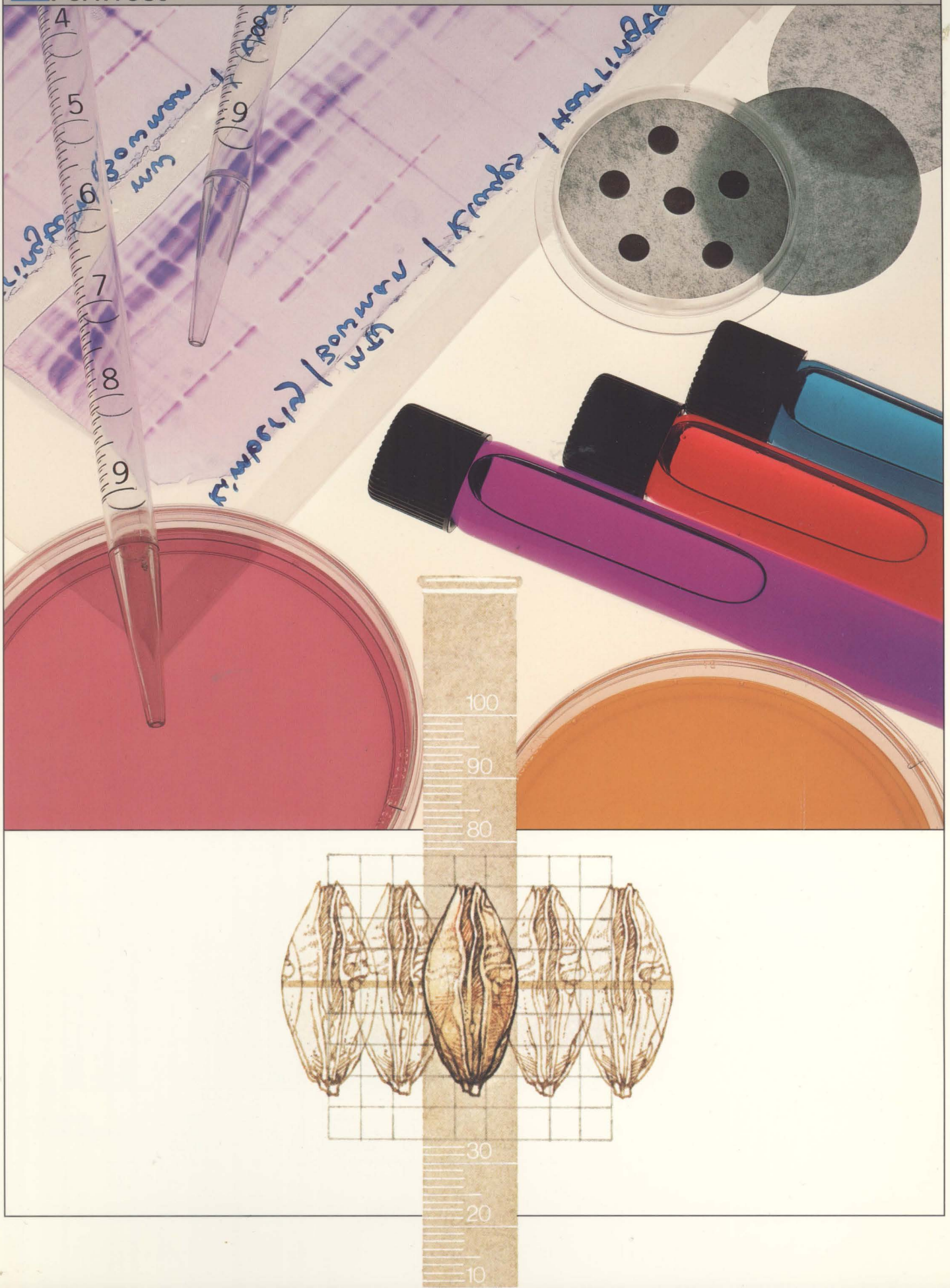


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Annual Report
STACK



THE COMPANY

PENWEST is a diversified producer of food and flavor ingredients and specialty carbohydrate products. The company buys commodities but sells high value-added products, including specialty chemical starch products to the paper and textile industries, and brewer's malt to the brewing industry. The company is a March, 1984 spin-off from Univar Corporation of Seattle.

The company's corn wet milling division is a leading producer of chemically-modified specialty starches and also processes solid corn sweeteners for pharmaceutical and food products. Its products are manufactured at plants in Cedar

Rapids, Iowa, and Idaho Falls, Idaho, under the Penick & Ford brand name.

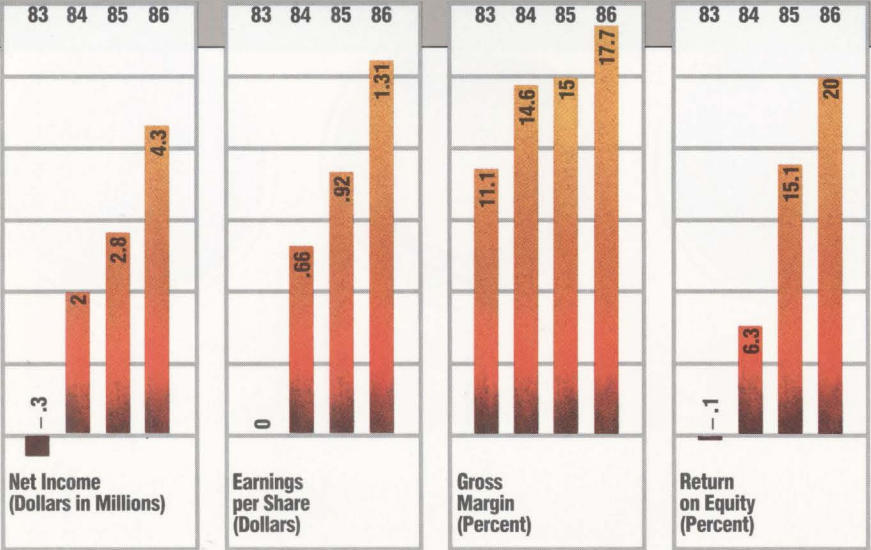
PENWEST's malting division, Great Western Malting Co., is the premier producer of high-quality brewer's malt in the western United States, and also supplies major breweries in the Midwest, Southwest, South, Southeast and selected nations of the Pacific Rim. Production facilities are located in Vancouver, Washington, Pocatello, Idaho and Los Angeles, California.

PENWEST's corporate headquarters are at 300 One Bellevue Center, Bellevue, WA 98004. Telephone: (206) 462-6000.

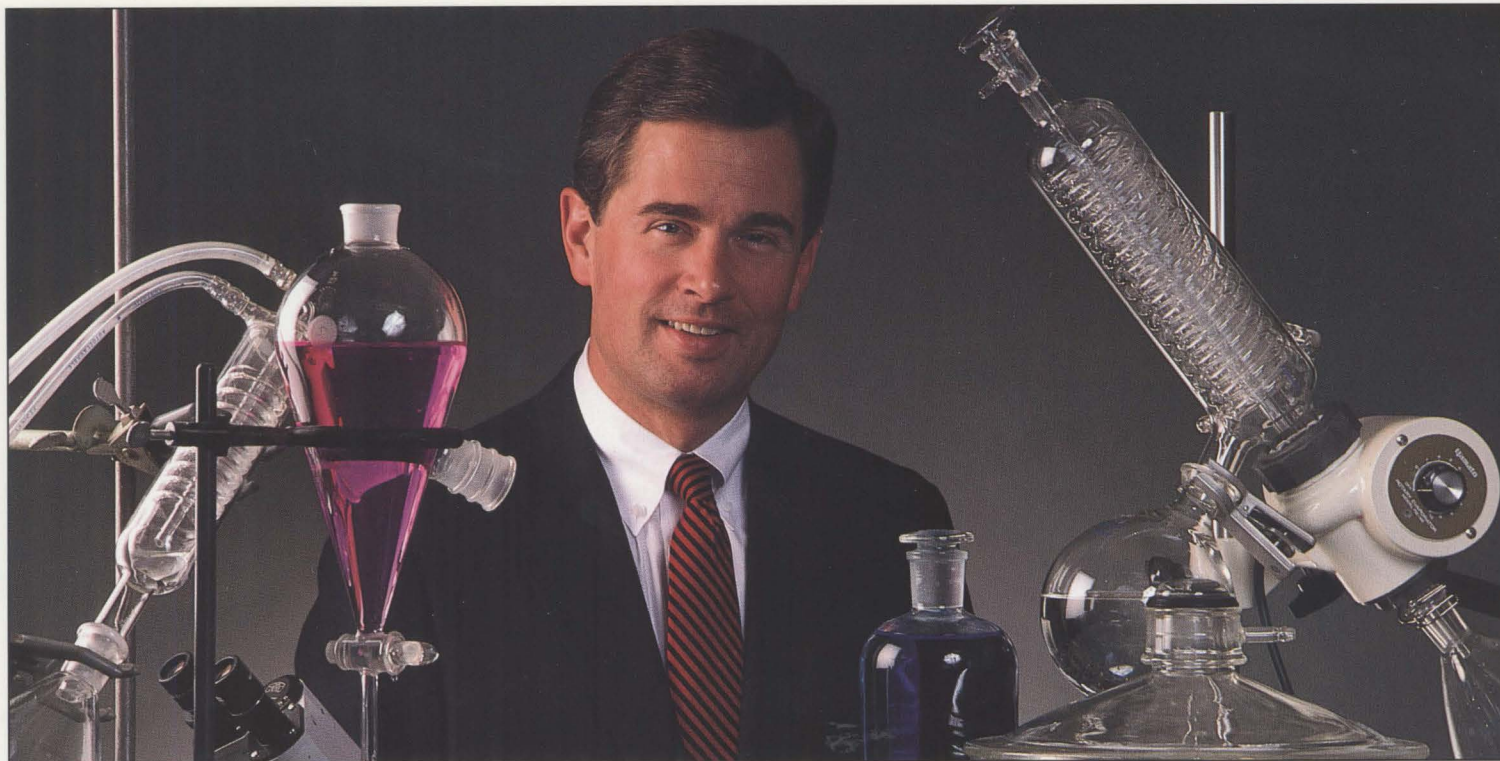
Financial Highlights

	Year Ended August 31			Year Ended February 29/28	
	1986	1985	1984	1984	1983
(Thousands of dollars except per share data)					
Operating Data:	(Restated)		(Unaudited)		
Net sales	\$134,809	\$146,141	\$138,966	\$131,689	\$127,701
Net income	4,253	2,802	1,992	1,832	(269)
Earnings per share	1.31	0.92	0.66	NA	NA
Balance Sheet Data:					
Current assets	38,823	43,533	42,070	53,774	64,306
Total assets	117,216	125,713	129,153	144,203	161,287
Current liabilities	20,811	20,481	15,497	28,407	25,494
Long-term debt	45,876	61,879	62,381	64,425	54,161
Revolving credit			13,000	15,000	35,000
Shareholders' equity	25,572	21,315	18,513	17,457	32,145
Average shares outstanding	3,251,527	3,034,655	3,036,401	NA	NA

This annual report was printed on paper treated with specialty starch products developed and sold through PENWEST's corn wet milling division.



The company's growth has been steady and consistent over time.



Letter To Shareholders

Your company completed its second full fiscal year of independent operations on August 31, with excellent growth in earnings, continued reduction of debt, stronger market positions and greater depth in operating management.

Earnings for the year were \$4.3 million, or \$1.31 per fully-diluted share, up 52 percent from \$2.8 million and 92 cents per fully-diluted share last year.

Revenues were \$135 million in fiscal 1986 compared

with \$146 million a year ago, reflecting lower export sales and raw material commodities prices. Domestic unit volume was up for both operating divisions.

Interest-bearing debt was \$48 million at August 31, down from \$64 million at the same time a year ago. Management negotiated a new borrowing arrangement with three lenders, making \$15 million available at the prime lending rate. The loan enabled the company to pay off a \$10 million subordinated note bearing interest at 13 percent.

The loan agreement subsequently was expanded to \$22 million, also at prime, enabling the company to purchase a

warrant for PENWEST stock held by VWR Corporation. The warrant was retired when the transaction was completed, eliminating its dilutive effect on stated earnings per share. Had the warrant been retired prior to the 1986 fiscal year, earnings per share would have been \$1.41 rather than the \$1.31 reported. The purchase also provides greater flexibility for strategic decision-making and broadens the company's options for future capitalization.

The purchase will reduce shareholders' equity by about \$7 million, but that reduction is expected to be substantially offset by tax gains under recently enacted tax reform legislation. A more detailed discussion is included in the Management's Discussion on page 14 of this report.

Grain prices continued to fall during the year, reducing the company's raw materials and inventory carrying costs and offering the possibility for higher margins.

Both divisions did well, achieving gains in net margins and market share.

Great Western Malting became the nation's second largest maltster during the year, moving up from third, and continues to hold a dominant market share in the West.

Penick & Ford, which produces chemically-modified specialty starches for the paper and textile industries, saw increases in both profits and market share, despite excess capacity in the coated paper industry and additional starch capacity in the corn wet milling industry.

A major management building process was completed at Penick & Ford during the year, with the addition of key officers in finance, distribution, marketing, and research and development. The new team combines many years of experience in the industry and related industries, and will mount a more aggressive marketing effort, tighten controls on costs, and broaden the company's product development capability.

PENWEST is a market-driven company, with customer

service as the centerpiece of our basic strategy. The company has increased its commitment to research and development across-the-board, a commitment geared to offering our customers better products to serve real needs. We believe that we can maintain a competitive advantage in our industry by becoming more innovative in new product development, by preserving the integrity and quality of our existing products, and by remaining sensitive to the expectations of our customers.

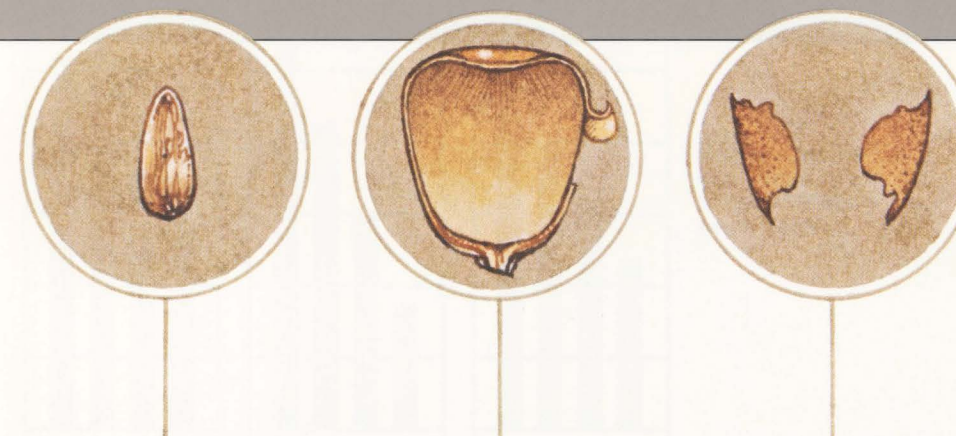
While we had an excellent year, we believe the future holds even greater promise. If current trends continue, we expect to be operating at capacity at both divisions within three or four years. Further debt reduction will lower interest expense and contribute positively to earnings.

Your management is excited about the company's prospects. We look forward to meeting competitive challenges, creating an environment of excellence for our people, developing new business opportunities through internal growth or by acquisition, and maintaining the company's reputation for outstanding service and quality.

By achieving these objectives, we can best serve our long-term goal of increasing the value of our shareholders' investment.

The company's annual meeting of shareholders will be held Tuesday, January 20, at 2 P.M. in the 12th floor auditorium, Rainier Bank Tower, Seattle. We encourage all shareholders to attend and participate.

Tod R. Hamachek
President and Chief Executive Officer



Each kernel of corn is composed of three parts. Corn wet milling is the process by which these parts are separated, refined and modified.



Growth Profile

There are three components to PENWEST's earnings growth.

Varietal Malts Great Western Malting is growing in an industry that is not. While its growth has been and probably will continue to be modest, it has been steady and predictable, providing a solid revenue base for the company over a long period of time. The division is uniquely positioned geographically and in terms of its high-quality products.

Great Western is the nation's second largest maltster, and the dominant supplier in the western United States where its market share is between 75 and 80 percent. All of its competitors lie to the east—in North Dakota, Minnesota, Illinois and Wisconsin.

In addition to its geographic advantage, Great Western enjoys a reputation for outstanding quality. The division is the major supplier to a number of the world's largest brewers whose policies are to buy on quality, service and price.

The products are varietal malting barleys of three types: conventional 6-row barley from the Dakotas and Minnesota; western 6-row from the northern intermountain West; and 2-row, a super-premium favored by many of the world's leading brewers for premium and super premium beers. In the U.S., 2-row is grown only in the Pacific Northwest and northern intermountain West.

Great Western is the only supplier of western 6-row malt and the dominant supplier of 2-row malt.

Specialty Starches PENWEST's specialty chemical division is Penick & Ford, a fast-growth, value-added business which also occupies a unique niche in its industry. The division's basic business is producing chemically-modified specialty starches for the paper and textile industries, with special focus on chemically-modified starch products for coated and uncoated fine papers.

While Penick & Ford does produce some commodity

starches, 80 percent of the division's output consists of high value-added products, compared with only 50 percent four years ago.

The division also produces a dry corn-based sweetener used, among other things, as a bulking agent for Equal® brand sweetener; and specialized chemical potato starches which are used by some paper manufacturers to strengthen the internal bonding of the paper's wood fibers and improve the operating efficiencies of paper machines.

Penick & Ford emphasizes high-quality products and outstanding service, and has assembled a technical staff that is among the finest in the industry.

During the past three years the division has experienced a very strong compounded growth rate in volume, and currently operates in excess of 90 percent of capacity. Penick & Ford products are finding increasing acceptance in the marketplace. New products are under development.

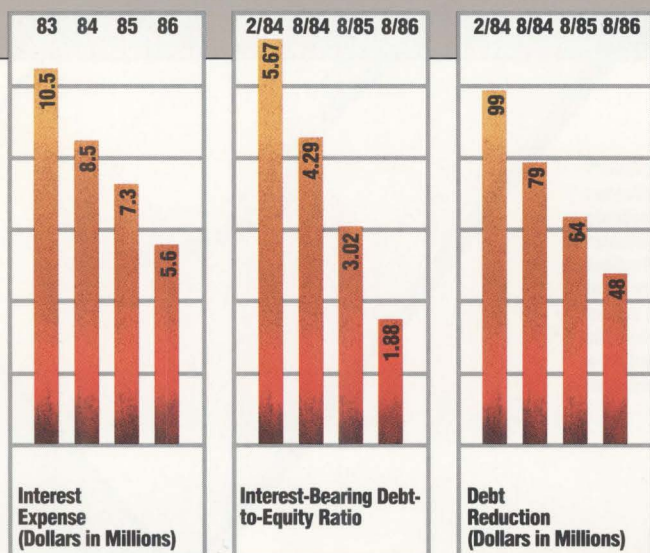
The company expects the division to show excellent growth in the future.

Debt Paydown The third component of PENWEST's growth is the unleveraging of the company as a whole.

At spinoff from Univar in March, 1984, PENWEST was burdened with \$99 million in interest-bearing debt. That amount was paid down to \$48 million at August 31, reducing debt by more than 50 percent in two and one-half years. The effect of that reduction was a significant contribution to earnings.

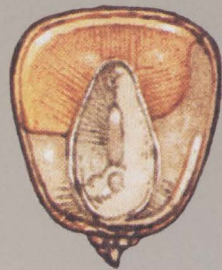
The rate of debt paydown will not continue indefinitely, however, since the amount of debt is subject to change, depending on the needs of the business. The company does not see zero debt as a necessarily desirable target. For example, the purchase of the warrant, described earlier, increases the company's total debt by \$7 million, but will deliver positive offsets that more than justify the additional interest expense.

Yet unleveraging *does* contribute to growth, and must be considered when evaluating PENWEST as an investment.



Rapid debt paydown has been a significant contributor to PENWEST's growth in earnings.

Penick & Ford



The company's specialty starch division, Penick & Ford, completed a highly successful year in terms of sales, margins, strengthened management, new product development and strategic planning.

In a year which saw the division's major customers—coated paper makers—post a 4 percent drop in unit volume, Penick & Ford showed substantial growth and gained an increasing share of market, especially in the fast-growing specialty starch market.

The corn wet milling industry is becoming increasingly competitive as ethanol sales lag, freeing wet milling capacity for other starch products. Our major customers also are engaged in a fierce competitive struggle, not only among domestic producers but from manufacturers in Japan and Western Europe, as well. There is an overcapacity of coated paper production in the U.S., but it is not expected to have an adverse effect on Penick & Ford.

Management believes that the most effective way of remaining profitable in such an environment is to concentrate on high-quality, high-value-added specialty products requiring particular expertise and offering attractive margins. Our strategy has been to emphasize these products in our sales and product development efforts, while producing commodity starches only as necessary.

As a measure of Penick & Ford's success, the division has announced a 30 percent increase in plant capacity to produce its Penford Gum line of specialty ethylated starches and Apollo line of cationic starches.

Competitive pressures in the coated paper industry will have the practical effect of improving paper quality with better printing characteristics, as manufacturers seek competitive advantages beyond price and service. We believe Penick & Ford is ideally positioned to serve that need because the division has built a solid reputation for quality

and consistency, and is well known for its ability to work closely with customers in designing custom products.

The division developed three new products during the year, the first of a new generation of specialty chemical starches. Two cationic starch products were introduced, one for increasing paper strength, and another, with improved environmental characteristics, for surface sizing. The third product is a starch acetate for textile warp sizing. All have met with good customer acceptance.

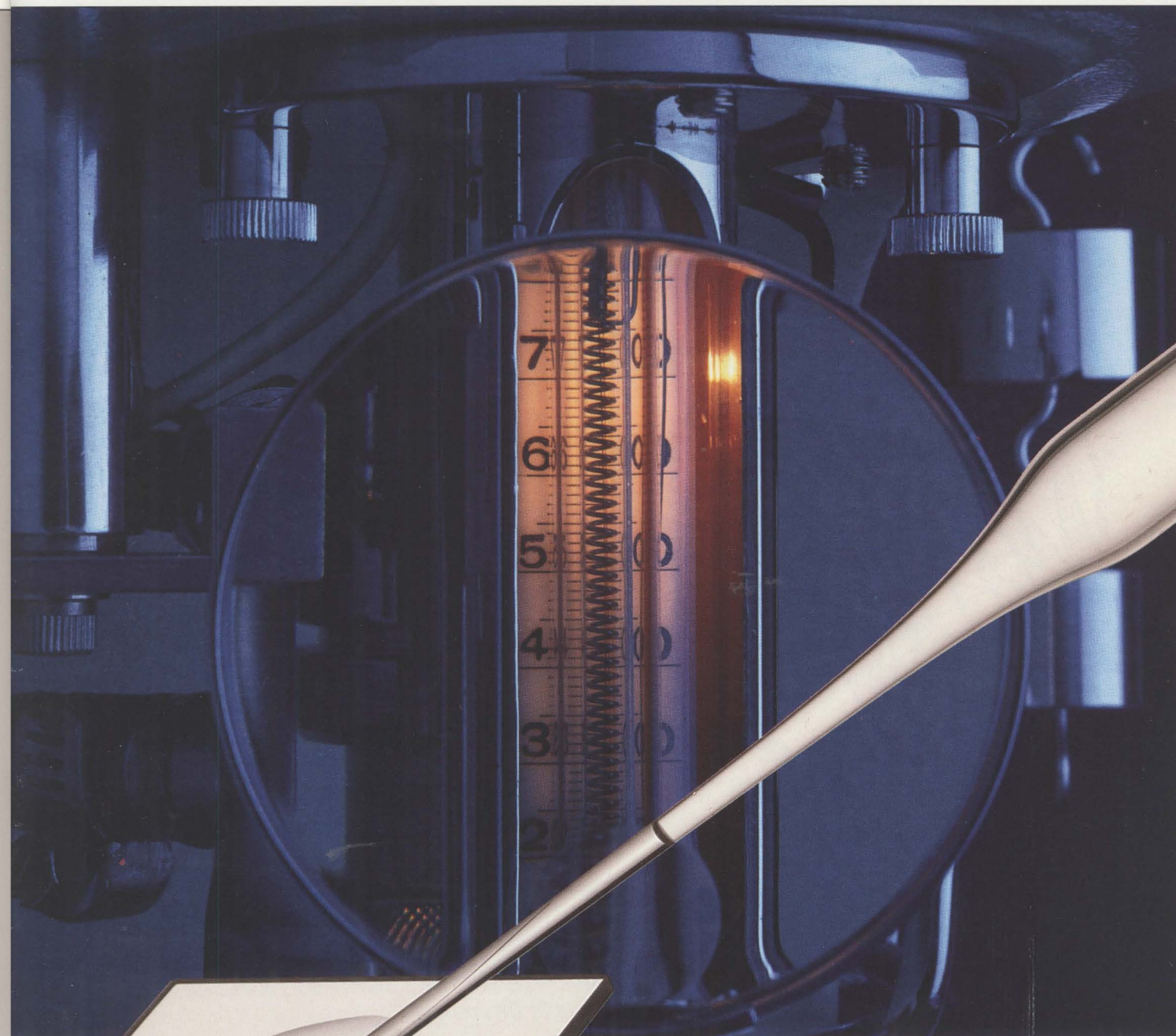
The management rebuilding program launched a year ago was continued in 1986. A new divisional vice president of finance has been brought aboard to enhance financial management and direct new computer-based information systems. A new vice president for research and development and two new R & D professionals have joined the technical staff. The new management team also includes a vice president of marketing with extensive experience selling to the paper industry, and a vice president of distribution with more than 20 years experience in the transportation industry. We have placed renewed emphasis on working as a team, have upgraded training across-the-board with particular focus on management and sales training, and put into place a better employee information system.

Also during the year, the division completed development of a five-year strategic plan, and launched an innovative guaranteed product delivery program that management believes is unique in the industry. The five-year plan outlines revenue and income objectives, and details a more aggressive sales and marketing effort.

Overall, we anticipate a good fiscal 1987 for Penick & Ford. The division will continue its new product development program, a strengthened management team is better able to meet competitive challenges, and the five-year plan is in place and operating smoothly.



Penick & Ford offers about a dozen basic product lines to the paper and textile industries.



Penick & Ford maintains exceptionally high quality standards at each step of manufacture. Starch products undergo lab tests while in process, and no finished goods are shipped until statistically-selected samples are examined.



Chemically-modified specialty starches from Penick & Ford are used by America's leading paper and textile companies. While new starch products and variations of established products continue to emerge from research, the first step in the process—corn wet milling—has remained essentially unchanged for centuries.

Penick & Ford Limited

1 Corn milling is nearly as old as human history. Yet science continues to develop new and innovative uses for this renewable resource. Penick & Ford Limited is a leader in developing high-quality specialty starch products, mainly for the paper and textile industries. This annual report is printed on paper produced with a Penick & Ford product—a specialty starch that imparts strength and durability to the paper, and makes possible four-color printing that is bright, crisp and consistent.

Each kernel of corn is composed of three parts. Corn wet milling is the process by which these parts are separated, refined and modified for a variety of uses—everything from food products to specialty chemicals.

1. The fibrous seed coat or hull (also called pericarp) is the protective coating that surrounds the kernel.
2. The embryo or germ contains a tiny sac that holds the corn oil.
3. About 80 percent of the weight of each kernel is the endosperm. It is about 90 percent starch and seven percent gluten (protein).



2 Corn wet milling begins after the corn is removed from the cob and cleaned. As many as 6,000 bushels (152.4 metric tons) at a time are immersed in giant stainless steel tanks called steepers. The corn remains in warm steepwater (125–130°F or 52–54°C) treated with a small quantity of sulfur dioxide. Within a few hours it begins to swell and soften as the mild acidity of the steepwater loosens the gluten bonds within the corn, releasing a portion of the starch and protein.

Within about 40 hours, the soluble parts of the kernel have been absorbed into the water, leaving the kernel itself intact. Most of this protein-rich steepwater extract is combined with gluten and fiber to make animal feed. Some is used by pharmaceutical companies as a growth medium to produce the bonding agent in antibiotics.



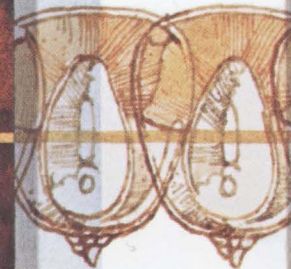
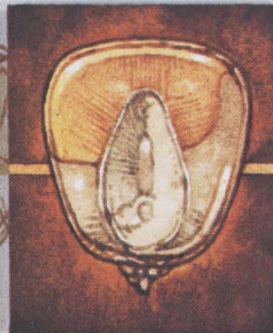
3 The softened kernels next pass through a mill which loosens the hull, and separates the germ from the endosperm. Water is added, producing a thick slurry. Because the germ contains about 50 percent oil, it is lighter than the endosperm and hull. Centrifugal force is used to separate the germ from the slurry. After the germ has been washed and dried, the crude oil is removed by mechanical presses or by solvents. Further refining yields a fine quality salad and cooking oil, or a raw material for corn oil margarines. Germ meal is used in animal feed.

The remaining mixture of hull and endosperm is then processed through a series of grinding and screening operations. Hull particles are screened out for animal feed, while the finer particles of gluten and starch pass through.



*Corn refining is
a centuries-old process,
but the products of this process
are virtually limitless.*

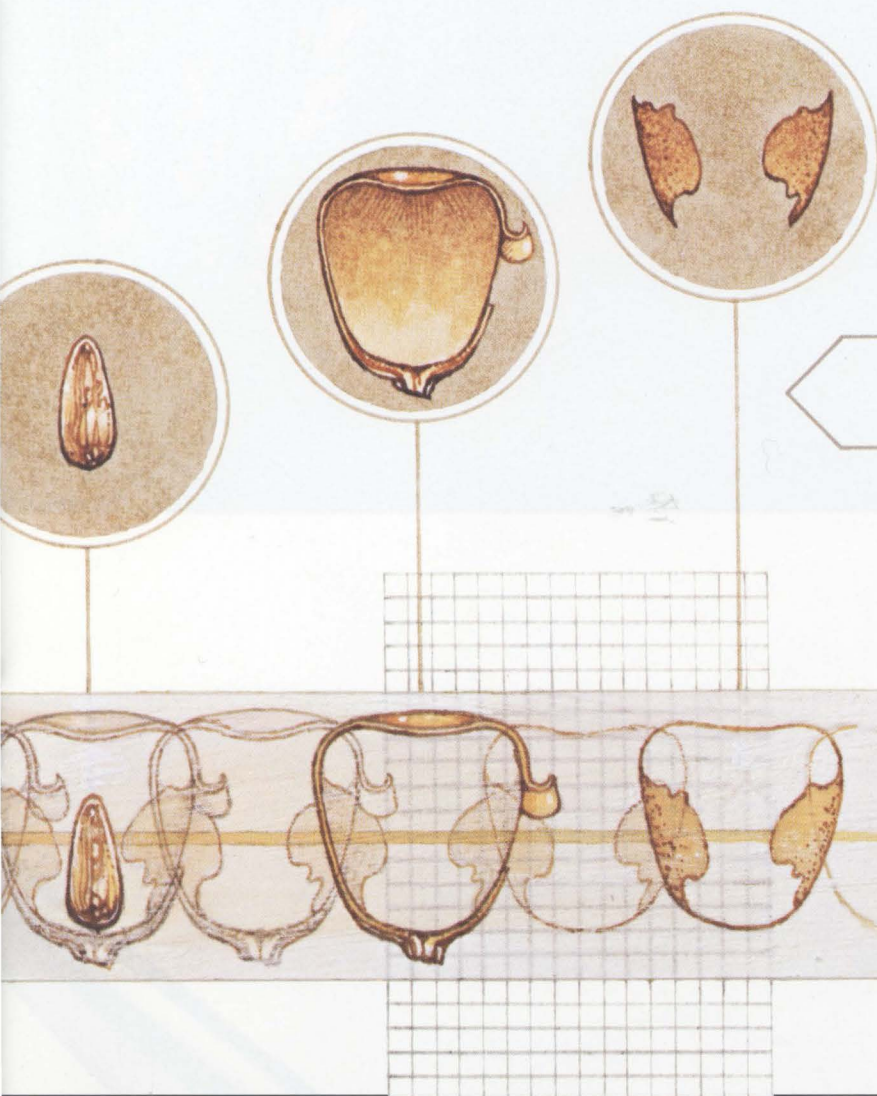
*A precise science
the process begins
by coaxing the
kernel apart.*



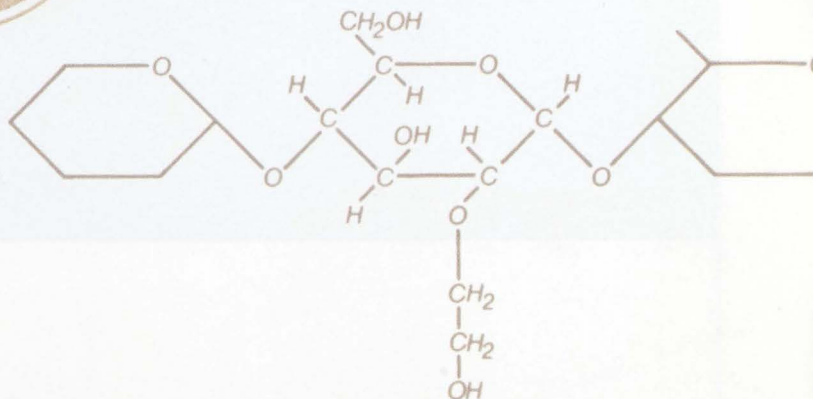


4 The water slurry of starch and gluten is separated by a centrifuge. Because starch and gluten differ in density, the components are almost completely separated. The gluten, which is about 60 percent protein, is sold as animal feed. The starch—which is more than 99 percent pure—is washed a third time to remove small quantities of solubles and then filtered and dried. This common, unmodified corn starch is used in adhesives, salad dressings, canned foods, dry food mixes, laundry starch and other products.

However, most of Penick & Ford's starch volume is composed of highly modified specialty starches which, in many cases, are custom designed for individual users.



The starch molecule is then chemically modified to create a variety of specialty starches.

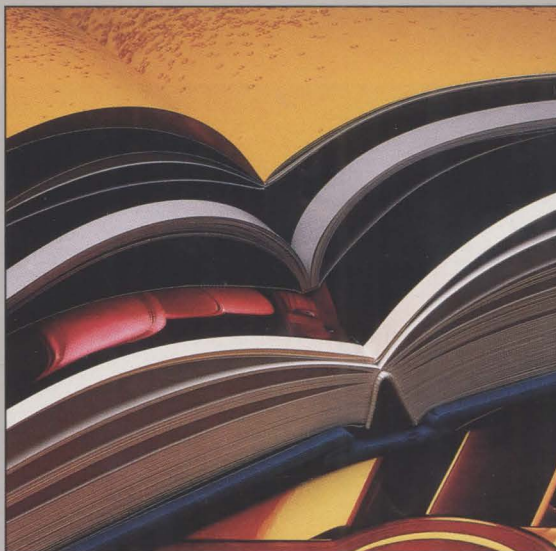


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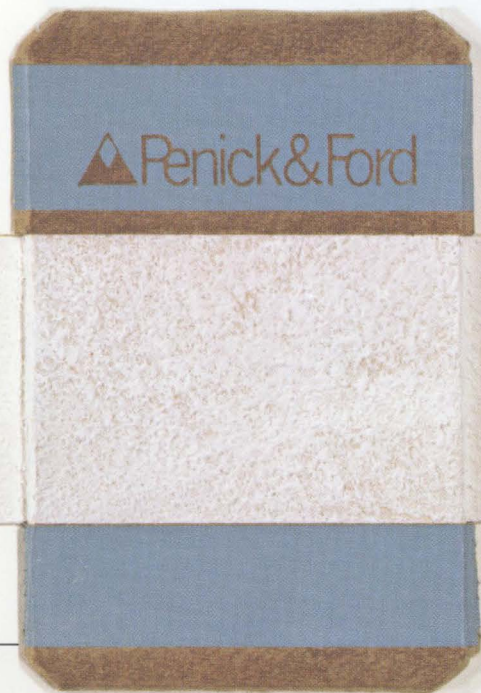
Modified starches are created by adding chemical reagents and catalysts to pure starch slurry. The chemical composition and physical properties of the starch are improved for sizing and coating paper or fabric.

Ethylated starches are used in coatings which provide that glossy look to high quality magazine or catalogue paper. The smooth feel actually represents a uniform film on paper surfaces, enabling press operators to use high-viscosity ink for better four-color printing.

Cationic starches are used at the "wet end" of the paper machine, providing strong internal bonding of paper fibers. The result is high strength combined with light weight, improving the "runability" of paper. Because of this ability to add tensile strength, cationic starches also are used in fine paper, coated paper and linerboard. Cationics adhere better, cause less waste and therefore create less effluent contamination than other starches.



*These extraordinary starches
become basic ingredients in some of
America's highest quality specialty
papers and textiles.*

 Penick & Ford

Great Western Malting Co.



PENWEST's malting division, Great Western Malting, had a good year, with growth in domestic volume, improved gross margins, more efficient cost controls, management reorganization, and an accelerated research and development program.

Domestic volume growth was achieved despite beer sales that were essentially flat nationally and up only slightly in the West. This continuing ability to grow in a flat market reflects an increasing demand for the division's

high-quality malted barley varieties.

A key customer completed a major expansion in Houston during fiscal 1986, and is building a Colorado brewery that is expected to come on line in 1988. If current trends hold, Great Western, which currently operates at about 86 percent of capacity compared with the industry average of 70 percent, will be at full capacity by 1989, with all major capital expenditures completed.

The division's major costs, in order of importance, are raw materials, transportation, energy and labor. Great Western has made progress in controlling costs in a continuing effort to increase gross margins.

Some of the division's raw materials are purchased on the spot market, reducing storage and inventory costs, but Great Western is able to accommodate special varietal needs through more costly contract growing in which the premium is passed on to the customer.

With malt houses in Pocatello, Idaho, Vancouver, Washington, and Los Angeles, California, Great Western has for

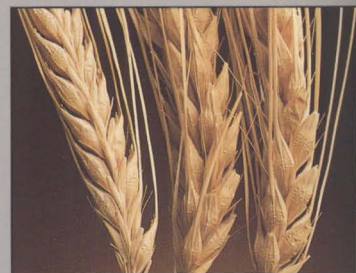
many years enjoyed a competitive advantage in transportation costs to western breweries. Rail costs have stabilized since the Staggers Act of 1980 deregulated rail transport, and the division subsequently negotiated some favorable contracts. In addition, Great Western is exploring the possibility of using truck transport to breweries in close proximity to Vancouver and Los Angeles.

Energy costs at the Vancouver plant are significantly lower than the industry norm because of a cogeneration facility, built there in 1982, which supplies all of the plant's thermal needs and sells surplus power to an adjoining public utility district.

The company negotiated equitable three-year labor contracts in 1984 and 1985 at the Los Angeles and Vancouver plants, respectively. The Pocatello plant is union-free. Great Western enjoys good labor relations at all three locations.

A management reorganization was completed during the fiscal year and in the first quarter of fiscal 1987, producing a leaner middle management structure with greater emphasis on marketing and customer service.

Great Western, in cooperation with a biotechnology firm and two major universities, is making a serious effort to apply genetic engineering to the production of malting barley. The aim is to produce a strain or strains with improved agronomic characteristics. Progress to date is very encouraging, and the first experimental crop from this research is expected to be planted in 1987.



Great Western is the only supplier of western 6-row malt and the dominant supplier of 2-row. The division also produces malt from conventional 6-row barley.

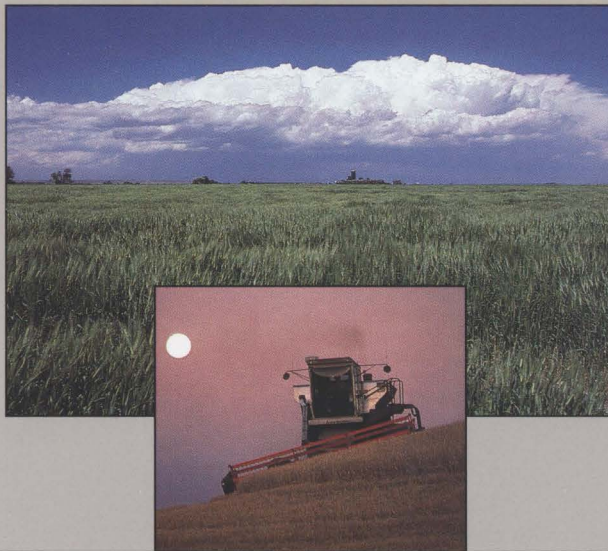


Scientifically-selected samples of barley from each rail car are examined in Great Western's laboratories. The grain is tested for protein content, moisture and kernel size distribution. In the photos, barley samples undergo a germination test measuring rate of growth.



Great Western Malting
 sells quality malt prod-
 ucts to small "boutique"
 brewers as well as to
 most of the major
 brewers in America—
 including the world's
 largest.

Great Western Malting Co.



1 Since the ancients, the art of brewing has been a revered profession among the world's great cultures. The magic blend of malted barley, pure water, natural processes and the brewer's skill has for centuries created the beverage of choice for millions.

The basic ingredient in beer is malted barley, which contains the enzymes that start the brewing process and is the principal source of beer flavor. The grain is a specialty crop, painstakingly developed by experts skilled in plant genetics to provide those qualities sought by brewers and maltsters.

Recognized as one of the world's leading producers of high-quality malt, Great Western Malting Company is the principal supplier to the world's largest brewer, and to most major brewers in the United States and some nations of the Pacific Rim.

Great Western buys and processes barley from six widely separated regions of Montana, Idaho, Washington, Oregon, California and the Upper Midwest.



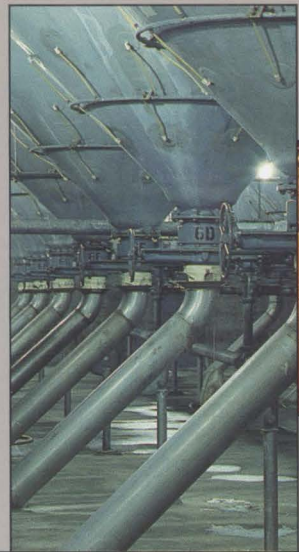
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Barley is purchased directly from growers. It is shipped by rail to each of Great Western's three malt houses, where it is weighed, cleaned and stored in huge, concrete bins according to type, size, protein level, color and geographic origin. When separated, 12 varieties of barley from one crop year can easily require as many as 120 bins at each of the plants.

All phases of production in the plants are checked by biochemists in Great Western's modern quality-control laboratories. They evaluate the barley before and after purchase, inspect it periodically throughout processing and analyze the final malts before shipment.

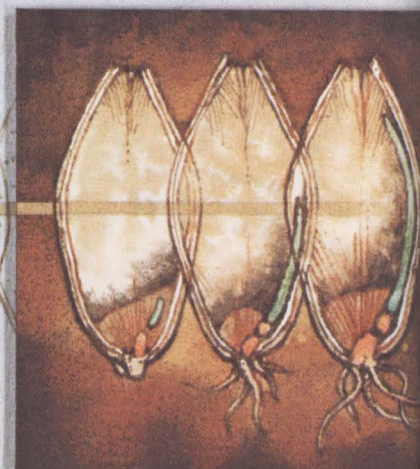
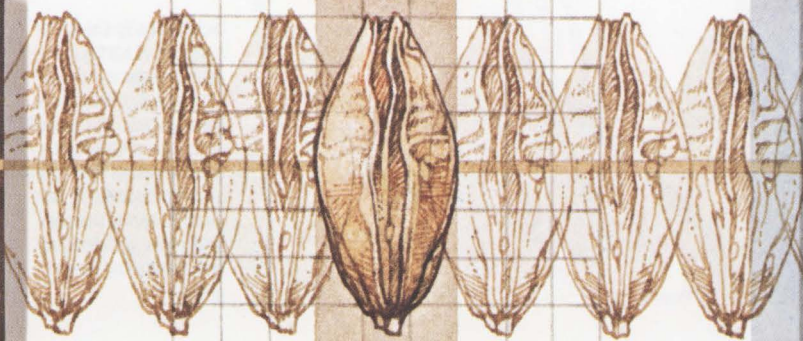
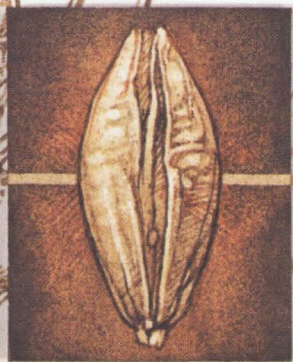
Each brewer has unique specifications for the malt used in his various beer brands, and it is one of the maltster's challenges to meet those specifications while maintaining uniform quality overall.

Great Western ranks consistently among the top two or three suppliers to the brewing industry.



*Malting
is an age-old art
that begins with only the
finest malting barley.*

*To "malt" a grain is
to "grow" it - to simulate
a process of nature.*



3

To "malt" a grain is to "grow" it.

Great Western's business, basically, is supervising the movement of millions of bushels of barley through an environment that simulates the processes of nature.

The barley is steeped—placed in large tanks with cool, oxygen-enriched water. Each barley berry awakens . . . enzymes are released . . . rootlets begin forming . . . and the plant-to-be begins to grow. This part of the process has been compared to "springtime" in nature.

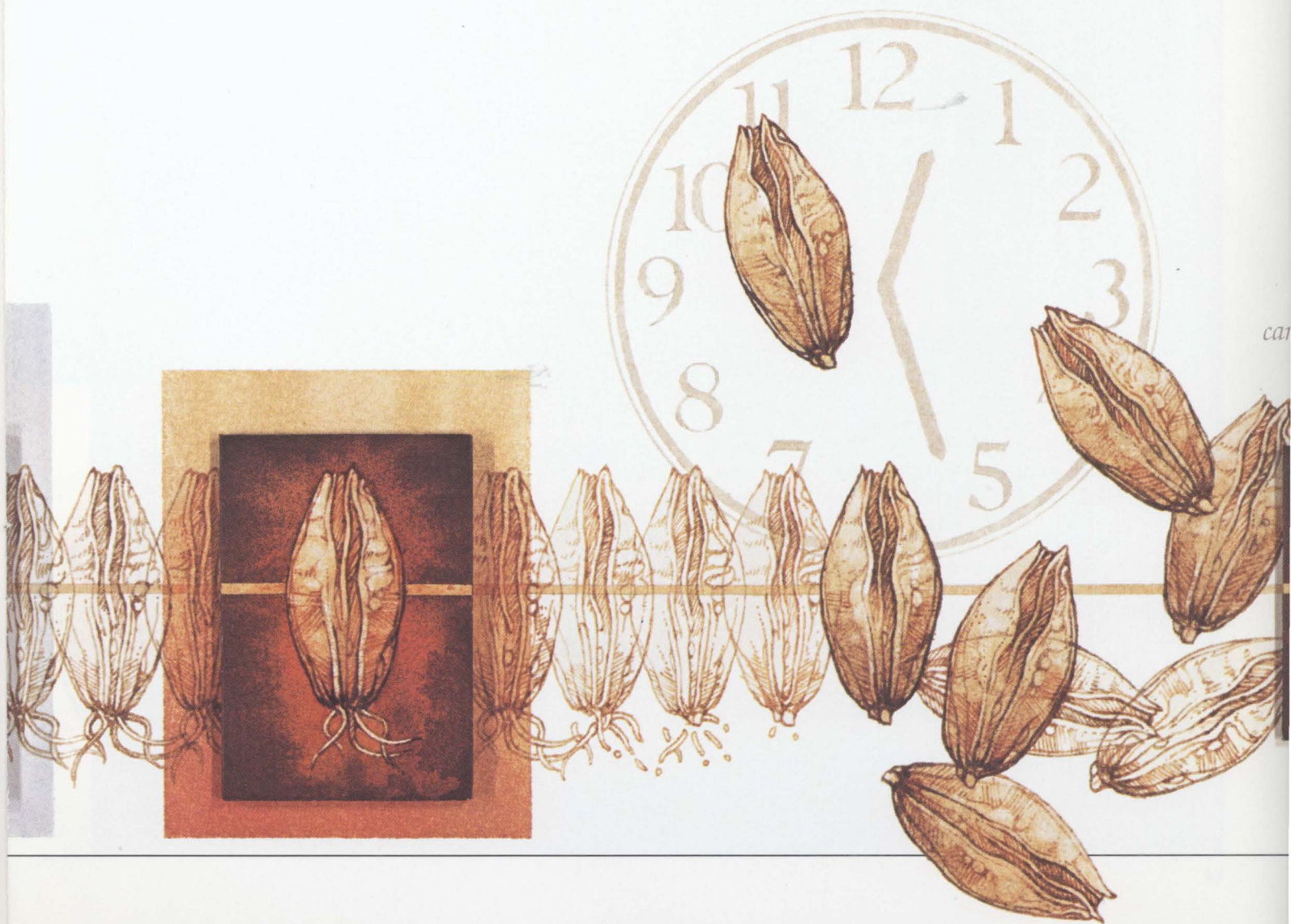
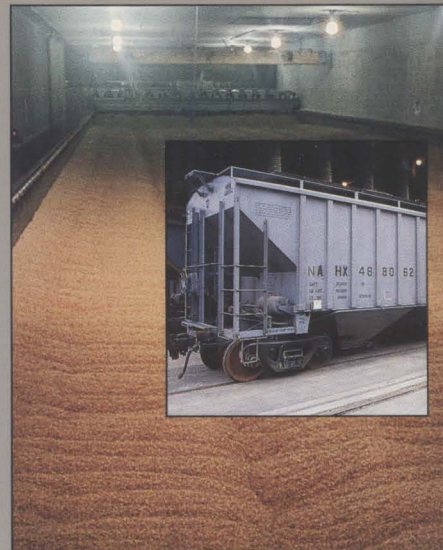
The second phase is germination—the "summertime" of malting. The sprouting seeds are transported to large compartments of slowly-revolving drums, depending on the type of malting system used. Here, growth continues for several days in a carefully regulated environment.

The precise conditions of the environment are determined by the requirements of the brewer who will use the malt.

4

"Harvest time" of the malting process begins when the "green malt" is moved to giant kilns with perforated floors. Gas-fired furnaces supply heat which is drawn through the beds of malt, reducing the moisture of the grain in very precise stages, slowing down and then halting the growth process. Finally the malt is toasted at 180 degrees F(83°C), imparting the aroma and flavor—the "maltness" we smell and taste in beer, malted milk and certain cereals.

When the process is complete, the malt—looking very much like the barley from which it evolved—is transferred to giant aging bins, separated by type and blended to order. Shipment is made in large, modern, specially-lined hopper cars which are sealed and shipped to the great breweries of America. For the export market malt is most frequently shipped in marine containers though some world brewers now prefer delivery in bulk . . . in the hold of a ship.



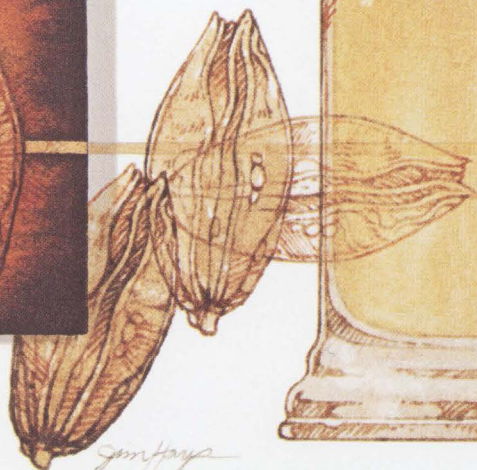
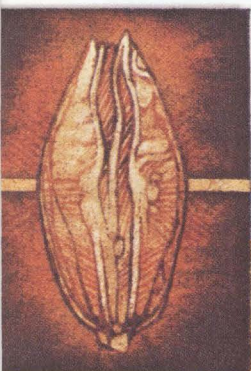
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Because of Great Western's own high standards of quality, and because the company serves several of the world's leading and most quality-conscious brewers, each step of the malting process is controlled with scientific precision and meticulous attention to detail.

Yet, for all the advances in science and technology, the maltster shares with brewmasters a deep sense of the "art" in his craft, a feel for the living grain that comes only from experience . . . and caring.

 Penwest

*The result of this
ful, nurturing process
is malt – the soul
of beer.*

*Sam Hays*

Financial Review

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

Fiscal Year Ended February 29, 1984

For the period ended February 29, 1984, the PENWEST group was operated as the manufacturing subsidiaries of Univar Corporation.

Pre-tax income for the year totaled \$3.4 million. Sales for the period grew by \$4 million, largely the impact of growth in corn wet milling operations sales. Volume at the corn wet milling operations exceeded the break-even point, and these operations began to consistently report earnings. This increased volume largely explains a 3.3 percent overall improvement in the gross margin percentage.

The malting unit, however, continued to face low demand from its West Coast brewing customers. As a result of excess U.S. malt capacity and flat beer sales, profitability generally weakened. In response to low demand, the unit temporarily closed its least efficient capacity.

Interest expense dropped by more than \$2.4 million from the preceding period. This reduction was primarily due to decreased average rates on floating-rate debt.

At the close of business on February 29, 1984 Penick & Ford declared a \$17 million dividend to Univar. This dividend was financed by borrowing under a \$10 million subordinated note and additional drawings against the company's line of credit.

Six Months Ended August 31, 1984

Consolidated sales for the six months ended August 31, 1984 increased 11 percent to \$75.4 million from \$68.1 million for the comparable six-month period ended August 31, 1983. New corn wet milling marketing and sales strategies initiated at spin-off began to take effect as sales of specialty starch products improved during the period. The new strategies, combined with continued strength in the paper industry, provided good improvement in PENWEST's corn wet milling operations. Domestic malt operations, however, continued to be adversely affected by excess malting capacity, low or no growth in beer sales, and the ongoing shift to light beers. Domestic malt challenges were partially offset by additional Pacific Rim export sales, enabling malt operations to more fully utilize plant capacity.

Gross margin increased over the comparable six-month period in the preceding year. The improvement reflected efficiencies of higher production levels, primarily in corn products.

For the six months ended August 31, 1984, interest expense amounted to \$4.8 million, up \$426,000 from the preceding comparable period. The increase related to debt incurred to finance the \$17 million dividend paid to Univar at date of spin-off.

Fiscal Year Ended August 31, 1985

Consolidated sales grew by \$7.2 million over the amount for the comparable 12-month period. Both the corn wet milling and malting units showed revenue and volume growth. The malting unit had very strong export shipments during the first half of the year.

The gross margin percentage improved from the preceding year. The improvement was largely due to a change in accounting estimate. In August 1985, the company concluded a review of its depreciation policies and elected to establish salvage values on certain malting unit assets. The effect of this change was to decrease depreciation expense by \$905,000 in the fiscal year. Competitive price pressures resulted in tight operating margins in both the corn wet milling and malting units.

Operating expenses increased by \$1 million from the preceding 12 months. The increase reflects the full 12 months' impact in operating costs associated with running separate operations from Univar, and additional staffing and programs in both operating units.

Interest expense dropped \$1.3 million. This reduction is due to a combination of lower borrowings and lower interest rates.

In February of 1986 PENWEST reported that earnings for fiscal 1985 had been restated after discovering losses from some unauthorized commodities trading. Previously announced earnings of \$3.16 million, or \$1.04 per share, were adjusted to \$2.8 million, or 92 cents per share.

Fiscal Year Ended August 31, 1986

Consolidated sales fell by \$11.3 million. This drop is due to two factors. First, sales in the prior year included a large international shipment to the Far East not repeated in 1986. Second, certain raw material prices dropped dramatically during the year and resulted in selling price declines. However, the company's profitability is tied to high value-added specialty products, and dollar sales can vary with little or no impact on the company's bottom line.

Gross margins improved by 2.7 percent and \$1.9 million in absolute dollars. These improvements reflected increased demand for higher margin modified starches and for the company's premium varietal malt lines, greater energy efficiencies, and strong cost containment.

Operating expenses increased \$1.2 million. This increase reflected additional staffing and programs in both operations, primarily related to the overall strategy of focusing on high value-added products. Interest expense dropped \$1.7 million. This reduction was due to a combination of lower outstanding borrowings and lower interest rates.

Liquidity and Capital Resources

PENWEST has variations in grain inventory levels during the year, particularly related to its malt operations. Most barley purchases are made in the fall following harvest. The degree of barley purchases is affected by crop conditions, market concerns, and geographic considerations. As a result, inventories and related debt financing increase in the fall with peaks in January and low points in August. Financing of these inventory level changes is provided under bank lines of

credit. Borrowing reached a maximum of \$9.5 million during the current year, and was paid off by year end. During the year, the company negotiated a new borrowing agreement making \$15 million available at the prime lending rate. Borrowings under this agreement are unsecured. Subsequent to year end, the company renegotiated its revolving line of credit increasing its line of credit to \$22 million. The changes allow the company to use its credit agreement to finance the warrant purchase described on this page. In the two and one half years since spin-off, PENWEST reduced its interest-bearing debt from \$98.9 million to \$48.2 million. This reduction was accomplished with the benefit of strong operating results accompanied by tight cash, operating, and financial management. Current maturities total \$15 million over the next five years. PENWEST should be able to comfortably service these maturities. Management believes liquidity is adequate.

Significant Financial Events

Warrant

When PENWEST spun off in 1984, Univar continued to guarantee certain PENWEST debts. In consideration thereof, PENWEST granted Univar a warrant to purchase 693,000 shares of PENWEST common stock—the per-share exercise price was \$6.40. Subsequently, the warrant was transferred to VWR Corporation in 1986 when it was spun off from Univar.

On September 10, 1986 PENWEST announced it had agreed to purchase the warrant from VWR Corporation for \$7 million in cash. The offer to purchase was made in order to provide greater flexibility for strategic decision-making and to broaden the company's options for future capitalization. The purchase will reduce PENWEST's shareholders' equity by the \$7 million purchase price plus those costs related to the acquisition of the warrant.

The immediate effect of the warrant purchase will be on earnings per share. Accounting rules require PENWEST to include the warrant shares in the calculation of common shares outstanding, thereby diluting or reducing the reported earnings per share. As an example, had the warrant been retired at the beginning of fiscal 1986, earnings per share would have increased from \$1.31 to \$1.41, an 8 percent increase. This increase gives consideration to additional interest expense from borrowings required to finance purchase of the warrant.

Deferred Taxes

PENWEST has nearly \$25 million in deferred income taxes on its balance sheet. This liability results from differences that have accumulated to date between taxable income and pre-tax financial income. The major timing difference results from the use of accelerated depreciation for tax purposes and straight line for financial reporting purposes.

In September 1986, the Financial Accounting Standards Board (FASB) issued a proposed change to income tax accounting. If this proposal is finalized as it is now drafted, it would require that any deferred tax liability or asset be adjusted to reflect the effect of an enacted change in tax laws or rates in the quarter the law is enacted.

The recently enacted Tax Reform Act of 1986 would lower rates from 46 percent to 34 percent. If the FASB issues its new statement in its proposed form, PENWEST will record an approximate \$5.9 million income tax reduction in the year the accounting statement is issued to reflect the reduction in the deferred tax obligation as a result of the tax rate change. This in turn will increase shareholders' equity by \$5.9 million.

In summary, PENWEST will likely have two major financial events affecting shareholders' equity. The warrant purchase decreases equity but provides many benefits for shareholders. That transaction was concluded in the first quarter of fiscal 1987. The tax accounting changes, while not currently assured, are likely to occur and will increase equity. The two items nearly offset and should leave shareholders' equity in good shape to support future growth.

Consolidated Balance Sheets

August 31 (Thousands of dollars)	1986	1985
<i>Assets</i>		(Restated)
<i>Current assets:</i>		
Invested cash		\$ 4,000
Trade accounts receivable	\$ 14,874	14,979
Inventories	23,019	23,790
Prepaid expenses and other	930	764
<i>Total current assets</i>	38,823	43,533
<i>Property, plant and equipment:</i>		
Land	1,061	1,061
Plant and equipment	126,962	124,154
Less accumulated depreciation	(50,091)	(43,715)
<i>Net property, plant and equipment</i>	77,932	81,500
<i>Other assets</i>	461	680
	\$117,216	\$125,713
<i>Liabilities and Shareholders' Equity</i>		
<i>Current liabilities:</i>		
Bank checks outstanding less cash in bank	\$ 2,830	\$ 4,436
Current portion of long-term debt	2,310	2,510
Accounts payable	10,945	7,425
Accrued liabilities	4,726	6,110
<i>Total current liabilities</i>	20,811	20,481
<i>Long-term debt</i>	45,876	51,879
<i>Subordinated debt</i>		10,000
<i>Deferred income taxes</i>	24,957	22,038
<i>Shareholders' equity:</i>		
Preferred stock, par value		
\$1.00 per share		
Authorized—1,000,000 shares, none outstanding		
Common stock, par value		
\$1.00 per share		
Authorized—9,000,000 shares		
Outstanding—2,773,620 shares in 1986 and 2,769,520 in 1985	2,774	2,770
Additional paid-in capital	11,689	11,689
Retained earnings	11,109	6,856
<i>Total shareholders' equity</i>	25,572	21,315
	\$117,216	\$125,713

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income

	Year Ended August 31		Six Months Ended August 31	Year Ended February 29
(Thousands of dollars)	1986	1985	1984	1984
		(Restated)		
Sales	\$134,809	\$146,141	\$ 75,382	\$131,689
Cost of sales	111,001	124,241	64,452	112,655
Gross margin	23,808	21,900	10,930	19,034
Operating expenses	10,181	9,020	4,102	7,488
Income from operations	13,627	12,880	6,828	11,546
Interest expense	5,576	7,259	4,760	8,113
Income before taxes	8,051	5,621	2,068	3,433
Income taxes	3,798	2,819	1,012	1,601
Net income	\$ 4,253	\$ 2,802	\$ 1,056	\$ 1,832
<i>Earnings per common share and common share equivalent:</i>				
Primary	\$1.35	\$0.92	\$0.36	NA
Fully-diluted	\$1.31	\$0.92	\$0.35	NA
<i>Average common shares and equivalents:</i>				
Primary	3,153,216	3,034,655	2,983,996	NA
Fully-diluted	3,251,527	3,034,655	3,036,401	NA

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Financial Position

	Year Ended August 31		Six Months Ended August 31	Year Ended February 29
(Thousands of dollars)	1986	1985	1984	1984
		(Restated)		
<i>Source of funds:</i>				
Operations—				
Net income	\$ 4,253	\$ 2,802	\$ 1,056	\$ 1,832
Depreciation and amortization	6,525	6,735	3,983	8,234
Deferred income taxes and other	2,919	2,478	954	5,173
	13,697	12,015	5,993	15,239
Contribution from Univar Corporation				480
Subordinated note from Univar				10,000
	13,697	12,015	5,993	25,719
<i>Application of funds:</i>				
Net additions to property, plant and equipment	2,906	1,926	174	1,672
Reduction in long-term debt	16,003	13,502	4,044	19,736
Dividend distributed to Univar				17,000
Other	(172)	108	569	756
	18,737	15,536	4,787	39,164
<i>Working capital:</i>				
Increase (decrease)	(5,040)	(3,521)	1,206	(13,445)
Add—beginning working capital	23,052	26,573	25,367	38,812
Ending working capital	\$ 18,012	\$ 23,052	\$ 26,573	\$ 25,367
<i>Increase (decrease) in components of working capital:</i>				
<i>Current assets—</i>				
Invested cash	\$ (4,000)	\$ 4,000		
Trade accounts receivable	(105)	(1,152)	\$ (400)	\$ (5,027)
Inventories	(771)	(1,184)	(11,780)	(4,051)
Prepaid expenses and other	166	(201)	476	(1,141)
	(4,710)	1,463	(11,704)	(10,219)
<i>Current liabilities—</i>				
Bank checks outstanding less cash in bank	(1,606)	4,640	1,143	(1,034)
Notes payable			(15,553)	14,553
Current portion of long-term debt	(200)	(1,535)	85	2,421
Accounts payable	3,520	9	1,209	920
Accrued liabilities	(1,384)	1,870	206	(864)
Advances from Univar				(12,770)
	330	4,984	(12,910)	3,226
Increase (decrease) in working capital	\$ (5,040)	\$ (3,521)	\$ 1,206	\$ (13,445)

The accompanying notes are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

(Thousands of dollars)	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Shareholders' Equity
<i>Balances, March 1, 1983:</i>	\$ 5,058	\$ 8,921	\$18,166	\$32,145
Net income			1,832	1,832
Cash dividend distributed to Univar			(17,000)	(17,000)
Contribution from Univar-(executive office expense)		480		480
<i>Balances, February 29, 1984:</i>	5,058	9,401	2,998	17,457
Net income			1,056	1,056
Retirement of manufacturing subsidiaries' common stock	(5,058)	5,058		
Issuance of PENWEST common stock	2,770	(2,770)		
<i>Balances, August 31, 1984:</i>	2,770	11,689	4,054	18,513
Net income (Restated)			2,802	2,802
<i>Balances, August 31, 1985:</i>	2,770	11,689	6,856	21,315
Net income			4,253	4,253
Exercise of stock options	4			4
<i>Balances, August 31, 1986:</i>	\$ 2,774	\$11,689	\$11,109	\$25,572

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

Note A

Organization and Transactions with Univar Corporation and VWR Corporation

PENWEST, LTD. was incorporated as a subsidiary of Univar Corporation on September 20, 1983. On February 29, 1984, Univar transferred to PENWEST all of the outstanding stock of the manufacturing subsidiaries of Univar (Penick & Ford, Limited, Idaho Malting Company, Pacific Cogeneration, Inc. and Great Western Malting Export Corporation). On March 1, 1984, Univar distributed all of the outstanding shares of PENWEST to the shareholders of Univar.

The consolidated financial statements for the fiscal years ended August 31, 1986 and 1985, and the six-month period ended August 31, 1984, include PENWEST and its wholly-owned subsidiaries. The combined financial statements for fiscal year ended February 29, 1984 include the accounts of the manufacturing subsidiaries of Univar. Material intercompany balances and transactions have been eliminated.

The combined financial statements of the manufacturing subsidiaries of Univar include corporate office expenses which management has estimated would have been incurred by the manufacturing subsidiaries had they been operating independently. The after-tax impact on earnings of this allocation was recorded as a contribution to additional paid-in capital of the manufacturing subsidiaries.

On February 29, 1984, Penick & Ford, Limited distributed a cash dividend of \$17,000,000 to Univar. Simultaneously, Univar loaned \$10,000,000 to Penick & Ford, Limited on a subordinated note for five years at an interest rate of 13 percent (See Note D). The 13 percent subordinated note was paid in full on May 30, 1986.

VWR Corporation (a February 28, 1986 spin-off from Univar) guarantees certain debts of PENWEST which were formerly guaranteed by Univar. In consideration thereof, PENWEST granted Univar a warrant to purchase PENWEST shares that would equal 20 percent of PENWEST common stock outstanding after exercise. At the time VWR spun off from Univar, the warrant to purchase PENWEST stock was transferred to VWR. Subsequent to August 31, 1986, PENWEST agreed to purchase the warrant from VWR (see Note J). The warrant had an exercise price of \$6.40 per share.

Note B

Summary of Significant Accounting Policies Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Expenditures for maintenance and repairs are expensed as incurred. The company uses the straight-line method to compute depreciation for financial reporting purposes. For income tax purposes, the company generally uses accelerated depreciation methods.

Interest is capitalized on major construction projects while in progress. No interest was capitalized in any of the fiscal periods presented.

Income Taxes

Deferred income taxes are provided on timing differences between financial and income tax reporting methods. Investment tax credits are accounted for by the flow-through method as a direct reduction of the current federal income tax provision.

Earnings Per Share

Earnings per common share and common share equivalent were computed by dividing net income by the weighted average number of common shares and common share equivalents outstanding during the period (for primary and fully diluted). Stock options and warrants to purchase stock are considered to be common share equivalents when dilutive, using the treasury stock method. As the company began independent operations on March 1, 1984, earnings per share information has not been presented for prior periods.

Segment Information—Major Customers

PENWEST operates principally in one line of business—agricultural processing. One customer accounted for sales of \$63,093,000 in the fiscal year ended August 31, 1986; \$61,735,000 in the fiscal year ended August 31, 1985; \$28,481,000 in the six months ended August 31, 1984; and \$53,675,000 in the fiscal year ended February 29, 1984.

Note C

Inventories

Inventories are stated at the lower of cost or market. Cost, which includes material, labor and manufacturing overhead costs, is determined by the first-in, first-out (FIFO) method.

Inventories consist of:

August 31 (Thousands of dollars)	1986	1985
Raw materials, supplies and other	\$ 10,509	\$ 11,708
Work in progress	1,195	1,236
Finished goods	11,315	10,846
Total inventories	\$ 23,019	\$ 23,790

Note D

Long-term Debt and Revolving Credit Agreement

The long-term debt of the company and its subsidiaries is as follows:

(Thousands of dollars)	1986	1985
10¾ percent promissory note, payable in monthly installments of \$202,230, including interest to 2001, secured by certain real property and equipment	\$ 19,916	\$ 20,186
9 percent promissory note, payable in monthly installments of \$180,000, including interest to 1998, secured by certain property and equipment	15,805	16,501
8¾ percent mortgages, three of which are payable in monthly installments of \$132,600, including interest, and three of which are interest-only quarterly payments to 1991, secured by certain real property and equipment	8,865	10,002
Term loan, with variable interest keyed to certificate of deposit rates plus 1.1 percent, payable in annual installments to 1994, secured by certain real property and equipment	3,600	7,700
Subordinated 13 percent unsecured promissory note, paid in full on May 30, 1986		10,000
	48,186	64,389
Less current portion	2,310	2,510
Net long-term debt	\$ 45,876	\$ 61,879

The 8¾ percent mortgages are guaranteed by Univar Corporation. The 10¾ percent and 9 percent promissory notes carry a combined maximum guarantee by VWR Corporation of \$20,000,000. Substantially all property, plant, and equipment collateralize the above notes and term loan.

Maturities of long-term debt for the fiscal years ending August 31, 1987 through 1991 are as follows (thousands of dollars):

1987	\$ 2,310
1988	\$ 2,530
1989	\$ 2,770
1990	\$ 1,914
1991	\$ 5,862

The company negotiated a new unsecured revolving line of credit with three banks effective May 30, 1986, electing to reduce the amount it may borrow from \$22,000,000 to \$15,000,000. Borrowing rates available to the company under the revolver were reduced to prime rate or less depending on the selection of borrowing options. PENWEST can elect to borrow under a prime rate option, certificate of deposit option, or Bankers' Acceptance option. The approximate average borrowing under the revolver was \$1,056,000 in the fiscal year ended August 31, 1986. The approximate weighted average interest rate during the same period was 8.89 percent. The maximum amount of borrowings during the fiscal year was \$9,525,000 on June 20, 1986.

The revolving credit agreement includes, among other terms, various limitations on long-term indebtedness, minimum net worth balances and working capital ratios, and restrictions on PENWEST's ability to purchase or redeem its own stock. Under the most restrictive of these terms, minimum net worth at August 31, 1986, must be at least \$22,127,000. The term of this agreement is extended on an annual basis unless the commitments are withdrawn. If any bank withdraws, reduction of its commitment can be accomplished in four equal quarterly reductions commencing approximately one year after notice of election to withdraw.

Note E

Stock Options and Warrant

As of August 31, 1986, options to purchase 81,500 common shares were outstanding under PENWEST's stock option plan, 24,000 of which were exercisable. During the fiscal year ended August 31, 1986, 6,400 shares were exercised at an average price of \$6.49. The option prices, which were equivalent to market price at the date of grant, range from \$6.25 to \$16.50 per share.

The company also has granted a warrant, now held by VWR Corporation, to purchase 693,405 shares of common stock (See Notes A and J).

Note F Pension Plans

Substantially all employees of PENWEST and its subsidiaries are covered by defined benefit pension plans. Total pension expense was \$726,000 for the fiscal year ended August 31, 1986; \$730,000 for the fiscal year ended August 31, 1985; \$276,000 for the six month period ended August 31, 1984; and \$788,000 for fiscal year ended February 29, 1984. Pension costs include amortization of prior service costs over periods ranging up to 30 years.

PENWEST uses the Projected Unit Credit Method to calculate actuarial costs. The assumed rate of return on investments was 9 percent for the salaried plan and 8 percent for the negotiated hourly plan and the assumed salary increases were 6 percent.

It is the policy of PENWEST to fund amounts necessary to meet at least the minimum funding requirements of the Employee Retirement Income Security Act of 1974.

Combined benefit and asset information for the salaried plan of PENWEST and the negotiated hourly plan sponsored by Penick & Ford, Limited is presented below:

(Thousands of dollars)	1986	1985
Actuarial present value of plan benefits as of January 1:		
Vested	\$ 9,150	\$ 8,518
Non-vested	429	276
	\$ 9,579	\$ 8,794
Net assets available for benefits	\$ 7,471	\$ 6,311

Net assets available for plan benefits include the market value of fund assets (\$5,446,000) and accumulated amounts charged to operations, but not yet funded (\$2,025,000).

Certain employees are covered under multiemployer pension plans. Expenses for these plans were \$255,000 in 1986, \$256,000 in 1985, \$113,000 in the six month period ended August 31, 1984 and \$225,000 in the fiscal year ended February 29, 1984.

Provisions of the Multi-Employer Pension Amendments Act of 1980 require participating employers to assume a proportionate share of multiemployer plans unfunded vested benefits in the event of withdrawal from or termination of the plan. Information concerning the company's share of unfunded vested benefits is not available from the plan administrator. Provisions of the Act may have the effect of requiring increased contributions in future years.

Note G Income Taxes

Income tax expense consists of the following:

	Total	Federal	State
<i>Year Ended August 31, 1986:</i>			
Current	\$ 339		\$ 339
Deferred	3,459	\$ 3,459	
Total Provision	\$ 3,798	\$ 3,459	\$ 339
<i>Year Ended August 31, 1985:</i> (Restated)			
Current	\$ 341		\$341
Deferred	2,478	\$ 2,446	32
Total Provision	\$ 2,819	\$ 2,446	\$ 373
<i>Six Months Ended August 31, 1984:</i>			
Current	\$ 58	\$ 39	\$ 19
Deferred	954	877	77
Total Provision	\$ 1,012	\$ 916	\$ 96
<i>Year Ended February 29, 1984:</i>			
Current	\$(3,572)	\$(3,692)	\$ 120
Deferred	5,173	5,100	73
Total Provision	\$ 1,601	\$ 1,408	\$ 193

The sources of timing differences resulting in deferred income taxes and the tax effect of each consisted of the following:

	Year Ended August 31	1985	Six Months Ended August 31	Year Ended February 29
(Thousands of dollars)	1986		1984	1984
		(Restated)		
Depreciation	\$ 2,143	\$ 4,888	\$ 2,355	\$ 4,769
Other	90	200	68	404
Reinstatement (reduction) due to net operating loss and tax credit carryforward	1,226	(2,610)	(1,469)	
Total deferred provision	\$ 3,459	\$ 2,478	\$ 954	\$ 5,173

The company has net operating loss and investment tax credit carryforwards for income tax purposes of \$3,759,000 and \$421,000, respectively, at August 31, 1986. These carryforwards are available to offset future taxable income and taxes payable through 2000. Should these be utilized, the deferred tax liability will be increased by \$2,257,000.

Any tax adjustments attributable to the manufacturing subsidiaries of Univar for the year prior to the spin-off will be borne by PENWEST. The consolidated tax returns of Univar Corporation, which includes the manufacturing subsidiaries, have been audited by the Internal Revenue Service and settled through February 28, 1983.

Note H Leases

Certain of the company's property, plant and equipment is leased under operating leases ranging from one to 20 years with options to renew for up to 20 additional years.

Rental expense under operating leases was as follows:

	Year Ended August 31		Six Months Ended August 31	Year Ended February 29
(Thousands of dollars)	1986	1985	1984	1984
	(Restated)			
Minimum rentals	\$1,367	\$1,142	\$ 505	\$1,020
Sublease rentals	(211)	(217)	(108)	(229)
<i>Total</i>	\$1,156	\$ 925	\$ 397	\$ 791

Future lease payments as of August 31, 1986, for non-cancellable operating leases having initial lease terms of more than one year, are as shown below:

Years ending August 31 (Thousands of dollars)	Operating Leases
1987	\$1,142
1988	929
1989	743
1990	439
1991	52
Thereafter	68
<i>Total minimum payments</i>	\$3,373

Total minimum lease payments for operating leases, as shown above, have not been reduced by minimum sublease rentals of \$596,000 due in the future under non-cancellable leases.

Note I Restatement of 1985 Financial Statements

In February 1986, PENWEST announced it was restating its earnings for the fiscal year ended August 31, 1985, after discovering losses from unauthorized commodities trading.

Previously reported 1985 net earnings of \$3.16 million, or \$1.04 per fully-diluted share, have been adjusted to \$2.8 million, or 92 cents per fully-diluted share.

Note J Subsequent Event—Warrant Purchase

Subsequent to year end PENWEST purchased and retired the warrant held by VWR Corporation (see Note A). The purchase price was \$7,000,000 in cash, financed through PENWEST's revolving line of credit agreement.

Previously, earnings per share have been calculated by giving dilutive effective to shares represented by the warrant. Since the warrant has been purchased and retired by PENWEST, common shares and common share equivalents used in computing earnings per share will be reduced.

Earnings per share for the fiscal year ended August 31, 1986 would have increased from the reported fully-diluted \$1.31 to \$1.41, had the foregoing transaction been effected at the beginning of PENWEST's fiscal year.

Note K Quarterly Financial Data (Unaudited)

(Thousands of dollars except per share data)	Sales	Gross Margin	Net Income	Fully Diluted EPS
<i>1985/86</i>				
First Quarter	\$ 31,744	\$ 4,958	\$ 634	\$ 0.21
Second Quarter	32,576	5,613	754	0.24
Third Quarter	35,427	6,103	1,188	0.37
Fourth Quarter	35,062	7,134	1,677	0.49
<i>Total</i>	\$134,809	\$23,808	\$ 4,253	\$ 1.31
<i>1984/85 (Restated)</i>				
First Quarter	\$ 35,892	\$ 4,795	\$ 420	\$ 0.14
Second Quarter	36,035	5,014	468	0.15
Third Quarter	36,711	5,209	549	0.18
Fourth Quarter	37,503	6,882	1,365	0.45
<i>Total</i>	\$146,141	\$21,900	\$ 2,802	\$ 0.92
<i>Six months ended August 31, 1984</i>				
First Quarter	\$ 37,619	\$ 5,660	\$ 502	\$ 0.18
Second Quarter	37,763	5,270	554	0.17
<i>Total</i>	\$ 75,382	\$10,930	\$ 1,056	\$ 0.35
<i>1983/84</i>				
First Quarter	\$ 34,103	\$ 4,834	\$ 379	
Second Quarter	34,002	4,850	518	
Third Quarter	30,860	5,039	775	
Fourth Quarter	32,724	4,311	160	
<i>Total</i>	\$131,689	\$19,034	\$ 1,832	

Note L

Effects of Inflation (Unaudited)

In accordance with generally accepted accounting principles, PENWEST financial statements are presented in terms of actual historical costs. The following supplementary information, required by the Statement of Financial Accounting Standards (FAS) No. 33, attempts to demonstrate the effects of changes in specific prices of certain assets used by the company (current cost method) on financial statement reporting.

The current cost method uses price changes of specific assets (inventory and fixed assets) to measure the effects of inflation. Appropriate external cost indices and current con-

struction cost information were used to restate these assets.

FAS No. 33 does not allow income taxes to be adjusted, even though Income Before Taxes is reduced substantially under an inflation adjusted analysis. This results in distorted effective income tax rates during each period presented.

Measuring the effects of inflation requires the use of assumptions and estimates. No consideration has been given to technological or other improvements that would be made if operating capacity were replaced. In addition, the differing effects of inflation between different industries has not been taken into account. As such, the information provided, in light of its experimental nature, is not a precise indicator of inflationary effects.

Consolidated Supplemental Inflation Adjusted Income Statement

	As Reported in the Primary Statements	Specific Prices (Current Cost)
For the Fiscal Year Ended August 31, 1986 (Thousands of dollars)		
Net sales	\$134,809	\$134,809
Cost of sales	111,001	114,325
Operating expenses—net	10,181	10,181
Interest expense	5,576	5,576
	126,758	130,082
Income before taxes	8,051	4,727
Income taxes	3,798	3,798
Net income (loss)	\$ 4,253	\$ 929
Depreciation and amortization included in cost of goods sold and other operating expenses above	\$ 6,525	\$ 9,042
Purchasing power gain from holding net monetary liabilities during the year		\$ 2,661
Increase in specific prices (current cost) of inventories and property, plant and equipment held during the year		\$ 3,983
Less effect of increase in general price level		(83)
Increase in specific prices over increase in general price level		\$ 4,066

At August 31, 1986, current cost of inventories was \$22,833 and current cost of property, plant and equipment, net of accumulated depreciation was \$155,457.

Five-Year Comparison of Selected Supplemental Financial Data Adjusted for Effects of Changing Prices
In average 1986 Fiscal Year Dollars (except "historical" amounts)

	Year Ended August 31		Six Months Ended August 31	Year Ended February 29/28	
(Thousands of dollars, except per share data)	1986	1985	1984	1984	1983
	(Restated)				
Net sales:					
Historical	\$134,809	\$146,141	\$ 75,382	\$131,689	\$127,701
Net income (loss):					
Historical	4,253	2,802	1,056	1,832	(269)
Current cost	929	(998)	(3,458)	(9,409)	(10,610)
Net income (loss) per share:					
Historical	1.31	0.92	0.36		
Current cost	0.29	(.46)	(1.25)		
Purchasing power gain from holding net monetary liabilities during the year	2,661	3,978	2,612	4,754	4,183
Increase in specific prices of inventories and properties over increase in general price level	4,066	3,789	2,820	6,182	7,038
Net assets at year-end:					
Historical	25,572	21,315	18,513	17,457	32,145
Current cost	102,911	96,913	102,498	110,607	127,227
Market price per share at year-end:					
Historical	17.25	9.63	10.00		
Average consumer price index	332.4	320.0	309.4	299.8	288.7

Auditors' Report

Board of Directors and Shareholders
PENWEST, LTD.
Bellevue, Washington

We have examined the consolidated balance sheets of PENWEST, LTD. and subsidiaries as of August 31, 1986 and 1985, and the related consolidated statements of income, changes in financial position, and shareholders' equity for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements of PENWEST, LTD. and subsidiaries for the six months ended August 31, 1984 and the combined financial statements of the manufacturing subsidiaries of Univar Corporation (Penick & Ford, Limited, Idaho Malting Company, Pacific Cogeneration, Inc., and Great Western Malting Export Corporation) for the year ended February 29, 1984 were examined by

other auditors whose report dated October 5, 1984 expressed an unqualified opinion on those statements.

In our opinion, the 1986 and 1985 financial statements referred to above present fairly the consolidated financial position of PENWEST, LTD. and subsidiaries as of August 31, 1986 and 1985, and the consolidated results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the period.

Ernst & Whinney

Seattle, Washington
October 3, 1986

Directors, Officers and Headquarters

Board of Directors

Richard E. Engebrecht
President and Chief
Executive Officer, VWR
Corporation

Tod R. Hamachek
President and Chief
Executive Officer,
PENWEST

N. Stewart Rogers
Senior Vice President-
Finance, Univar
Corporation

Lowry Wyatt
Consultant and Retired
Senior Vice President,
Weyerhaeuser Company

Russell E. Hamachek
Chairman of Western
Acquisitions Group, Inc.,
Retired Vice President,
Univar Corporation
and Retired President/
CEO, Great Western
Malting Co.

C. Calvert Knudsen
Vice Chairman,
MacMillan
Bloedel Ltd.

William K. Street
President and CEO,
The Ostrom Company

James H. Wiborg
Chairman and Chief
Strategist, Univar
Corporation

Curtis P. Lindley
Chairman of the Board,
PENWEST

Officers

Tod R. Hamachek
President and Chief
Executive Officer

Franklin E. Olsen, Jr.
Vice President-Employee
Relations

Ronald B. Vogel
Executive Vice President
and General Manager of
Great Western Malting Co.

Dale C. Leman
Vice President-Finance
and Treasurer

H. Thomas Reed
President and General
Manager of Penick &
Ford, Limited

Jeffrey T. Cook
Controller and
Secretary

Committees

Executive Committee
James H. Wiborg,
Chairman
Tod R. Hamachek
C. Calvert Knudsen
Curtis P. Lindley
N. Stewart Rogers

Audit/Pension Committee
N. Stewart Rogers,
Chairman
Richard E. Engebrecht
Russell E. Hamachek
William K. Street

Compensation Committee
Lowry Wyatt, Chairman
C. Calvert Knudsen
William K. Street
James H. Wiborg

GREAT WESTERN MALTING Co.

Headquarters
Foot of West 11th St.
P.O. Box 1529
Vancouver, WA 98668
(206) 693-3661
(503) 285-7711

5945 South Malt Avenue
Los Angeles, CA 90040

1666 Kraft Road
Pocatello, ID 83204

PENICK & FORD, Limited

Headquarters
1001 First Street, S.W.
Cedar Rapids, IA 52404
(319) 398-3700

1088 W. Sunnyside Road
Idaho Falls, ID 83401

PENWEST

Headquarters
300 One Bellevue Center
Bellevue, WA 98004
(206) 462-6000

General Information

Annual Meeting

2 p.m. Tuesday,
January 20, 1987
12th Floor Auditorium
Rainier Bank Tower
Fifth Avenue and
University Street
Seattle, Washington

Form 10-K

The company files an annual report with the Securities and Exchange Commission on Form 10-K, pursuant to the Securities Exchange Act

of 1934. Shareholders may obtain a copy of this report without charge by writing:

Jeffrey T. Cook
Controller and Secretary
PENWEST
300 One Bellevue Center
Bellevue, WA 98004

Transfer Agent and Registrar

First Interstate Bank of California
Corporate Trust
P.O. Box 54261
Los Angeles, CA 90054

Legal Counsel

Shidler McBroom Gates & Lucas
999 Third Ave.,
Suite 3500
Seattle, Washington 98104

Auditors

Ernst & Whinney
999 Third Ave.,
Suite 3300
Seattle, Washington 98104

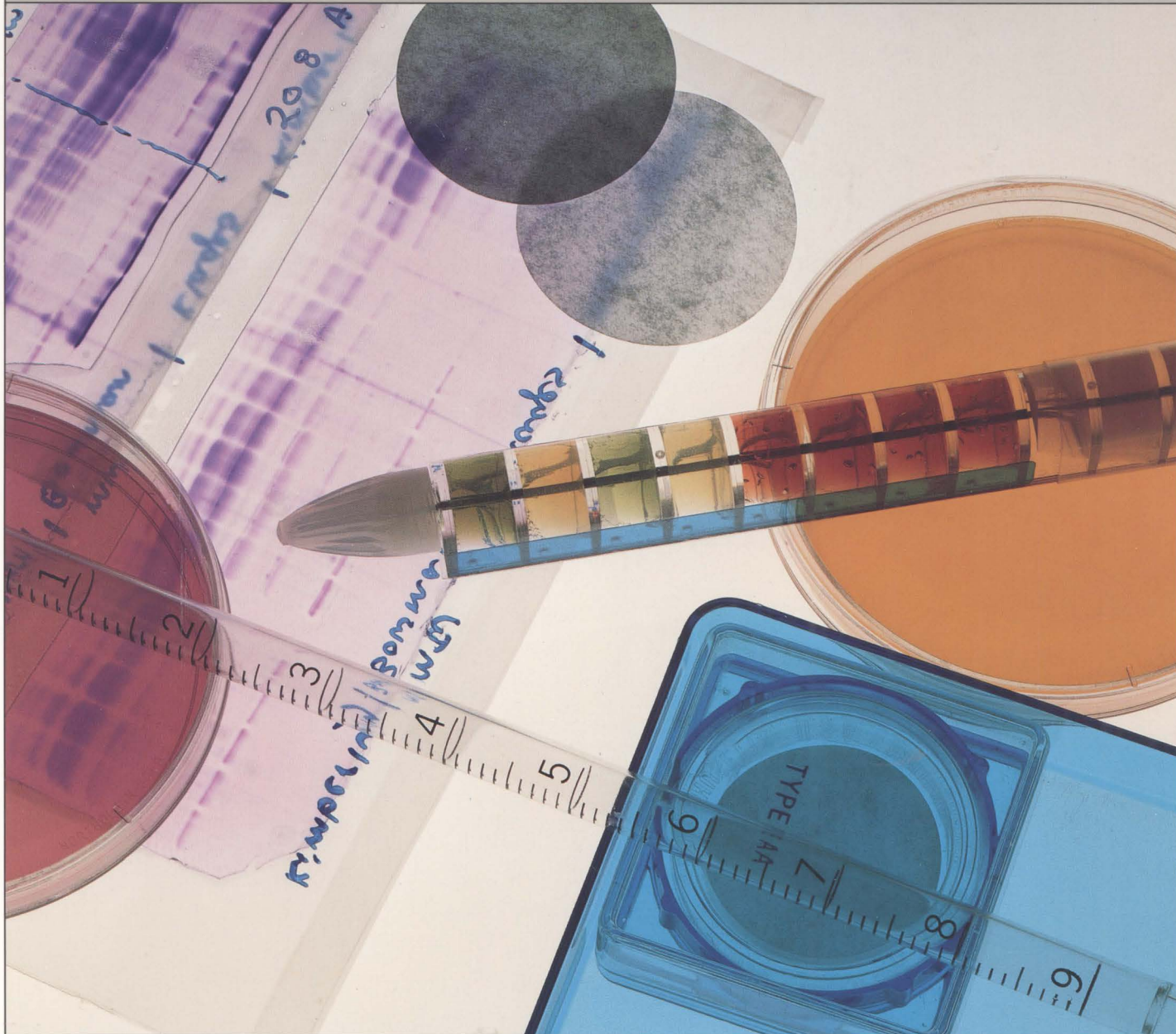
Investor Relations Counsel

Corporate Communications, Inc.
200 West Mercer
Suite 412
Seattle, Washington 98119

Stock Price Data

Common stock of PENWEST began trading on March 1, 1984.
Traded National Over-The-Counter
NASDAQ Symbol: PENW

	Market Price	
	High	Low
Six Months Ended August 31, 1984		
Quarter Ended May 31	7¾	5½
Quarter Ended August 31	11¾	6¼
1984/85		
Quarter Ended November 30	10¼	8¼
Quarter Ended February 28	11½	7¾
Quarter Ended May 31	12⅞	9¾
Quarter Ended August 31	11¼	9¼
1985/86		
Quarter Ended November 30	10½	9⅞
Quarter Ended February 28	13½	10½
Quarter Ended May 31	16¼	12⅞
Quarter Ended August 31	17⅞	15



One Bellevue Center
Suite 300
Bellevue, WA
98004