceedings

We are the subject of various pending or threatened legal actions in the ordinary course of our business. All such matters are subject to many uncertainties and outcomes that are not predictable with assurance. In our opinion, there were no claims or litigation pending as of May 27, 2007, that were reasonably likely to have a material adverse effect on our consolidated financial position or results of operations. See the information contained under the section entitled

Environmental Matters on page 4 in Item 1 of this report for a discussion of environmental matters in which we are involved.

ITEM 4 Submission of Matters to a Vote of Security Holders

None.

PART II

ITEM 5

Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is listed on the New York Stock Exchange. On July 13, 2007, there were approximately 33,259 record holders of our common stock. Information regarding the market prices for our common stock and dividend payments for the two most recent fiscal years is set forth in Note 18 to the Consolidated Financial Statements on page 70 in Item 8 of this report. Information regarding restrictions on our ability to pay dividends in certain situations is set forth in Note 9 to the Consolidated Financial Statements on pages 56 and 57 in Item 8 of this report.

The following table sets forth information with respect to shares of our common stock that we purchased during the fiscal quarter ended May 27, 2007:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased[(a)]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program[(b)]	Maximum Number of Shares that may yet be Purchased Under the Program[(b)]
February 26, 2007 through April 1, 2007	548,810	$ 57.65	548,810	74,367,463
April 2, 2007 through April 29, 2007	2,400,809	$ 59.15	2,400,809	71,966,654
April 30, 2007 through May 27, 2007	5,259,985	$ 60.16	5,259,985	66,706,669
Total	8,209,604	$ 59.70	8,209,604	66,706,669

(a) The total number of shares purchased includes: (i) 96,700 shares purchased from the ESOP fund of our 401(k) savings plan; (ii) 6,925 shares of restricted stock withheld for the payment of withholding taxes upon vesting of restricted stock; and (iii) 8,105,979 shares purchased in the open market. These amounts include 1,069,100 shares acquired at an average price of $60.30 for which settlement occurred after May 27, 2007.

(b) On December 11, 2006, our Board of Directors approved and we announced an authorization for the repurchase of up to 75 million shares of our common stock. Purchases can be made in the open market or in privately negotiated transactions, including the use of call options and other derivative instruments, Rule 10b5-1 trading plans, and accelerated repurchase programs. The Board did not specify an expiration date for the authorization.

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ITEM 6 Selected Financial Data

The following table sets forth selected financial data for each of the fiscal years in the five-year period ended May 27, 2007:

In Millions, Except per Share Data and Percentages Fiscal Year Ended	May 27, 2007	May 28, 2006	May 29, 2005	May 30, 2004	May 25, 2003
Operating data:					
Net sales	$ 12,442	$ 11,712	$ 11,308	$ 11,122	$ 10,544
Gross margin[(a)]	4,487	4,167	3,982	4,088	3,969
Selling, general and administrative expenses	2,390	2,179	1,998	2,052	2,050
Operating profit	2,058	1,958	1,900	2,010	1,857
Interest expense, net	427	399	455	508	547
Income taxes	560	538	661	526	458
Net earnings	1,144	1,090	1,240	1,055	917
Depreciation and amortization	418	424	443	399	365
Advertising and media expense	543	524	481	514	526
Research and development expense	191	178	165	158	149
Average shares outstanding:					
Basic	347	358	371	375	369
Diluted	360	379	409	413	395
Net earnings per share:					
Basic	$ 3.30	$ 3.05	$ 3.34	$ 2.82	$ 2.49
Diluted	$ 3.18	$ 2.90	$ 3.08	$ 2.60	$ 2.35
Operating ratios:					
Gross margin as a percentage of net sales	36.1%	35.6%	35.2%	36.8%	37.6%
Selling, general and administrative expenses as a percentage of net sales	19.2%	18.6%	17.7%	18.5%	19.4%
Operating profit as a percentage of net sales	16.5%	16.7%	16.8%	18.1%	17.6%
Income taxes as a percentage of earnings before income taxes	34.3%	34.5%	36.6%	35.0%	35.0%
Return on average total capital[(a)(b)]	11.1%	10.5%	11.4%	10.0%	9.5%
Balance sheet data:					
Land, buildings and equipment	$ 3,014	$ 2,997	$ 3,111	$ 3,197	$ 3,087
Total assets	18,184	18,075	17,923	18,331	18,087
Long-term debt, excluding current portion	3,218	2,415	4,255	7,410	7,516
Total debt[(a)]	6,206	6,049	6,192	8,226	8,857
Stockholders equity	5,319	5,772	5,676	5,248	4,175
Cash flow data:					
Net cash provided by operating activities	1,765	1,848	1,794	1,521	1,726
Capital expenditures	460	360	434	653	750
Net cash provided (used) by investing activities	(597)	(369)	413	(530)	(1,113)
Net cash used by financing activities	(1,398)	(1,405)	(2,385)	(943)	(885)
Fixed charge coverage ratio	4.37	4.54	4.61	3.74	3.26

In Millions, Except per Share Data and Percentages Fiscal Year Ended	**May 27, 2007**	**May 28, 2006**	**May 29, 2005**	**May 30, 2004**	**May 25, 2003**
Operating cash flow to debt ratio[(a)]	28.4%	30.6%	29.0%	18.5%	19.5%
Share data:					
Low stock price	$ 49.27	$ 44.67	$ 43.01	$ 43.75	$ 37.38
High stock price	$ 61.11	$ 52.16	$ 53.89	$ 49.66	$ 48.18
Cash dividends per common share	$ 1.44	$ 1.34	$ 1.24	$ 1.10	$ 1.10

Fiscal 2004 was a 53-week year; all other fiscal years were 52 weeks.

In fiscal 2007, we adopted SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R) , resulting in an after-tax reduction to stockholders equity of $440 million, and SFAS No. 123R, Share Based Payment , resulting in a decrease to fiscal 2007 net earnings of $43 million, and a decrease to fiscal 2007 cash flows from operations and corresponding decrease to cash flows used by financing activities of $73 million. See Notes 2 and 13 to the Consolidated Financial Statements beginning on page 43 in Item 8 of this report.

(a) See Glossary on page 71 for definition.

(b) See pages 33 to 34 in MD&A in Item 7 of this report for our discussion of these measures not defined by generally accepted accounting principles.

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ITEM 7

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

EXECUTIVE OVERVIEW

We are a global consumer foods company. We develop distinctive food products and market these value-added products under unique brand names. We work continuously on product innovation to improve our established brands and to create new products that meet consumers evolving needs and preferences. In addition, we build the equity of our brands over time with strong consumer-directed marketing and innovative merchandising. We believe our brand-building strategy is the key to winning and sustaining leading share positions in markets around the globe.

Our fundamental business goal is to generate superior returns for our stockholders over the long term. We believe that increases in net sales, segment operating profits, earnings per share, and return on average total capital are the key measures of financial performance for our businesses. See page 33 for our discussion of segment operating profit and return on average total capital, which are not defined by generally accepted accounting principles (GAAP).

Our objectives are to consistently deliver:

- low single-digit average annual growth in net sales;
- mid single-digit average annual growth in total segment operating profit;
- high single-digit average annual growth in earnings per share (EPS); and
- at least a 50 basis point average annual increase in return on average total capital.

We believe that this financial performance, coupled with an attractive dividend yield, should result in long-term value creation for stockholders. We also return a substantial amount of cash annually to stockholders through share repurchases.

For the fiscal year ended May 27, 2007, our net sales grew 6 percent, total segment operating profit grew 7 percent, diluted EPS increased 10 percent, and our return on average total capital improved by 60 basis points. These results met or exceeded our long-term targets. Net cash provided by operations totaled nearly $1.8 billion in fiscal 2007, enabling us to increase our annual dividend payments per share by 7.5 percent from fiscal 2006 and continue returning cash to stockholders through share repurchases, which totaled $1,321 million in fiscal 2007. We made significant capital investments totaling $460 million to support future growth and productivity.

We achieved each of our four key operating objectives for fiscal 2007:

- We generated net sales growth across our businesses. Both Big G cereals and Pillsbury USA renewed net sales growth in fiscal 2007 following modest sales declines in fiscal 2006. In addition, all of our other U.S. Retail divisions and our International and Bakeries and Foodservice segments each posted net sales gains in fiscal 2007.
- We achieved net sales contributions from new products, as we introduced more than 400 new food items in markets around the world.
- We capitalized on growth opportunities for our brands in new channels and international markets. During 2007, we increased our unit volume and net sales in fast-growing retail channels such as drug, dollar and discount stores, convenience stores, and supercenters. Outside the United States, International segment net sales increased 16 percent in fiscal 2007 and exceeded $2 billion for the first time.
- We also recorded increases in both gross margin and segment operating profit in fiscal 2007, despite continued input cost inflation and a significant increase in our consumer marketing spending.

Details of our financial results are provided in the Fiscal 2007 Consolidated Results of Operations section below.

Our fiscal 2008 operating objectives are consistent with our long-term growth model and are built around broad-based growth in net sales, focused cost-savings initiatives to offset higher input costs, and increased levels of investment in media and other brand-building marketing programs to fuel continued net sales growth. To drive growth in net sales, we plan to increase unit volumes, improve sales mix, and achieve net price realization through a combination of pricing actions and trade promotion efficiencies. We also will continue to focus on faster-growing retail formats and foodservice channels such as membership and convenience stores, and expand our branded product sales to hospitality and healthcare-related foodservice customers with new products and portion sizes. Internationally, we are focused on building our global brands. Our company-wide cost-saving initiatives include evaluating sales mix and trade spending efficiency, portfolio management techniques including product rationalization and simplification, capital investments in manufacturing technology, and global sourcing. We expect pricing and cost-savings initiatives to help us largely offset significant input cost inflation, especially for dairy ingredients, oils (primarily soybean), and grains. Our plans also call for reinvestment of some of these cost savings in

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media and other brand-building marketing programs, resulting in another high single-digit increase in these expenditures.

Our plans also call for $575 million of expenditures for capital projects, and a significant amount of cash returned to stockholders. We intend to continue repurchasing shares in fiscal 2008, with a goal of reducing average diluted shares outstanding a net 2 percent. On June 25, 2007, our Board of Directors approved a dividend increase to an annual rate of $1.56 per share. This represents a 9 percent compound annual growth rate in dividends from fiscal 2004 to fiscal 2008.

Application of hedge accounting under Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS 133), requires significant resources, recordkeeping, and analytical systems. As a result of the rising compliance costs and the complexity associated with the application of hedge accounting, we have elected to discontinue the use of hedge accounting for our commodity derivatives at the beginning of fiscal 2008 for all new commodity derivatives entered into after that date. Accordingly, the changes in the values of these derivatives will be recorded in earnings currently, resulting in volatility in both net earnings and gross margin. These gains and losses will be reported in cost of sales in our Consolidated Statements of Earnings and in unallocated corporate expenses in our segment operating results. Regardless of designation for accounting purposes, we believe all our commodity hedges are economic hedges of our risk exposures. Commodity derivatives previously accounted for as cash flow hedges are not affected by this change and any gains or losses deferred to accumulated other comprehensive income (loss) in stockholders equity will remain there until the hedged item affects earnings.

Certain terms used throughout this report are defined in a glossary on page 71 of this report.

FISCAL 2007 CONSOLIDATED RESULTS OF OPERATIONS

For fiscal 2007, we reported diluted EPS of $3.18, up 10 percent from $2.90 per share earned in fiscal 2006. Earnings after tax were $1,144 million in fiscal 2007, up 5 percent from $1,090 million in fiscal 2006.

The components of net sales growth are shown in the following table:

Components of Net Sales Growth

	Fiscal 2007 vs. 2006
Unit Volume Growth	+4 pts
Price/Product Mix	+2 pts
Foreign Currency Exchange	+1 pt
Trade and Coupon Promotional Expenses	Flat
Net Sales Growth	+6%

Table does not add due to rounding.

Net sales for fiscal 2007 grew 6 percent to $12.4 billion, driven by 4 percentage points of unit volume growth, primarily in our U.S. Retail and International segments, and 2 percentage points of growth from pricing and favorable product mix across many of our businesses. In addition, foreign currency exchange effects added 1 percentage point of growth, while promotional spending was flat compared to fiscal 2006.

Cost of sales was up $410 million in fiscal 2007 versus fiscal 2006. Cost of sales as a percent of net sales decreased from 64.4 percent in fiscal 2006 to 63.9 percent in fiscal 2007 as $115 million of higher ingredient (primarily grains and dairy) and energy costs were more than offset by efficiency gains at our manufacturing facilities. These gains resulted from cost-saving capital projects, the operating benefits of our broad-based unit volume growth, changes to product formulations, and continued actions to replace low-turning products with faster-turning items.

Selling, general and administrative (SG&A) expenses increased by $211 million in fiscal 2007 versus fiscal 2006. SG&A expense as a percent of net sales increased from 18.6 percent in fiscal 2006 to 19.2 percent in fiscal 2007. The increase in SG&A expense from fiscal 2006 was largely the result of a $78 million increase in media and brand-building consumer marketing spending and $69 million of incremental stock compensation expense resulting from our adoption of SFAS No. 123 (Revised), Share-Based Payment (SFAS 123R).

Net interest expense for fiscal 2007 totaled $427 million, $28 million higher than net interest expense for fiscal 2006. Higher interest rates caused nearly all of the increase. Interest expense includes preferred distributions paid on subsidiary minority interests. The average rate on our total outstanding debt and subsidiary minority interests was 6.1 percent during fiscal 2007, compared to 5.8 percent during fiscal 2006.

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Restructuring, impairment and other exit costs totaled $39 million in fiscal 2007 as follows:

Expense (Income), in millions	
Noncash impairment charge for certain Bakeries and Foodservice product lines	$ 37
Gain from the sale of our previously closed plant in San Adrian, Spain	(7)
Loss from divestitures of our par-baked bread and frozen pie product lines	10
Adjustment of reserves from previously announced restructuring actions	(1)
Total	$ 39

In late May 2007, we concluded that the future cash flows generated by certain product lines in our Bakeries and Foodservice segment will be insufficient to recover the net book value of the related long-lived assets. We recorded a noncash impairment charge of $37 million against these assets in the fourth quarter of fiscal 2007. We are further evaluating the viability of the impaired product lines and may incur additional charges in the future, depending upon the outcome of those evaluations.

Net proceeds received for the par-baked bread product line were $13 million, and net proceeds from the sale of our frozen pie product line were $1 million.

The **effective income tax rate** was 34.3 percent for fiscal 2007, including an increase of $30 million in benefits from our international tax structure and benefits from the settlement of tax audits. In fiscal 2006, our effective income tax rate was 34.5 percent, including the benefit of $11 million of adjustments to deferred tax liabilities associated with our International segment s brand intangibles.

After-tax earnings from joint ventures totaled $73 million in fiscal 2007, compared to $69 million in fiscal 2006. In fiscal 2007, net sales for Cereal Partners Worldwide