KRAFT

Of course we're big...

2001 ANNUAL REPORT

...but that’s a small part of our story.

TANG
CAPRI SUN ALL NATURAL
sugus
A.1. STEAK SAUCE
LACTA
CLUB SOCIAL
Miracoli
EST. 1853 GEVALIA® KAFFE
Terry's
Milka
VEGEMITE CONCENTRATED YEAST EXTRACT KRAFT
GREY POUPON.
OREO
RITZ CRACKERS
TERRABU
KRAFT dairylea
Figaro
Freia
Suchard
NABISCO
ALTOIDS
café HAG
DIGIORNO
Estrella
triscuit Baked Whole Wheat Wafers
Royal®
KRAFT Macaroni & Cheese
CARTE NOIRE
MR. PEANUT PLANTER
Kenco®
KRAFT PHILADELPHI
MAXWELL HOUSE® Good to the last drop!® Coffee
JELL-O
KRAFT Miracle Whip
Boca Meatless Products
Cracker Barr
COLD • CRISP • DELICIOUS claussen
Trakinas
Oscar Mayer Lunchables LUNCH COMBINATIONS
KRAFT Singl
Wheat Thins
KRAFT Cheez Whiz CHEESE DIP
Chips Ahoy!
Post®
Crystal Light
KRAFT Velveeta
JACQUES VABRE
JACOBS
ONKO
KRAFT Stove Top
The NABOB coffee co.
Cool Whip Whipped Topping
Côte d'Or Since 1883
Kool-Aid
TOBLERONE
EL CASERIO
SIMMENTHAL
Oscar Mayer
LIFESAVERS
LOUIS RICH
TOMBSTONE PIZZA
Marabou

Think of us as an energetic one year old with 100 years' experience.

On June 13, 2001, we began trading as a public company. Our $8.4 billion initial public offering was the second biggest in U.S. history. With nearly $34 billion in revenues, we are the largest food company in North America and the second largest worldwide. 35 of our brands have been delighting consumers for more than 100 years. The care and quality that J. L. Kraft, Johann Jacobs, Oscar Mayer and C. W. Post first put into their products live in our brands today.

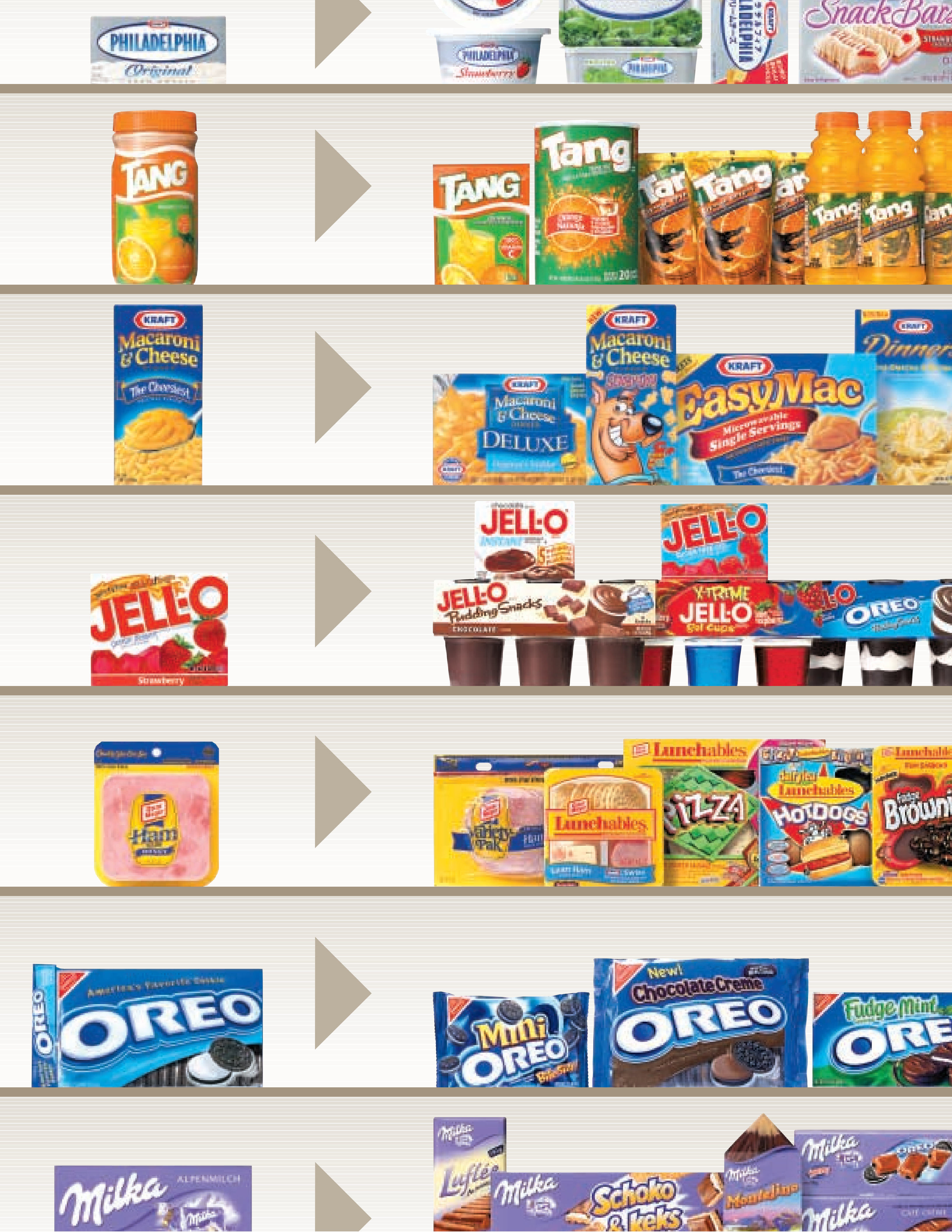
We touch a billion people, one at a time.

Six of our brands have global revenues of more than $1 billion, 61 have revenues of more than $100 million. We're a member of the family in 99.6% of all American households. Last year, we listened to more than 2.5 million people to learn how to better meet consumers' needs. Each month, 12 million people visit our websites for product, menu and nutrition information. A billion people see our advertising around the world. We're building a future on innovations in taste, nutrition, convenience, variety and value.


OREO
Oscar Mayer
KEEP REFRIGERATED
LUNCH COMBINATIONS
KRAFT
Singles

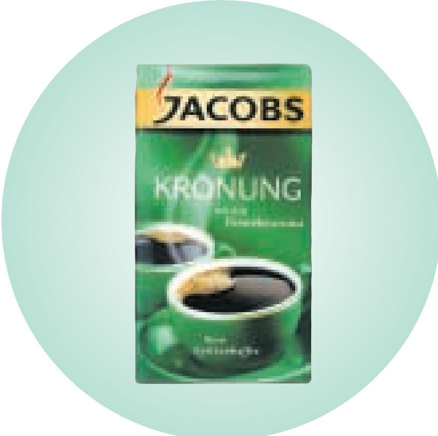
We know how to make good ideas grow.

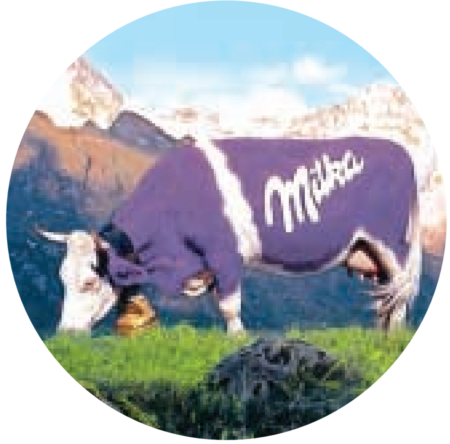
One good idea leads to another, and another, and another. In 2001, new products generated more than $1.1 billion in revenues. **We hold thousands of patents worldwide and, since 1981, we've received more U.S. food-related patents than any other food company.** We invest more in advertising than any other U.S. food company. **In the last six years, we've received more than 100 advertising awards around the world.** Our focus is on four key growth areas: snacks, beverages, convenient meals and health & wellness.


PHILADELPHIA
Original
PHILADELPHIA
Strawberry
SnackBars
TANG
TANG
Tang
Tang
KRAFT
Macaroni & Cheese
The Cheesiest
KRAFT
Macaroni & Cheese
DELUXE
KRAFT
Macaroni & Cheese
KRAFT
EasyMac
Microwavable Single Servings
The Cheesiest
KRAFT
Dinners
JELL-O
Strawberry
JELL-O
INSTANT
JELL-O
JELL-O
Pudding Snacks
CHOCOLATE
X-TREME
JELL-O
Gel Cups
JELL-O
OREO
Ham
Variety Pak
Lunchables
Lunchables
PIZZA
Lunchables
HOT DOGS
Lunchables
Brownie
America's Favorite Cookie
OREO
OREO
Mini
OREO
New!
Chocolate Creme
OREO
Fudge Mint
ALPENMILCH
Milka
Milka
Milka
Schoko & Keks
Milka
Milka
Milka

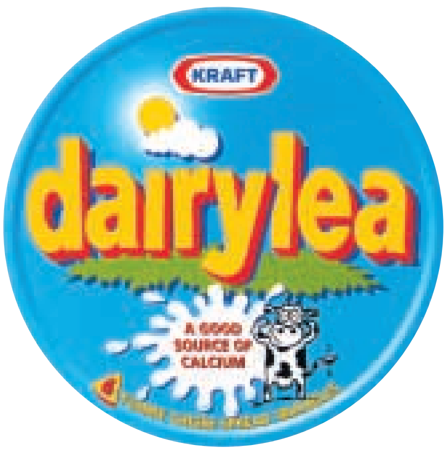
We’re local, all around the world.

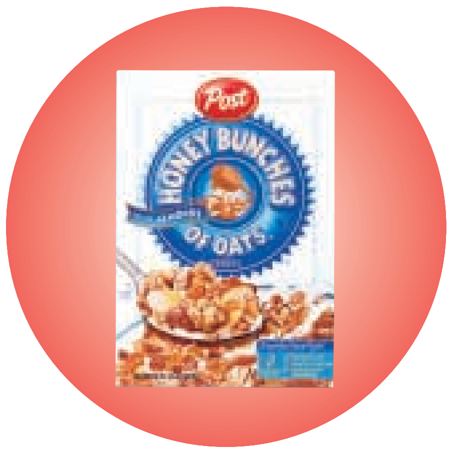
Our brands are sold in millions of neighborhood stores in more than 145 countries. We’ve earned the #1 share in 21 of our top 25 categories in the U.S. and 21 of our top 25 country categories elsewhere in the world. **We have operations in 68 countries.** In developing markets, our volume grew 11% in 2001. **We have a global sales force of more than 19,000 professionals.** Last year, we supported the communities we live in around the world with more than $25 million in food and financial contributions.


JACOBS
KRÖNUNG

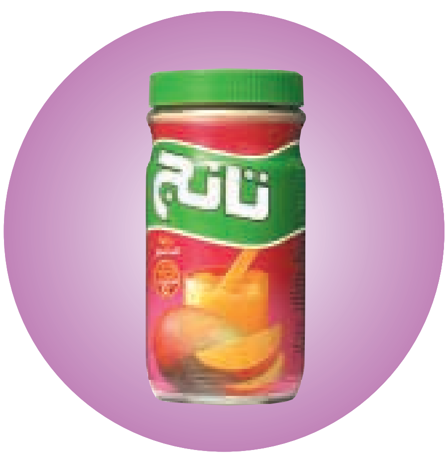

Milka


OREO


KRAFT
dairylea
A GOOD SOURCE OF CALCIUM

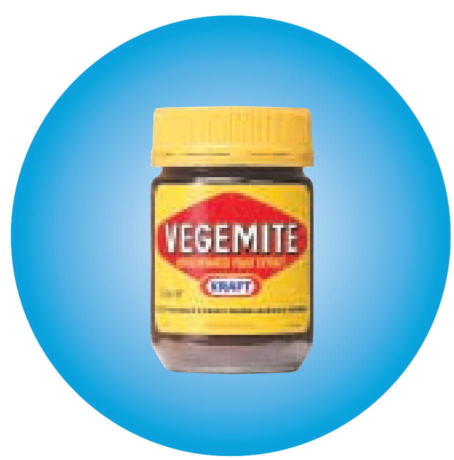

Post
HONEY BUNCHES OF OATS


KRAKER
CLUB SOCIAL




KRAFT
NEU
PHILADELPHIA
Créamo


LIFE SAVERS


VEGEMITE
KRAFT

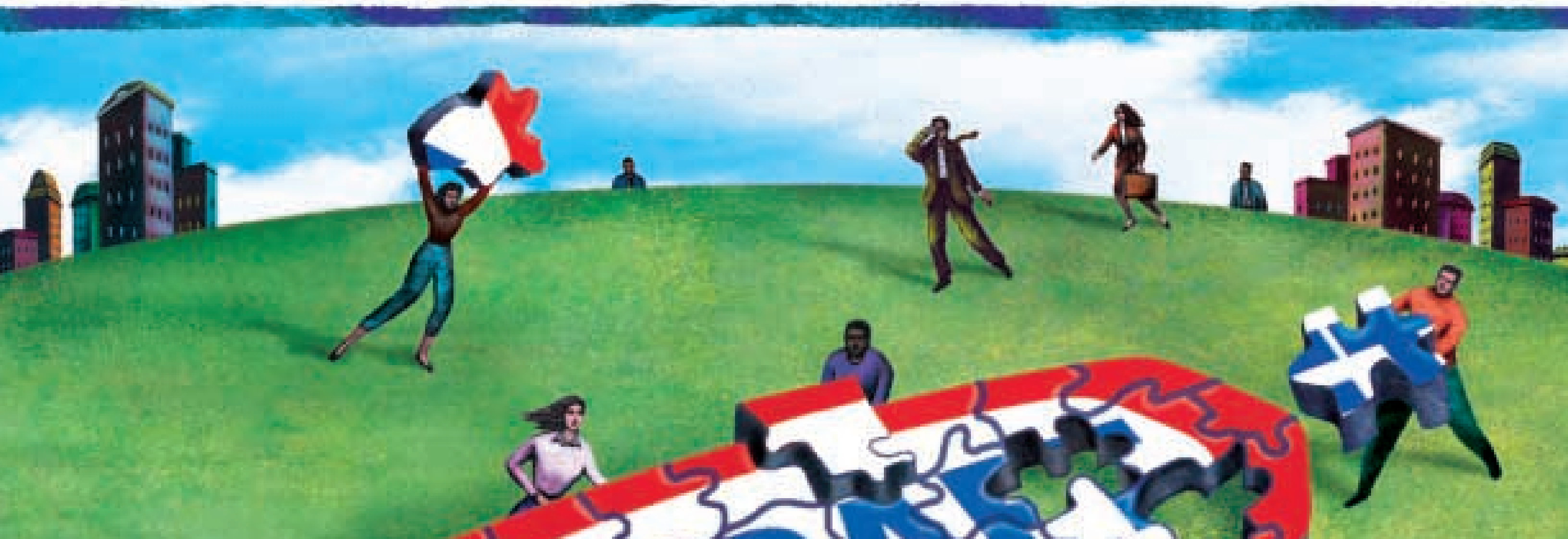
We think of discipline as one more opportunity to innovate.

At every step, from the purchase of raw materials to the final product on the shelf, we find ways to create a competitive advantage. Our cost control breakthroughs generated savings of 3.5% of cost of goods sold in 2001 to reinvest in growth and build the bottom line. **With the integration of Nabisco, so far we've captured more than $100 million in synergy savings.** We've developed proprietary tools to make the most of our marketing investments. **Our worldwide councils of category experts share best practices and leverage new product ideas and technologies for profitable growth.**


THANK YOU SIR!
MAY I HAVE ANOTHER!
THE CURIOUSLY STRONG MINTS®
ALTOIDS

We’re a team of 113,690 passionate entrepreneurs.

Profitable growth is everyone’s goal. **Our top 27 executives average 20 years of service with Kraft in many different business units and countries around the world.** ***The Wall Street Journal*** **reported, “In the food world, Kraft is considered the Harvard of career management.”** **U.S. grocery retailers ranked Kraft #1 in Best Combination of Growth and Profitability, Most Innovative Marketing Programs and Best Sales Force/Customer Teams.**



And what we do is build sustainable growth.

We are a global growth company. With the integration of Nabisco, our reported revenues increased by 28%. **Our volume increased 3.7%* and once again our earnings growth was among the best in the food industry.** In 2001, our return on sales was 18.1%, an increase of 7.6 percentage points since 1991. **For the 28 weeks Kraft stock traded in 2001, total shareholder return was 10.6%.** Growth is the heart of our culture. **We're committed to driving shareholder value with consistent, top-tier performance.**

**For a more meaningful comparison, results are presented on a pro forma basis, and volume results are compared to a 52-week fiscal year 2000. See 2001 Financial Highlights on page18 for a more detailed explanation.*

3.7%
2001

Volume
52-week
*Pro Forma**

2000

8.9%
2001

Operating Companies Income
*Pro Forma**

2000

19.9%
2001

Net Earnings
*Pro Forma**

2000

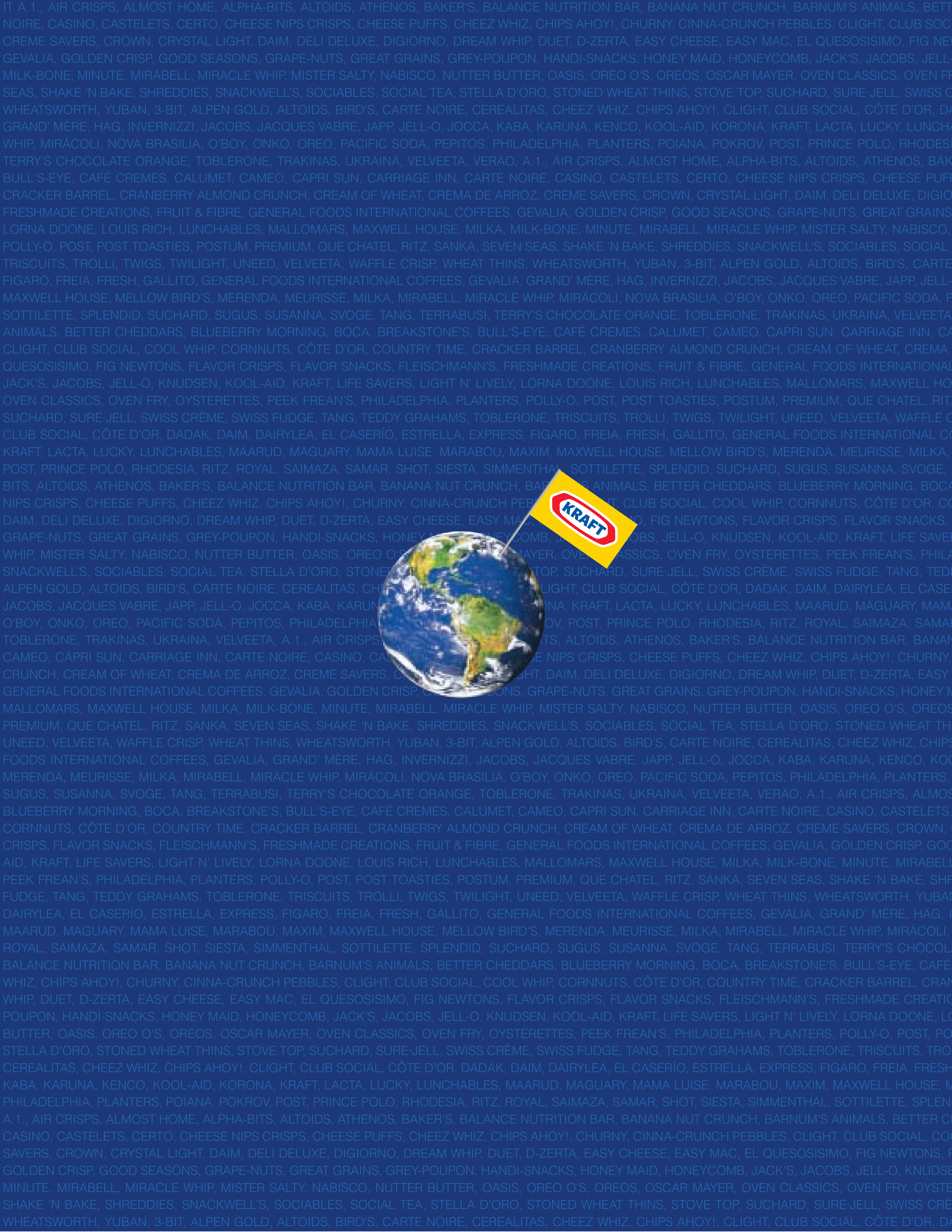
10.6%
12/31/01

Total Shareholder Return

6/13/01

We are

the world's favorite foods...


KRAFT

From the first cup of coffee in the morning to a last late-night snack, Kraft Foods makes the world's favorite foods. Our market basket of products, which includes six brands with more than $1 billion in revenues and a total of 61 brands with revenues of at least $100 million, is balanced across five growing global sectors: Snacks, Beverages, Cheese, Convenient Meals and Grocery.

Whether it's with global brands like *Nabisco*, *Philadelphia* and *Tang*, or regional favorites like *Oscar Mayer*, *Jacobs* and *Post*, we're on trend with local tastes in more than 145 countries around the world. And along with our products come great food and nutrition ideas. Our websites, which are among the most popular of any consumer goods company, offer recipes, menu planning, kitchen basics and in-depth health & wellness information. With the best brands and a range of helpful services, we're making food a simpler, easier, more enjoyable part of life.

Total Revenues $33.9 Billion

Snacks

As more consumers eat on the run and snack whenever they get a chance, Kraft is right beside them with some of the best-known brands of cookies, crackers, confectionery and salty snacks. Now, with the addition of Nabisco, Kraft is the world's leading producer of cookies and crackers, including global leaders like the *Oreo* and *Ritz* brands. We're also one of the largest chocolate producers worldwide, with brands such as *Milka*, *Toblerone* and *Côte d'Or*. Brands like *Life Savers*, *Creme Savers*, *Altoids* and *Sugus* round out our confectionery business. *Estrella* in Europe and *Planters* in North America are just two of our leading brands of salty snacks.

- *Oreo*, the world's number one cookie, got a lot bigger with the launch of Chocolate Creme *Oreo.*
- We're positioned for growth in Russia and Poland with the acquisition of Stollwerck, a leading producer of chocolate confectionery.
- *Creme Savers*, our newest $100 million brand, grew revenues more than 25%, with new flavors and expanded distribution.
- *Club Social* and *Trakinas*, two of our core biscuit brands in Latin America, grew volume better than 30% in the large Brazilian market.
- Bringing together two icon brands, we launched *Jell-O Oreo* ready-to-eat pudding.
- Our growth in developing markets continued with the expansion of *Milka* into Ukraine and *Siesta* into Romania, Lithuania and Bulgaria.
- Broader distribution in the grocery and convenience store channels drove strong growth of *Planters* Trail Mix, which has six of the top ten items in the trail mix category.

Revenues $10.1 Billion

Beverages

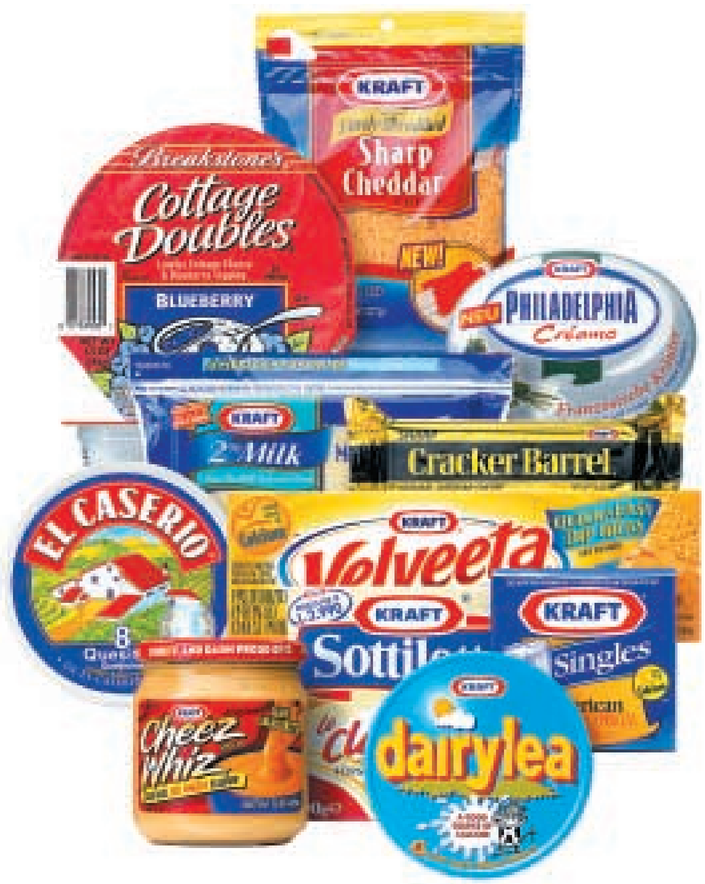
There's nothing more satisfying than hot coffee on a cold morning or a cold drink on a hot day. Kraft has them both, with a wide range of exciting global and local brands and innovative new products. We built our leading global position in coffee with *Maxwell House*, *Jacobs*, *Carte Noire* and other brands that meet consumers' unique local coffee preferences. In the fast-growing area of refreshment beverages, Kraft is leading the way with powerhouse global brands such as *Tang* and strong national and regional brands, including *Capri Sun*, *Crystal Light*, *Kool-Aid* and *Clight*.

- Our ready-to-drink beverages continued their double-digit growth in the U.S., with strong performances from *Capri Sun*, *Tang*, *Crystal Light* and *Kool-Aid* Jammers.
- We expanded our leading global position in coffee with acquisitions in Romania, Bulgaria and Morocco.
- We introduced *Tang* into Indonesia, India and Vietnam – three countries with a combined population of 1.3 billion people.
- We were the first to introduce an easy-open coffee can lid nationally in the U.S., on *Maxwell House* and *Yuban* coffees.
- Coffee became more convenient across Europe with new single-serve coffee sticks under the *Jacobs*, *Carte Noire*, *Gevalia* and *Maxwell House* brands.
- *Clight* expanded its Latin American presence with new products in Brazil and Venezuela.

Revenues $6.6 Billion

Cheese

Throughout history, cheese has been an essential element of the eating experience, and for more than a century, Kraft's innovations have brought quality, convenience and variety to consumers worldwide. *Philadelphia* cream cheese, our most global brand, is the perfect example. While people all over the world use cream cheese differently, the cream cheese they like best is *Philadelphia*. From *Cracker Barrel* natural cheese, and *Kraft* Singles, Shreds and Cubes, to *Dairylea and El Caserío* process cheese, Kraft makes the cheese that pleases the world.

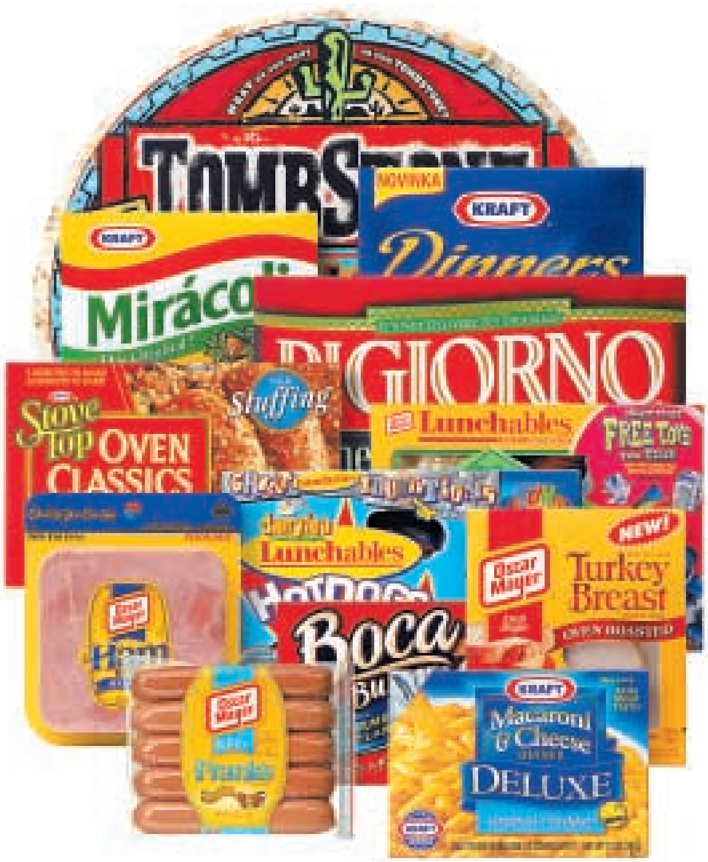


- Annual per capita cheese consumption is more than 30 pounds in the U.S., where *Kraft* is the number one brand.
- *Kraft* Singles with added calcium was introduced across the Asia Pacific region.
- Our global "Taste of Heaven" ad campaign for *Philadelphia* cream cheese is now building volume in 29 markets.
- We expanded our fast-growing *Kraft* 2% Milk line of cheese with two new flavors.
- We continued to renew growth in our cottage cheese business, adding new flavors to our innovative *Breakstone's* and *Knudsen Cottage Doubles*.

Revenues $6.3 Billion

Convenient Meals

Who ever has enough time? Kraft helps make life a little easier with products that are as convenient as they are delicious. From the perennial favorite *Oscar Mayer* sliced meats and hot dogs, to *Lunchables* lunch combinations, *Mirácoli* dinners, *Boca* meat alternatives, to *Stove Top Oven Classics* and *Tombstone*, *DiGiorno* and *Jack's* pizza, consumers rely on Kraft for creative ideas for their mealtime needs. Wherever there's a busy family seeking relief from mealtime mayhem, Kraft is there with satisfying and convenient solutions.



- Our high-growth pizza business picked up momentum from new *DiGiorno* Stuffed Crust and *Tombstone* Mexican pizzas in the U.S. and *Delissio* Personal Size pizza in Canada.
- By taking North America's favorite *Kraft* Macaroni & Cheese dinner and fast-adapting it to the Czech Republic with a variety of sauces to fit local tastes, we've created a whole new growth business.
- *Lunchables* lunch combinations, an American phenomenon, continued to gain ground in Europe with solid volume growth in the United Kingdom, Ireland and Spain.
- *Boca* meat alternatives grew from the number three to the number two brand in the U.S.
- We acquired *It's Pasta Anytime*, giving us a new shelf-stable technology for future new products.
- *Oscar Mayer* sliced meats accelerated their volume growth with revitalized ham and turkey products.

Revenues $5.5 Billion

Grocery

A good breakfast is important for the body, but a good dessert feeds the soul. Our grocery sector covers both, and just about everything in between, including sauces, pourable and spoonable dressings and mustard. Kraft starts the morning right with a wide variety of *Post* cereals, from *Grape Nuts* and *Shredded Wheat* to *Honey Bunches of Oats* and *Honeycomb*. Midday, a sandwich just isn't a sandwich without *Miracle Whip* – or *Vegemite* in Australia and New Zealand. And as everyone knows, there's always room for *Jell-O* – topped, of course, with *Cool Whip* dessert topping. Once again, Kraft has the perfect brand for any eating occasion.

- We joined together the *Kraft* and *Oscar Mayer* brands to launch three new bacon-flavored pourable salad dressings, increasing our number one share in the U.S.
- In Germany we offered health-conscious consumers new low-fat *Miracle Whip* with yogurt.
- In Latin America, we built on the strength of our popular *Clight* powdered soft drink brand with the successful introduction of *Clight* powdered gelatin dessert.
- With new Easy Squeeze packaging for *Kraft* mayonnaise and *Miracle Whip* dressing, we increased our share leadership in U.S. spoonable dressings.
- *Royal*, the leader in dry desserts in Latin America, grew even stronger with the introduction of new Space gelatin fantasy flavors.

Revenues $5.4 Billion

2001 Financial Highlights

Consolidated Results

(in millions, except per share data)	Reported 2001	Reported 2000	Reported % Change	Pro Forma 2001	Pro Forma 2000	Pro Forma % Change
Volume (in pounds)	**17,392**	13,130	32.5%	**17,374**	16,747*	3.7%*
Operating revenues	**$33,875**	$26,532	27.7	**$33,871**	$34,033	(0.5)
Operating companies income	**6,035**	4,755	26.9	**6,116**	5,616	8.9
Net earnings	**1,882**	2,001	(5.9)	**2,092**	1,745	19.9
Diluted earnings per share	**1.17**	1.38	(15.2)	**1.21**	1.01	19.8
Results by Business Segment						
North America						
Cheese, Meals and Enhancers						
Operating revenues	**$10,256**	$ 9,405	9.0%	**$10,256**	$10,272	(0.2%)
Operating companies income	**2,099**	1,845	13.8	**2,162**	2,057	5.1
Biscuits, Snacks and Confectionery						
Operating revenues	**5,917**	329	100+	**5,917**	5,761	2.7
Operating companies income	**966**	100	100+	**968**	777	24.6
Beverages, Desserts and Cereals						
Operating revenues	**5,370**	5,266	2.0	**5,370**	5,395	(0.5)
Operating companies income	**1,192**	1,090	9.4	**1,204**	1,125	7.0
Oscar Mayer and Pizza						
Operating revenues	**3,563**	3,461	2.9	**3,563**	3,473	2.6
Operating companies income	**539**	512	5.3	**544**	516	5.4
Total North America						
Operating revenues	**$25,106**	$18,461	36.0%	**$25,106**	$24,901	0.8%
Operating companies income	**4,796**	3,547	35.2	**4,878**	4,475	9.0
International						
Europe, Middle East and Africa						
Operating revenues	**$ 6,339**	$ 6,824	(7.1%)	**$ 6,339**	$ 6,754	(6.1%)
Operating companies income	**861**	1,019	(15.5)	**861**	857	0.5
Latin America and Asia Pacific						
Operating revenues	**2,430**	1,247	94.9	**2,426**	2,378	2.0
Operating companies income	**378**	189	100.0	**377**	284	32.7
Total International						
Operating revenues	**$ 8,769**	$ 8,071	8.6%	**$ 8,765**	$ 9,132	(4.0%)
Operating companies income	**1,239**	1,208	2.6	**1,238**	1,141	8.5
Total Kraft Foods						
Operating revenues	**$33,875**	$26,532	27.7%	**$33,871**	$34,033	(0.5%)
Operating companies income	**6,035**	4,755	26.9	**6,116**	5,616	8.9

Reported results include the operating results of Nabisco in 2001, but not in 2000. Reported results also reflect average shares of common stock outstanding during 2001 and assume an average of 1.455 billion shares outstanding during 2000.

Pro forma results assume Kraft owned Nabisco for all of 2000. In addition, pro forma results reflect common shares outstanding of 1.735 billion based on the assumption that shares issued immediately following the Kraft initial public offering (IPO) were outstanding during all periods presented and that, effective January 1, 2000, the net proceeds of the IPO were used to retire indebtedness incurred to finance the Nabisco acquisition. These results also exclude significant one-time items for loss on sale of a factory and integration costs, estimated sales made in advance of the century date change, gain on sale of a business, and results from operations divested since the beginning of 2000.

Results for fiscal year 2001 are based on a traditional 52-week year while fiscal year 2000 results reflect a 53-week year.

* *Pro forma volume results shown above and volume comparisons elsewhere in this report exclude the impact of the 53rd week in 2000 for a more meaningful comparison.*

Fellow Shareholders:

Yes, we're big. But we've never lost touch with the source of our success: the ability to listen with a creative ear...the imagination to meet people's needs with innovative food ideas…a commitment to trust we will not compromise.

And as we've grown, we've kept the best of local while capturing all the advantages of global scale – and done it with teamwork, discipline and speed. For those who invest in us, our goal is simple: consistent, top-tier performance.

Perhaps no other year in our history has embodied all this quite like 2001.

It was a transformational year for Kraft Foods.

- We integrated Nabisco and Kraft with great success, building new growth opportunities and gaining more than $100 million in synergy savings.
- We completed an initial public offering of 16.1% of Kraft's outstanding shares, raising $8.4 billion in net proceeds used to retire debt associated with the Nabisco acquisition.
- We began paying dividends at an annual rate of 52 cents per share and produced a total return for shareholders of 10.6% for the 28 weeks Kraft shares traded in 2001.
- New products generated more than $1.1 billion in revenues.
- Our volume grew 11% in developing markets around the world.
- We made five acquisitions to drive future growth.
- More than 12 million consumers visited our websites each month for ideas and information.
- Productivity savings for the year met our target of 3.5% of cost of goods sold.
- We grew worldwide volume 3.7%, in line with our stated goal of 3% - 4% growth.
- We generated a strong $3.3 billion in operating cash flow.
- And once again we delivered on our promise of top-tier financial results, with operating companies income up 8.9% to $6.1 billion, net earnings up 19.9% to $2.1 billion and diluted earnings per share up 19.8% to $1.21.

Our results were strong across the company.

All six of our business segments increased volume and operating companies income for the year.

Kraft Foods North America:
Beverages, Desserts and Cereals – Volume was up 9.3%, powered by double-digit gains in our ready-to-drink beverage business, which more than offset softness in Desserts and Cereals. Operating companies income for the segment increased 7.0%.

Biscuits, Snacks and Confectionery – Volume increased 1.6%, led by strong growth in our core cookies and crackers businesses. Operating companies income was up 24.6%, benefiting from volume growth and synergy gains.

Note: All amounts discussed in this letter are on a pro forma basis. In addition, the volume comparisons are also adjusted to reflect a 52-week fiscal year 2000.

Our Mission

To Be the Undisputed Global Food Leader

Consumers... First Choice

Customers... Indispensable Partner

Alliances... Most Desired Partner

Employees... Employer of Choice

Communities... Responsible Citizen

Investors... Top-Tier Performer

Cheese, Meals and Enhancers – Volume grew 0.9%, as growth in Meals and Enhancers and in Canada more than offset declines in Cheese and Food Service, due in part to exiting non-branded businesses. Operating companies income increased 5.1%.

Oscar Mayer and Pizza – Volume was up 2.3% on gains from our processed meats, meat alternatives and pizza businesses. Operating companies income was up 5.4%.

Kraft Foods International:
Europe, Middle East and Africa – Volume increased 1.3%, as strong growth in Central and Eastern Europe and gains in numerous Western European markets were partially offset by declines in Germany and Italy. Operating companies income increased 0.5%.

Latin America and Asia Pacific – Volume increased a strong 9.9%, led by broad-based growth in snacks, beverages, cheese and grocery products. Operating companies income increased 32.7%.

Overall, the earnings growth we delivered was once again among the industry's best. But as good a year as it was, we're not satisfied. Looking ahead, we will continue to build both the bottom and top lines with five enduring strategies:

Our Strategies

Accelerate growth of core brands

Drive global category leadership

Optimize our portfolio

Drive world-class productivity, quality and service

Build employee and organizational excellence

Accelerate growth of core brands – To drive growth, we're leveraging one of the industry's most powerful portfolios of brands to address the marketplace's most compelling trends. We're focusing new-product innovation on four high-growth consumer needs: snacking, beverages, convenient meals and health & wellness. We're capturing a greater share of the fastest-growing distribution channels, including supercenters, convenience stores, mass merchandisers, drug stores, club stores and food away from home. And we're developing customized products and marketing programs to reach rapidly expanding demographic segments such as the African-American and Hispanic populations in the U.S.

Drive global category leadership – Managed effectively, category leadership is a compelling advantage. With our large number of leading brands, we're able to capture a strong share of each category's growth, giving us the resources to reinvest in marketing and innovation and keep us well positioned for future growth. We build category strength with our worldwide councils of category experts, who share best practices, fast-adapt product ideas, and optimize productivity and sourcing in our global biscuits, cheese, coffee, confectionery and refreshment beverages businesses.

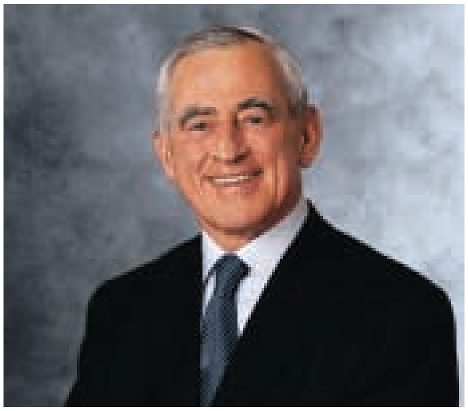
We are intent on driving growth in developing markets. More than 80% of the world's population lives in developing markets, yet only 9% of Kraft's revenues are sourced there. Our rapid expansion in these markets will continue by broadening our brand portfolio in current categories, bringing new categories to current geographies, expanding to new geographies and building distribution in all geographies where we operate.

Optimize our portfolio – With the integration of Nabisco, our reported revenues increased 28%, giving us a leading global position in snack foods. We will continue to acquire high-potential businesses to jump-start us in new fast-growing categories or countries and give us greater scale in existing ones. We also will divest slower-growth or lower-margin businesses that no longer constitute a strategic fit.

Drive world-class productivity, quality and service – Strong cost management funds our future, helping us deliver top-tier growth and profitability. Using a continuously replenished, three-year pipeline of ideas, our productivity programs now yield annual savings of 3.5% of cost of goods sold, while helping us improve product quality and customer-service levels. We're also on track to achieve $600 million in ongoing annual synergy savings from the integration of Nabisco.

Build employee and organizational excellence – Even with our great brand strength and global scale, the biggest advantage we have is our people. Using highly successful recruitment, retention and development initiatives, we've built the best team in the business. We have the experience, the bench strength, the diversity and the leadership skills that set us apart. And every one of us is committed to the same goal – consistent, top-tier performance.

We expect to deliver on that goal again in 2002. For the year, we expect to grow volume in the 3%-4% range. And we project diluted earnings per share growth in the range of 14%-16%, to $2.00-$2.05, reflecting new accounting standards on goodwill amortization. Of course, in every year there are challenges, some anticipated and some we cannot foresee. But whether it's currency translation, commodity costs or economic weakness in certain countries, you have our committment that we will do our best to overcome them.


Geoffrey C. Bible


Betsy D. Holden


Roger K. Deromedi

In so many ways, 2001 was an extraordinary year for Kraft Foods.

As eventful as it was, and as pleased as we are to celebrate all its successes, our focus is on what's next: an emerging trend that creates new opportunity…another developing market where our brands can prosper...a thriving high-potential business we can acquire...the next innovative idea to reduce supply-chain costs...a new leadership program to help the best team get even better.

We look ahead with confidence – to another strong year in 2002 and a future of long-term, sustainable growth.

Geoffrey C. Bible
Chairman of the Board
Kraft Foods Inc.

Betsy D. Holden
Co-CEO, Kraft Foods Inc.
President & CEO
Kraft Foods North America

Roger K. Deromedi
Co-CEO, Kraft Foods Inc.
President & CEO
Kraft Foods International

February 28, 2002

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

Overview

Kraft Foods Inc. ("Kraft"), together with its subsidiaries (collectively referred to as the "Company") is the largest branded food and beverage company headquartered in the United States. Prior to June 13, 2001, the Company was a wholly-owned subsidiary of Philip Morris Companies Inc. ("Philip Morris"). On June 13, 2001, the Company completed an initial public offering ("IPO") of 280,000,000 shares of its Class A common stock at a price of $31.00 per share. The IPO proceeds, net of the underwriting discount and expenses, of $8.4 billion were used to retire a portion of an $11.0 billion long-term note payable to Philip Morris incurred in connection with the acquisition of Nabisco Holdings Corp. ("Nabisco"). After the IPO, Philip Morris owns approximately 83.9% of the outstanding shares of the Company's capital stock through its ownership of 49.5% of the Company's Class A common stock, and 100% of the Company's Class B common stock. The Company's Class A common stock has one vote per share while the Company's Class B common stock has ten votes per share. Therefore, Philip Morris holds 97.7% of the combined voting power of the Company's outstanding common stock.

The Company conducts its global business through two units: Kraft Foods North America, Inc. ("KFNA") and Kraft Foods International, Inc. ("KFI"). KFNA manages its operations by product category, while KFI manages its operations by geographic region. KFNA's segments are Cheese, Meals and Enhancers; Biscuits, Snacks and Confectionery; Beverages, Desserts and Cereals; and Oscar Mayer and Pizza. KFNA's food service business within the United States and its businesses in Canada and Mexico are reported through the Cheese, Meals and Enhancers segment. KFI's segments are Europe, Middle East and Africa; and Latin America and Asia Pacific.

Financial Reporting Release No. 60, which was recently issued by the Securities and Exchange Commission ("SEC"), requires all registrants to discuss critical accounting policies or methods used in the preparation of financial statements. Note 2 to the consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. In the opinion of management, the Company does not have any individual accounting policy which is critical to the preparation of its consolidated financial statements. This is due principally to the definitive nature of accounting requirements for consumer products companies. Also, in most instances, the Company must use an accounting policy or method because it is the only policy or method permitted under accounting principles generally accepted in the United States of America ("U.S. GAAP"). The following is a review of the more significant accounting policies and methods used by the Company:

Revenue Recognition: As required by U.S. GAAP, the Company recognizes operating revenues upon shipment of products to customers when title and risk of loss pass to its customers. Provisions and allowances for sales returns and bad debts are also recorded in the Company's consolidated financial statements. The amounts recorded for these provisions and related allowances are not significant to the Company's consolidated financial position or results of operations. As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company will adopt new required accounting standards mandating that certain costs currently reported as marketing, administration and research costs be shown as a reduction of operating revenues or an increase in cost of sales. As a result, previously reported revenues will be reduced by approximately $4.6 billion, $3.6 billion and $3.4 billion for 2001, 2000 and 1999, respectively. The adoption of the new accounting standards will have no impact on net earnings or basic or diluted earnings per share.

Depreciation and Amortization: The Company depreciates property, plant and equipment and amortizes goodwill and other intangible assets using straight-line methods. Through December 31, 2001, the Company used forty years to amortize goodwill and other intangible assets, in recognition of the strength of its brands, which resulted in amortization expense of $962 million for the year ended December 31, 2001. Beginning on January 1, 2002, with the adoption of a new required accounting standard, the Company will no longer be required to amortize a substantial portion of its goodwill and other intangible assets. As a result, the Company estimates that amortization expense will approximate $10 million for the year ending December 31, 2002. The Company will also be required to continue to review annually its goodwill and other intangible assets for possible impairment or loss of value. However, the Company does not currently anticipate having to record an impairment loss when it adopts the new standard.

Marketing Costs: As required by U.S. GAAP, the Company records marketing costs as an expense in the year to which such costs relate. The Company does not defer the recognition of any amounts on its consolidated balance sheet with respect to marketing costs. The Company expenses advertising costs as incurred in the period in which the related advertisement initially appears. The Company records consumer incentive and trade promotion costs as an expense in the period in which these programs are offered, based on estimates of utilization and redemption rates that are developed from historical information. As discussed above under "*Revenue Recognition,*" beginning January 1, 2002, the Company will adopt the previously mentioned revenue recognition accounting standards mandating that certain costs currently reported as marketing expense be shown as a reduction of operating revenues or an increase in cost of sales. As a result, previously reported amounts for marketing, administration and research costs will be reduced by approximately $4.7 billion, $3.7 billion and $3.4 billion for 2001, 2000 and 1999, respectively. The adoption of the new accounting standards will have no impact on net earnings or basic or diluted earnings per share.

Hedging Instruments: As of January 1, 2001, the Company adopted the provisions of a new required accounting standard, which did not have a material effect on net earnings (less than $1 million) or accumulated other comprehensive losses (less than $1 million). The new accounting standard requires that the fair value of all derivative financial instruments be recorded on the Company's consolidated balance sheet as assets or liabilities. Substantially all of the Company's derivative financial instruments are effective as hedges under the new standard; accordingly, the changes in their fair value are recognized in earnings when the related hedged items are recorded in earnings. During 2001, the Company recognized deferred losses of $15 million in earnings, which offset the impact of gains on the related hedged items. In Note 16 of the notes to consolidated financial statements, the Company has included a detailed discussion of the types of exposures that it periodically hedges, as well as a summary of the various instruments which it utilizes. The Company does not use derivative financial instruments for speculative purposes.

Employee Benefit Plans: The Company and its subsidiaries provide a range of benefits to their employees and retired employees, including pensions, postretirement health care benefits and postemployment benefits (primarily severance). The Company records annual amounts relating to these plans based on calculations specified by U.S. GAAP, which include various actuarial assumptions, such as discount rates, assumed rates of return, compensation increases, turnover rates and health care cost trend rates. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. As required by U.S. GAAP, the effect of the modifications is generally recorded or amortized over future periods. The Company believes that the assumptions utilized in recording its obligations under its plans, which are presented in Note 14 to the consolidated financial statements, are reasonable based on its experience and advice from its actuaries.

Related Party Transactions: As discussed in Note 3 to the Company's consolidated financial statements, Philip Morris and certain of its affiliates provide the Company with various services, including planning, legal, treasury, accounting and financial services, auditing, insurance, human resources, office of the secretary, corporate affairs, information technology and tax services. Billings for these services were $339 million in 2001, $248 million in 2000 and $165 million in 1999. The increases reflect information services and financial services that were previously performed by the Company, but are now provided by Philip Morris at approximately the same cost. Although the value of services provided by Philip Morris cannot be quantified on a stand-alone basis, management believes that the billings are reasonable based on the level of support provided by Philip Morris, and that the charges reflect all services provided.

The Company also has long-term notes payable to Philip Morris of $5.0 billion at December 31, 2001 and $21.4 billion at December 31, 2000. A significant portion of the amount outstanding at December 31, 2000 related to borrowings for the acquisition of Nabisco. The decrease from 2000 to 2001 reflects the repayment of borrowings with proceeds from the IPO, a public global bond offering and short-term borrowings. The interest rates on the debt with Philip Morris were established at market rates available to Philip Morris at the time of issuance for similar debt with matching maturities. However, the $5.0 billion remaining long-term note payable to Philip Morris has no prepayment penalty, and the Company may repay some or all of the note with the proceeds from external debt offerings in the current low interest rate environment.

In addition, the accounts of the Company are included in the consolidated federal income tax return of Philip Morris. To the extent that foreign tax credits, capital losses and other credits generated by the Company, which cannot be utilized on a stand-alone basis, are utilized in Philip Morris' consolidated federal income tax return, the benefit is recognized in the Company's calculation of its provision for income taxes. The Company's provisions for income taxes for the years ended December 31, 2001, 2000 and 1999 were lower than provisions calculated on a stand-alone basis by $185 million, $139 million and $107 million, respectively.

The preparation of all financial statements includes the use of estimates and assumptions that affect a number of amounts included in the Company's financial statements, including, among other things, employee benefit costs and related disclosures, inventories under the last-in-first-out ("LIFO") method, marketing costs (advertising, consumer incentives and trade promotions), environmental costs and income taxes. The Company bases its estimates on historical experience and other assumptions which it believes are reasonable. If actual amounts are ultimately different from previous estimates, the revisions are included in the Company's results for the period in which the actual amounts become known. Historically, the aggregate differences, if any, between the Company's estimates and actual amounts in any year have not had a significant impact on the Company's consolidated financial statements.

Business Environment

The Company is subject to fluctuating commodity costs, currency movements and competitive challenges in various product categories and markets, including a trend toward increasing consolidation in the retail trade and consequent inventory reductions and changing consumer preferences. Certain competitors may have different profit objectives and some international competitors may be less susceptible to currency exchange rates. To confront these challenges, the Company continues to take steps to build the value of its brands and improve its food business portfolio with new products and marketing initiatives.

Fluctuations in commodity costs can cause retail price volatility, intensify price competition and influence consumer and trade buying patterns. KFNA's and KFI's businesses are subject to fluctuating commodity costs, including dairy, coffee bean and cocoa costs. Dairy commodity costs on average have been higher in 2001 than those seen in 2000. Cocoa bean prices have also been higher, while coffee bean prices have been lower than in 2000. During the latter part of 2000 and into 2001, energy costs rose in response to higher prices charged for oil and natural gas. However, this increase in energy costs did not have a material adverse effect on the operating results of the Company.

On December 11, 2000, the Company acquired all of the outstanding shares of Nabisco for $55 per share in cash. The purchase of the outstanding shares, retirement of employee stock options and other payments totaled approximately $15.2 billion. In addition, the acquisition included the assumption of approximately $4.0 billion of existing Nabisco debt. The Company financed the acquisition through the issuance of two long-term notes payable to Philip Morris totaling $15.0 billion and short-term intercompany borrowings of $255 million. The acquisition has been accounted for as a purchase. Nabisco's balance sheet was consolidated with the Company as of December 31, 2000, and beginning January 1, 2001, Nabisco's earnings have been included in the consolidated operating results of the Company; however, Nabisco's earnings from December 11, 2000 to December 31, 2000 were not included in the consolidated operating results of the Company since such amounts were insignificant. The Company's interest cost associated with acquiring Nabisco has been included in interest and other debt expense, net, on the Company's consolidated statements of earnings for the years ended December 31, 2001 and 2000.

The integration of Nabisco into Kraft has continued throughout 2001. The closure of a number of Nabisco domestic and international facilities resulted in severance and other exit costs of $379 million, which are included in the adjustments for the allocation of purchase price. The closures will result in the termination of approximately 7,500 employees and will require total cash payments of $373 million, of which approximately $74 million has been spent through December 31, 2001. Substantially all of the closures will be completed by the end of 2002.

The integration of Nabisco into the operations of the Company will also result in the closure or reconfiguration of several of the Company's existing facilities. The aggregate charges to the Company's consolidated statement of earnings to close or reconfigure its facilities and integrate Nabisco are estimated to be in the range of $200 million to $300 million. During 2001, the Company incurred pre-tax integration costs of $53 million for site reconfigurations and other consolidation programs in the United States.

During 2001, the Company purchased coffee businesses in Romania, Morocco and Bulgaria and also acquired confectionery businesses in Russia and Poland. The total cost of these and other smaller acquisitions was $194 million. The operating results of these businesses were not material to the Company's consolidated financial position or results of operations in any of the periods presented.

During 2000, the Company purchased the outstanding common stock of Balance Bar Co., a maker of energy and nutrition snack products. In a separate transaction, the Company also acquired Boca Burger, Inc., a privately held manufacturer and marketer of soy-based meat alternatives. The total cost of these and other smaller acquisitions was $365 million. The operating results of these businesses were not material to the Company's consolidated financial position or results of operations in any of the periods presented.

During 2001, 2000 and 1999, the Company sold several small businesses, including a French confectionery business in 2000. The aggregate proceeds received in these transactions during 2001, 2000 and 1999 were $21 million, $300 million and $175 million, respectively, on which pre-tax gains of $8 million, $172 million and $62 million, respectively, were recorded. The operating results of businesses divested were not material to the consolidated operating results of the Company in any of the periods presented.

Euro: Twelve of the fifteen member countries of the European Union have established fixed conversion rates between their existing currencies and one common currency—the euro. In January 2002, the new euro-denominated currency (bills and coins) was issued. The Company's operating subsidiaries affected by the euro conversion have addressed the systems and business issues raised by the euro currency conversion. These issues included, among others: (1) the need to adapt computer and other business systems and equipment to accommodate euro-denominated transactions; and (2) the competitive impact of cross-border price transparency, which makes it more difficult for businesses to charge different prices for the same products on a country-by-country basis. The euro conversion has not had, and the Company currently anticipates that it will not have, a material adverse impact on its financial condition or results of operations.

Century Date Change: The Company did not experience any material disruptions to its business as a result of the Century Date Change ("CDC"). The Company's increases in 1999 year-end inventories and trade receivables caused by preemptive CDC contingency plans resulted in incremental cash outflows during 1999 of approximately $155 million. The cash outflows reversed in the first quarter of 2000. In addition, the Company had increased shipments in the fourth quarter of 1999 because customers purchased additional product in anticipation of potential CDC-related disruptions. The increased shipments in 1999 resulted in estimated incremental operating revenues and operating companies income in 1999 of approximately $97 million and $40 million, respectively, and corresponding decreases in operating revenues and operating companies income in 2000.

53rd Week and Trade Inventory Reductions: The Company's subsidiaries end their fiscal years on the last Saturday in December. Accordingly, most years contain 52 weeks of operating results while every fifth or sixth year includes 53 weeks. The Company's consolidated statement of earnings for the year ended December 31, 2000 included a 53rd week. The benefit to 2000 operating results from an extra week of shipments was partially offset by inventory reductions undertaken by trade customers for certain of the Company's products. A reduction in trade inventories also occurred in 2001. The net result is that Kraft's 2001 volume and revenue comparisons to 2000 were affected by the extra week of shipments in 2000. Volume comparisons contained in Management's Discussion and Analysis for 2001 versus 2000 have been provided on a comparable 52-week basis to provide a more meaningful comparison of operating results.

Separation Programs: In October 2001, the Company announced that it was offering a voluntary retirement program to certain salaried employees in the United States. The program is expected to terminate approximately 750 employees and will result in an estimated pre-tax charge of approximately $140 million upon final employee acceptance in the first quarter of 2002. This pre-tax charge is part of the previously discussed $200 million to $300 million in pre-tax charges related to the integration of Nabisco.

During 1999, KFNA offered voluntary retirement incentive or separation programs to certain eligible hourly and salaried employees in the United States. Employees electing to terminate employment under the terms of these programs were entitled to enhanced retirement or severance benefits. Approximately 1,100 hourly and salaried employees accepted the benefits offered by these programs and elected to retire or terminate. As a result, the Company recorded a pre-tax charge of $157 million in 1999. This charge was included in marketing, administration and research costs in the consolidated statements of earnings for the following segments: Cheese, Meals and Enhancers, $71 million; Oscar Mayer and Pizza, $38 million; Biscuits, Snacks and Confectionery, $2 million; and Beverages, Desserts and Cereals, $46 million. Payments of pension and postretirement benefits are made in accordance with the terms of the applicable benefit plans. Severance benefits, which were paid over a period of time, commenced upon dates of termination, which ranged from April 1999 to March 2000. The program and related payments were completed during 2000. Salary and related benefit costs of employees prior to their retirement or termination date were expensed as incurred.

Consolidated Operating Results

The acquisition of Nabisco and subsequent IPO were significant events that affect the comparability of earnings. In order to isolate the financial effects of these events, and to provide a more meaningful comparison of the Company's results of operations, the following tables and the subsequent discussion of the Company's consolidated operating results refer to results on a reported, underlying and pro forma basis. Reported results include the operating results of Nabisco in 2001, but not in 2000 and 1999. Reported results also reflect average shares of common stock outstanding during 2001, and reflect an average of 1.455 billion shares outstanding during 2000 and 1999. Underlying results include the operating results of Nabisco in 2001, but not in 2000 and 1999, and adjust for certain unusual items as detailed on the tables, such as results from operations divested since the beginning of 1999. Pro forma results assume the Company owned Nabisco for all of 2000. In addition, pro forma results reflect common shares outstanding of 1.735 billion based on the assumption that shares issued immediately following the IPO were outstanding during 2001 and 2000, and that, effective January 1, 2000, the net proceeds of the IPO were used to retire a portion of a long-term note payable used to finance the Nabisco acquisition. Pro forma results also adjust for certain unusual items as detailed on the tables, such as the results from operations divested since the beginning of 2000.

Consolidated Operating Results

(in millions)

Year Ended December 31,	**2001**	2000	1999
Reported volume (in pounds):			
Kraft Foods North America			
Cheese, Meals and Enhancers	**5,219**	4,820	4,874
Biscuits, Snacks and Confectionery	**2,350**	54	47
Beverages, Desserts and Cereals	**3,421**	3,117	2,883
Oscar Mayer and Pizza	**1,519**	1,507	1,433
Total Kraft Foods North America	**12,509**	9,498	9,237
Kraft Foods International			
Europe, Middle East and Africa	**2,826**	2,829	2,816
Latin America and Asia Pacific	**2,057**	803	764
Total Kraft Foods International	**4,883**	3,632	3,580
Total reported volume	**17,392**	13,130	12,817
Reported operating revenues:			
Kraft Foods North America			
Cheese, Meals and Enhancers	**$10,256**	$ 9,405	$ 9,360
Biscuits, Snacks and Confectionery	**5,917**	329	265
Beverages, Desserts and Cereals	**5,370**	5,266	5,074
Oscar Mayer and Pizza	**3,563**	3,461	3,198
Total Kraft Foods North America	**25,106**	18,461	17,897
Kraft Foods International			
Europe, Middle East and Africa	**6,339**	6,824	7,676
Latin America and Asia Pacific	**2,430**	1,247	1,224
Total Kraft Foods International	**8,769**	8,071	8,900
Total reported operating revenues	**$33,875**	$26,532	$26,797
Reported operating companies income:			
Kraft Foods North America			
Cheese, Meals and Enhancers	**$ 2,099**	$ 1,845	$ 1,658
Biscuits, Snacks and Confectionery	**966**	100	73
Beverages, Desserts and Cereals	**1,192**	1,090	1,009
Oscar Mayer and Pizza	**539**	512	450
Total Kraft Foods North America	**4,796**	3,547	3,190
Kraft Foods International			
Europe, Middle East and Africa	**861**	1,019	895
Latin America and Asia Pacific	**378**	189	168
Total Kraft Foods International	**1,239**	1,208	1,063
Total reported operating companies income	**$ 6,035**	$ 4,755	$ 4,253

The following is a reconciliation of reported operating results to underlying and pro forma operating results:

(in millions)

Year Ended December 31,	2001	2000	1999
Reported volume (in pounds)	**17,392**	13,130	12,817
Volume of businesses sold	**(18)**	(82)	(176)
Estimated impact of century date change		55	(55)
Underlying volume (in pounds)	**17,374**	13,103	12,586
Nabisco volume		3,852	
Pro forma volume (in pounds)	**17,374**	16,955	
Reported operating revenues	**$33,875**	$26,532	$26,797
Operating revenues of businesses sold	**(4)**	(162)	(373)
Estimated impact of century date change		97	(97)
Underlying operating revenues	**33,871**	26,467	$26,327
Nabisco operating revenues		7,566	
Pro forma operating revenues	**$33,871**	$34,033	
Reported operating companies income	**$ 6,035**	$ 4,755	$ 4,253
Operating companies income of businesses sold	**(1)**	(39)	(64)
Estimated impact of century date change		40	(40)
Loss on the sale of a North American food factory and integration costs	**82**		
Separation programs			157
Gain on sale of a French confectionery business		(139)	
Underlying operating companies income	**6,116**	4,617	$ 4,306
Nabisco operating companies income		999	
Pro forma operating companies income	**$ 6,116**	$ 5,616	

2001 compared with 2000

Reported volume for 2001 increased 4,262 million pounds (32.5%) over 2000, due primarily to the acquisition of Nabisco. Pro forma volume increased 2.5% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 3.7%, reflecting new product introductions and volume gains in developing markets.

Reported operating revenues for 2001 increased $7,343 million (27.7%) over 2000, due primarily to the acquisition of Nabisco. Pro forma operating revenues decreased slightly from 2000, due primarily to the 53rd week of sales in 2000, the adverse effect of currency exchange rates and lower sales prices on coffee products (driven by commodity-related price declines), partially offset by the favorable impact of volume growth.

Reported operating companies income, which is defined as operating income before general corporate expenses and amortization of goodwill and other intangible assets, was affected by the following unusual items during 2001 and 2000:

- *Sale of Food Factory and Integration Costs:* During 2001, the Company recorded pre-tax charges of $53 million for site reconfigurations and other consolidation programs in the United States. In addition, the Company recorded a pre-tax charge of $29 million related to the sale of a North American food factory. These pre-tax charges, which aggregate $82 million, were included in marketing, administration and research costs in the consolidated statement of earnings for the following segments: Cheese, Meals and Enhancers, $63 million; Biscuits, Snacks and Confectionery, $2 million; Beverages, Desserts and Cereals, $12 million; and Oscar Mayer and Pizza, $5 million.

- *Sale of French Confectionery Business:* During 2000, the Company sold a French confectionery business ("French Confectionery Sale") for proceeds of $251 million on which a pre-tax gain of $139 million was recorded. The pre-tax gain is included in the Europe, Middle East and Africa segment's marketing, administration and research costs in the consolidated statement of earnings.

The operating companies income comparison was also affected by approximately $40 million of operating income from the previously mentioned CDC sales.

Reported operating companies income increased $1,280 million (26.9%) over 2000, due primarily to the acquisition of Nabisco. On a pro forma basis, operating companies income increased $500 million (8.9%), driven by volume growth, productivity savings and Nabisco synergies, partially offset by unfavorable currency movements.

Currency movements have decreased operating revenues by $522 million and operating companies income by $60 million from 2000. Decreases in operating revenues and operating companies income are due to the strength of the U.S. dollar against the euro, Canadian dollar and certain Asian and Latin American currencies. Although the Company cannot predict future movements in currency exchange rates, the strength of the U.S. dollar, primarily against the euro and Asian currencies, if sustained during 2002, could continue to have an unfavorable impact on operating revenues and operating companies income comparisons.

Reported interest and other debt expense, net, increased $840 million in 2001. This increase was due primarily to notes issued to Philip Morris in the fourth quarter of 2000 to finance the acquisition of Nabisco. On a pro forma basis, interest and other debt expense, net, decreased $213 million in 2001 from $1,348 million in 2000. This decrease in pro forma interest expense is due to the use of free cash flow to repay debt and ongoing efforts to externally refinance debt payable to Philip Morris in the current low interest rate environment.

During 2001, the Company's reported effective tax rate increased by 4.0 percentage points to 45.4% as compared with 2000, due primarily to higher Nabisco-related goodwill amortization, which is not tax deductible.

Reported diluted and basic earnings per share ("EPS"), which were both $1.17 for 2001, decreased by 15.2% from 2000, due primarily to higher levels of goodwill amortization and interest expense associated with the acquisition of Nabisco. Reported net earnings of $1,882 million for 2001 decreased $119 million (5.9%) from 2000. On a pro forma basis, diluted and basic EPS, which were both $1.21 for 2001, increased by 19.8% over 2000, due primarily to higher operating results in all segments. Pro forma net earnings of $2,092 million for 2001 increased $347 million (19.9%) from 2000.

2000 compared with 1999

Reported volume for 2000 increased 313 million pounds (2.4%) over 1999. Reported volume in 2000 benefited from the inclusion of 53 weeks in 2000 operating results, partially offset by a decrease related to trade inventory reductions in the United States. Volume increased in every segment except Cheese, Meals and Enhancers, where a decrease in lower-margin food service products more than offset volume increases in higher margin products. On an underlying basis, volume increased 4.1%.

Reported operating revenues for 2000 decreased $265 million (1.0%) from 1999, due primarily to unfavorable currency movements ($857 million), the estimated shift in CDC revenues ($194 million) and revenues from divested businesses, partially offset by higher volume/mix ($756 million), the impact of acquisitions ($148 million) and higher pricing ($49 million). On an underlying basis, operating revenues increased 0.5%.

Reported operating companies income for 2000 increased $502 million (11.8%) over 1999, due primarily to higher volume/mix ($387 million), higher margins ($402 million, due primarily to price increases and lower commodity and manufacturing costs), 1999 separation charges ($157 million) and the gain on the French Confectionery Sale in 2000 ($139 million), partially offset by higher marketing expenses ($366 million), unfavorable currency movements ($91 million), the shift in CDC income ($80 million) and the impact of divested businesses. On an underlying basis, operating companies income increased 7.2%.

Interest and other debt expense, net, increased $58 million (10.8%), due primarily to the notes issued to Philip Morris in connection with the acquisition of Nabisco.

During 2000, the Company's reported effective tax rate decreased 0.9 percentage points to 41.4%. This decrease was due primarily to a reduction in state and local income taxes resulting from the mix of pre-tax earnings in various states.

Reported net earnings in 2000 increased $248 million (14.1%) and 2000 basic and diluted earnings per share each increased by 15.0%. On an underlying basis, net earnings of $1.9 billion increased 6.6% over $1.8 billion in 1999, and basic and diluted earnings per share each grew 7.2% from $1.25 in 1999 to $1.34 in 2000.

Operating Results by Reportable Segment

Kraft Foods North America

(in millions)

Year Ended December 31,	2001	2000	1999
Reported volume (in pounds):			
Cheese, Meals and Enhancers	**5,219**	4,820	4,874
Biscuits, Snacks and Confectionery	**2,350**	54	47
Beverages, Desserts and Cereals	**3,421**	3,117	2,883
Oscar Mayer and Pizza	**1,519**	1,507	1,433
Total reported volume (in pounds)	**12,509**	9,498	9,237
Volume of businesses sold:			
Cheese, Meals and Enhancers		(5)	(13)
Estimated impact of century date change:			
Cheese, Meals and Enhancers		16	(16)
Biscuits, Snacks and Confectionery		1	(1)
Beverages, Desserts and Cereals		19	(19)
Oscar Mayer and Pizza		5	(5)
Underlying volume (in pounds)	**12,509**	9,534	9,183
Nabisco volume:			
Cheese, Meals and Enhancers		418	
Biscuits, Snacks and Confectionery		2,260	
Beverages, Desserts and Cereals		41	
Pro forma volume (in pounds)	**12,509**	12,253	
Reported operating revenues:			
Cheese, Meals and Enhancers	**$10,256**	$ 9,405	$ 9,360
Biscuits, Snacks and Confectionery	**5,917**	329	265
Beverages, Desserts and Cereals	**5,370**	5,266	5,074
Oscar Mayer and Pizza	**3,563**	3,461	3,198
Total reported operating revenues	**25,106**	18,461	17,897
Operating revenues of businesses sold:			
Cheese, Meals and Enhancers		(10)	(25)
Estimated impact of century date change:			
Cheese, Meals and Enhancers		34	(34)
Biscuits, Snacks and Confectionery		3	(3)
Beverages, Desserts and Cereals		22	(22)
Oscar Mayer and Pizza		12	(12)
Underlying operating revenues	**25,106**	18,522	$17,801
Nabisco operating revenues:			
Cheese, Meals and Enhancers		843	
Biscuits, Snacks and Confectionery		5,429	
Beverages, Desserts and Cereals		107	
Pro forma operating revenues	**$25,106**	$24,901	

Kraft Foods North America *(continued)*

(in millions)

Year Ended December 31,	2001	2000	1999
Reported operating companies income:			
Cheese, Meals and Enhancers	**$2,099**	$1,845	$1,658
Biscuits, Snacks and Confectionery	**966**	100	73
Beverages, Desserts and Cereals	**1,192**	1,090	1,009
Oscar Mayer and Pizza	**539**	512	450
Total reported operating companies income	**4,796**	3,547	3,190
Operating companies income of businesses sold:			
Cheese, Meals and Enhancers		(4)	(8)
Estimated impact of century date change:			
Cheese, Meals and Enhancers		15	(15)
Biscuits, Snacks and Confectionery		1	(1)
Beverages, Desserts and Cereals		7	(7)
Oscar Mayer and Pizza		4	(4)
Loss on sale of a North American food factory and integration costs:			
Cheese, Meals and Enhancers	**63**		
Biscuits, Snacks and Confectionery	**2**		
Beverages, Desserts and Cereals	**12**		
Oscar Mayer and Pizza	**5**		
Separation programs:			
Cheese, Meals and Enhancers			71
Biscuits, Snacks and Confectionery			2
Beverages, Desserts and Cereals			46
Oscar Mayer and Pizza			38
Underlying operating companies income	**4,878**	3,570	$3,312
Nabisco operating companies income:			
Cheese, Meals and Enhancers		201	
Biscuits, Snacks and Confectionery		676	
Beverages, Desserts and Cereals		28	
Pro forma operating companies income	**$4,878**	$4,475	

2001 compared with 2000

KFNA's reported volume for 2001 increased 31.7% over 2000, due primarily to the acquisition of Nabisco. On a pro forma basis, volume for 2001 increased 2.1%, or 3.4% excluding the 53rd week of shipments in 2000. The increase was due primarily to higher shipments across all segments and reflects contributions from new products.

Reported operating revenues increased $6.6 billion (36.0%) over 2000, due primarily to the acquisition of Nabisco ($6.6 billion) and the shift in CDC revenues ($71 million), partially offset by unfavorable currency movements ($62 million). On a pro forma basis, operating revenues increased 0.8%, due primarily to higher revenues from the Biscuits, Snacks and Confectionery segment and the Oscar Mayer and Pizza segment, partially offset by the impact of the 53rd week in 2000.

Reported operating companies income for 2001 increased $1,249 million (35.2%) over 2000, due primarily to the acquisition of Nabisco ($1.2 billion), lower marketing, administration and research costs ($177 million) and the shift in CDC income ($27 million), partially offset by lower margins ($39 million, driven by higher dairy commodity-related costs) and the loss on the sale of a North American food factory and integration costs ($82 million). On a pro forma basis, operating companies income increased 9.0%.

The following discusses operating results within each of KFNA's reportable segments.

Cheese, Meals and Enhancers: Reported volume in 2001 increased 8.3% over 2000, due primarily to the acquisition of Nabisco. On a pro forma basis, volume in 2001 decreased 0.6% due primarily to the 53rd week of shipments in 2000. Excluding the 53rd week of shipments in 2000, volume increased 0.9%, as volume gains in meals, enhancers and Canada were partially offset by declines in cheese and food services. Meals recorded volume gains, reflecting higher shipments of macaroni & cheese dinners. Enhancers also recorded volume gains, reflecting higher shipments of spoonable and pourable dressings. In Canada, volume grew on higher shipments of branded products. In cheese, shipments decreased due primarily to the Company's decision to exit the lower-margin, non-branded cheese business. Volume also declined in process cheese loaves and cream cheese, as retailers continued to reduce trade inventory levels, partially offset by higher volume in grated and natural cheese. In U.S. food service, shipments declined due to weakness in the economy and the Company's exit from lower-margin businesses.

During 2001, reported operating revenues increased $851 million (9.0%) over 2000, due primarily to the acquisition of Nabisco ($861 million), higher pricing ($89 million, primarily related to higher dairy commodity costs) and the shift in CDC revenues ($34 million), partially offset by lower volume/mix ($65 million) and unfavorable currency movements ($62 million). On a pro forma basis, operating revenues decreased slightly from the comparable period of 2000, as unfavorable currency and lower volume/mix were partially offset by higher pricing in cheese and food service.

Reported operating companies income for 2001 increased $254 million (13.8%) over 2000, due primarily to the acquisition of Nabisco ($234 million), lower marketing, administration and research costs ($173 million, primarily lower marketing expense) and the shift in CDC income ($15 million), partially offset by unfavorable margins due to higher dairy commodity costs ($81 million) and the loss on the sale of a North American food factory and integration costs ($63 million). Marketing expense decreased due to lower price promotions on cheese products as cheese commodity costs increased. This followed a period of heavy price promotion in 2000, when low cheese commodity costs drove a period of intense price competition. On a pro forma basis, operating companies income increased 5.1%.

Biscuits, Snacks and Confectionery: Reported volume in 2001 increased more than 100% over 2000, due to the acquisition of Nabisco. On a pro forma basis, volume in 2001 increased 1.5% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 1.6%, due primarily to new product introductions in biscuits, partially offset by lower shipments of snack nuts.

During 2001, reported operating revenues increased $5.6 billion or more than 100% over 2000, due to the acquisition of Nabisco. On a pro forma basis, operating revenues increased 2.7%, due primarily to higher volume driven by new biscuit products and higher pricing of biscuit and confectionery products.

Reported operating companies income for 2001 increased $866 million, or more than 100% over 2000, due primarily to the acquisition of Nabisco ($925 million), partially offset by higher marketing, administration and research costs ($39 million). On a pro forma basis, operating companies income increased 24.6%, due primarily to higher volume from new biscuit products, lower commodity costs for snack nuts, and productivity and Nabisco synergy savings.

Beverages, Desserts and Cereals: Reported volume in 2001 increased 9.8% over 2000, due primarily to growth in beverages. On a pro forma basis, volume in 2001 increased 7.7% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 9.3%, due primarily to increased shipments of ready-to-drink beverages, benefiting from the introduction of new products. Desserts volume was below the prior year due to lower shipments of dry packaged desserts and frozen toppings. Cereal volume declined due primarily to weak category performance and increased competition in the ready-to-eat cereal category.

During 2001, reported operating revenues increased $104 million (2.0%) over 2000, due primarily to the acquisition of Nabisco ($93 million), the acquisition of Balance Bar Co. ($20 million), the shift in CDC revenues ($22 million) and higher volume/mix ($17 million), partially offset by lower pricing ($49 million, due primarily to coffee commodity-related price reductions). On a pro forma basis, operating revenues decreased 0.5%, reflecting commodity-related price reductions on coffee products and lower shipments in desserts and cereals.

Reported operating companies income for 2001 increased $102 million (9.4%) over 2000, primarily reflecting higher margins ($87 million), the acquisition of Nabisco ($32 million), lower marketing, administration and research costs ($21 million) and the shift in CDC income ($7 million), partially offset by integration costs ($12 million). On a pro forma basis, operating companies income increased 7.0%.

Oscar Mayer and Pizza: Reported volume in 2001 increased 0.8% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 2.3%, due to volume gains in processed meats and pizza. The processed meats business recorded volume gains in luncheon meats, hot dogs, bacon and soy-based meat alternatives. Volume in the pizza business increased, driven by new products.

During 2001, reported operating revenues increased $102 million (2.9%) over 2000 due primarily to higher volume/mix ($75 million), the shift in CDC revenues ($12 million) and the acquisition of Boca Burger, Inc.

Reported operating companies income for 2001 increased $27 million (5.3%) over 2000 primarily reflecting higher volume/mix ($45 million), lower marketing, administration and research costs ($22 million) and the shift in CDC income, partially offset by unfavorable margins ($36 million, due primarily to higher meat and cheese commodity costs).

2000 compared with 1999

KFNA's reported volume for 2000 increased 2.8% over 1999. On an underlying basis, volume increased 3.8%, including the benefit related to the 53rd week of shipments, partially offset by a decrease related to trade inventory reductions in 2000.

Reported operating revenues increased $564 million (3.2%) over 1999, due primarily to higher volume/mix ($465 million), the impact of acquisitions ($148 million) and higher pricing ($79 million), partially offset by the shift in CDC revenues ($142 million).

Reported operating companies income increased $357 million (11.2%) over 1999, due primarily to higher margins ($318 million, driven by higher pricing and lower commodity-related costs), the 1999 pre-tax charge for separation programs ($157 million) and higher volume/mix ($240 million), partially offset by higher marketing, administration and research costs ($310 million, the majority of which related to higher marketing expenses) and the shift in CDC income ($54 million). On an underlying basis, operating companies income increased 7.8%.

The following discusses operating results within each of KFNA's reportable segments.

Cheese, Meals and Enhancers: Reported volume in 2000 decreased 1.1% from 1999, due primarily to a decrease in the United States food service business, which more than offset an increase in retail businesses. The decrease in food service volume was due to the expiration of an exclusive distribution agreement, the loss of a contract to supply cold cuts and the pruning of low margin products. Cheese volume increased over 1999 with gains in process, natural and cream cheese products. Meals volume was lower in 2000, reflecting lower shipments of Mexican dinners and rice. Enhancers volume decreased slightly. Volume in Canada grew due to new product introductions. On an underlying basis, volume decreased 0.3%.

Reported operating revenues increased $45 million (0.5%) over 1999, due primarily to higher volume/mix ($99 million, primarily favorable product mix from the pruning of low margin products) and favorable currency movements ($30 million), partially offset by the shift in CDC revenues ($68 million) and the impact of divestitures ($15 million).

Reported operating companies income increased $187 million (11.3%) over 1999 due to higher margins ($254 million, driven by lower commodity-related and manufacturing costs), higher volume/mix ($67 million) and the 1999 separation charge ($71 million), partially offset by higher marketing, administration and research costs ($171 million, the majority of which related to higher marketing expenses) and the shift in CDC income ($30 million). Marketing expense increased as the Company increased price promotions on cheese products during 2000 in the United States during a period of intense competition that resulted from low cheese commodity costs. On an underlying basis, operating companies income increased 8.8%.

Biscuits, Snacks and Confectionery: Reported volume in 2000 increased 14.9% over 1999, reflecting the continued success of two-compartment snacks and the introduction of new intense mint and chocolate products.

Reported operating revenues increased $64 million (24.2%) over 1999, due primarily to higher volume/mix. Reported operating companies income increased $27 million (37.0%) over 1999, due primarily to higher volume/mix ($45 million) and the 1999 separation charge, partially offset by higher marketing, administration and research costs ($24 million). On an underlying basis, operating companies income increased 36.5%.

Beverages, Desserts and Cereals: Reported volume in 2000 increased 8.1% from 1999. Beverages volume grew on the strength of ready-to-drink beverages, reflecting new product introductions, and higher coffee shipments due to growth in *Starbucks* grocery coffee. Volume also grew in frozen whipped toppings, due in part to the introduction of new products. These increases were partially offset by lower volume in ready-to-eat cereals, due to aggressive competitive activity, and lower volume in dry packaged desserts, reflecting lower promotions. On an underlying basis, volume increased 9.5%, of which 0.6 percentage points related to the acquisition of Balance Bar Co.

Reported operating revenues increased $192 million (3.8%) over 1999, due primarily to higher volume/mix ($126 million) and the acquisition of Balance Bar Co. ($113 million), partially offset by the shift in CDC revenues ($44 million).

Reported operating companies income increased $81 million (8.0%) over 1999, due primarily to higher volume/mix ($50 million), the 1999 separation charges ($46 million), higher margins ($20 million, due primarily to lower commodity costs) and the acquisition of Balance Bar Co., partially offset by higher marketing, administration and research costs ($29 million, the majority of which related to higher marketing expenses), and the shift in CDC income ($14 million). On an underlying basis, operating companies income increased 4.7%.

Oscar Mayer and Pizza: Reported volume in 2000 increased 5.2% from 1999. Volume grew in pizza, reflecting the continued success of rising crust pizza and new product introductions. Volume growth also reflected the introduction of new lunch combination varieties, the acquisition of Boca Burger, Inc. and gains in hot dogs and cold cuts. On an underlying basis, volume increased 5.9%, of which approximately 0.8 percentage points related to the acquisition of Boca Burger, Inc.

Reported operating revenues increased $263 million (8.2%) over 1999, due primarily to higher volume/mix ($168 million), higher pricing ($82 million) and the acquisition of Boca Burger, Inc. ($35 million), partially offset by the shift in CDC revenues ($24 million).

Reported operating companies income increased $62 million (13.8%) over 1999, due primarily to higher volume/mix ($78 million), higher margins ($43 million) and the 1999 separation charge ($38 million), partially offset by higher marketing, administration and research costs ($86 million, the majority of which related to higher marketing expenses) and the shift in CDC income ($8 million). On an underlying basis, operating companies income increased 6.6%.

Kraft Foods International

(in millions)

Year Ended December 31,	2001	2000	1999
Reported volume (in pounds):			
Europe, Middle East and Africa	**2,826**	2,829	2,816
Latin America and Asia Pacific	**2,057**	803	764
Total reported volume (in pounds)	**4,883**	3,632	3,580
Volume of businesses sold:			
Europe, Middle East and Africa	**(1)**	(40)	(93)
Latin America and Asia Pacific	**(17)**	(37)	(70)
Estimated impact of century date change:			
Europe, Middle East and Africa		7	(7)
Latin America and Asia Pacific		7	(7)
Underlying volume (in pounds)	**4,865**	3,569	3,403
Nabisco volume:			
Europe, Middle East and Africa		44	
Latin America and Asia Pacific		1,089	
Pro forma volume (in pounds)	**4,865**	4,702	
Reported operating revenues:			
Europe, Middle East and Africa	**$6,339**	$6,824	$7,676
Latin America and Asia Pacific	**2,430**	1,247	1,224
Total reported operating revenues	**8,769**	8,071	8,900
Operating revenues of businesses sold:			
Europe, Middle East and Africa		(131)	(294)
Latin America and Asia Pacific	**(4)**	(21)	(54)
Estimated impact of century date change:			
Europe, Middle East and Africa		14	(14)
Latin America and Asia Pacific		12	(12)
Underlying operating revenues	**8,765**	7,945	$8,526
Nabisco operating revenues:			
Europe, Middle East and Africa		47	
Latin America and Asia Pacific		1,140	
Pro forma operating revenues	**$8,765**	$9,132	

Kraft Foods International *(continued)*

(in millions)

Year Ended December 31,	2001	2000	1999
Reported operating companies income:			
Europe, Middle East and Africa	**$ 861**	$1,019	$ 895
Latin America and Asia Pacific	**378**	189	168
Total reported operating companies income	**1,239**	1,208	1,063
Gain on sale of a French confectionery business:			
Europe, Middle East and Africa		(139)	
Operating companies income of businesses sold:			
Europe, Middle East and Africa		(32)	(52)
Latin America and Asia Pacific	**(1)**	(3)	(4)
Estimated impact of century date change:			
Europe, Middle East and Africa		8	(8)
Latin America and Asia Pacific		5	(5)
Underlying operating companies income	**1,238**	1,047	$ 994
Nabisco operating companies income:			
Europe, Middle East and Africa		1	
Latin America and Asia Pacific		93	
Pro forma operating companies income	**$1,238**	$1,141	

2001 compared with 2000

KFI's reported volume for 2001 increased 34.4% over 2000, due primarily to the acquisition of Nabisco. On a pro forma basis, volume for 2001 increased 3.5% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 4.7%, benefiting from gains across most consumer sectors and driven by continued growth in the developing markets of Central and Eastern Europe, Latin America and Asia Pacific.

During 2001, reported operating revenues increased $698 million (8.6%) over 2000, due primarily to the acquisition of Nabisco ($1.2 billion) and the shift in CDC revenues ($26 million), partially offset by unfavorable currency movements ($460 million) and the revenues of divested businesses ($148 million). On a pro forma basis, operating revenues decreased 4.0%, primarily reflecting unfavorable currency movements.

Reported operating companies income for 2001 increased $31 million (2.6%) over 2000, due primarily to the acquisition of Nabisco ($128 million), lower marketing, administration and research costs ($119 million) and the shift in CDC income ($13 million), partially offset by the gain on the French Confectionery Sale in 2000 ($139 million), unfavorable currency movements ($51 million) and income of divested businesses ($34 million). On a pro forma basis, which does not include the French Confectionery Sale in 2000, operating companies income increased 8.5%.

The following discusses operating results within each of KFI's reportable segments.

Europe, Middle East and Africa: Reported and pro forma volume for 2001 decreased slightly from 2000, due primarily to the 53rd week of shipments in 2000. Excluding the 53rd week of shipments in 2000, volume increased 1.3%, due primarily to volume gains in the developing markets of Central and Eastern Europe and growth in many Western European markets, partially offset by lower volume in Germany, reflecting increased price competition and trade inventory reductions, and lower canned meats volume in Italy. In beverages, volume increased in both coffee and refreshment beverages. Coffee volume grew in many markets, driven by new product introductions and recent acquisitions in Romania, Morocco and Bulgaria. In Germany, coffee volume increased despite trade inventory reductions. Refreshment beverages volume increased, driven by higher sales to the Middle East. Snacks volume increased, driven by confectionery and salty snacks, particularly in Central and Eastern Europe. Snacks volume in Germany was lower due to increased price competition and trade inventory reductions. Cheese volume increased due primarily to *Philadelphia* cream cheese growth across the region, partially offset by lower volume in Germany. In convenient meals and grocery, volume declined as lower canned meats volume in Italy and a decline in grocery volume in Germany were partially offset by higher shipments of lunch combinations and pourable dressings in the United Kingdom.

Reported operating revenues for 2001 decreased $485 million (7.1%) from 2000, due primarily to unfavorable currency movements ($251 million), revenues from divested businesses ($131 million), lower pricing ($123 million, primarily commodity-driven coffee price decreases) and lower volume/mix ($69 million), partially offset by the acquisition of Nabisco ($46 million), the 2001 acquisitions of coffee businesses in Romania, Morocco and Bulgaria ($29 million) and the shift in CDC revenues ($14 million). On a pro forma basis, operating revenues decreased 6.1%, reflecting unfavorable currency movements and commodity-related coffee price decreases.

Reported operating companies income for 2001 decreased $158 million (15.5%) from 2000, due primarily to the gain on the French Confectionery Sale in 2000 ($139 million), unfavorable currency movements ($19 million), income from divested businesses ($32 million), lower volume/mix ($12 million) and unfavorable margins ($16 million), partially offset by lower marketing, administration and research costs ($50 million) and the shift in CDC income. On a pro forma basis, operating companies income increased 0.5%.

Latin America and Asia Pacific: Reported volume for 2001 increased more than 100% from 2000, due primarily to the acquisition of Nabisco. On a pro forma basis, volume for 2001 increased 9.6% over 2000. Excluding the 53rd week of shipments in 2000, volume increased 9.9%, due to gains across most consumer sectors. Beverages volume increased, due primarily to growth in refreshment beverages in Latin America and Asia Pacific, and coffee in Asia Pacific. Cheese volume increased due primarily to cream cheese and process cheese. Grocery volume was higher, due primarily to new product introductions. Snacks volume increased, driven primarily by new biscuit product introductions and geographic expansion, partially offset by lower volume in Argentina, due to economic weakness. Continued erosion of the economic climate in Argentina may negatively affect volume and income growth in the Latin America and Asia Pacific segment during 2002.

During 2001, reported operating revenues increased $1,183 million (94.9%) over 2000, due primarily to the acquisition of Nabisco, partially offset by unfavorable currency movements. On a pro forma basis, operating revenues increased 2.0%.

Reported operating companies income for 2001 increased $189 million (100.0%) over 2000, due primarily to the acquisition of Nabisco ($128 million), lower marketing, administration and research costs ($69 million), higher margins ($14 million) and the shift in CDC income, partially offset by unfavorable currency movements ($32 million). On a pro forma basis, operating companies income increased 32.7%, due primarily to productivity savings and Nabisco synergies.

2000 compared with 1999

KFI's reported volume for 2000 increased 1.5% over 1999, due primarily to volume increases in both the Europe, Middle East & Africa and Latin America & Asia Pacific segments. On an underlying basis, volume increased 4.9%, including the impact of the 53rd week of shipments in 2000.

Reported operating revenues for 2000 decreased $829 million (9.3%) from 1999, due primarily to unfavorable currency movements ($887 million), the shift in CDC revenues ($52 million), lower pricing ($30 million, due primarily to commodity-driven coffee price decreases) and the impact of divestitures ($196 million), partially offset by higher volume/mix ($291 million). On an underlying basis, operating revenues decreased 6.8%.

Reported operating companies income for 2000 increased by $145 million (13.6%) to $1.2 billion, due primarily to higher volume/mix ($147 million), the gain on the French Confectionery Sale ($139 million) and higher margins ($84 million, primarily relating to lower commodity costs), partially offset by unfavorable currency movements ($96 million), higher marketing, administration and research costs ($78 million), the shift in CDC income ($26 million) and the impact of divested businesses. On an underlying basis, operating companies income increased 5.3%.

The following discusses operating results within each of KFI's reportable segments.

Europe, Middle East and Africa: Reported volume for 2000 increased 0.5% over 1999, while underlying volume increased 2.9% over 1999, with growth in all product categories. In beverages, coffee volume benefited from growth in the developing markets of Central and Eastern Europe and in the established markets of Sweden, Austria, Italy and the United Kingdom. Volume in refreshment beverages grew in Central and Eastern Europe, driven by the expansion of powdered soft drinks. Volume growth in snacks reflected double-digit gains in salty snacks on expansion into Central and Eastern Europe, as well as new confectionery product launches and line extensions. Cheese volume grew on the strength of *Philadelphia* cream cheese, reflecting successful marketing programs across Europe and a re-launch in the Middle East. Volume also grew for process cheese in Italy and Spain. In convenient meals, volume grew on the successful launch of new lunch combination varieties in the United Kingdom and line extensions of packaged dinners in Germany and Belgium. Volume grew in grocery, reflecting gains in spoonable dressings, benefiting from effective marketing programs in Italy and new product launches in Spain.

Reported operating revenues decreased $852 million (11.1%) from 1999, due primarily to unfavorable currency movements ($830 million), lower pricing ($60 million, due primarily to commodity-driven coffee price decreases), the shift in CDC revenues ($28 million) and the impact of divestitures ($163 million), partially offset by higher volume/mix ($186 million). On an underlying basis, operating revenues decreased 9.0%.

Reported operating companies income increased $124 million (13.9%) over 1999, due primarily to the gain on the French Confectionery Sale ($139 million), higher volume/mix ($104 million) and higher margins ($70 million, due primarily to lower coffee commodity costs), partially offset by unfavorable currency movements ($97 million), higher marketing, administration and research costs ($58 million), the shift in CDC income ($16 million) and the impact of divestitures ($20 million). On an underlying basis, operating companies income increased 2.5%.

Latin America and Asia Pacific: Reported volume for 2000 increased 5.1% over 1999. On an underlying basis, volume in 2000 increased 12.5% over 1999, led by strong growth in Brazil, Australia, China, the Philippines, Indonesia, Japan and Korea and higher exports to the Caribbean. Beverages volume grew due to increased coffee volume in the Caribbean and China. Refreshment beverages volume increased, benefiting from new flavors in Brazil, marketing programs in China and the Philippines, and expansion into Thailand. Snacks volume gains were driven by confectionery volume growth in Asia Pacific, reflecting new product launches in Indonesia, China and the Philippines. In Latin America, volume benefited from the launch of new chocolate products in Brazil. Cheese volume grew, driven by marketing and promotion of *Philadelphia* cream cheese in Australia and Japan, as well as gains in process cheese in the Philippines and Indonesia. Convenient meals volume grew, led by exports of macaroni & cheese dinners to Asian markets. Grocery volume grew on higher shipments of yeast spread in Australia and increased shipments of gelatins and cereals to Asia.

Reported operating revenues increased $23 million (1.9%) over 1999, due primarily to higher volume/mix ($105 million) and higher pricing ($30 million), partially offset by unfavorable currency movements ($57 million), the shift in CDC revenues ($24 million) and the impact of divestitures ($33 million). On an underlying basis, operating revenues increased 6.9%.

Reported operating companies income increased $21 million (12.5%) over 1999, due primarily to higher volume/mix ($43 million) and higher pricing ($14 million), partially offset by higher marketing, administration and research costs ($20 million) and the shift in CDC income ($10 million). On an underlying basis, operating companies income increased 20.1%.

Financial Review

Net Cash Provided by Operating Activities

Net cash provided by operating activities was $3.3 billion in 2001 and 2000, while $2.7 billion was provided by operating activities in 1999. The increase in 2000 operating cash flows over 1999 primarily reflected increased net earnings of $248 million and reduced levels of receivables and inventories of $318 million, which included the shift in working capital attributable to the CDC.

Net Cash Used in Investing Activities

During 2001, 2000 and 1999, net cash used in investing activities was $1.2 billion, $16.1 billion and $669 million, respectively. The increase in 2000 primarily reflects the cash used for the acquisition of Nabisco.

Capital expenditures, which were funded by operating activities, were $1.1 billion, $906 million and $860 million in 2001, 2000 and 1999, respectively. The capital expenditures were primarily to modernize the manufacturing facilities, lower cost of production and expand production capacity for growing product lines. The additional expenditures in 2001 were due primarily to the acquisition of Nabisco. Capital expenditures are expected to be approximately $1.2 billion in 2002 and are expected to be funded from operations.

During 2001, the Company purchased coffee businesses in Romania, Morocco and Bulgaria and also acquired confectionery businesses in Russia and Poland. The total cost of these and other smaller acquisitions was $194 million.

During 2000, the Company purchased Boca Burger, Inc. and Balance Bar Co. The total cost of these and other smaller acquisitions was $365 million.

Net Cash Used in Financing Activities

During 2001, net cash of $2.1 billion was used in financing activities, compared with $13.0 billion provided by financing activities during 2000. During 2001, financing activities included net debt repayments of $2.0 billion, excluding debt repayments made with IPO proceeds. The net proceeds from the IPO were used to repay debt to Philip Morris and, as a result, had no impact on financing cash flows. In 2000, the Company's financing activities provided cash, as additional borrowings to finance the acquisition of Nabisco exceeded the cash used to pay dividends. During 1999, net cash of $2.0 billion was used in financing activities.

Debt and Liquidity

The SEC recently issued Financial Reporting Release No. 61, which sets forth the views of the SEC regarding enhanced disclosures relating to liquidity and capital resources. The information provided below about the Company's debt, credit facilities, guarantees and future commitments is included here to facilitate a review of the Company's liquidity.

Debt: The Company's total debt, including intercompany accounts payable to Philip Morris, was $16.0 billion at December 31, 2001, and $25.8 billion at December 31, 2000. The decrease was due primarily to the repayment of $8.4 billion of long-term notes payable to Philip Morris with the net proceeds from the IPO.

During 2001, the Company refinanced $2.6 billion, representing the remaining portion of an $11.0 billion long-term note payable to Philip Morris, with the proceeds from short-term borrowings. In addition, the Company refinanced long-term, fixed-rate Swiss franc notes payable to Philip Morris with short-term Swiss franc borrowings from Philip Morris at variable interest rates.

During 2001, in anticipation of a public bond offering, the Company converted its $4.0 billion, 7.40% note payable to Philip Morris, originally maturing in December 2002, into a 3.56125% note payable to Philip Morris maturing in November 2001. On November 2, 2001, the Company completed a $4.0 billion public global bond offering at a weighted average interest rate of 5.48%, the net proceeds of which were used to repay the 3.56125% short-term note payable to Philip Morris.

As discussed in Notes 3, 7 and 8 to the consolidated financial statements, the Company's total debt of $16.0 billion at December 31, 2001 is due to be repaid as follows: in 2002, $4.9 billion; in 2003-2004, $0.5 billion; in 2005-2006, $2.0 billion; and thereafter, $8.6 billion. Debt obligations due to be repaid in 2002 will be satisfied with a combination of short-term borrowings, refinancing transactions in the debt markets and operating cash flows. The Company's debt-to-equity ratio was 0.68 at December 31, 2001 and 1.84 at December 31, 2000.

Credit Ratings: The Company's credit ratings by Moody's at December 31, 2001 were "P-1" in the commercial paper market and "A2" for long-term debt obligations. The Company's credit ratings by Standard & Poor's at December 31, 2001 were "A-1" in the commercial paper market, and "A-" for long-term debt obligations. The Company's credit ratings by Fitch Rating Services at December 31, 2001 were "F-1" in the commercial paper market and "A" for long-term debt obligations. Changes in the Company's credit ratings, although none are currently anticipated, could result in corresponding changes in the Company's borrowing costs. However, none of the Company's debt agreements require accelerated repayment in the event of a decrease in credit ratings.

Credit Facilities: In July 2001, reflecting the Company's reduced requirements for credit facilities following the IPO, Philip Morris terminated an existing $9.0 billion 364-day revolving credit agreement that could have been transferred to the Company. Upon termination of this facility, the Company entered into agreements for a $2.0 billion 5-year revolving credit facility expiring in July 2006 and a $4.0 billion 364-day revolving credit facility expiring in July 2002. Including these revolving credit facilities, the Company's total credit facilities were $6.8 billion at December 31, 2001, of which approximately $6.5 billion were undrawn at December 31, 2001. Certain of these credit facilities are used to support commercial paper borrowings, the proceeds of which will be used for general corporate purposes. A portion of the facilities is used to meet the short-term working capital needs of the Company's international businesses. Certain of the credit facilities require the maintenance of a minimum net worth, as defined, of $18.2 billion, which the Company exceeded at December 31, 2001. The Company does not currently anticipate any difficulty in continuing to exceed this covenant requirement. The foregoing revolving credit facilities do not include any other covenants that could require an acceleration of maturity or the posting of collateral. The five-year revolving credit facility enables the Company to reclassify short-term debt on a long-term basis. At December 31, 2001, $2.0 billion of commercial paper borrowings that the Company intends to refinance were reclassified as long-term debt. The Company expects to continue to refinance long-term and short-term debt from time to time. The nature and amount of the Company's long-term and short-term debt and the proportionate amount of each can be expected to vary as a result of future business requirements, market conditions and other factors.

Guarantees and Commitments: At December 31, 2001, the Company was contingently liable for guarantees and commitments of $41 million. These include surety bonds related to dairy commodity purchases and guarantees related to letters of credit. Guarantees do not have, and are not expected to have, a significant impact on the Company's liquidity. The Company's consolidated rent expense for 2001 was $372 million. Accordingly, the Company does not consider its lease commitments to be a significant determinant of the Company's liquidity.

The Company believes that its cash from operations, existing credit facilities and access to global capital markets will provide sufficient liquidity to meet its working capital needs, planned capital expenditures and payment of its anticipated quarterly dividends.

Dividends

Dividends paid in 2001 and 2000 were $225 million and $1.0 billion, respectively. The dividends paid in 2000 reflect dividends to Philip Morris. During 2001, the Company declared two regular quarterly dividends of $0.13 per share on its Class A and Class B common stock. The present annualized dividend rate is $0.52 per common share. The declaration of dividends is subject to the discretion of the Company's board of directors and will depend on various factors, including the Company's net earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by the Company's board of directors.

Market Risk

The Company operates internationally, with manufacturing and sales facilities in various locations around the world, and utilizes certain financial instruments to manage its foreign currency and commodity exposures, which primarily relate to forecasted transactions and interest rate exposures. Derivative financial instruments are used by the Company, principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates, commodity prices and interest rates by creating offsetting exposures. The Company is not a party to leveraged derivatives. For a derivative to qualify as a hedge at inception and throughout the hedged period, the Company formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of a forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. The Company does not use derivative financial instruments for speculative purposes.

Substantially all of the Company's derivative financial instruments are effective as hedges under the new accounting standard. Accordingly, the Company recorded deferred losses of $18 million in accumulated other comprehensive losses. This reflects the initial adoption of the accounting pronouncement and a decrease in the fair value of derivatives during the year of $33 million, partially offset by deferred losses transferred to earnings of $15 million. The fair value of all derivative financial instruments has been calculated based on active market quotes.

Foreign Exchange Rates: The Company uses forward foreign exchange contracts and foreign currency options to mitigate its exposure to changes in foreign currency exchange rates from third-party and intercompany forecasted transactions. The primary currencies to which the Company is exposed include the euro and Canadian dollar. At December 31, 2001 and 2000, the Company had option and forward foreign exchange contracts with aggregate notional amounts of $431 million and $237 million, respectively, for the purchase or sale of foreign currencies.

Commodities: The Company is exposed to price risk related to forecasted purchases of certain commodities used as raw materials by the Company's businesses. Accordingly, the Company uses commodity forward contracts, as cash flow hedges, primarily for coffee, cocoa, milk, cheese and wheat. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar and soybean. At December 31, 2001 and 2000, the Company had net long commodity positions of $589 million and $617 million, respectively.

Interest Rates: The Company uses interest rate swaps to hedge the fair value of an insignificant portion of its long-term debt. The differential to be paid or received is accrued and recognized as interest expense. If an interest rate swap agreement is terminated prior to maturity, the realized gain or loss is recognized over the remaining life of the agreement if the hedged amount remains outstanding, or immediately if the underlying hedged exposure does not remain outstanding. If the underlying exposure is terminated prior to the maturity of the interest rate swap, the unrealized gain or loss on the related interest rate swap is recognized in earnings currently. At December 31, 2001, the aggregate notional principal amount of those agreements, which converted fixed-rate debt to variable-rate debt, was $102 million. Aggregate maturities at December 31, 2001 were $29 million in 2003 and $73 million in 2004. During the year ended December 31, 2001, there was no ineffectiveness relating to these fair value hedges.

Value at Risk: The Company uses a value at risk ("VAR") computation to estimate the potential one-day loss in the fair value of its interest rate-sensitive financial instruments and to estimate the potential one-day loss in pre-tax earnings of its foreign currency and commodity price-sensitive derivative financial instruments. The VAR computation includes the Company's debt; short-term investments; foreign currency forwards, swaps and options; and commodity futures, forwards and options. Anticipated transactions, foreign currency trade payables and receivables, and net investments in foreign subsidiaries, which the foregoing instruments are intended to hedge, were excluded from the computation.

The VAR estimates were made assuming normal market conditions, using a 95% confidence interval. The Company used a "variance/co-variance" model to determine the observed interrelationships between movements in interest rates and various currencies. These interrelationships were determined by observing interest rate and forward currency rate movements over the preceding quarter for the calculation of VAR amounts at December 31, 2001 and 2000, and over each of the four preceding quarters for the calculation of average VAR amounts during each year. The values of foreign currency and commodity options do not change on a one-to-one basis with the underlying currency or commodity, and were valued accordingly in the VAR computation.

The estimated potential one-day loss in fair value of the Company's interest rate-sensitive instruments, primarily debt, under normal market conditions and the estimated potential one-day loss in pre-tax earnings from foreign currency and commodity instruments under normal market conditions, as calculated in the VAR model, were as follows:

	Pre-Tax Earnings Impact			
(in millions)	At 12/31/01	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	**$ 2**	**$ 6**	**$ 13**	**$ 2**
Commodity prices	**5**	**7**	**11**	**5**

	Fair Value Impact			
(in millions)	At 12/31/01	Average	High	Low
Instruments sensitive to:				
Interest rates	**$122**	**$79**	**$122**	**$56**

	Pre-Tax Earnings Impact			
(in millions)	At 12/31/00	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	$ 20	$20	$ 24	$15
Commodity prices	9	8	9	7

	Fair Value Impact			
(in millions)	At 12/31/00	Average	High	Low
Instruments sensitive to:				
Interest rates	$166	$83	$166	$39

This VAR computation is a risk analysis tool designed to statistically estimate the maximum probable daily loss from adverse movements in interest rates, foreign currency rates and commodity prices under normal market conditions. The computation does not purport to represent actual losses in fair value or earnings to be incurred by the Company, nor does it consider the effect of favorable changes in market rates. The Company cannot predict actual future movements in such market rates and does not present these VAR results to be indicative of future movements in such market rates or to be representative of any actual impact that future changes in market rates may have on its future results of operations or financial position.

New Accounting Standards

Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," and its related amendment, SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (collectively referred to as "SFAS No. 133"). These standards require that all derivative financial instruments be recorded on the consolidated balance sheets at their fair value as either assets or liabilities. Changes in the fair value of derivatives are recorded each period in earnings or accumulated other comprehensive losses, depending on whether a derivative is designated and effective as part of a hedge transaction and, if it is, the type of hedge transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive losses are included in earnings in the periods in which earnings are affected by the hedged item. As of January 1, 2001, the adoption of these new standards did not have a material effect on net earnings (less than $1 million) or accumulated other comprehensive losses (less than $1 million).

The Emerging Issues Task Force ("EITF") issued EITF Issue No. 00-14, "Accounting for Certain Sales Incentives" and EITF Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." As a result, certain items previously included in marketing, administration and research costs on the consolidated statement of earnings will either be recorded as a reduction of operating revenues or as an increase in cost of sales. These EITF Issues will be effective in the first quarter of 2002. The Company estimates that adoption of EITF Issues No. 00-14 and No. 00-25 will result in a reduction of operating revenues in 2001, 2000 and 1999 of approximately $4.6 billion, $3.6 billion and $3.4 billion, respectively. Marketing, administration and research costs will decline in 2001, 2000 and 1999 by approximately $4.7 billion, $3.7 billion and $3.4 billion, respectively, while cost of sales will increase by an insignificant amount. The adoption of these EITF Issues will have no impact on net earnings or basic and diluted EPS.

During 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." Effective January 1, 2002, the Company will no longer be required to amortize indefinite life goodwill and intangible assets as a charge to earnings. In addition, the Company will be required to conduct an annual review of goodwill and other intangible assets for potential impairment. The Company estimates that net earnings and diluted earnings per share would have been approximately $2,839 million and $1.76, respectively, for the year ended December 31, 2001; $2,531 million and $1.74, respectively, for the year ended December 31, 2000; and $2,287 million and $1.57, respectively, for the year ended December 31, 1999, had the provisions of the new standards been applied in those years. The Company does not currently anticipate having to record a charge to earnings for the potential impairment of goodwill or other intangible assets as a result of adoption of these new standards.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of." SFAS No. 144 provides updated guidance concerning the recognition and measurement of an impairment loss for certain types of long-lived assets, expands the scope of a discontinued operation to include a component of an entity and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. SFAS No. 144 is effective for the Company on January 1, 2002. The Company does not expect the adoption of SFAS No. 144 to have a material impact on the Company's 2002 financial statements.

Contingencies

See Note 17 to the consolidated financial statements for a discussion of contingencies.

Forward-Looking and Cautionary Statements

The Company and its representatives may from time to time make written or oral forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to shareholders. One can identify these forward-looking statements by use of words such as "strategy," "expects," "plans," "believes," "will," "estimates," "intends," "projects," "goals," "targets" and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company is hereby identifying important factors that could cause actual results and outcomes to differ materially from those contained in any forward-looking statement made by or on behalf of the Company; any such statement is qualified by reference to the following cautionary statements.

Each of the Company's segments is subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic conditions. Their results are dependent upon their continued ability to promote brand equity successfully, to anticipate and respond to new consumer trends, to develop new products and markets and to broaden brand portfolios, in order to compete effectively with lower priced products in a consolidating environment at the retail and manufacturing levels, and to improve productivity. The Company's results are also dependent on its ability to successfully integrate and derive cost savings from the integration of Nabisco's operations with the Company. In addition, the Company is subject to the effects of foreign economies, currency movements and fluctuations in levels of customer inventories. The food industry continues to be subject to the possibility that consumers could lose confidence in the safety and quality of certain food products. Developments in any of these areas, which are more fully described above and which descriptions are incorporated into this section by reference, could cause the Company's results to differ materially from results that have been or may be projected by or on behalf of the Company. The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

Selected Financial Data—Five-Year Review

(in millions of dollars, except per share data)

	2001	2000	1999	1998	1997
Summary of Operations:					
Operating revenues	**$33,875**	$26,532	$26,797	$27,311	$27,690
Cost of sales	**17,531**	13,917	14,573	15,544	15,978
Operating income	**4,884**	4,012	3,579	3,535	3,559
Interest and other debt expense, net	**1,437**	597	539	536	476
Earnings before income taxes	**3,447**	3,415	3,040	2,999	3,083
Pre-tax profit margin	**10.2%**	12.9%	11.3%	11.0%	11.1%
Provision for income taxes	**1,565**	1,414	1,287	1,367	1,291
Net earnings	**1,882**	2,001	1,753	1,632	1,792
Basic EPS	**1.17**	1.38	1.20	1.12	1.23
Diluted EPS	**1.17**	1.38	1.20	1.12	1.23
Dividends declared per share	**0.26**	—	—	—	—
Weighted average shares (millions) — Basic	**1,610**	1,455	1,455	1,455	1,455
Weighted average shares (millions) — Diluted	**1,610**	1,455	1,455	1,455	1,455
Capital expenditures	**1,101**	906	860	841	737
Depreciation	**680**	499	491	494	512
Property, plant and equipment, net	**9,109**	9,405	6,526	6,494	6,198
Inventories	**3,026**	3,041	2,563	2,570	2,643
Total assets	**55,798**	52,071	30,336	31,391	31,257
Total long-term debt	**8,134**	2,695	433	483	531
Notes payable to parent and affiliates	**5,000**	21,407	6,602	6,234	5,000
Total debt	**16,007**	25,826	7,828	7,168	6,393
Total deferred income taxes	**4,565**	942	789	707	340
Shareholders' equity	**23,478**	14,048	13,461	15,134	15,761
Common dividends declared as a % of Basic EPS	**22.2%**	—	—	—	—
Common dividends declared as a % of Diluted EPS	**22.2%**	—	—	—	—
Book value per common share outstanding	**13.53**	9.65	9.25	10.40	10.83
Market price per Class A common share — high/low	**35.57-29.50**	—	—	—	—
Closing price of Class A common share at year end	**34.03**	—	—	—	—
Price/earnings ratio at year end — Basic	**29**	—	—	—	—
Price/earnings ratio at year end — Diluted	**29**	—	—	—	—
Number of common shares outstanding at year end (millions)	**1,735**	1,455	1,455	1,455	1,455
Number of employees	**114,000**	117,000	71,000	78,000	82,000

Consolidated Balance Sheets

(in millions of dollars)

At December 31,	2001	2000
Assets		
Cash and cash equivalents	$ 162	$ 191
Receivables (less allowances of $151 and $152)	3,131	3,231
Inventories:		
Raw materials	1,281	1,175
Finished product	1,745	1,866
	3,026	3,041
Deferred income taxes	466	504
Other current assets	221	185
Total current assets	7,006	7,152
Property, plant and equipment, at cost:		
Land and land improvements	387	419
Buildings and building equipment	2,915	2,949
Machinery and equipment	9,264	8,858
Construction in progress	706	816
	13,272	13,042
Less accumulated depreciation	4,163	3,637
	9,109	9,405
Goodwill and other intangible assets (less accumulated amortization of $7,099 and $6,100)	35,957	31,584
Prepaid pension assets	2,675	2,623
Other assets	1,051	1,307
Total Assets	$55,798	$52,071
Liabilities		
Short-term borrowings	$ 681	$ 146
Current portion of long-term debt	540	713
Due to parent and affiliates	1,652	865
Accounts payable	1,897	1,971
Accrued liabilities:		
Marketing	1,398	1,601
Employment costs	658	625
Other	1,821	1,411
Income taxes	228	258
Total current liabilities	8,875	7,590
Long-term debt	8,134	2,695
Deferred income taxes	5,031	1,446
Accrued postretirement health care costs	1,850	1,867
Notes payable to parent and affiliates	5,000	21,407
Other liabilities	3,430	3,018
Total liabilities	32,320	38,023
Contingencies (Note 17)		
Shareholders' Equity		
Class A common stock, no par value (555,000,000 and 275,000,000 shares issued and outstanding in 2001 and 2000)		
Class B common stock, no par value (1,180,000,000 shares issued and outstanding)		
Additional paid-in capital	23,655	15,230
Earnings reinvested in the business	2,391	992
Accumulated other comprehensive losses (primarily currency translation adjustments)	(2,568)	(2,174)
Total shareholders' equity	23,478	14,048
Total Liabilities and Shareholders' Equity	$55,798	$52,071

See notes to consolidated financial statements.

Consolidated Statements of Earnings

(in millions of dollars, except per share data)

For the years ended December 31,	**2001**	2000	1999
Operating revenues	**$33,875**	$26,532	$26,797
Cost of sales	**17,531**	13,917	14,573
Gross profit	**16,344**	12,615	12,224
Marketing, administration and research costs	**10,498**	8,068	8,106
Amortization of goodwill and other intangible assets	**962**	535	539
Operating income	**4,884**	4,012	3,579
Interest and other debt expense, net	**1,437**	597	539
Earnings before income taxes	**3,447**	3,415	3,040
Provision for income taxes	**1,565**	1,414	1,287
Net earnings	**$ 1,882**	$ 2,001	$ 1,753
Per share data:			
Basic earnings per share	**$ 1.17**	$ 1.38	$ 1.20
Diluted earnings per share	**$ 1.17**	$ 1.38	$ 1.20

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in millions of dollars)

For the years ended December 31,	**2001**	2000	1999
Cash Provided By (Used In) Operating Activities			
Net earnings	**$ 1,882**	$ 2,001	$ 1,753
Adjustments to reconcile net earnings to operating cash flows:			
Depreciation and amortization	**1,642**	1,034	1,030
Deferred income tax provision	**414**	245	151
Gains on sales of businesses	**(8)**	(172)	(62)
Loss on sale of a North American food factory and integration costs	**82**		
Cash effects of changes, net of the effects from acquired and divested companies:			
Receivables, net	**23**	204	156
Inventories	**(107)**	175	(95)
Accounts payable	**(73)**	13	(18)
Income taxes	**74**	35	127
Other working capital items	**(407)**	(195)	(137)
Increase in pension assets and postretirement liabilities, net	**(245)**	(215)	(205)
Increase (decrease) in amount due to parent and affiliates	**138**	104	(21)
Other	**(87)**	25	14
Net cash provided by operating activities	**3,328**	3,254	2,693
Cash Provided By (Used In) Investing Activities			
Capital expenditures	**(1,101)**	(906)	(860)
Purchase of Nabisco, net of acquired cash		(15,159)	
Purchases of other businesses, net of acquired cash	**(194)**	(365)	(14)
Proceeds from sales of businesses	**21**	300	175
Other	**52**	(8)	30
Net cash used in investing activities	**(1,222)**	(16,138)	(669)
Cash Provided By (Used In) Financing Activities			
Net issuance (repayment) of short-term borrowings	**2,505**	(816)	(22)
Long-term debt proceeds	**4,077**	87	78
Long-term debt repaid	**(705)**	(112)	(111)
Net proceeds from sale of Class A common stock	**8,425**		
Proceeds from issuance of notes payable to parent and affiliates		15,000	768
Repayment of notes payable to parent and affiliates	**(16,350)**	(124)	(178)
Increase in amounts due to parent and affiliates	**142**	143	450
Dividends paid	**(225)**	(1,009)	(3,016)
Other		(187)	
Net cash (used in) provided by financing activities	**(2,131)**	12,982	(2,031)
Effect of exchange rate changes on cash and cash equivalents	**(4)**	(2)	(10)
Cash and cash equivalents:			
(Decrease) increase	**(29)**	96	(17)
Balance at beginning of year	**191**	95	112
Balance at end of year	**$ 162**	$ 191	$ 95
Cash paid:			
Interest	**$ 1,433**	$ 605	$ 533
Income taxes	**$ 1,058**	$ 1,051	$ 1,022

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(in millions of dollars, except per share data)

	Class A and B Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Losses: Currency Translation Adjustments	Accumulated Other Comprehensive Losses: Other	Accumulated Other Comprehensive Losses: Total	Total Shareholders' Equity
Balances, January 1, 1999	$—	$16,493	$ —	$(1,349)	$ (10)	$(1,359)	$15,134
Comprehensive earnings:							
Net earnings			1,753				1,753
Other comprehensive losses, net of income taxes:							
Currency translation adjustments				(392)		(392)	(392)
Additional minimum pension liability					(18)	(18)	(18)
Total other comprehensive losses							(410)
Total comprehensive earnings							1,343
Dividends declared		(1,263)	(1,753)				(3,016)
Balances, December 31, 1999	—	15,230	—	(1,741)	(28)	(1,769)	13,461
Comprehensive earnings:							
Net earnings			2,001				2,001
Other comprehensive losses, net of income taxes:							
Currency translation adjustments				(397)		(397)	(397)
Additional minimum pension liability					(8)	(8)	(8)
Total other comprehensive losses							(405)
Total comprehensive earnings							1,596
Dividends declared			(1,009)				(1,009)
Balances, December 31, 2000	—	15,230	992	(2,138)	(36)	(2,174)	14,048
Comprehensive earnings:							
Net earnings			**1,882**				**1,882**
Other comprehensive losses, net of income taxes:							
Currency translation adjustments				**(298)**		**(298)**	**(298)**
Additional minimum pension liability					**(78)**	**(78)**	**(78)**
Change in fair value of derivatives accounted for as hedges					**(18)**	**(18)**	**(18)**
Total other comprehensive losses							**(394)**
Total comprehensive earnings							**1,488**
Sale of Class A common stock to public		**8,425**					**8,425**
Dividends declared ($0.26 per share)			**(483)**				**(483)**
Balances, December 31, 2001	**$—**	**$23,655**	**$2,391**	**$(2,436)**	**$(132)**	**$(2,568)**	**$23,478**

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1. Background and Basis of Presentation:

Background: Kraft Foods Inc. ("Kraft") was incorporated in 2000 in the Commonwealth of Virginia. Following Kraft's formation, Philip Morris Companies Inc. ("Philip Morris") transferred to Kraft its ownership interest in Kraft Foods North America, Inc., a Delaware corporation, through a capital contribution. In addition, during 2000, Philip Morris transferred management responsibility for its food businesses in Latin America to Kraft Foods North America, Inc. and its wholly-owned subsidiary, Kraft Foods International, Inc. Kraft, together with its subsidiaries (collectively referred to as the "Company"), is engaged in the manufacture and sale of retail packaged foods in the United States, Canada, Europe, Latin America and Asia Pacific.

On December 11, 2000, the Company acquired all of the outstanding shares of Nabisco Holdings Corp. ("Nabisco") for $55 per share in cash. See Note 5, Acquisitions, for a complete discussion of this transaction.

Prior to June 13, 2001, the Company was a wholly-owned subsidiary of Philip Morris. On June 13, 2001, the Company completed an initial public offering ("IPO") of 280,000,000 shares of its Class A common stock at a price of $31.00 per share. The IPO proceeds, net of the underwriting discount and expenses, of $8.4 billion were used to retire a portion of an $11.0 billion long-term note payable to Philip Morris incurred in connection with the acquisition of Nabisco. After the IPO, Philip Morris owns approximately 83.9% of the outstanding shares of the Company's capital stock through its ownership of 49.5% of the Company's Class A common stock and 100% of the Company's Class B common stock. The Company's Class A common stock has one vote per share while the Company's Class B common stock has ten votes per share. Therefore, Philip Morris holds 97.7% of the combined voting power of the Company's outstanding common stock.

Basis of presentation: The consolidated financial statements include the Company and its subsidiaries. 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, the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of operating revenues and expenses during the reporting periods. Actual results could differ from those estimates. The Company's operating subsidiaries report year-end results as of the Saturday closest to December 31 each year. This resulted in fifty-three weeks of operating results in the Company's consolidated statement of earnings for the year ended December 31, 2000.

Certain prior years' amounts have been reclassified to conform with the current year's presentation.

Note 2. Summary of Significant Accounting Policies:

Cash and cash equivalents: Cash equivalents include demand deposits with banks and all highly liquid investments with original maturities of three months or less.

Inventories: Inventories are stated at the lower of cost or market. The last-in, first-out ("LIFO") method is used to cost substantially all domestic inventories. The cost of other inventories is principally determined by the average cost method.

Impairment of long-lived assets: The Company reviews long-lived assets, including intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. The Company performs undiscounted operating cash flow analyses to determine if an impairment exists. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

In October 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of." SFAS No. 144 provides updated guidance concerning the recognition and measurement of an impairment loss for certain types of long-lived assets, expands the scope of a discontinued operation to include a component of an entity and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. SFAS No. 144 is effective for the Company on January 1, 2002. The Company does not expect the adoption of SFAS No. 144 to have a material impact on the Company's 2002 financial statements.

Depreciation, amortization and goodwill valuation: Property, plant and equipment are stated at historical cost and depreciated by the straight-line method over the lives of the assets. Machinery and equipment are depreciated over periods ranging from 3 to 20 years and buildings and building improvements over periods up to 40 years. Goodwill and other intangible assets substantially comprise brand names purchased through acquisitions.
In consideration of the long histories of these brands, goodwill and other intangible assets associated with them are amortized on the straight-line method over 40 years.

During 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." Effective January 1, 2002, the Company will no longer be required to amortize indefinite life goodwill and intangible assets as a charge to earnings. In addition, the Company will be required to conduct an annual review of goodwill and other intangible assets for potential impairment. The Company estimates that net earnings and diluted earnings per share ("EPS") would have been approximately $2,839 million and $1.76, respectively, for the year ended December 31, 2001; $2,531 million and $1.74, respectively, for the year ended December 31, 2000; and $2,287 million and $1.57, respectively, for the year ended December 31, 1999, had the provisions of the new standards been applied in those years. The Company does not currently anticipate having to record a charge to earnings for the potential impairment of goodwill or other intangible assets as a result of adoption of these new standards.

Marketing costs: The Company promotes its products with significant marketing activities, including advertising, consumer incentives and trade promotions. Advertising costs are expensed as incurred. Consumer incentive and trade promotion activities are recorded as expense based on amounts estimated as being due to customers and consumers at the end of a period, based principally on the Company's historical utilization and redemption rates.

Revenue recognition: The Company recognizes operating revenue upon shipment of goods when title and risk of loss pass to customers. The Company classifies shipping and handling costs as part of cost of sales.

The Emerging Issues Task Force ("EITF") issued EITF Issue No. 00-14, "Accounting for Certain Sales Incentives" and EITF Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." As a result, certain items previously included in marketing, administration and research costs on the consolidated statement of earnings will either be recorded as a reduction of operating revenues or as an increase in cost of sales. These EITF Issues will be effective in the first quarter of 2002. The Company estimates that adoption of EITF Issues No. 00-14 and No. 00-25 will result in a reduction of operating revenues in 2001, 2000 and 1999 of approximately $4.6 billion, $3.6 billion and $3.4 billion, respectively. Marketing, administration and research costs will decline in 2001, 2000 and 1999 by approximately $4.7 billion, $3.7 billion and $3.4 billion, respectively, while cost of sales will increase by an insignificant amount. The adoption of these EITF Issues will have no impact on net earnings or basic and diluted EPS.

Hedging instruments: Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and its related amendment, SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (collectively referred to as "SFAS No. 133"). These standards require that all derivative financial instruments be recorded on the consolidated balance sheets at their fair value as either assets or liabilities. Changes in the fair value of derivatives are recorded each period in earnings or accumulated other comprehensive losses, depending on whether a derivative is designated and effective as part of a hedge transaction and, if it is, the type of hedge transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive losses are included in earnings in the periods in which earnings are affected by the hedged item. As of January 1, 2001, the adoption of these new standards did not have a material effect on net earnings (less than $1 million) or accumulated other comprehensive losses (less than $1 million).

Stock-based compensation: The Company accounts for employee stock compensation plans in accordance with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," which does not result in compensation cost.

Income taxes: The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." The accounts of the Company are included in the consolidated federal income tax return of Philip Morris. Income taxes are generally computed on a separate company basis. To the extent that foreign tax credits, capital losses and other credits generated by the Company, which cannot be utilized on a separate company basis, are utilized in Philip Morris' consolidated federal income tax return, the benefit is recognized in the calculation of the Company's provision for income taxes. The Company's provisions for income taxes included in the consolidated statements of earnings for the years ended December 31, 2001, 2000 and 1999 were lower than provisions calculated on a separate return basis by $185 million, $139 million and $107 million, respectively. The Company makes payments to, or is reimbursed by, Philip Morris for the tax effects resulting from its inclusion in Philip Morris' consolidated federal income tax return.

Software costs: The Company capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use. Capitalized software costs, which are not significant, are amortized on a straight-line basis over the estimated useful lives of the software, which do not exceed five years.

Foreign currency translation: The Company translates the results of operations of its foreign subsidiaries using average exchange rates during each period, whereas balance sheet accounts are translated using exchange rates at the end of each period. Currency translation adjustments are recorded as a component of shareholders' equity. Transaction gains and losses for all periods presented were not significant.

Environmental costs: The Company is subject to laws and regulations relating to the protection of the environment. The Company provides for expenses associated with environmental remediation obligations when such amounts are probable and can be reasonably estimated. Such accruals are adjusted as new information develops or circumstances change.

While it is not possible to quantify with certainty the potential impact of actions regarding environmental remediation and compliance efforts that the Company may undertake in the future, in the opinion of management, environmental remediation and compliance costs, before taking into account any recoveries from third parties, will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Note 3. Related Party Transactions:

Philip Morris and certain of its affiliates provide the Company with various services, including planning, legal, treasury, accounting, auditing, insurance, human resources, office of the secretary, corporate affairs, information technology and tax services. In 2001, the Company entered into a formal agreement with Philip Morris providing for a continuation of these services, the cost of which increased $91 million as Philip Morris provided information technology and financial services, all of which were previously performed by the Company at approximately the same cost. Billings for these services, which were based on the cost to Philip Morris to provide such services, were $339 million, $248 million and $165 million for the years ended December 31, 2001, 2000 and 1999, respectively. These costs were paid to Philip Morris monthly. Although the cost of these services cannot be quantified on a stand-alone basis, management believes that the billings are reasonable based on the level of support provided by Philip Morris and its affiliates, and that they reflect all services provided. The effects of these transactions are included in operating cash flows in the Company's consolidated statements of cash flows.

In addition, the Company's daily net cash or overdraft position is transferred to Philip Morris or a European subsidiary of Philip Morris. The Company pays or receives interest based upon the applicable commercial paper rate, or the London Interbank Offered Rate, on the net amount payable to, or receivable from, Philip Morris or its European subsidiary.

The Company also has long-term notes payable to its parent, Philip Morris, and its affiliates as follows:

(in millions)

At December 31,	**2001**	2000
Notes payable in 2009, interest at 7.00%	**$5,000**	$ 5,000
Notes payable in 2002, interest at 7.75%		11,000
Notes payable in 2002, interest at 7.40%		4,000
Swiss franc notes payable in 2008, interest at 4.58%		715
Swiss franc notes payable in 2006, interest at 3.58%		692
	$5,000	$21,407

The two notes maturing in 2002 were related to the financing for the acquisition of Nabisco and were at market interest rates available to Philip Morris for debt with matching maturities.

During 2001, the Company used the IPO proceeds, net of the underwriting discount and expenses, of $8.4 billion to retire a portion of the $11.0 billion long-term note payable to Philip Morris. The remainder of this note was repaid with the proceeds from commercial paper borrowings. The Company repaid the $4.0 billion note primarily with the net proceeds from a $4.0 billion public global bond offering. The Company also refinanced the two long-term Swiss franc notes payable to Philip Morris with short-term Swiss franc borrowings from Philip Morris at variable interest rates. The short-term Swiss franc borrowings are included in due to parent and affiliates on the Company's consolidated balance sheet as of December 31, 2001.

Based on interest rates available to the Company for issuances of debt with similar terms and remaining maturities, the aggregate fair values of the Company's long-term notes payable to Philip Morris and its affiliates at December 31, 2001 and 2000 were $5,325 million and $21,357 million, respectively. The fair values of the Company's current amounts due to parent and affiliates approximate carrying amounts.

Note 4. Divestitures:

During 2001, the Company sold several small food businesses. The aggregate proceeds received in these transactions were $21 million, on which the Company recorded a pre-tax gain of $8 million.

During 2000, the Company sold a French confectionery business for proceeds of $251 million, on which a pre-tax gain of $139 million was recorded. Several small international and domestic food businesses were also sold in 2000. The aggregate proceeds received in these transactions were $300 million, on which the Company recorded pre-tax gains of $172 million.

During 1999, the Company sold several small international and domestic food businesses. The aggregate proceeds received in these transactions were $175 million, on which the Company recorded pre-tax gains of $62 million.

The operating results of the businesses sold were not material to the Company's consolidated operating results in any of the periods presented. Pre-tax gains on these divestitures were included in marketing, administration and research costs on the Company's consolidated statements of earnings.

Note 5. Acquisitions:

Nabisco: On December 11, 2000, the Company acquired all of the outstanding shares of Nabisco for $55 per share in cash. The purchase of the outstanding shares, retirement of employee stock options and other payments totaled approximately $15.2 billion. In addition, the acquisition included the assumption of approximately $4.0 billion of existing Nabisco debt. The Company financed the acquisition through the issuance of two long-term notes payable to Philip Morris totaling $15.0 billion and short-term intercompany borrowings of $255 million. The acquisition has been accounted for as a purchase. Nabisco's balance sheet was consolidated with the Company as of December 31, 2000, and beginning January 1, 2001, Nabisco's earnings have been included in the consolidated operating results of the Company; however, Nabisco's earnings from December 11, 2000 to December 31, 2000 were not included in the consolidated operating results of the Company since such amounts were insignificant. The Company's interest cost associated with acquiring Nabisco has been included in interest and other debt expense, net, on the Company's consolidated statements of earnings for the years ended December 31, 2001 and 2000.

During 2001, the Company completed the allocation of excess purchase price relating to Nabisco. As a result, the Company recorded, among other things, the final valuations of property, plant and equipment and intangible assets, primarily trade names, amounts relating to the closure of Nabisco facilities and related deferred income taxes. The final allocation of excess purchase price at December 31, 2001 was as follows:

	(in millions)
Purchase price	**$15,254**
Historical value of tangible assets acquired and liabilities assumed	**(1,271)**
Excess of purchase price over assets acquired and liabilities assumed at the date of acquisition	**16,525**
Increases for allocation of purchase price:	
Property, plant and equipment	**367**
Other assets	**347**
Accrued postretirement health care costs	**230**
Pension liabilities	**190**
Debt	**50**
Legal, professional, lease and contract termination costs	**129**
Other liabilities, principally severance	**602**
Deferred income taxes	**3,583**
Goodwill and other intangible assets at December 31, 2001	**$22,023**

Goodwill and other intangible assets at December 31, 2001 include approximately $11.7 billion related to trade names. The Company also recorded deferred federal income taxes of $3.9 billion related to trade names.

The closure of a number of Nabisco domestic and international facilities resulted in severance and other exit costs of $379 million, which are included in the above adjustments for the allocation of purchase price. The closures will result in the elimination of approximately 7,500 employees and will require total cash payments of $373 million, of which approximately $74 million has been spent through December 31, 2001.

The integration of Nabisco into the operations of the Company will also result in the closure of several of the Company's existing facilities. The aggregate charges to the Company's consolidated statement of earnings to close or reconfigure its facilities and integrate Nabisco are estimated to be in the range of $200 million to $300 million. During 2001, the Company incurred pre-tax integration costs of $53 million for site reconfigurations and other consolidation programs in the United States. In October 2001, the Company announced that it was offering a voluntary retirement program to certain salaried employees in the United States. The program is expected to eliminate approximately 750 employees and will result in an estimated pre-tax charge of approximately $140 million upon final employee acceptance in the first quarter of 2002.

Assuming the acquisition of Nabisco occurred at the beginning of 2000 and 1999, pro forma operating revenues would have been approximately $34 billion in each year; pro forma net earnings would have been $1.4 billion in 2000 and $1.1 billion in 1999; while basic and diluted EPS would have been $0.96 in 2000 and $0.77 in 1999. These pro forma results, which are unaudited, do not give effect to any synergies expected to result from the merger of Nabisco's operations with those of the Company, nor do they give effect to the reduction of interest expense from the repayment of borrowings with the proceeds from the IPO. The pro forma results also do not reflect the effects of SFAS No. 141 and 142 on the amortization of goodwill or other intangible assets, or the EITF Issues concerning the classification of certain expenses on the consolidated statements of earnings. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been consummated and the IPO completed, at the beginning of each year, nor are they necessarily indicative of future consolidated operating results.

Other acquisitions: During 2001, the Company purchased coffee businesses in Romania, Morocco and Bulgaria and also acquired confectionery businesses in Russia and Poland. The total cost of these and other smaller acquisitions was $194 million.

During 2000, the Company purchased the outstanding common stock of Balance Bar Co., a maker of energy and nutrition snack products. In a separate transaction, the Company also acquired Boca Burger, Inc., a manufacturer and marketer of soy-based meat alternatives. The total cost of these and other smaller acquisitions was $365 million.

During 1999, the Company purchased several small North American and international food businesses for $14 million.

The effects of these acquisitions were not material to the Company's consolidated financial position or results of operations in any of the periods presented.

Note 6. Inventories:

The cost of approximately 54% and 56% of inventories in 2001 and 2000, respectively, was determined using the LIFO method. The stated LIFO amounts of inventories were approximately $150 million and $171 million higher than the current cost of inventories at December 31, 2001 and 2000, respectively.

Note 7. Short-Term Borrowings and Borrowing Arrangements:

At December 31, 2001, the Company had short-term borrowings of $2,681 million, consisting principally of commercial paper borrowings with an average year-end interest rate of 1.9%. Of this amount, the Company reclassified $2.0 billion of the commercial paper borrowings to long-term debt based upon its intent and ability to refinance these borrowings. At December 31, 2000, the Company had short-term borrowings of $146 million with an average year-end interest rate of 9.2%.

The fair values of the Company's short-term borrowings at December 31, 2001 and 2000, based upon current market interest rates, approximate the amounts disclosed above.

During 2001, the Company entered into agreements for a $2.0 billion 5-year revolving credit facility maturing in July 2006 and a $4.0 billion 364-day revolving credit facility maturing in July 2002. The Company intends to use these credit facilities to support commercial paper borrowings, the proceeds of which will be used for general corporate purposes. These facilities require the maintenance of a minimum net worth. None of these facilities were drawn at December 31, 2001. In addition, the Company maintains credit lines with a number of lending institutions amounting to approximately $768 million. The Company maintains these credit lines primarily to meet the short-term working capital needs of its international businesses.

Note 8. Long-Term Debt:

At December 31, 2001 and 2000, the Company's long-term debt consisted of the following:

(in millions)

	2001	2000
Short-term borrowings, reclassified as long-term debt	**$2,000**	$ —
Notes, 4.63% to 7.55% (average effective rate 5.95%), due through 2035	**6,229**	2,751
Debentures, 7.00% to 8.50% (average effective rate 10.14%), $315 million face amount, due through 2017	**258**	401
Foreign currency obligations	**136**	173
Other	**51**	83
	8,674	3,408
Less current portion of long-term debt	**(540)**	(713)
	$8,134	$2,695

Aggregate maturities of long-term debt, excluding short-term borrowings reclassified as long-term debt, are as follows:

	(in millions)
2002	$ 540
2003	378
2004	85
2005	730
2006	1,252
2007-2011	2,593
Thereafter	1,153

Based on market quotes, where available, or interest rates currently available to the Company for issuance of debt with similar terms and remaining maturities, the aggregate fair value of the Company's long-term debt, including the current portion of long-term debt, at December 31, 2001 and 2000 was $8,679 million and $3,459 million, respectively.

Note 9. Capital Stock:

The Company's articles of incorporation authorize 3.0 billion shares of Class A common stock, 2.0 billion shares of Class B common stock and 500 million shares of preferred stock. At December 31, 2001, there were 555 million Class A common shares and 1.18 billion Class B common shares issued and outstanding, of which Philip Morris holds 275 million Class A common shares and all of the Class B common shares. There are no preferred shares issued and outstanding. Class A common shares are entitled to one vote each while Class B common shares are entitled to ten votes each. Therefore, Philip Morris holds 97.7% of the combined voting power of the Company's outstanding common stock. At December 31, 2001, 75,949,530 shares of common stock were reserved for stock options and other stock awards.

Note 10. Stock Plans:

The Company's Board of Directors has adopted the 2001 Kraft Performance Incentive Plan (the "Plan"), which was established concurrently with the IPO. Under the Plan, the Company may grant stock options, stock appreciation rights, restricted stock, reload options and other awards based on the Company's Class A common stock, as well as performance-based annual and long-term incentive awards. Up to 75 million shares of the Company's Class A common stock may be issued under the Plan. The Company's Board of Directors granted options for 21,029,777 shares of Class A common stock concurrent with the closing date of the IPO (June 13, 2001) at an exercise price equal to the IPO price of $31.00 per share. A portion of the shares granted (18,904,637) becomes exercisable on January 31, 2003, and will expire ten years from the date of the grant. The remainder of the shares granted (2,125,140) may become exercisable on a schedule based on total shareholder return for the Company's Class A common stock during the three years following the date of the grant, or will become exercisable five years from the date of the grant. These options will also expire ten years from the date of the grant. Shares available to be granted under the Plan at December 31, 2001 were 54,688,173.

The Company's Board of Directors has also adopted the Kraft Director Plan. Under the Kraft Director Plan, awards are granted only to members of the Board of Directors who are not full-time employees of the Company or Philip Morris or their subsidiaries. Up to 500,000 shares of Class A common stock may be awarded under the Kraft Director Plan. During 2001, 8,945 stock options were granted under the Kraft Director Plan. Shares available to be granted under the Kraft Director Plan at December 31, 2001 were 491,055.

The Company accounts for the plans in accordance with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," which does not result in compensation cost.

Option activity was as follows for the year ended December 31, 2001:

	Shares Subject to Option	*Weighted Average Exercise Price*
Balance at January 1, 2001	**—**	**$ —**
Options granted	**21,038,722**	**31.00**
Options canceled	**(268,420)**	**31.00**
Balance at December 31, 2001	**20,770,302**	**31.00**

Prior to the IPO, certain employees of the Company participated in Philip Morris' stock compensation plans. Philip Morris does not currently intend to issue additional Philip Morris stock compensation to the Company's employees. Philip Morris accounts for its plans in accordance with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," which does not result in compensation cost.

The Company's employees held options to purchase the following number of shares of Philip Morris' stock: 57,349,595 shares at an average exercise price of $34.66 per share at December 31, 2001; 56,977,329 shares at an average exercise price of $30.46 per share at December 31, 2000; and 39,911,082 shares at an average exercise price of $34.34 per share at December 31, 1999. Of these amounts, the following were exercisable at each date: 44,930,609 at an average exercise price of $31.95 per share at December 31, 2001; 38,444,963 at an average exercise price of $34.82 per share at December 31, 2000; and 31,071,681 at an average exercise price of $32.75 per share at December 31, 1999.

Had compensation cost for stock option awards under the Kraft plans and Philip Morris' plans been determined by using the fair value at the grant date, the Company's net earnings and EPS (basic and diluted) would have been $1,785 million and $1.11 for the year ended December 31, 2001; $1,947 million and $1.34 for the year ended December 31, 2000; and $1,713 million and $1.18 for the year ended December 31, 1999. The foregoing impact of compensation cost was determined using a modified Black-Scholes methodology and the following assumptions:

	Risk-Free Interest Rate	*Weighted Average Expected Life*	*Expected Volatility*	*Expected Dividend Yield*	*Fair Value at Grant Date*
2001 Kraft	**4.81%**	**5 years**	**29.70%**	**1.68%**	**$ 9.13**
2001 Philip Morris	**4.86**	**5**	**33.88**	**4.78**	**10.36**
2000 Philip Morris	6.58	5	31.71	9.00	3.19
1999 Philip Morris	5.81	5	26.06	4.41	8.21

In addition, certain of the Company's employees held shares of Philip Morris restricted stock and rights to receive shares of stock, giving these employees in most instances all of the rights of shareholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights. Such shares are subject to forfeiture if certain employment conditions are not met. During 2001 and 2000, Philip Morris granted to certain of the Company's U.S. employees restricted stock of 279,120 shares and 2,113,570 shares, respectively. Philip Morris also issued to certain of the Company's non-U.S. employees rights to receive 31,310 and 683,790 equivalent shares during 2001 and 2000, respectively. During 1999, there were no restricted stock grants issued to the Company's employees. At December 31, 2001, restrictions on the stock, net of forfeitures, lapse as follows: 2002—2,638,410 shares; and 2003—92,000 shares. The fair value of the restricted shares and rights at the date of grant is amortized to expense ratably over the restriction period through a charge from Philip Morris. In 2001, 2000 and 1999, the Company recorded compensation expense related to restricted stock awards of $39 million, $23 million and $3 million, respectively.

Note 11. Earnings Per Share:

Basic and diluted EPS were calculated using the following for the years ended December 31, 2001, 2000 and 1999:

(in millions)

	2001	2000	1999
Net earnings	**$1,882**	$2,001	$1,753
Weighted average shares for basic and diluted EPS	**1,610**	1,455	1,455

During June 2001, the Company completed an IPO of 280,000,000 shares of its Class A common stock. Immediately following the IPO, the Company had 1,735,000,000 Class A and B common shares outstanding.

Note 12. Pre-tax Earnings and Provision for Income Taxes:

Pre-tax earnings and provision for income taxes consisted of the following for the years ended December 31, 2001, 2000 and 1999:

(in millions)

	2001	2000	1999
Pre-tax earnings:			
United States	**$2,282**	$2,188	$1,990
Outside United States	**1,165**	1,227	1,050
Total pre-tax earnings	**$3,447**	$3,415	$3,040
Provision for income taxes:			
United States federal:			
Current	**$ 594**	$ 572	$ 543
Deferred	**299**	218	164
	893	790	707
State and local	**112**	120	144
Total United States	**1,005**	910	851
Outside United States:			
Current	**445**	477	449
Deferred	**115**	27	(13)
Total outside United States	**560**	504	436
Total provision for income taxes	**$1,565**	$1,414	$1,287

At December 31, 2001, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately $1.5 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested. The Company is unable to provide a meaningful estimate of additional deferred taxes that would have been provided were these earnings not considered permanently reinvested.

The effective income tax rate on pre-tax earnings differed from the U.S. federal statutory rate for the following reasons for the years ended December 31, 2001, 2000 and 1999:

	2001	2000	1999
U.S. federal statutory rate	**35.0%**	35.0%	35.0%
Increase (decrease) resulting from:			
State and local income taxes, net of federal tax benefit	**2.0**	2.2	3.0
Goodwill amortization	**9.4**	5.2	5.9
Other	**(1.0)**	(1.0)	(1.6)
Effective tax rate	**45.4%**	41.4%	42.3%

The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities consisted of the following at December 31, 2001 and 2000:

(in millions)

	2001	2000
Deferred income tax assets:		
Accrued postretirement and postemployment benefits	**$ 774**	$ 789
Other	**737**	539
Total deferred income tax assets	**1,511**	1,328
Deferred income tax liabilities:		
Trade names	**(3,847)**	
Property, plant and equipment	**(1,379)**	(1,527)
Prepaid pension costs	**(850)**	(743)
Total deferred income tax liabilities	**(6,076)**	(2,270)
Net deferred income tax liabilities	**$(4,565)**	$ (942)

Note 13. Segment Reporting:

The Company manufactures and markets packaged retail food products, consisting principally of beverages, cheese, snacks, convenient meals and various packaged grocery products through its North American and international food businesses. Reportable segments for the North American businesses are organized and managed principally by product category. The North American food segments are Cheese, Meals and Enhancers; Biscuits, Snacks and Confectionery; Beverages, Desserts and Cereals; and Oscar Mayer and Pizza. Kraft Foods North America's food service business within the United States and its businesses in Canada and Mexico are managed through the Cheese, Meals and Enhancers segment. International operations are organized and managed by geographic location. The international food segments are Europe, Middle East and Africa; and Latin America and Asia Pacific.

The Company's management reviews operating companies income to evaluate segment performance and allocate resources. Operating companies income excludes general corporate expenses and amortization of goodwill. Interest and other debt expense, net, and provision for income taxes are centrally managed and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management. The Company's assets, which are principally in the United States and Europe, are managed geographically. The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies.

Reportable segment data were as follows:

(in millions)

For the Years Ended December 31,	2001	2000	1999
Operating revenues:			
Cheese, Meals and Enhancers	**$10,256**	$ 9,405	$ 9,360
Biscuits, Snacks and Confectionery	**5,917**	329	265
Beverages, Desserts and Cereals	**5,370**	5,266	5,074
Oscar Mayer and Pizza	**3,563**	3,461	3,198
Total Kraft Foods North America	**25,106**	18,461	17,897
Europe, Middle East and Africa	**6,339**	6,824	7,676
Latin America and Asia Pacific	**2,430**	1,247	1,224
Total Kraft Foods International	**8,769**	8,071	8,900
Total operating revenues	**$33,875**	$26,532	$26,797
Operating companies income:			
Cheese, Meals and Enhancers	**$ 2,099**	$ 1,845	$ 1,658
Biscuits, Snacks and Confectionery	**966**	100	73
Beverages, Desserts and Cereals	**1,192**	1,090	1,009
Oscar Mayer and Pizza	**539**	512	450
Total Kraft Foods North America	**4,796**	3,547	3,190
Europe, Middle East and Africa	**861**	1,019	895
Latin America and Asia Pacific	**378**	189	168
Total Kraft Foods International	**1,239**	1,208	1,063
Total operating companies income	**6,035**	4,755	4,253
Amortization of goodwill and other intangibles	**(962)**	(535)	(539)
General corporate expenses	**(189)**	(208)	(135)
Total operating income	**4,884**	4,012	3,579
Interest and other debt expense, net	**(1,437)**	(597)	(539)
Earnings before income taxes	**$ 3,447**	$ 3,415	$ 3,040

As previously noted, the Company's international operations are managed by geographic location. Operating revenues by consumer sector for Kraft Foods International were as follows:

Consumer Sector

(in millions)

For the Years Ended December 31,	2001	2000	1999
Snacks	**$3,263**	$2,723	$2,999
Beverages	**3,097**	3,201	3,551
Cheese	**1,267**	1,259	1,316
Grocery	**866**	584	664
Convenient Meals	**276**	304	370
Total	**$8,769**	$8,071	$8,900

During 2001, the Company recorded pre-tax charges of $53 million for site reconfigurations and other consolidation programs in the United States. In addition, the Company recorded a pre-tax charge of $29 million to close a North American food factory. These pre-tax charges, which aggregate $82 million, were included in marketing, administration and research costs in the consolidated statement of earnings for the following segments: Cheese, Meals and Enhancers, $63 million; Biscuits, Snacks and Confectionery, $2 million; Beverages, Desserts and Cereals, $12 million; and Oscar Mayer and Pizza, $5 million.

During 1999, the Company's North American food business announced that it was offering voluntary retirement incentive or separation programs to certain eligible hourly and salaried employees in the United States. Employees electing to terminate employment under the terms of these programs were entitled to enhanced retirement or severance benefits. Approximately 1,100 hourly and salaried employees accepted the benefits offered by these programs and elected to retire or terminate. As a result, the Company recorded a pre-tax charge of $157 million during 1999. This charge was included in marketing, administration and research costs in the consolidated statement of earnings for the following segments: Cheese, Meals and Enhancers, $71 million; Oscar Mayer and Pizza, $38 million; Biscuits, Snacks and Confectionery, $2 million; and Beverages, Desserts and Cereals, $46 million. Payments of pension and postretirement benefits are made in accordance with the terms of the applicable benefit plans. Severance benefits, which were paid over a period of time, commenced upon dates of termination which ranged from April 1999 to March 2000. The program and related payments were completed during 2000. Salary and related benefit costs of employees prior to their retirement or termination date were expensed as incurred.

See Notes 4 and 5 regarding divestitures and acquisitions. The acquisition of Nabisco primarily affected the reported results of the Biscuits, Snacks and Confectionery and the Latin America and Asia Pacific segments.

(in millions)

For the Years Ended December 31,	2001	2000	1999
Depreciation expense:			
Cheese, Meals and Enhancers	**$ 163**	$150	$135
Biscuits, Snacks and Confectionery	**152**		
Beverages, Desserts and Cereals	**113**	109	102
Oscar Mayer and Pizza	**55**	51	49
Total Kraft Foods North America	**483**	310	286
Europe, Middle East and Africa	**158**	163	175
Latin America and Asia Pacific	**39**	26	30
Total Kraft Foods International	**197**	189	205
Total depreciation expense	**$ 680**	$499	$491
Capital expenditures:			
Cheese, Meals and Enhancers	**$ 257**	$247	$246
Biscuits, Snacks and Confectionery	**171**		
Beverages, Desserts and Cereals	**202**	193	204
Oscar Mayer and Pizza	**131**	148	125
Total Kraft Foods North America	**761**	588	575
Europe, Middle East and Africa	**231**	239	255
Latin America and Asia Pacific	**109**	79	30
Total Kraft Foods International	**340**	318	285
Total capital expenditures	**$1,101**	$906	$860

Geographic data for operating revenues, total assets and long-lived assets (which consist of all non-current assets, other than goodwill and other intangible assets and prepaid pension assets) were as follows:

(in millions)

For the Years Ended December 31,	**2001**	2000	1999
Operating revenues:			
United States	**$23,078**	$16,910	$16,540
Europe	**6,062**	6,642	7,500
Other	**4,735**	2,980	2,757
Total operating revenues	**$33,875**	$26,532	$26,797

(in millions)

At December 31,	**2001**	2000	1999
Total assets:			
United States	**$43,889**	$40,454	$19,429
Europe	**7,366**	7,630	8,292
Other	**4,543**	3,987	2,615
Total assets	**$55,798**	$52,071	$30,336
Long-lived assets:			
United States	**$ 6,750**	$ 6,684	$ 3,904
Europe	**2,136**	2,116	2,021
Other	**1,274**	1,912	971
Total long-lived assets	**$10,160**	$10,712	$ 6,896

Note 14. Benefit Plans:

The Company and its subsidiaries sponsor noncontributory defined benefit pension plans covering substantially all U.S. employees. Pension coverage for employees of the Company's non-U.S. subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. In addition, the Company's U.S. and Canadian subsidiaries provide health care and other benefits to substantially all retired employees. Health care benefits for retirees outside the United States and Canada are generally covered through local government plans.

Pension Plans: Net pension (income) cost consisted of the following for the years ended December 31, 2001, 2000 and 1999:

(in millions)	*U.S. Plans*			*Non-U.S. Plans*		
	2001	2000	1999	**2001**	2000	1999
Service cost	**$ 107**	$ 69	$ 76	**$ 45**	$ 37	$ 40
Interest cost	**339**	213	212	**112**	98	100
Expected return on plan assets	**(648)**	(523)	(511)	**(126)**	(103)	(97)
Amortization:						
Net gain on adoption of SFAS No. 87		(11)	(11)		(1)	(1)
Unrecognized net (gain) loss from experience differences	**(21)**	(36)	(15)	**(1)**	(1)	2
Prior service cost	**8**	7	6	**5**	4	4
Settlements	**(12)**	(34)	(41)			
Net pension (income) cost	**$(227)**	$(315)	$(284)	**$ 35**	$ 34	$ 48

In 2001 and 2000, retiring employees elected lump-sum payments, resulting in settlement gains of $12 million and $34 million, respectively. During 2001, the Company announced that it was offering a voluntary early retirement program to certain eligible salaried employees in the United States. The program is expected to eliminate approximately 750 employees and will result in a pre-tax charge of approximately $140 million upon final employee acceptance in the first quarter of 2002. During 1999, the Company instituted an early retirement and workforce reduction program that resulted in settlement gains, net of additional termination benefits of $41 million.

The changes in benefit obligations and plan assets, as well as the funded status of the Company's pension plans at December 31, 2001 and 2000, were as follows:

(in millions)	*U.S. Plans*		*Non-U.S. Plans*	
	2001	2000	**2001**	2000
Benefit obligation at January 1	**$4,327**	$2,766	**$1,915**	$1,740
Service cost	**107**	69	**45**	37
Interest cost	**339**	213	**112**	98
Benefits paid	**(403)**	(258)	**(108)**	(94)
Acquisitions	**71**	1,463	**(22)**	236
Settlements	**14**	11		
Actuarial losses	**500**	51	**22**	91
Currency			**18**	(205)
Other	**9**	12	**39**	12
Benefit obligation at December 31	**4,964**	4,327	**2,021**	1,915
Fair value of plan assets at January 1	**7,039**	6,282	**1,589**	1,314
Actual return on plan assets	**(386)**	(215)	**(227)**	103
Contributions	**37**	33	**63**	32
Benefits paid	**(394)**	(278)	**(76)**	(64)
Acquisitions	**(45)**	1,226	**(41)**	265
Currency			**18**	(121)
Actuarial gains (losses)	**108**	(9)	**3**	60
Fair value of plan assets at December 31	**6,359**	7,039	**1,329**	1,589
Excess (deficit) of plan assets versus benefit obligations at December 31	**1,395**	2,712	**(692)**	(326)
Unrecognized actuarial losses (gains)	**756**	(691)	**226**	(42)
Unrecognized prior service cost	**56**	54	**49**	27
Unrecognized net transition obligation	**(1)**		**7**	7
Net prepaid pension asset (liability)	**$2,206**	$2,075	**$ (410)**	$ (334)

The combined U.S. and non-U.S. pension plans resulted in a net prepaid asset of $1,796 million and $1,741 million at December 31, 2001 and 2000, respectively. These amounts were recognized in the Company's consolidated balance sheets at December 31, 2001 and 2000 as prepaid pension assets of $2,675 million and $2,623 million, respectively, for those plans in which plan assets exceeded their accumulated benefit obligations and as other liabilities of $879 million and $882 million at December 31, 2001 and 2000, respectively, for plans in which the accumulated benefit obligations exceeded their plan assets.

At December 31, 2001 and 2000, certain of the Company's U.S. plans were unfunded, with projected benefit and accumulated benefit obligations of $213 million and $164 million, respectively, in 2001 and $156 million and $97 million, respectively, in 2000. For certain non-U.S. plans, which have accumulated benefit obligations in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were $1,165 million, $1,073 million and $416 million, respectively, as of December 31, 2001 and $639 million, $596 million and $49 million, respectively, as of December 31, 2000.

The following weighted-average assumptions were used to determine the Company's obligations under the plans:

	U.S. Plans		*Non-U.S. Plans*	
	2001	2000	**2001**	2000
Discount rate	**7.00%**	7.75%	**5.80%**	5.88%
Expected rate of return on plan assets	**9.00**	9.00	**8.49**	8.51
Rate of compensation increase	**4.50**	4.50	**3.36**	3.55

The Company and certain of its subsidiaries sponsor employee savings plans, to which the Company contributes. These plans cover certain salaried, non-union and union employees. The Company's contributions and costs are determined by the matching of employee contributions, as defined by the plans. Amounts charged to expense for defined contribution plans totaled $63 million, $43 million and $41 million in 2001, 2000 and 1999, respectively.

Postretirement Benefit Plans: Net postretirement health care costs consisted of the following for the years ended December 31, 2001, 2000 and 1999:

			(in millions)
	2001	2000	1999
Service cost	**$ 34**	$ 23	$ 27
Interest cost	**168**	109	101
Amortization:			
Unrecognized net loss from experience differences	**5**	2	3
Unrecognized prior service cost	**(8)**	(8)	(7)
Other expense			21
Net postretirement health care costs	**$199**	$126	$145

During 1999, the Company instituted early retirement and workforce reduction programs that resulted in curtailment losses of $21 million.

The Company's postretirement health care plans are not funded. The changes in the benefit obligations of the plans at December 31, 2001 and 2000 were as follows:

(in millions)

	2001	2000
Accumulated postretirement benefit obligation at January 1	$2,102	$1,380
Service cost	34	23
Interest cost	168	109
Benefits paid	(172)	(111)
Acquisitions	8	633
Plan amendments	1	(7)
Actuarial losses	295	75
Accumulated postretirement benefit obligation at December 31	2,436	2,102
Unrecognized actuarial losses	(464)	(159)
Unrecognized prior service cost	53	62
Accrued postretirement health care costs	$2,025	$2,005

The current portion of the Company's accrued postretirement health care costs of $172 million and $138 million at December 31, 2001 and 2000, respectively, are included in other accrued liabilities on the consolidated balance sheets.

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation for U.S. plans was 7.5% in 2000, 6.8% in 2001 and 6.2% in 2002, gradually declining to 5.0% by the year 2005 and remaining at that level thereafter. For Canadian plans, the assumed health care cost trend rate was 8.0% in 2000, 9.0% in 2001 and 8.0% in 2002, gradually declining to 4.0% by the year 2006 and remaining at that level thereafter. A one-percentage-point increase in the assumed health care cost trend rates for each year would increase the accumulated postretirement benefit obligation as of December 31, 2001 and postretirement health care cost (service cost and interest cost) for the year then ended by approximately 9.2% and 12.9%, respectively. A one-percentage-point decrease in the assumed health care cost trend rates for each year would decrease the accumulated postretirement benefit obligation as of December 31, 2001 and postretirement health care cost (service cost and interest cost) for the year then ended by approximately 7.6% and 10.4%, respectively.

The accumulated postretirement benefit obligations for U.S. plans at December 31, 2001 and 2000 were determined using an assumed discount rate of 7.0% and 7.75%, respectively. The accumulated postretirement benefit obligations for Canadian plans at December 31, 2001 and 2000 were determined using assumed discount rates of 6.75% and 7.0%, respectively.

Postemployment Benefit Plans: The Company and certain of its affiliates sponsor postemployment benefit plans covering substantially all salaried and certain hourly employees. The cost of these plans is charged to expense over the working lives of the covered employees. Net postemployment costs consisted of the following for the years ended December 31, 2001, 2000 and 1999:

(in millions)

	2001	2000	1999
Service cost	$20	$13	$12
Amortization of unrecognized net gains	(8)	(4)	(8)
Other expense			19
Net postemployment costs	$12	$ 9	$23

The Company instituted a workforce reduction program in its North American food business in 1999. This action resulted in incremental postemployment costs, which are shown as other expense above.

The Company's postemployment plans are not funded. The changes in the benefit obligations of the plans at December 31, 2001 and 2000 were as follows:

(in millions)

	2001	2000
Accumulated benefit obligation at January 1	$ 373	$333
Service cost	20	13
Benefits paid	(156)	(76)
Acquisitions	269	74
Actuarial losses	14	29
Accumulated benefit obligation at December 31	520	373
Unrecognized experience gains	52	22
Accrued postemployment costs	$ 572	$395

The accumulated benefit obligation was determined using an assumed ultimate annual turnover rate of 0.3% in 2001 and 2000, assumed compensation cost increases of 4.5% in 2001 and 2000, and assumed benefits as defined in the respective plans. Postemployment costs arising from actions that offer employees benefits in excess of those specified in the respective plans are charged to expense when incurred.

Note 15. Additional Information:

(in millions)

For the Years Ended December 31,	2001	2000	1999
Research and development expense	$ 358	$ 270	$ 262
Advertising expense	$1,190	$1,198	$1,272
Interest and other debt expense, net:			
Interest expense, parent and affiliates	$1,103	$ 531	$ 458
Interest expense, external debt	349	84	89
Interest income	(15)	(18)	(8)
	$1,437	$ 597	$ 539
Rent expense	$ 372	$ 277	$ 285

Minimum rental commitments under non-cancelable operating leases in effect at December 31, 2001 were as follows:

	(in millions)
2002	$212
2003	171
2004	135
2005	109
2006	86
Thereafter	136
	$849

Note 16. Financial Instruments:

Derivative financial instruments: The Company operates internationally, with manufacturing and sales facilities in various locations around the world and utilizes certain financial instruments to manage its foreign currency and commodity exposures, primarily related to forecasted transactions and interest rate exposures. Derivative financial instruments are used by the Company, principally to reduce exposures to market risks resulting from fluctuations in interest rates and foreign exchange rates by creating offsetting exposures. The Company is not a party to leveraged derivatives. For a derivative to qualify as a hedge at inception and throughout the hedged period, the Company formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of a forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction will not occur, the gain or loss would be recognized in earnings currently. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period.

The Company uses forward foreign exchange contracts and foreign currency options to mitigate its exposure to changes in foreign currency exchange rates from third-party and intercompany forecasted transactions. The primary currencies to which the Company is exposed include the Euro, Japanese yen and Canadian dollar. At December 31, 2001 and 2000, the Company had option and forward foreign exchange contracts with aggregate notional amounts of $431 million and $237 million, respectively, for the purchase or sale of foreign currencies. The effective portion of unrealized gains and losses associated with forward contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported on the Company's consolidated statement of earnings.

The Company uses interest rate swaps to hedge the fair value of an insignificant portion of its long-term debt. The differential to be paid or received is accrued and recognized as interest expense. If an interest rate swap agreement is terminated prior to maturity, the realized gain or loss is recognized over the remaining life of the agreement if the hedged amount remains outstanding, or immediately if the underlying hedged exposure does not remain outstanding. If the underlying exposure is terminated prior to the maturity of the interest rate swap, the unrealized gain or loss on the related interest rate swap is recognized in earnings currently. At December 31, 2001, the aggregate notional principal amount of those agreements was $102 million. Aggregate maturities at December 31, 2001 were $29 million in 2003 and $73 million in 2004. During the year ended December 31, 2001, there was no ineffectiveness relating to these fair value hedges.

During the year ended December 31, 2001, ineffectiveness related to cash flow hedges was not material. The Company is hedging forecasted transactions for periods not exceeding the next eighteen months and expects substantially all amounts reported in accumulated other comprehensive losses to be reclassified to the consolidated statement of earnings within the next twelve months.

The Company is exposed to price risk related to forecasted purchases of certain commodities used as raw materials by the Company's businesses. Accordingly, the Company uses commodity forward contracts, as cash flow hedges, primarily for coffee, cocoa, milk, cheese and wheat. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar, soybean and energy. In general, commodity forward contracts qualify for the normal purchase exception under SFAS No. 133 and are, therefore, not subject to the provisions of SFAS No. 133. At December 31, 2001 and 2000, the Company had net long commodity positions of $589 million and $617 million, respectively. Unrealized gains or losses on net commodity positions were immaterial at December 31, 2001 and 2000. The effective portion of unrealized gains and losses on commodity futures and option contracts is deferred as a component of accumulated other comprehensive losses and is recognized as a component of cost of sales in the Company's consolidated statement of earnings when the related inventory is sold.

Hedging activity affected accumulated other comprehensive losses, net of income taxes, during the year ended December 31, 2001, as follows:

	(in millions)
Balance as of January 1, 2001	**$ —**
Derivative losses transferred to earnings	**15**
Change in fair value	**(33)**
Balance as of December 31, 2001	**$(18)**

The Company does not engage in trading or other speculative use of financial instruments. Derivative losses reported in accumulated other comprehensive losses are a result of qualifying hedging activity. Transfers of these losses from accumulated other comprehensive losses to earnings are offset by gains on the underlying hedged items.

Credit exposure and credit risk: The Company is exposed to credit loss in the event of nonperformance by counterparties. However, the Company does not anticipate nonperformance and such exposure was not material at December 31, 2001.

Fair value: The aggregate fair value, based on market quotes, of the Company's third-party debt at December 31, 2001 was $9,360 million as compared with its carrying value of $9,355 million. The aggregate fair value of the Company's third-party debt at December 31, 2000 was $3,605 million as compared with its carrying value of $3,554 million. Based on interest rates available to the Company for issuances of debt with similar terms and remaining maturities, the aggregate fair value and carrying value of the Company's long-term notes payable to Philip Morris and its affiliates were $5,325 million and $5,000 million, respectively, at December 31, 2001 and $21,357 million and $21,407 million, respectively, at December 31, 2000.

See Notes 3, 7 and 8 for additional disclosures of fair value for short-term borrowings and long-term debt.

Note 17. Contingencies:

The Company and its subsidiaries are parties to a variety of legal proceedings arising out of the normal course of business, including a few cases in which substantial amounts of damages are sought. The Company believes that it has valid defenses and is vigorously defending the litigation pending against it. While the results of litigation cannot be predicted with certainty, management believes that the final outcome of these proceedings will not have a material adverse effect on the Company's consolidated financial position or results of operations.

Prior to the effectiveness of the registration statement covering the shares of the Company's Class A common stock being sold in the IPO, some of the underwriters of the IPO provided written copies of a "pre-marketing feedback" form to certain potential purchasers of the Company's Class A common stock. The feedback form was for internal use only and was designed to elicit orally certain information from designated accounts as part of designing strategy in connection with the IPO. This form may have constituted a prospectus that did not meet the requirements of the Securities Act of 1933.

If the distribution of this form by the underwriters did constitute a violation of the Securities Act of 1933, persons who received this form, directly or indirectly, and who purchased the Company's Class A common stock in the IPO may have the right, for a period of one year from the date of the violation, to obtain recovery of the consideration paid in connection with their purchase of the Company's Class A common stock or, if they had already sold the stock, attempt to recover losses resulting from their purchase of the Class A common stock. The Company cannot determine the amount of Class A common stock that was purchased by recipients of the "pre-marketing feedback" form. However, the Company does not believe that any attempts to rescind these purchases or to recover these losses will have a material adverse effect on its consolidated financial position or results of operations.

Note 18. Quarterly Financial Data (Unaudited):

(in millions, except per share data)	**2001 Quarters**			
	First	**Second**	**Third**	**Fourth**
Operating revenues	**$8,367**	**$8,692**	**$8,056**	**$8,760**
Gross profit	**$4,100**	**$4,300**	**$3,832**	**$4,112**
Net earnings	**$ 326**	**$ 505**	**$ 503**	**$ 548**
Weighted average shares for diluted EPS	**1,455**	**1,510**	**1,735**	**1,736**
Per share data:				
Basic EPS	**$ 0.22**	**$ 0.33**	**$ 0.29**	**$ 0.32**
Diluted EPS	**$ 0.22**	**$ 0.33**	**$ 0.29**	**$ 0.32**
Dividends declared			**$ 0.13**	**$ 0.13**
Market price—high		**$32.00**	**$34.81**	**$35.57**
—low		**$29.50**	**$30.00**	**$31.50**

(in millions, except per share data)	2000 Quarters			
	First	Second	Third	Fourth
Operating revenues	$6,460	$6,974	$6,215	$6,883
Gross profit	$3,079	$3,417	$2,958	$3,161
Net earnings	$ 470	$ 568	$ 548	$ 415
Weighted average shares for diluted EPS	1,455	1,455	1,455	1,455
Per share data:				
Basic EPS	$ 0.32	$ 0.39	$ 0.38	$ 0.29
Diluted EPS	$ 0.32	$ 0.39	$ 0.38	$ 0.29

Basic and diluted EPS are computed independently for each of the periods presented. Accordingly, the sum of the quarterly EPS amounts may not agree to the total year.

On June 13, 2001, the Company completed an IPO by issuing 280 million shares of its Class A common stock.

During the third quarter of 2000, the Company recorded a pre-tax gain of $139 million on the sale of a French confectionery business.

The principal stock exchange, on which the Company's Class A common stock is listed, is the New York Stock Exchange. At January 31, 2002, there were approximately 1,500 holders of record of the Company's Class A common stock.

Report of Independent Accountants

To the Board of Directors and Shareholders of Kraft Foods Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, shareholders' equity and cash flows present fairly, in all material respects, the consolidated financial position of Kraft Foods Inc. and its subsidiaries (the "Company") at December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Chicago, Illinois
January 28, 2002

Company Report on Financial Statements

The consolidated financial statements and all related financial information herein are the responsibility of the Company. The financial statements, which include amounts based on judgments, have been prepared in accordance with generally accepted accounting principles. Other financial information in the annual report is consistent with that in the financial statements.

The Company maintains a system of internal controls that it believes provides reasonable assurance that transactions are executed in accordance with management's authorization and properly recorded, that assets are safeguarded, and that accountability for assets is maintained. The system of internal controls is characterized by a control-oriented environment within the Company, which includes written policies and procedures, careful selection and training of personnel, and audits by a professional staff of internal auditors.

PricewaterhouseCoopers LLP, independent accountants, have audited and reported on the Company's consolidated financial statements. Their audits were performed in accordance with generally accepted auditing standards.

The Audit Committee of the Board of Directors, composed of four non-employee directors, meets periodically with PricewaterhouseCoopers LLP, the Company's internal auditors and management representatives to review internal accounting control, auditing and financial reporting matters. Both PricewaterhouseCoopers LLP and the internal auditors have unrestricted access to the Audit Committee and may meet with it without management representatives being present.

Board of Directors and Officers
(at year end 2001)

Board of Directors

Geoffrey C. Bible *1*
Chairman of the Board, Kraft Foods Inc.,
and Chairman and Chief Executive Officer,
Philip Morris Companies Inc.

Louis C. Camilleri *
Senior Vice President and
Chief Financial Officer,
Philip Morris Companies Inc.

Roger K. Deromedi
Co-Chief Executive Officer,
Kraft Foods Inc., and
President and Chief Executive Officer,
Kraft Foods International, Inc.

W. James Farrell *1, 2*
Chairman and Chief Executive Officer,
Illinois Tool Works Inc.
Glenview, IL

Betsy D. Holden
Co-Chief Executive Officer,
Kraft Foods Inc., and
President and Chief Executive Officer,
Kraft Foods North America, Inc.

John C. Pope *1, 2*
Chairman,
PFI Group, LLC
Chicago, IL

Mary L. Schapiro *1, 2*
President,
NASD Regulation, Inc.
Washington, D.C.

William H. Webb
Vice Chairman and Chief Operating Officer,
Philip Morris Companies Inc.

Deborah C. Wright *1, 2*
President and Chief Executive Officer,
Carver Bancorp, Inc.
New York, NY

Committees
1 Member of Compensation and Governance Committee
Geoffrey C. Bible, Chair
2 Member of Audit Committee
John C. Pope, Chair

** The Philip Morris Companies Inc. Board of Directors has announced its intention to elect Louis C. Camilleri as President and Chief Executive Officer of Philip Morris Companies Inc., effective April 25, 2002, following the Philip Morris Companies Inc. Annual Meeting of Shareholders.*

Officers

Kraft Foods Inc.

Betsy D. Holden
Co-Chief Executive Officer,
Kraft Foods Inc., and
President and Chief Executive Officer,
Kraft Foods North America, Inc.

Roger K. Deromedi
Co-Chief Executive Officer,
Kraft Foods Inc., and
President and Chief Executive Officer,
Kraft Foods International, Inc.

Calvin J. Collier
Senior Vice President, General Counsel and
Corporate Secretary,
Kraft Foods Inc.

James P. Dollive
Senior Vice President and
Chief Financial Officer,
Kraft Foods Inc.

Kraft Foods North America, Inc.

Mary Kay Haben
Group Vice President,
Kraft Foods North America, Inc., and
President,
Cheese, Meals and Enhancers Group

David S. Johnson
Group Vice President,
Kraft Foods North America, Inc., and
President,
Beverages, Desserts and Cereals Group

Michael B. Polk
Group Vice President,
Kraft Foods North America, Inc., and
President,
Biscuit, Snacks and Confectionery Group

Irene B. Rosenfeld
Group Vice President,
Kraft Foods North America, Inc., and
President,
Operations, Technology, Information Systems,
Kraft Foods Canada, Mexico and Puerto Rico

Richard G. Searer
Group Vice President,
Kraft Foods North America, Inc., and
President,
Oscar Mayer, Pizza and Food Service Group

Kraft Foods International, Inc.

Ronald J. S. Bell
Group Vice President,
Kraft Foods International, Inc., and
President, European Union

Maurizio Calenti
Group Vice President,
Kraft Foods International, Inc., and
President, CEEMA

Joachim Krawczyk
Group Vice President,
Kraft Foods International, Inc., and
President, Latin America

Hugh H. Roberts
Group Vice President,
Kraft Foods International, Inc., and
President, Asia Pacific

Kraft Cares: A Catalytic Approach to Community Partnerships

Our business is built on innovation—a passion to find creative solutions to people's needs. We try to bring that same spirit to our relationship with society.

While we contribute more than $25 million annually in food and financial support to nonprofit organizations around the world, we do more than simply provide a meal or write a check. Through ***Kraft Cares***, our community outreach program, we join with the organizations we support to help solve the structural problems that stand in the way of greater effectiveness.

In our global efforts to help fight hunger, a good example of this catalytic approach is the ***Kraft Community Nutrition Program***. Our goal is not only to help increase the quantity of food available to food banks and other feeding organizations, but also to significantly improve the nutritional quality of the food they provide.

Through the ***Fresh Produce Initiative***, one of several initiatives in the program, we're helping the food bank network in the U.S. dramatically increase the quantity of nutritious fresh fruits and vegetables it provides to the people who need them most. By helping the network build an infrastructure of refrigeration, transportation, and food handling equipment, we've increased by more than 400 million servings the annual volume of fresh fruits and vegetables reaching the hungry. Similar programs in France and Korea provide refrigerated trucks to the national food bank networks and significantly increase the distribution of fresh foods.

Our ***Food Rescue Initiative*** equips feeding organizations with the infrastructure to expand the distribution of prepared and perishable foods collected from supermarkets, restaurants and cafeterias. And our ***Seafood Initiative*** is helping to increase the amount of nutritious seafood products reaching people in need.

We bring the same passion for innovation to our funding for arts in education.

For children, exposure to the arts—both to the art of others and to hands-on creative experience—builds more than a sense of aesthetics. The arts can help develop critical thinking, communication skills, team building and discipline, all of which better enable students to meet the challenges of their core curriculum. Kraft funds programs that increase the access of children, especially at-risk children, to the visual and performing arts.

Our ***Art Discovery*** program, for example, helps enrich the educational programming offered by arts organizations to under-resourced schools in Chicago. And to reach an even larger number of schools, we created the ***Art Discovery*** website (www.artdiscovery.org). The site provides information to help schools access a spectrum of educational resources offered by Chicago's extraordinary performing, visual and literary arts organizations.

In our funding to address the important issue of domestic violence, we supported professional training for staff members of 120 domestic violence shelters in the Czech Republic. We've also targeted longer-term solutions. Violence in the home often interferes with job performance and can become a barrier to employment. Yet survivors need to provide for themselves and their children in order to reshape their lives. Kraft's funding helped create unique community partnerships that enable survivors to gain the tools necessary to find and keep work. Women received supportive services while training for new job opportunities. Through these community-centered services, hundreds of women have found hope for a better future.

Our involvement in addressing societal needs goes beyond corporate action. Our commitment also comes alive in the hands of our employees. With their contribution of time and financial support, Kraft employees around the world make a difference in the communities where they live and work.

Through the ***Kraft Employee Fund***, the United Way and other charitable programs, employees in 2001 donated more than $4 million of their own funds in support of community-based nonprofit organizations.

On ***Kraft Cares Day***, more than a thousand employee volunteers donate their time and expertise to do work—from painting schools to delivering meals—in the places where people need it most. And employees from around the company help tens of thousands of students build a future through Junior Achievement. In fact, Kraft's 2,000 volunteers make up Junior Achievement's largest corporate team in the U.S.

Finally, we continue our long-standing commitment to helping those who are confronted with the hardship of natural disasters or other crisis situations. In partnership with disaster-relief organizations, we regularly provide ready-to-eat food products and much-needed supplies to disaster victims and emergency workers alike. For example, Kraft worked quickly to get emergency survival kits to earthquake victims in Peru. Within hours of the tragic events of September 11, Kraft was making arrangements to rush 14 truckloads of food to New York and Washington.

Whether it's through corporate support, employee involvement or disaster relief, all of us at Kraft want to help find innovative solutions to society's most pressing needs.

Corporate and Shareholder Information

Kraft Foods Inc.
Kraft Foods North America, Inc.
Three Lakes Drive
Northfield, IL 60093-2753
www.kraft.com

Kraft Foods International, Inc.
800 Westchester Avenue
Rye Brook, NY 10573-1301

Shareholder Services

Transfer Agent and Registrar

EquiServe Trust Company, N.A., our shareholder services and transfer agent, will be happy to answer questions about your accounts, certificates or dividends.

U.S. and Canadian shareholders may call: 1-866-655-7238

From outside the U.S. or Canada, shareholders may call:
1-201-222-4994

Postal address:
EquiServe Trust Company, N.A.
P.O. Box 2584
Jersey City, NJ 07303-2584

E-mail address:
kraft@equiserve.com

To eliminate duplicate mailings, please contact EquiServe (if you are a registered shareholder) or your broker (if you hold your stock through a brokerage firm).

Shareholder Publications

Kraft Foods Inc. makes a variety of publications, reports and Securities and Exchange Commission (SEC) filings available to its shareholders. For copies, please visit our website at: www.kraft.com. If you do not have Internet access, you can call our Shareholder Publications Center toll-free: 1-800-295-1255.

Stock Exchange Listing

Kraft Foods Inc. is listed on the New York Stock Exchange (ticker symbol KFT).

KFT
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NYSE

2002 Annual Meeting

The Annual Meeting of Shareholders will be held at 9:00 a.m. on Monday, April 22, 2002, at Kraft Foods Inc., Robert M. Schaeberle Technology Center, 200 DeForest Avenue, East Hanover, NJ 07936. For further information, call 1-800-295-1255.

Independent Accountants

PricewaterhouseCoopers LLP
1 North Wacker Drive
Chicago, IL 60606-2807

Form 10-K

The company's annual report to the SEC (Form 10-K) will be available to shareholders in March. For a copy, please visit www.kraft.com or call our Shareholder Publications Center toll-free: 1-800-295-1255.

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Internet Access Helps Reduce Costs

As a convenience to shareholders and an important cost-reduction measure, you can register to receive future shareholder materials (i.e., Annual Report and proxy statement) via the Internet. Shareholders also can vote their proxy via the Internet. For complete instructions, visit www.kraft.com.

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...but being better drives our future.