INTERSTATE BAKERIES CORPORATION

2001 Annual Report

Our Company's

success

begins and ends

with us.

Straight Talk for Tough Times

INTERSTATE BAKERIES CORPORATION is the largest wholesale baker and distributor of fresh delivered bread and snack cakes in the United States. The Company has three major divisions — the Western Division, headquartered in Phoenix, Arizona; the Central Division, headquartered in Kansas City, Missouri; and the Eastern Division, headquartered in Charlotte, North Carolina. The Company also sells dry products.

The Company operates 63 bakeries throughout the United States and employs more than 34,000 people. From these strategically dispersed bakeries, the Company's sales force delivers baked goods to more than 200,000 food outlets on approximately 10,400 delivery routes. The Company's products are distributed throughout the United States, primarily through its direct route system and approximately 1,400 Company-operated thrift stores, and to some extent through distributors.

The IBC product line is marketed under a number of well-known national and regional brands, which include *Wonder, Hostess, Home Pride, Drake's, Beefsteak, Bread du Jour, Dolly Madison, Butternut, Merita, Parisian, Colombo, Sunbeam, Millbrook, Eddy's, Holsum, Sweetheart, Cotton's Holsum, J.J. Nissen, Marie Callender's* and *Mrs. Cubbison's.* In addition, the Company is a baker and distributor of *Roman Meal* and *Sun Maid* bread.

On The Cover:
Vanessa Maskal
General Sales Manager
***Drake's* Bakery**
Wayne, New Jersey

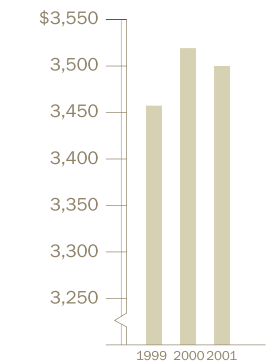
Financial Highlights

(In Thousands, Except Per Share Data)

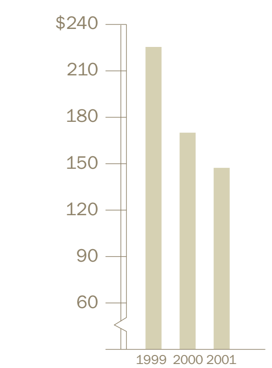
	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
Statement of Income			
Net sales	$ 3,496,482	$ 3,522,929	$ 3,459,377
Operating income	147,103	170,398	224,477
% of net sales	4.2%	4.8%	6.5%
Net income	$ 61,125	$ 89,388	$ 126,155
% of net sales	1.7%	2.5%	3.6%
Per common share:			
Net income (diluted basis)	$ 1.13	$ 1.31	$ 1.74
Book value	7.80	8.98	8.60
Common stock dividends	.28	.28	.28
Average diluted shares outstanding	54,296	68,356	72,483
	June 2, 2001	June 3, 2000	May 29, 1999
Balance Sheet			
Total assets	$ 1,623,496	$ 1,651,925	$ 1,680,775
Long-term debt[1]	555,937	385,000	369,000
Stockholders' equity	392,805	591,677	603,803
Debt to total capital	58.6%	39.4%	37.9%

[1] The June 2, 2001 amount reflects the result of the Company's debt refinancing completed July 19, 2001.

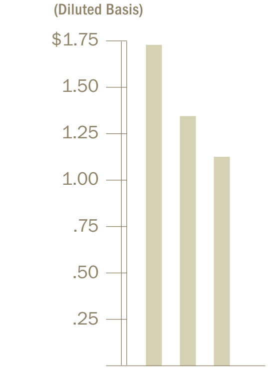
Net Sales
(In Millions)



Operating Income
(In Millions)



Earnings Per Share
(Diluted Basis)



Common Stock Information

The Company's common stock is listed on the New York Stock Exchange and is traded under the symbol IBC. The table below presents the high and low sales prices for the stock and cash dividends paid during fiscal 2001 and 2000:

Fiscal Year	Quarter	Stock Price High	Stock Price Low	Cash Dividends
2001	1	$19.63	$13.81	$ .07
	2	17.94	13.94	.07
	3	16.78	10.81	.07
	4	17.03	13.49	.07
2000	1	$24.81	$20.50	$ .07
	2	24.50	19.56	.07
	3	19.81	11.44	.07
	4	16.56	11.56	.07

The Company had approximately 6,500 shareholders on June 2, 2001.

To Our Fellow Shareholders and Employees:

Fiscal 2001 was, in a word, unique. A fair description of our business year might be that we opened amid great expectations, suffered some early major disappointments and then closed out on a hopeful note though hardly fulfilled. The year played out far tougher than anyone had anticipated or ever imagined. The unprecedented rise in energy and fuel prices shrank margins and left many of us in the baking industry struggling to post even modest gains. Contributing to our own woes were some self-inflicted hits. We lost volume across the country due to overly aggressive pricing. We also wrestled far too long with a major Northwest consolidation project designed to make us a stronger competitor. Instead, it left us with lowered market share. The lingering effects of a strike and bakery start-up problems from the prior year further impacted the Northeast. Our inability to resolve these issues in a timely manner strained our credibility with the investment community.

It was a problematic year and a very disappointing one when measured against the tough standards we set for ourselves. We took our hits, and today we stand much stronger operationally, better prepared in the marketplace and more able to manage future external cost pressures. New efficient plants are in place, and more importantly, running smoothly. We can focus on continuity, execution and consistent revenue growth in the coming fiscal year.

Charting the Past Financial Year

In reviewing the numbers, net sales increased approximately 1.0 percent when adjusted for the extra sales week in the prior fiscal year. For the 52 weeks ended June 2, 2001, net sales reached $3,496,482,000 compared to the previous year's 53-week total of $3,522,929,000. Pricing rather than sales volume drove the improvement. Unit sales growth failed to meet our expectations in all four quarters, though by year-end, we had successfully stabilized most declining volume trends, particularly those in the Northeast and Northwest markets. Operating income was $147,103,000, or 4.2 percent of net sales, compared to last year's $170,398,000, or 4.8 percent of net sales. Net income also lagged behind at $61,125,000, or 1.7 percent of net sales, compared to $89,388,000, or 2.5 percent of net sales. Earnings per share declined to $1.13 (on a diluted basis), compared to the prior year's $1.31.

Runaway energy and fuel prices coupled with higher labor-related costs effectively checked our opportunity at earnings improvement for the year. Flat top-line sales performance squeezes margins in the face of even minor expense inflation. Selling, delivery and administrative expenses finished at 45.4 percent of net sales, almost a full percentage point higher than the prior year. However, our gross profit margin improved over the prior year, ending at 52.7 percent of net sales.

During the year, we repurchased from Ralston Purina Company 15,498,000 shares of our common stock at market prices, thus reducing its holding to 29.5 percent. We further amended the shareholder agreement between our two companies to reduce Ralston's stock ownership to 15 percent or less by August 1, 2004, and 10 percent or less by August 1, 2005. We retained first purchase right on any additional disposals of IBC stock by Ralston.

During the year, we filed a shelf registration with the SEC to sell periodically up to $500,000,000 in debt securities and/or preferred and common stock, proceeds of which may be used for a variety of corporate purposes. In addition, a $610,000,000, 364-day bank term loan entered into during the year and our revolving credit agreement were both refinanced on a long-term basis during the first quarter of the new fiscal year.

We generally were disappointed with our stock's performance for the year. Our price per share rose as high as $19.63 and fell as low as $10.81 over the 52 weeks, but closed near the price per share with which we opened our fiscal year. However, in recent weeks following the close of the fiscal year, our price has rebounded to the $21-$22 range. This is more in line with our belief that our Company continues to provide good long-term value and is an attractive buy, even at current prices. Some industry analysts have asserted that the food category essentially is in a funk with little opportunity for growth. We dispute that, certainly at least in regards to our Company. We are confident Wall Street will eventually reward shareholders of food companies that achieve or exceed their performance potential.

Operational Review

Call our past fiscal year eventful, certainly memorable. We won't soon forget it. The energy expense to operate our plants and heat our ovens opened oppressively and grew progressively worse, particularly for our 14 bakeries in California. Diesel fuel prices surpassed all-time highs. Medical costs went up, as did other labor-related expenses. Sales growth and careful management of expenses are essential in tough economic times. We were unable to get the top-line sales growth needed to offset these costs. Margins, not unexpectedly, suffered.

Our problems in the Northeast centered on sales issues and the very high cost of getting our product to market. The 280,000-square-foot *Wonder, Hostess* and *J.J. Nissen* plant at Biddeford, Maine, is one of the world's largest baking facilities. Quality of product is excellent. Reformulation of delivery routes has reduced costs. But we have more work to do throughout the Northeast to rebuild product demand first diminished during the plant start-up phase and then by a subsequent New England Teamsters' strike during the fourth quarter of the prior year. Progress has been slow and we continue to struggle in some areas, particularly New York City and Philadelphia, because of high delivery costs and low prices. This will continue to be our biggest challenge in the new fiscal year.

Our new, state-of-the-baking-art *Wonder* bread facility at Tacoma, Washington, is now working smoothly. The start-up, however, was problematic. We encountered significant problems at the onset, which affected all operational areas. Sales were impacted, though we solved the more serious operational problems by midyear. All *Wonder* bread, bun and roll production for the Northwest marketing area — previously at three bakeries — is now totally in-house at Tacoma. *Hostess* production for the region is concentrated at our Seattle cake bakery.

In sharp contrast to Tacoma, the Knoxville, Tennessee, new plant start-up was completed to textbook perfection. These bakeries were part of a broad program to modernize IBC facilities across the country. Our newest *Wonder* bread plant is scheduled to go on-line in Kansas City in September.

To eliminate baking redundancy and reduce costs, three bakeries were closed during the past year, including Spokane, Washington, which was closed as part of the Northwest consolidation project. We also closed the Richmond, Virginia, *Wonder* bakery and moved its bread and roll production to Rocky Mount, North Carolina, thus further utilizing that facility's new high-speed production capacity, and moved *Butternut* bread production from Minonk, Illinois, to nearby Decatur. During the first quarter of the new fiscal year, we also announced the closure of the Detroit *Hostess* bakery with production scheduled to move to other IBC cake bakeries.

Growth Strategies

We continue to pursue growth through strategic acquisition. However, viable candidates remain in short supply, and none materialized last year. We participated in the Unilever auction of its Best Foods bakery division, a particularly attractive business but at an eventual selling price in excess of what we could justify paying.

New product introduction continues as a growth strategy, even as we simplify our total product lines. In effect, we plan to offer fewer varieties, but better-selling product types to more regions. A good example is *Zingers*, which this past year we packaged under both the *Dolly Madison* and *Hostess* brands. We also introduced a new select line of *Home Pride* products, including *Wheatberry*, *Golden Grain*, *100% Stone Ground Wheat*, *Buttermilk* and *Potato* breads. New on the cake side are the *Hostess* coconut *Ding Dong* and the *Drake's Mini-Caramel* cake.

Another significant initiative we are working on is extended shelf life, or "ESL" as we refer to it. This project has tremendous potential to add to our bottom line. As we extend shelf life, we decrease the number of sales visits, reduce the number of returns and, in the process, increase route sales averages. It is paramount to us that ESL formulations do not affect our product quality or freshness. We have successfully implemented this program across our *Dolly Madison* cake line and selected bread varieties and are looking to implement it across all remaining lines over the next year.

Brand building and brand awareness are essential elements to improving margins, as well as sales growth. This year's focus will be to improve demand for our higher-margin branded bread and cake products. Our advertising continues to have a positive effect in the marketplace and we continually strive to design more effective and better-targeted promotional programs to drive sales. We will also be more price competitive in the marketplace. Last year, we had some "pricing gaps" that frankly took us out of the game. After a complete review, pricing was adjusted and is now more in line with the market. We will always aggressively address our margin targets, but closer attention will be paid to avoid future pricing inequities.

The changing economic environment is a challenge to our industry and IBC. Though we have seen recent moderation in gasoline and diesel fuel prices, there is no reason to believe external cost pressures will lessen in the new fiscal year. We can't avoid them, but we can employ strategies to limit our exposure to cost escalations. We manage fluctuating ingredient prices by hedging or selectively buying forward. This purchase strategy is now applied to all our commodity needs, including fuel. We continually strive to take costs out of our system. Production efficiencies enhance fiscal health in tough times. Our employees are dedicated to proficient and competitive operations. That includes achieving a more efficient product distribution system. We are continually merging and purging lower volume sales routes to ensure more sales per delivery run. Our ESL project mentioned earlier will result in more productivity in this area.

Focusing on the New Year

The good news is that the tempest-filled year is behind us, and that we weathered the worst a tough year could throw. We have learned from the past, but it's the future that demands our attention.

During difficult financial or slow growth periods, companies often show their true character. In a rush to protect the bottom line, some companies lose sight of their long-term growth strategies for the seeming security of short-term gains. We have invested in our plants and will now get the benefits. When you've carefully built a foundation for growth, it would be imprudent to abandon it in the face of a few disappointments. We are a powerful food company with product sales reaching more than 90 percent of the U.S. markets. We have the financial flexibility to move decisively. We have a solid business plan and a strong commitment by our employees to see that it's precisely executed. We remain committed to working smarter and more efficiently while making good use of all available resources.

The proof of what we say, of course, must come through performance. We are realistic. Success in the new fiscal year likely will be no easier to achieve than in the prior one. But you will see change in fiscal 2002. We intend to work our hardest to ensure that our Company continues on the correct course, that we exploit every opportunity and that we build shareholder value. Our collective resolve is to do whatever it takes to succeed in fiscal 2002 and beyond.

Charles A. Sullivan
Chairman of the Board
and Chief Executive Officer

Tough times re-energize our competitive spirit.

To the casual observer, baking seems like a simple business. It is — though the recipe for success in our industry is far more complex. Over 80 years as an industry leader has been predicated on delivering consumers quality-prepared bread, cake and specialty bakery products they trust each day to be tasty, consistently fresh, fairly priced and convenient to buy. That's no small challenge, but we've been up to it.

Some things haven't changed with the decades. Our industry is still vulnerable to singular fluctuations in commodity prices and other costs. Spiraling prices to heat our ovens and fuel our delivery trucks puts tremendous pressure on the bottom line. Competition makes the profit margin razor thin. Consumer tastes change. Adverse weather often presents its own peculiar challenges.

Admittedly, in eight decades, you can have a few headaches. The last two fiscal years certainly were no walk in the park. But we have persevered and thrived as a food company focused on the details that lead to success. One such focus is the consumer. A second is product quality. This we know: everyone, from the mixer operator to the route salesman, is empowered as keeper of the brand promise. Every one is focused on processes and procedures, individually done with an eye to making a difference for our company.

Whatever it takes, we're committed to a great fiscal 2002.

Consumers demand consistent freshness, flavor and great taste. Our reliable bread brands make every buying decision fast and easy.

What's our competitive edge? We invest. We spend money to refine baking processes, update equipment and improve technology. Expensive, yes, but worth every penny when you consistently bake and deliver the best bread and cake.

Jim Williams
General Manager
***Wonder* Bread Bakery**
Kansas City, Missouri

A company's true value isn't always found in the financial statements.

A stroll down a bakery aisle is a sensory trip. The fresh smell. The squeezing of a loaf. Bright packaging. Finally, when a choice is made, odds are high it is an IBC brand. *Wonder* and *Home Pride* are the No. 1 national sellers in white and wheat breads, respectively. *Butternut*, *Merita* and *J.J.Nissen* are regional powerhouses. The reason why: consumers want premium, quality-baked breads and rolls rich in texture, taste and nutrition. They want value. They don't want to be disappointed.

Whether it's a specialty item like croutons or a loaf of fresh bread, our powerhouse brands consistently satisfy the consumer.

A balance sheet gives you dollars-and-cents knowledge about a company, but it doesn't describe its soul. Brand trust is what sets us apart from the competition. The demand for quality and freshness on the shelves requires a vigorous commitment by every IBC employee. Our success, quite simply, begins and ends with us. We know the reputation of our brands is constantly on the line. We know that to take care of our future we must do today's job right every time.

Do you want to understand the true worth of our Company? Look past the financial statements. Strip away the strategic and marketing complexities. Examine the one fundamental truth in baking: consumers define the quality of bread. They are the final arbiters of whether we've made good on our brand promise. Other baking companies make good bread. But the vote's already in. We are the national market leader because we care more about the product we produce.

We labored at a disadvantage in some markets last year. That's behind us. We corrected operational problems. Our pricing is in better order. Success is always in the details. This coming fiscal year, we'll be on top.

Rob Plough
General Sales Manager
***Butternut* Bread Bakery**
Cincinnati, Ohio

Take nothing for granted if you want to remain No. 1.

There's more to eating than good nutrition. Consumers also want foods that taste great and are fun to eat. We virtually pioneered the snack cake category. We introduced *Twinkies* and their cream filling more than 70 years ago. Imitators worldwide now mimic the famous white icing squiggle that makes *Hostess Cupcakes* one of the most recognized brands — and best sellers — in the land. Others imitate, but cannot duplicate. With over a billion sold annually, *Twinkies* and our *Hostess Cupcake* consistently are the first choice for a snack break or a post-meal delight.

Snackers buy on impulse. Our Company leads in sweet indulgence sales by offering a variety of tasty treats like *Hostess Cupcakes* and *Twinkies.*

Great brands, cake product varieties, innovations — that's the good news. But the grab-and-go lifestyle of today's consumers keeps us on our toes. Our competitors aren't just other bakers. We compete with anyone offering a meal or snack solution that fits with today's active lifestyles. With this in mind, we strike back with diversified or value-added product offerings. We strengthen our brand portfolio or complement our product lines with acquisitions and innovations. And we constantly improve and update equipment, technology and even our baking processes. That keeps us competitive. That gives us an edge when we need it.

Brand power. Our stars make the future bright.

Since 1994, we've invested more than a half billion dollars in capital improvements. That includes building or refurbishment of six major bakeries. Why do we do it? It's all about remaining the industry leader.

Why are we better positioned for growth than other food companies? Our brands. Consumers know they get value for their money. Even in a penny-counting economy, you won't go without your Twinkies and Ding Dongs.

Jim Duffy
Operations Manager
***Hostess* Cake Bakery**
Los Angeles, California

We keep our eyes on the goal — pleasing consumers.

Consistent quality, variety and great taste is the hallmark of our *Hostess*, *Dolly Madison* and *Drake's* snack cake brands.

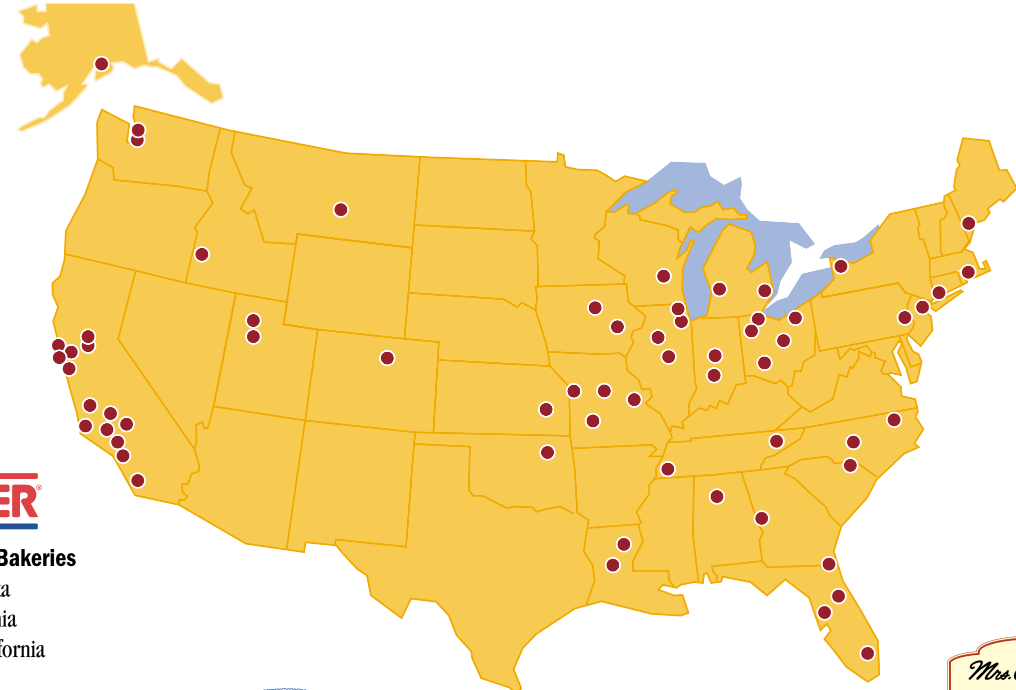
We try to see things through our customers' eyes, and because of the short shelf life of bakery products, our business is truly locally focused. Our eyes must always be on the details. We call it perfecting the basics. We're a decentralized organization. We believe in individual accountability. Each person is responsible for the total operation, not just that job before him or her. This is important when you realize even a minor oversight can waste a thousand loaves of bread in less than five minutes. A delivery even a little late can damage a customer relationship that has taken years to develop.

There are always difficulties in this business. But we have the wherewithal to endure tough economic times, poor wheat harvests, even floods and hurricanes. The measure of great companies are those that weather storms, that innovate, that change with the changing times, that look for opportunity in every challenge.

In the long run, our ability to perfect the basics, particularly in a dynamic or tough competitive environment, makes the difference in whether we score or miss the mark. Over the years, new technology certainly has made a difference in the speed of baking our bread and cake. Innovative baking processes have improved the quality, freshness and the shelf life. But some aspects of our business never change: understand consumer demands and do whatever it takes to meet their needs.

Market forces have been tough. But even in the toughest of economic times, the race is won by making smart decisions, then moving decisively in the right direction. We're prepared to handle whatever challenge tomorrow brings.

Mary West
Controller
***Holsum* Bread Bakery**
Miami, Florida



Wonder Bread Bakeries
Anchorage, Alaska
Pomona, California
Sacramento, California
Tampa, Florida
Hodgkins, Illinois
Waterloo, Iowa
Kansas City, Missouri
Jamaica, New York
Akron, Ohio
Columbus, Ohio
Defiance, Ohio
Toledo, Ohio
Salt Lake City, Utah
Tacoma, Washington

Hostess Cake Bakeries
Los Angeles, California
Schiller Park, Illinois
Detroit, Michigan
Seattle, Washington

Wonder/Hostess Bakeries
San Francisco, California
Denver, Colorado
Indianapolis, Indiana
Davenport, Iowa
St. Louis, Missouri
Buffalo, New York
Tulsa, Oklahoma
Philadelphia, Pennsylvania
Memphis, Tennessee
Ogden, Utah

J.J. Nissen/Wonder/Hostess Bakery
Biddeford, Maine

Butternut Bread Bakeries
Decatur, Illinois
Peoria, Illinois
Grand Rapids, Michigan
Boonville, Missouri
Springfield, Missouri
Cincinnati, Ohio

Merita Bread Bakeries
Birmingham, Alabama
Jacksonville, Florida
Orlando, Florida
Charlotte, North Carolina
Rocky Mount, North Carolina
Florence, South Carolina
Knoxville, Tennessee

Dolly Madison Cake Bakeries
Columbus, Georgia
Columbus, Indiana
Emporia, Kansas
Los Angeles, California

Eddy's Bread Bakery
Boise, Idaho

Drake's Bakery
Wayne, New Jersey

Millbrook Bread Bakeries
Glendale, California
Los Angeles, California
San Diego, California

Cotton's Bread Bakeries
Alexandria, Louisiana
Monroe, Louisiana

Parisian Bread Bakery
San Francisco, California

Sunbeam Bread Bakery
New Bedford, Massachusetts

Dry Products
Montebello, California

Sweetheart Bread Bakery
Billings, Montana

Braun's Bagel Bakery
Milwaukee, Wisconsin

Holsum Bread Bakery
Miami, Florida

DiCarlo Bread Bakery
San Pedro, California

Colombo Bread Bakeries
Castroville, California
Oakland, California
Sacramento, California

Five-Year Summary of Financial Data

(In Thousands, Except Per Share Data)

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999	52 Weeks Ended May 30, 1998	52 Weeks Ended May 31, 1997
Statement of Income					
Net sales	$3,496,482	$3,522,929	$3,459,377	$3,265,842	$3,212,431
Operating income	147,103	170,398	224,477	231,592	191,143
% of net sales	4.2%	4.8%	6.5%	7.1%	6.0%
Net income	$ 61,125	$ 89,388	$ 126,155	$ 127,924	$ 97,177
% of net sales	1.7%	2.5%	3.6%	3.9%	3.0%
Earnings per share[2]:					
Basic	$ 1.13	$ 1.31	$ 1.76	$ 1.74	$ 1.30
Diluted	1.13	1.31	1.74	1.71	1.28
Common stock dividends per share[2]	.28	.28	.28	.28	.27
Weighted average common shares outstanding[2]:					
Basic	54,110	68,156	71,662	73,512	74,928
Diluted	54,296	68,356	72,483	74,845	76,200
Balance Sheet					
Total assets	$1,623,496	$1,651,925	$1,680,775	$1,549,986	$1,493,087
Long-term debt, excluding current maturities[1]	555,937	385,000	369,000	261,000	251,000
Stockholders' equity	392,805	591,677	603,803	565,155	538,722
Debt to total capital	58.6%	39.4%	37.9%	31.6%	31.8%

[1] The June 2, 2001 amount reflects the result of the Company's debt refinancing completed July 19, 2001.
[2] All per share and average shares outstanding amounts reflect a November 1997 two-for-one stock split.

RESULTS OF OPERATIONS

Fiscal 2001 Compared With Fiscal 2000

Net sales for the fifty-two weeks ended June 2, 2001 were $3,496,482,000, a decrease of $26,447,000 from net sales of $3,522,929,000 for the fifty-three weeks ended June 3, 2000. Excluding the impact of the extra week, net sales were up approximately 1.0%. This slight improvement reflects selling price increases realized in fiscal 2001, offset by unit volume declines. The improvement is also reflective of the impact of an eight-day work stoppage at five Northeastern bakeries during fiscal 2000.

Fiscal 2001 gross profit was $1,843,964,000, or 52.7% of net sales, comparable to the gross profit in fiscal 2000 which totaled $1,850,761,000, or 52.5% of net sales. This stable margin performance represents the effect of higher selling prices and operational efficiencies, partially offset by higher labor and labor-related costs, as well as higher utility costs.

Selling, delivery and administrative expenses totaled $1,585,962,000, or 45.4% of net sales, for fiscal 2001, up from $1,568,759,000, or 44.5% of net sales, the prior year. This unfavorable variance was attributable to inflationary labor and labor-related cost increases, as well as higher utility and fuel costs, measured against only slightly increased net sales, adjusted for the extra week in fiscal 2000.

Based upon these factors, operating income decreased to $147,103,000, or 4.2% of net sales, from $170,398,000, or 4.8% of net sales, the previous year, a decline of $23,295,000.

Interest expense for fiscal 2001 was $47,086,000, up $19,277,000 from fiscal 2000 interest expense of $27,809,000. This increase reflects higher borrowing levels resulting from the Company's repurchase of over 15,500,000 shares of treasury stock during fiscal 2001. Overall interest rates were also somewhat higher in fiscal 2001 on the debt undertaken to purchase the treasury stock.

The fiscal 2001 effective income tax rate of 39.2%, as well as the fiscal 2000 rate of 37.5%, approximate the overall federal and state statutory rates.

Reflecting these factors, net income for fiscal 2001 was $61,125,000, or 1.7% of net sales, representing $1.13 per basic and diluted share. This represents a decline of $28,263,000 from net income of $89,388,000, or 2.5% of net sales and $1.31 per basic and diluted share, in fiscal 2000.

Fiscal 2000 Compared With Fiscal 1999

Net sales for the fifty-three weeks ended June 3, 2000 were $3,522,929,000, increasing $63,552,000 and 1.8% over net sales for the fifty-two weeks ended May 29, 1999 of $3,459,377,000. Excluding the impact of the extra week, as well as acquisitions and dispositions, net sales were down slightly, approximately .8% for the year. This decrease reflects an eight-day work stoppage at five Northeastern bakeries during fiscal 2000, as well as other slight overall unit volume declines, partially offset by selling price increases.

Gross profit for fiscal 2000 was $1,850,761,000, representing 52.5% of net sales, comparable to fiscal 1999's gross profit of $1,823,994,000, or 52.7% of net sales. Lower ingredient costs during fiscal 2000 contributed to higher gross margins, but this favorable impact was offset by higher labor and labor-related costs, as well as higher packaging costs principally resulting from higher fuel prices.

Selling, delivery and administrative expenses were $1,568,759,000, or 44.5% of net sales, for fiscal 2000 compared to $1,489,472,000, or 43.1% of net sales, for fiscal 1999. This unfavorable variance reflects labor and labor-related cost increases, as well as substantially higher fuel costs, measured against essentially flat net sales.

Reflecting these factors, operating income for fiscal 2000 was $170,398,000, or 4.8% of net sales, down $54,079,000 from fiscal 1999's operating income of $224,477,000, or 6.5% of net sales.

Interest expense for fiscal 2000 was $27,809,000, an increase of $4,696,000 over interest expense of $23,113,000 in fiscal 1999. This increase reflects higher average borrowing levels during fiscal 2000, primarily due to acquisitions and treasury stock repurchases, higher interest rates and lower capitalized interest.

The effective income tax rate of 37.5% for fiscal 2000 and 1999 approximates the overall federal and state statutory rates.

Based upon these results, net income for fiscal 2000 decreased $36,767,000 to $89,388,000, or 2.5% of net sales and $1.31 per basic and diluted share, from $126,155,000, or 3.6% of net sales and $1.76 and $1.74 per basic and diluted share, respectively, in fiscal 1999.

CAPITAL RESOURCES AND LIQUIDITY

The Company's primary source of liquidity is cash provided by operations which totaled $182,212,000 for fiscal 2001, an increase of $15,521,000 from fiscal 2000's $166,691,000. This increase reflects favorable working capital variances, partially offset by lower net income. Cash generated by operations during fiscal 2001, along with additional net borrowings described below of $171,000,000, was used to repurchase common stock of $244,953,000, pay common stock dividends of $15,189,000 and fund capital expenditures of $88,127,000.

In August 2000, the Company repurchased 15,498,000 shares of its common stock from Ralston Purina Company at market rates. To finance the purchase of these shares, which totaled approximately $244,000,000, as well as repay all its outstanding senior notes, the Company entered into a new unsecured $610,000,000 364-day bank term loan and amended its existing revolving credit agreement. Both the 364-day bank term loan, with $565,000,000 outstanding at June 2, 2001, and the Company's revolving credit facility, with $20,000,000 outstanding at June 2, 2001, were refinanced subsequent to year end, on July 19, 2001. On that date, the Company entered into a new $800,000,000 secured senior credit agreement which includes a $375,000,000 five-year term loan, a $125,000,000 six-year term loan and a $300,000,000 revolving credit facility with a five-year maturity (of which $55,000,000 was borrowed at closing). The term loans require quarterly debt repayments, including $29,063,000 repayable in fiscal 2002, with variable interest rates from 1.25% to 2.75% over the London Interbank Offered Rate based upon the Company's current debt rating. In July 2001, the Company entered into interest rate swap agreements to offset the variable rate characteristic of a portion of these new borrowings. Based upon the current debt rating of the Company, the interest rate swap agreements result in fixed interest rates on $400,000,000 from 5.74% to 6.81% with termination dates ranging from July 2002 to July 2004.

The debt outstanding at June 2, 2001 has been classified in the Company's consolidated financial statements in accordance with the terms of this refinancing.

For fiscal 2002, the Company anticipates cash needs of approximately $118,163,000, consisting of $75,000,000 of planned capital expenditures, $29,063,000 of required debt repayments and $14,100,000 of common stock dividends. The Company expects these cash needs to be funded by ongoing operations. In addition, the Company continues to evaluate its investment alternatives including acquisition opportunities and the repurchase of common shares under its stock repurchase program. At June 2, 2001, approximately 7,500,000 shares were available to be repurchased under the program.

LEGAL MATTERS

In July 2000, a jury in California awarded compensatory damages totaling approximately $10,800,000 against the Company and in favor of 18 plaintiffs who alleged various forms of racial discrimination at the Company's San Francisco bakery. The trial court subsequently reduced these compensatory damages to approximately $5,800,000. In August 2000, the jury also awarded punitive damages totaling approximately $121,000,000. During October 2000, the trial court further reduced the compensatory damages to $3,000,000 and the punitive award to $24,300,000. In February 2001, the trial court also awarded $2,000,000 in attorneys' fees to the plaintiffs. The Company is actively appealing all of the judgments awarded to the plaintiffs in the case, asking for either a new trial or a reduction or elimination of the damage awards, while the plaintiffs have cross-appealed the trial court's reductions of damage awards. Based upon the opinion of outside counsel, although the Company feels its appeals present strong arguments, no substantially certain outcome exists and it is not possible to estimate the amount of a probable loss, if any, to the Company at this time. The Company believes it has adequate reserves for the compensatory damages and legal fees awarded.

NEW ACCOUNTING PRONOUNCEMENTS

See Note 1 to the Company's consolidated financial statements for discussions regarding new accounting pronouncements relating to derivative instruments and hedging activities, sales incentives, shipping and handling costs, consideration paid to a reseller of a vendor's products, business combinations and goodwill and other intangible assets.

FORWARD-LOOKING STATEMENTS

The Company or its representatives may from time-to-time provide information, in either written or oral form, which contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. In receiving and reviewing such information, it should be kept in mind that forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those discussed or projected. Factors which create these risks and uncertainties can be either internal to the Company or related to general external market conditions.

Consolidated Balance Sheet

	June 2, 2001	June 3, 2000
	(In Thousands)	
Assets		
Current assets:		
Accounts receivable, less allowance for doubtful accounts of $4,069,000 ($4,638,000 in 2000)	$ 197,832	$ 204,660
Inventories	76,208	78,840
Other current assets	62,885	57,647
Total current assets	336,925	341,147
Property and equipment:		
Land and buildings	418,928	397,923
Machinery and equipment	1,038,323	989,704
	1,457,251	1,387,627
Less accumulated depreciation	(582,941)	(501,549)
Net property and equipment	874,310	886,078
Intangibles	412,261	424,700
	$1,623,496	$1,651,925
Liabilities and Stockholders' Equity		
Current liabilities:		
Long-term debt payable within one year	$ 29,063	$ 29,000
Accounts payable	123,872	123,461
Accrued expenses	194,473	177,996
Total current liabilities	347,408	330,457
Long-term debt	555,937	385,000
Other liabilities	184,854	212,981
Deferred income taxes	142,492	131,810
Total long-term liabilities	883,283	729,791
Stockholders' equity:		
Preferred stock, par value $.01 per share; authorized - 1,000,000 shares; issued - none	–	–
Common stock, par value $.01 per share; authorized - 120,000,000 shares; issued - 79,851,000 shares (79,837,000 in 2000)	799	798
Additional paid-in capital	551,963	551,819
Retained earnings	373,087	327,151
Treasury stock, at cost - 29,495,000 shares (13,948,000 in 2000)	(533,044)	(288,091)
Total stockholders' equity	392,805	591,677
	$1,623,496	$1,651,925

See accompanying notes.

Consolidated Statement of Income

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
	(In Thousands, Except Per Share Data)		
Net sales	$3,496,482	$3,522,929	$3,459,377
Cost of products sold	1,652,518	1,672,168	1,635,383
Selling, delivery and administrative expenses	1,585,962	1,568,759	1,489,472
Depreciation and amortization	110,899	111,604	110,045
	3,349,379	3,352,531	3,234,900
Operating income	147,103	170,398	224,477
Other income	(518)	(431)	(484)
Interest expense	47,086	27,809	23,113
	46,568	27,378	22,629
Income before income taxes	100,535	143,020	201,848
Provision for income taxes	39,410	53,632	75,693
Net income	$ 61,125	$ 89,388	$ 126,155
Earnings per share:			
Basic	$ 1.13	$ 1.31	$ 1.76
Diluted	$ 1.13	$ 1.31	$ 1.74

See accompanying notes.

Consolidated Statement of Cash Flows

(In Thousands)

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
Cash flows from operating activities:			
Net income	$ 61,125	$ 89,388	$ 126,155
Depreciation and amortization	110,899	111,604	110,045
Other	(11,006)	(15,416)	(4,270)
Change in operating assets and liabilities:			
Accounts receivable	6,828	13,596	(10,813)
Inventories	2,632	(12,156)	2,860
Other current assets	(5,238)	8,271	3,863
Accounts payable and accrued expenses	16,972	(28,596)	(37,805)
Cash from operating activities	182,212	166,691	190,035
Cash flows from investing activities:			
Acquisitions	–	(3,259)	(106,180)
Additions to property and equipment	(88,127)	(93,092)	(108,029)
Sale of assets	2,791	18,614	7,616
Other	(336)	(6,667)	(556)
Cash from investing activities	(85,672)	(84,404)	(207,149)
Cash flows from financing activities:			
Reduction of long-term debt	(394,000)	(25,000)	(92,000)
Reduction of notes payable	(45,000)	–	–
Addition to long-term debt	–	45,000	200,000
Addition to notes payable	610,000	–	–
Common stock dividends paid	(15,189)	(19,044)	(20,066)
Stock option exercise proceeds	101	1,968	7,232
Acquisition of treasury stock	(244,953)	(85,211)	(77,167)
Other	(7,499)	–	(885)
Cash from financing activities	(96,540)	(82,287)	17,114
Change in cash and cash equivalents	–	–	–
Cash and cash equivalents:			
Beginning of period	–	–	–
End of period	$ –	$ –	$ –
Cash payments made:			
Interest	$ 46,962	$ 27,994	$ 24,632
Income taxes	23,368	46,427	58,616

See accompanying notes.

Consolidated Statement of Stockholders' Equity

(In Thousands)

	Common Stock Issued: Number of Shares	Common Stock Issued: Par Value	Additional Paid-in Capital	Retained Earnings	Treasury Stock: Number of Shares	Treasury Stock: Cost
Balance May 30, 1998	79,126	$791	$539,359	$150,718	(6,382)	$(125,713)
Net income	–	–	–	126,155	–	–
Stock options exercised and related tax benefits	504	5	9,721	–	–	–
Dividends paid - $.28 per share	–	–	–	(20,066)	–	–
Treasury stock acquired	–	–	–	–	(3,030)	(77,167)
Balance May 29, 1999	79,630	796	549,080	256,807	(9,412)	(202,880)
Net income	–	–	–	89,388	–	–
Stock options exercised and related tax benefits	207	2	2,739	–	–	–
Dividends paid - $.28 per share	–	–	–	(19,044)	–	–
Treasury stock acquired	–	–	–	–	(4,536)	(85,211)
Balance June 3, 2000	79,837	798	551,819	327,151	(13,948)	(288,091)
Net income	–	–	–	61,125	–	–
Stock options exercised and related tax benefits	14	1	144	–	–	–
Dividends paid - $.28 per share	–	–	–	(15,189)	–	–
Treasury stock acquired	–	–	–	–	(15,547)	(244,953)
Balance June 2, 2001	79,851	$799	$551,963	$373,087	(29,495)	$(533,044)

See accompanying notes.

1. Description of Business and Significant Accounting Policies

Description of business - Interstate Bakeries Corporation (the "Company") is the largest baker and distributor of fresh bakery products in the United States.

Fiscal year end - The Company has a 52-53 week year that ends on the Saturday closest to the last day of May.

Principles of consolidation - The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Inventories - Inventories are stated at the lower of cost or market. Specific invoiced costs are used with respect to ingredients and average costs are used for other inventory items.

The components of inventories are as follows:

	(In Thousands) June 2, 2001	June 3, 2000
Ingredients and packaging	$46,846	$48,697
Finished goods	23,002	23,845
Other	6,360	6,298
	$76,208	$78,840

Property and equipment - Property and equipment are recorded at cost and depreciated over estimated useful lives of 4 to 35 years, using the straight-line method for financial reporting purposes and accelerated methods for tax purposes.

Depreciation expense was $96,516,000, $97,547,000 and $97,024,000 for fiscal 2001, 2000 and 1999, respectively. Interest cost capitalized as part of the construction cost of capital assets was $1,331,000, $1,200,000 and $3,084,000 in fiscal 2001, 2000 and 1999, respectively.

Intangibles - Included in intangibles, which are being amortized using the straight-line method, are the following:

	Life	(In Thousands) June 2, 2001	June 3, 2000
Licenses and patents	9 years	$ 2,510	$ 2,510
Trademarks and tradenames	25-40 years	204,425	204,425
Excess of purchase cost over net assets acquired	40 years	314,699	314,699
Deferred financing cost and other-net	Term of agreements	14,393	13,521
		536,027	535,155
Accumulated amortization		(123,766)	(110,455)
		$412,261	$424,700

Long-lived assets - Impairment losses are recognized when information indicates the carrying amount of long-lived assets, identifiable intangibles and goodwill related to those assets will not be recovered through future operations or disposal based upon a review of expected undiscounted cash flows. The Company currently expects the carrying amounts to be fully recoverable.

Financial instruments - The Company uses financial instruments, principally commodity derivatives and interest rate swap agreements, to manage commodity prices and interest rate risk. All financial instruments are used solely for hedging purposes and are not issued or held for speculative reasons.

The Company utilizes commodity hedging derivatives, generally futures and options on wheat, corn and soybean oil, to reduce its exposure to commodity price movements for future raw material needs. Gains or losses related to these hedging transactions are deferred and recorded to cost of products sold as the inventory produced from the related raw materials is sold.

The Company has from time to time entered into interest rate swap agreements with major banks and institutional lenders to manage the balance of variable versus fixed-rate debt based upon current and anticipated future market conditions. The differential to be paid or received is recognized over the term of the swap agreements as a component of interest expense.

The Company is exposed to credit loss in the event of nonperformance by counterparties on commodity derivatives and interest rate swap agreements. This credit loss is limited to the cost of replacing these contracts at current market rates. Management believes that the probability of such loss is remote.

Revenue recognition - The Company recognizes sales upon delivery of its products to the customer.

Advertising and promotion costs - Advertising and promotion costs, through both national and regional media, are expensed in the year in which the costs are incurred.

Earnings per share - Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share include the effect of all potential dilutive common shares, primarily stock options outstanding under the Company's stock compensation plan. Following is a reconciliation between basic and diluted weighted average shares outstanding used in the Company's earnings per share computations:

	52 Weeks Ended June 2, 2001	(In Thousands) 53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
Basic weighted average common shares outstanding	54,110	68,156	71,662
Effect of dilutive stock compensation	186	200	821
Diluted weighted average common shares outstanding	54,296	68,356	72,483

Diluted weighted average common shares outstanding exclude options on common stock of 5,506,000, 4,263,000 and 3,330,000 for fiscal 2001, 2000 and 1999, respectively, because their effect would have been antidilutive.

Statement of cash flows - For purposes of the statement of cash flows, the Company considers all investments purchased with an original maturity of three months or less to be cash equivalents.

Reclassifications - Certain reclassifications have been made to the Company's fiscal 2000 and 1999 consolidated financial statements to conform to the fiscal 2001 presentation.

New accounting pronouncements - In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes new accounting and reporting standards for derivative instruments and hedging activities. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," and in June 2000, the FASB issued SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities – An Amendment of FASB Statement No. 133."

The new rules, which will be adopted by the Company in the first quarter of fiscal 2002, require that all derivative instruments be recognized as assets or liabilities on the consolidated balance sheet at fair value. Changes in the fair value of derivatives are to be recorded each period in earnings or other comprehensive income ("OCI"), depending on whether the derivative is designated and is effective as a hedged transaction, and on the type of hedging transaction. Changes in the fair value of derivative instruments recorded to OCI are reclassified to earnings in the period affected by the underlying hedged item. Any portion of the change in fair value of a derivative instrument determined to be ineffective under the rules is recognized in current earnings. The transition adjustment to be recognized by the Company in fiscal 2002 for the adoption of these new rules is not material to the Company's financial position or net income.

Based upon the Company's review of its commodity hedging transactions, these transactions will qualify for cash flow hedge accounting treatment under the new rules. While the Company believes that the implementation of these statements will not affect the overall economic hedging strategy of the Company, the new pronouncement may affect the timing of when gains and losses on hedging transactions are reported in net income of the Company.

In May 2000, the Emerging Issues Task Force ("EITF") of the FASB announced that it had reached a consensus on Issue No. 00-14, "Accounting for Certain Sales Incentives." Issue No. 00-14 establishes requirements for the recognition and presentation in financial statements of sales incentives such as discounts, coupons and rebates. The consensus will be effective for the Company as of the first quarter of fiscal 2002. Based upon the Company's review, it will have no impact on the Company's financial position or net income but will require the Company to reclassify certain amounts, which are not material, between net sales and selling, delivery and administrative expenses for all periods presented.

In September 2000, the EITF reached final consensus on Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." The consensus establishes requirements for the classification and disclosure of shipping and handling costs incurred and those costs billed. Based upon a review of the consensus, the Company believes that no reclassifications to its consolidated statement of income are required. The Company includes shipping and handling costs in selling, delivery and administrative expenses and such costs amounted to approximately $776,797,000, $760,299,000 and $722,279,000 for fiscal 2001, 2000 and 1999, respectively.

In April 2001, the EITF reached consensus on Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." This issue addresses the recognition, measurement and classification of certain costs incurred by a vendor to benefit the reseller of the vendor's products such as slotting fees, cooperative advertising programs and reimbursement for lowered promotional prices. This consensus will require the Company to reclassify certain costs between net sales and selling, delivery and administrative expenses and will be adopted by the Company in the fourth quarter of fiscal 2002. The Company has not yet completed its analysis of Issue No. 00-25 but does not expect the implementation to impact net income of the Company.

In June 2001, the FASB approved the issuance of SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires all business combinations to be accounted for using the purchase method and provides guidance regarding the recognition of intangibles separate from goodwill in a purchase transaction. SFAS No. 142, which can be early adopted by the Company during the first quarter of fiscal 2002, eliminates the amortization of purchased goodwill and other intangibles with indefinite useful lives and provides guidance on the required testing of these assets for impairment. This impairment testing must be done at least annually or more frequently if an event occurs which indicates the intangible may be impaired.

The Company has not completed its evaluation of the adoption of SFAS Nos. 141 and 142 but expects a favorable impact to net income due to the elimination of goodwill amortization. The Company plans to early adopt SFAS No. 142 during the first quarter of fiscal 2002.

2. Acquisitions

During fiscal 1999, the Company acquired the assets of the Drake baking operation in Wayne, New Jersey ("Drake's"). Drake's employed over 800 people, distributed cake product throughout the northeastern United States and had annual net sales of approximately $115 million.

Also in fiscal 1999, the Company acquired the My Bread Baking Co. ("My Bread") operation in New Bedford, Massachusetts, in exchange for its Grand Junction, Colorado, bakery and an additional cash payment. My Bread had annual net sales of approximately $37 million and employed over 400 people.

These acquisitions were accounted for as purchases. In addition, the My Bread exchange included a noncash portion not reflected in investing activities on the statement of cash flows for fiscal 1999 amounting to $14,365,000.

The proforma impact as if these acquisitions had taken place at the beginning of the fiscal year prior to acquisition is not significant.

3. Debt

On July 19, 2001, subsequent to year end, the Company entered into a new $800,000,000 senior credit facilities agreement with a bank and institutional lender group, using the proceeds to repay all outstanding borrowings under the Company's 364-day term loan and revolving credit facility. The new credit facilities include (1) a five-year term loan in the amount of $375,000,000, repayable in quarterly installments of 2.50% in year one and two, 3.75% in year three and four and 12.50% in the fifth year; (2) a six-year term loan in the amount of $125,000,000, repayable at .25% per quarter in the first five years and 23.75% for each quarter in the sixth year; and (3) a five-year $300,000,000 revolving credit facility, maturing in July 2006, which allows up to $150,000,000 for letters of credit. Maturities on these facilities aggregate $29,063,000 in fiscal 2002, $38,750,000 in fiscal 2003, $52,813,000 in fiscal 2004, $57,500,000 in fiscal 2005 and $155,938,000 in fiscal 2006. The facilities are secured by all accounts receivable and a majority of owned real property, intellectual property and equipment. The outstanding borrowings bear interest at variable rates generally equal to the London Interbank Offered Rate ("LIBOR") plus from 1.25% to 2.50% (1.75% at closing) on the $375,000,000 term loan and the revolving credit facility and LIBOR plus from 2.25% to 2.75% (2.25% at closing) on the $125,000,000 term loan, depending upon the Company's debt rating. The Company also pays a fee of between .38% and .50% (.38% at closing) on the unused portion of the revolving credit facility.

In July 2001, the Company also entered into interest rate swap agreements to offset the variable rate characteristic of a portion of these new borrowings. Based upon the current debt rating of the Company, the interest rate swap agreements result in fixed interest rates on $400,000,000 from 5.74% to 6.81% with termination dates ranging from July 2002 to July 2004. Including the effect of these swap agreements, the weighted average interest rate on the $555,000,000 borrowed at the date of the debt closing was 6.17%. The Company believes these swap agreements qualify for cash flow hedge accounting treatment and should be highly effective as defined by SFAS Nos. 133, 137 and 138 (see Note 1 regarding discussion of these statements).

The senior credit facilities agreement contains covenants which, among other matters (1) limit the Company's ability to incur indebtedness, merge, consolidate and acquire, dispose of or incur liens on assets; (2) require the Company to satisfy certain ratios related to net worth, interest coverage and leverage; and (3) limit aggregate payments of cash dividends on common stock and common stock repurchases to a total of $100,000,000 plus 50% of consolidated net income after fiscal 2001.

At June 2, 2001 and June 3, 2000, the Company had the following debt outstanding:

	(In Thousands) June 2, 2001	June 3, 2000
Bank borrowings –		
Notes payable	$565,000	$ –
Revolving credit loans	20,000	185,000
6.43% Senior notes	–	200,000
10.00% Senior notes	–	29,000
	$585,000	$414,000

The debt outstanding at June 2, 2001 has been classified in the consolidated financial statements in accordance with the terms of the July 19, 2001 refinancing.

The weighted average interest rate on the outstanding bank borrowings was 5.61% and 6.51% at June 2, 2001 and June 3, 2000, respectively. In addition, the Company believes, based upon applicable terms, that the carrying value of all debt as of June 2, 2001 and June 3, 2000 approximates fair value, except the senior notes which had a fair value of $221,361,000 as of June 3, 2000.

4. Commitments and Contingencies

Future minimum rental commitments for all noncancelable operating leases, exclusive of taxes and insurance, are as follows:

Fiscal Years Ending	(In Thousands)
2002	$ 69,514
2003	55,198
2004	40,335
2005	27,624
2006	17,185
Thereafter	23,403
	$233,259

Net rental expense under operating leases was $79,152,000, $74,475,000 and $67,568,000 for fiscal 2001, 2000 and 1999, respectively. The majority of the operating leases contain renewal options for varying periods. Certain leases include purchase options during or at the end of the lease term.

In July 2000, a jury in California awarded compensatory damages totaling approximately $10,800,000 against the Company and in favor of 18 plaintiffs who alleged various forms of racial discrimination at the Company's San Francisco bakery. The trial court subsequently reduced these compensatory damages to approximately $5,800,000. In August 2000, the jury also awarded punitive damages totaling approximately $121,000,000. During October 2000, the trial court further reduced the compensatory damages to $3,000,000 and the punitive award to $24,300,000. In February 2001, the trial court also awarded $2,000,000 in attorneys' fees to the plaintiffs. The Company is actively appealing all of the judgments awarded to the plaintiffs in the case, asking for either a new trial or a reduction or elimination of the damage awards, while the plaintiffs have cross-appealed the trial court's reductions of damage awards. Based upon the opinion of outside counsel, although the Company feels its appeal presents strong arguments, no substantially certain outcome exists and it is not possible to estimate the amount of a probable loss, if any, to the Company at this time. The Company believes it has adequate reserves for the compensatory damages and legal fees awarded.

The Company is subject to various other routine legal proceedings, environmental actions and matters in the ordinary course of business, some of which may be covered in whole or in part by insurance. In management's opinion, none of these other matters will have a material adverse effect on the Company's financial position, but could be material to net income or cash flows for a particular quarter or annual period.

5. Income Taxes

The reconciliation of the provision for income taxes to the statutory federal rate is as follows:

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
Statutory federal tax	35.0%	35.0%	35.0%
State income tax	2.1	2.6	2.2
Intangibles amortization	2.4	1.6	1.2
Other	(0.3)	(1.7)	(0.9)
	39.2%	37.5%	37.5%

The components of the provision for income taxes are as follows:

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
	(In Thousands)		
Current:			
Federal	$31,242	$41,283	$62,227
State	2,609	3,814	5,829
	33,851	45,097	68,056
Deferred:			
Federal	4,527	5,963	6,702
State	1,032	2,572	935
	5,559	8,535	7,637
	$39,410	$53,632	$75,693

Temporary differences and carryforwards which give rise to the deferred income tax assets and liabilities are as follows:

	June 2, 2001	June 3, 2000
	(In Thousands)	
Deferred tax assets, net:		
Payroll and benefits accruals	$ 21,727	$ 19,178
Self-insurance reserves	19,293	17,216
Other	9,337	8,840
Valuation allowance	–	–
	$ 50,357	$ 45,234
Deferred tax liabilities, net:		
Property and equipment	$143,538	$141,330
Intangibles	53,492	53,569
Payroll and benefits accruals	(36,936)	(38,319)
Self-insurance reserves	(20,711)	(25,502)
Environmental accruals	(3,619)	(7,129)
Other	6,728	7,861
	$142,492	$131,810

6. Employee Benefit Plans

The 1991 Employee Stock Purchase Plan, which is noncompensatory, allows all eligible employees to purchase common stock of the Company. The common stock can be either issued by the Company at market prices or purchased on the open market. At June 2, 2001, 232,000 shares were authorized but not issued under this plan.

The Company sponsors a defined contribution retirement plan for eligible employees not covered by union plans. Contributions are based upon a percentage of annual compensation plus a percentage of voluntary employee contributions. Retirement expense related to this plan was $16,176,000, $16,355,000 and $16,268,000 for fiscal 2001, 2000 and 1999, respectively.

The Company participates in numerous negotiated multi-employer pension plans covering employees participating by reason of union contracts. Expense for these plans was $118,333,000, $112,740,000 and $107,220,000 for fiscal 2001, 2000 and 1999, respectively.

The Company also maintains a defined benefit pension plan to benefit certain union and nonunion employee groups, with participation generally resulting from business acquisitions.

The components of the pension income for the defined benefit pension plan are as follows:

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
	(In Thousands)		
Service cost	$ 697	$ 957	$ 1,025
Interest cost	3,707	3,498	3,100
Expected return on plan assets	(5,596)	(4,471)	(3,784)
Amortization:			
Unrecognized prior service cost	42	50	97
Unrecognized net gain	(1,917)	(361)	(462)
Net pension income	$(3,067)	$ (327)	$ (24)

The aggregate changes in the Company's accumulated benefit obligation ("ABO") and plan assets, along with actuarial assumptions used, related to the defined benefit pension plan are as follows:

	June 2, 2001	June 3, 2000
	(In Thousands)	
ABO at beginning of year	$ 47,435	$ 50,628
Service cost	697	957
Interest cost	3,707	3,498
Amendments	–	(73)
Actuarial (gain) loss	3,588	(3,685)
Benefits paid	(4,012)	(3,890)
ABO at end of year	51,415	47,435
Fair value of plan assets at beginning of year	71,743	57,488
Actual return on plan assets	(12,291)	18,010
Contributions:		
Employer	–	13
Employee	110	122
Benefits paid	(4,012)	(3,890)
Fair value of plan assets at end of year	55,550	71,743
Plan assets in excess of ABO	(4,135)	(24,308)
Unrecognized prior service cost	(174)	(214)
Unrecognized net gain	3,068	26,348
Net ABO liability (asset) at end of year	$ (1,241)	$ 1,826
Weighted average actuarial assumptions:		
Discount rate	7.5%	8.0%
Expected return on plan assets	8.0	8.0
Rate of compensation increase	4.5	4.5

In addition to providing retirement pension benefits, the Company provides health care benefits for eligible retired employees. Under the Company's plans, all nonunion employees, with 10 years of service after age 50, are eligible for retiree health care coverage between ages 60 and 65. Grandfathered nonunion employees and certain union employees who have bargained into the Company-sponsored health care plans are generally eligible after age 55, with 10 years of service, and have only supplemental benefits after Medicare eligibility is reached. Certain of the plans require contributions by retirees and spouses.

The components of the net postretirement benefit expense are as follows:

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
	(In Thousands)		
Service cost	$ 2,348	$ 2,343	$2,089
Interest cost	8,753	8,439	6,675
Amortization:			
Unrecognized prior service cost	322	353	320
Unrecognized net loss	334	213	–
Net postretirement benefit expense	$11,757	$11,348	$9,084

The aggregate change in the Company's accumulated postretirement benefit obligation ("APBO"), which is unfunded, is as follows:

	June 2, 2001	June 3, 2000
	(In Thousands)	
APBO at beginning of year	$109,795	$ 98,056
Service cost	2,348	2,343
Interest cost	8,753	8,439
Participant contributions	1,846	1,838
Amendments	47	197
Actuarial loss	2,445	9,754
Acquisitions	–	463
Benefits paid	(12,866)	(11,295)
APBO at end of year	112,368	109,795
Unrecognized prior service cost	(2,043)	(2,317)
Unrecognized net loss	(15,897)	(13,787)
Accrued postretirement benefit	94,428	93,691
Less current portion	(11,500)	(11,000)
APBO included in other liabilities	$ 82,928	$ 82,691

In determining the APBO, the weighted average discount rate was assumed to be 8.0% for fiscal 2001 and 2000 and 7.0% for fiscal 1999. The assumed health care cost trend rate for fiscal 2001 was 10.0%, declining gradually to 5.5% over the next 5 years. A 1.0% increase in this assumed health care cost trend rate would increase the service and interest cost components of the net postretirement benefit expense for fiscal 2001 by approximately $1,112,000, as well as increase the June 2, 2001 APBO by approximately $9,113,000.

Conversely, a 1.0% decrease in this rate would decrease the fiscal 2001 expense by approximately $981,000 and the June 2, 2001 APBO by approximately $8,079,000.

The Company also participates in a number of multi-employer plans which provide postretirement health care benefits to substantially all union employees not covered by Company-administered plans. Amounts reflected as benefit cost and contributed to such plans, including amounts related to health care benefits for active employees, totaled $171,510,000, $162,990,000 and $154,670,000 in fiscal 2001, 2000 and 1999, respectively.

7. Stock-Based Compensation

The 1996 Stock Incentive Plan (the "Plan") allows the Company to grant to employees and directors various stock awards, including stock options, which are granted at prices not less than the fair market value at the date of grant, and restricted stock. A maximum of 13,683,000 shares was approved to be issued under the Plan. On June 2, 2001, shares totaling 1,481,000 were authorized but not awarded under the Plan.

The stock options may be granted over a period not to exceed 10 years and generally vest from one to three years from the date of grant. The changes in outstanding options are as follows:

	(In Thousands) Shares Under Option	Weighted Average Exercise Price Per Share
Balance May 30, 1998	5,261	$24.78
Issued	1,030	26.60
Surrendered	(184)	29.81
Exercised	(504)	14.36
Balance May 29, 1999	5,603	25.89
Issued	2,129	18.65
Surrendered	(308)	28.56
Exercised	(207)	9.50
Balance June 3, 2000	7,217	24.12
Issued	1,348	14.16
Surrendered	(488)	26.67
Exercised	(14)	7.03
Balance June 2, 2001	8,063	$22.33

Stock options outstanding and exercisable on June 2, 2001 are as follows:

Range of Exercise Prices Per Share	(In Thousands) Shares Under Option	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life In Years
Outstanding:			
$ 6.25 - $14.50	2,700	$13.54	8.8
15.13 - 27.06	3,241	22.07	6.7
33.28 - 33.91	2,122	33.90	6.3
$ 6.25 - $33.91	8,063	$22.33	7.3
Exercisable:			
$ 6.25 - $14.50	833	$12.00	
15.13 - 27.06	2,357	21.41	
33.28 - 33.91	2,122	33.90	
$ 6.25 - $33.91	5,312	$24.93	

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB25"), and related interpretations in accounting for the Plan, and, therefore, no compensation expense has been recognized for stock options issued under the Plan. For companies electing to continue the use of APB25, SFAS No. 123, "Accounting for Stock-Based Compensation," requires proforma disclosures determined through the use of an option-pricing model as if the provisions of SFAS No. 123 had been adopted.

The weighted average fair value at date of grant for options granted during fiscal 2001, 2000 and 1999 was $5.49, $7.08 and $8.80 per share, respectively. The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

	2001	2000	1999
Expected dividend yield	1.8%	1.9%	1.3%
Expected volatility	41.7	36.8	28.5
Risk-free interest rate	4.6	6.3	5.4
Expected term in years	4.0	4.0	4.0

If the Company had adopted the provisions of SFAS No. 123, the impact would have been to reduce reported net income and earnings per share as follows:

	52 Weeks Ended June 2, 2001	53 Weeks Ended June 3, 2000	52 Weeks Ended May 29, 1999
Net income (in thousands)	$7,674	$12,804	$10,621
Earnings per share:			
Basic	.09	.12	.15
Diluted	.09	.12	.15

During fiscal 1998, the Company also awarded 200,000 shares of restricted stock under the Plan, with a weighted average fair value at the date of grant of $33.91 per share. These restricted shares vested ratably after one, two and three years of continued employment, and are currently fully vested. Compensation expense related to this award was $696,000, $2,260,000 and $2,260,000 for fiscal 2001, 2000 and 1999, respectively.

On June 2, 2001, 9,976,000 total shares of common stock were reserved for issuance under various employee benefit plans.

8. Accrued Expenses and Other Liabilities

Included in accrued expenses are the following:

(In Thousands)	June 2, 2001	June 3, 2000
Payroll, vacation and other compensation	$59,093	$56,321
Self-insurance reserves	54,622	48,708
Pension and welfare	36,014	34,638
Taxes other than income	20,780	19,967

Included in other liabilities are the following:

(In Thousands)	June 2, 2001	June 3, 2000
Self-insurance reserves	$56,917	$70,374
Accumulated postretirement benefit obligation	82,928	82,691

9. Stockholder Rights Plan

In May 2000, the Company's board of directors adopted a stockholder rights plan which provided that a dividend of one preferred stock purchase right was declared for each share of the Company's common stock outstanding and any common shares issued thereafter. The rights are not exercisable until 10 business days following either 1) a public announcement that a person or group acquired 15% or more of the Company's common stock or 2) the announcement of a tender offer which could result in a person or group acquiring 15% or more of the Company's common stock.

Each right, if exercisable, will entitle its holder to purchase one one-thousandth of a share of the Company's Series A Junior Participating Preferred Stock at an exercise price of $80.00, subject to adjustment. If a person or group acquires 15% or more of the Company's outstanding common stock, the holder of each right not owned by the acquiring party will be entitled to purchase shares of the Company's common stock (or in certain cases, preferred stock, cash or other property) having a market value of twice the exercise price of the right. In addition, after a person or group has become an acquiring person, if the Company is acquired in a merger or other business combination or 50% or more of its consolidated assets or earning power are sold, each right will entitle its holder to purchase at the exercise price of the right, a number of the acquiring party's common shares valued at twice the exercise price of the right.

The Board may redeem the rights at any time before they become exercisable for $.001 per right and, if not exercised or redeemed, the rights will expire on May 25, 2010.

10. Quarterly Financial Information (Unaudited)

Summarized quarterly financial information for the fiscal years ended June 2, 2001 and June 3, 2000 is as follows (each quarter represents a period of twelve weeks except the third quarters, which cover sixteen weeks, and the fourth quarter of fiscal 2000 which covers thirteen weeks):

(In Thousands, Except Per Share Data)

	First	Second	Third	Fourth
2001				
Net sales	$819,694	$817,813	$1,038,969	$820,006
Cost of products sold	384,220	391,859	492,207	384,232
Operating income	50,106	32,676	28,989	35,332
Net income	26,885	11,386	7,747	15,107
Earnings per share:				
Basic	.41	.22	.15	.30
Diluted	.41	.22	.15	.30
2000				
Net sales	$809,473	$810,600	$1,035,609	$867,247
Cost of products sold	380,714	378,963	494,886	417,605
Operating income	58,799	50,143	41,336	20,120
Net income	33,226	27,938	20,417	7,807
Earnings per share:				
Basic	.47	.40	.30	.12
Diluted	.47	.40	.30	.12

The fourth quarter of fiscal 2000 includes the impact of one-time events totaling $23,600,000 ($.22 per basic and diluted share on an after-tax basis) related to a work stoppage that idled five Northeast bakeries, bakery consolidation and start-up costs in the Pacific Northwest and an adjustment to the self-insurance reserves.

Independent Auditors' Report

To the Board of Directors and Stockholders
Interstate Bakeries Corporation

We have audited the accompanying consolidated balance sheets of Interstate Bakeries Corporation and its subsidiaries (the "Company") as of June 2, 2001 and June 3, 2000 and the related consolidated statements of income, stockholders' equity and cash flows for each of the three fiscal years in the period ended June 2, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of June 2, 2001 and June 3, 2000, and the results of their operations and their cash flows for each of the three fiscal years in the period ended June 2, 2001 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Kansas City, Missouri
July 20, 2001

Directors & Officers

DIRECTORS

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Chief Executive Officer
Interstate Bakeries Corporation
Kansas City, Missouri

MICHAEL J. ANDERSON
President and
Chief Executive Officer
The Andersons, Inc.
Maumee, Ohio

G. KENNETH BAUM
Chairman of the Board
George K. Baum Group, Inc.
Kansas City, Missouri

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Benatar & Associates and
A.T. Kearney, Inc.
Atlanta, Georgia

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Consultant
PaineWebber Group, Inc.
New York, New York

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President
Clipper Capital Corporation
New York, New York

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Vice President and
Chief Financial Officer
Ralston Purina Company
St. Louis, Missouri

FRANK E. HORTON, PH.D.
Principal
Horton & Associates
Denver, Colorado

RICHARD L. METRICK
Senior Managing Director
Investment Banking Department
Bear Stearns & Co., Inc.
New York, New York

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Interstate Bakeries Corporation

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and Chief Executive Officer

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Chief Operating Officer

RAY SANDY SUTTON
Vice President,
Corporate Secretary
and General Counsel

FRANK W. COFFEY
Senior Vice President
and Chief Financial Officer

JOHN F. McKENNY
Vice President and
Corporate Controller

PAUL E. YARICK
Vice President and
Treasurer

LINDA L. THOMPSON
Assistant Secretary and
Director, Shareholder Relations

Interstate Brands Corporation/Interstate Brands West Corporation

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and Chief Executive Officer

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Chief Operating Officer

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Vice President,
Corporate Secretary
and General Counsel

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Senior Vice President
and Chief Financial Officer

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Central/ Eastern Divisions

RICHARD D. WILLSON
Executive Vice President
Western Division

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Senior Vice President
Western Division – North

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Senior Vice President
Central Division – North

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Corporate Controller

STAN W. OSMAN
Vice President
Bread Marketing

RONALD D. PARQUE
Vice President
Dry Products Division

MICHAEL S. REDD
Vice President
Cake Marketing

TERRY A. STEPHENS
Vice President
National Account Sales

SCOTT A. WAY
Vice President
Internal Audit

PAUL E. YARICK
Vice President and
Treasurer

LINDA L. THOMPSON
Assistant Secretary

Corporate Headquarters
12 East Armour Boulevard
P.O. Box 419627
Kansas City, Missouri 64141
(816) 502-4000

Subsidiaries
Interstate Brands Corporation
Interstate Brands West Corporation
Mrs. Cubbison's Foods, Inc.
IBC Trucking Corporation

Division Offices
Western – Phoenix, Arizona
Eastern – Charlotte, North Carolina
Central – Kansas City, Missouri
Dry Products – Montebello, California

Common Stock
Listed on the New York Stock Exchange
Trading Symbol – IBC
Trade Journal Listing – IntstBaker
Transfer Agent & Registrar
UMB Bank, n.a.
928 Grand Avenue
Kansas City, Missouri 64106

10-K Report
A copy of the Company's 10-K report, as filed with the Securities and Exchange Commission, is available upon request to the Corporate Secretary at the Headquarters address.

Annual Meeting
The Annual Meeting of Stockholders of Interstate Bakeries Corporation will be held in the City Stage Theater of Union Station, 30 West Pershing, Kansas City, Missouri at 10:00 a.m. Central Daylight Time on Tuesday, September 25, 2001.

INTERSTATE BAKERIES CORPORATION

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Visit our websites at:
www.irin.com/ibc
www.twinkies.com
www.wonderbread.com