Kraft Foods Inc. 2003 Annual Report

KRAFT

How we will **grow our future.**

We can say it in six simple words. **Value. Transform**

We are committed to delivering sustainable growth – top

must delight the world with the right benefits at the right

a step ahead of tomorrow. We must expand our global

We must be organized to leverage our strengths. And

That's exactly what we intend to do.

ation. Scale. Cost. Organization. Responsibility.

line, bottom line and cash flow. To do it, we know our brands
price. We must continuously transform our products
scale. We must capture cost savings to fuel our growth.
we must act responsibly throughout the world community.

2003 Financial Highlights. Consolidated Results

(in millions, except per share data)	**2003**	2002	% Change
Volume (in pounds)	**18,681**	18,549	0.7%
Net revenues	**$ 31,010**	$ 29,723	4.3%
Operating income	**6,011**	6,114	(1.7)%
Net earnings	**3,476**	3,394	2.4%
Diluted earnings per share	**2.01**	1.96	2.6%
Results by Business Segment			
North America			
Cheese, Meals and Enhancers			
Net revenues	**$ 9,439**	$ 9,172**	2.9%
Operating companies income*	**2,230**	2,210**	0.9%
Biscuits, Snacks and Confectionery			
Net revenues	**4,801**	4,887**	(1.8)%
Operating companies income*	**887**	1,051**	(15.6)%
Beverages, Desserts and Cereals			
Net revenues	**4,567**	4,412	3.5%
Operating companies income*	**1,247**	1,136	9.8%
Oscar Mayer and Pizza			
Net revenues	**3,100**	3,014	2.9%
Operating companies income*	**556**	556	–
Total North America			
Net revenues	**$ 21,907**	$ 21,485	2.0%
Operating companies income*	**4,920**	4,953	(0.7)%
International			
Europe, Middle East and Africa			
Net revenues	**$ 7,045**	$ 6,203	13.6%
Operating companies income*	**1,012**	962	5.2%
Latin America and Asia Pacific			
Net revenues	**2,058**	2,035	1.1%
Operating companies income*	**270**	368	(26.6)%
Total International			
Net revenues	**$ 9,103**	$ 8,238	10.5%
Operating companies income*	**1,282**	1,330	(3.6)%

**Kraft's management reviews operating companies income, which is defined as operating income before general corporate expenses and amortization of intangibles, to evaluate segment performance and allocate resources. For a reconciliation of operating companies income to operating income, see Note 13. Segment Reporting.*

***During 2003, management responsibility for the Canadian Biscuits and Pet Snacks operations was transferred from the Biscuits, Snacks and Confectionery segment to the Cheese, Meals and Enhancers segment, which contains the other Canadian businesses. Accordingly, the 2002 amounts have been reclassified to reflect the transfer.*

Fellow Shareholders,

Our results in 2003 did not meet the growth targets we set at the start of the year. While we are not satisfied with our performance, we have taken significant steps to correct our course and get back on track for sustainable growth.

Kraft remains a strong and profitable food and beverage industry leader with great global potential. In this report, we share our plan for growth – how we intend to build brand value, transform our portfolio, expand our global scale, reduce our costs and asset base, strengthen our organization, and do so in a responsible way to deliver long-term sustainable growth.

For 2003, net revenues increased 4.3%. Volume was up 0.7%, or 1.6% excluding divestitures. Operating income declined 1.7%, net earnings increased 2.4% and diluted earnings per share were up 2.6% to $2.01. We generated more than $3 billion in discretionary cash flow – defined as net cash provided from operating activities less capital expenditures – an increase of 19.6% over 2002. And we raised our quarterly dividend 20% to $0.18 per common share.

Across our businesses, volume, excluding divestitures, and revenues were up in five of our six segments. However, operating companies income increased in only three segments.

We entered 2003 with good momentum. But, as the year unfolded, we encountered a number of significant challenges, most notably the rising cost of commodities, packaging and energy, and pensions and medical benefits. We tried to recover those costs through higher pricing in several categories. However, as a result of these higher prices, along with several new-product disappointments and other factors, our consumption and shares declined, particularly in cheese, cold cuts, coffee, crackers and cookies in the U.S.

In September, we initiated a reinvestment program to restore our brand value in those focus categories. We invested nearly $200 million in the last four months of the year to increase marketing and manage prices, and by January of 2004, we witnessed good progress. With the important exception of cookies, consumption and share trends improved across the other focus categories of cheese, cold cuts, coffee and crackers.

We were encouraged, but recognized we needed to do more than simply reverse these declines. We had to address several critical realities in a changed operating environment:

- Consumers and retailers are increasingly value-conscious.
- Powerful trends are reshaping the food business, including health and wellness, convenience, shifts in retail channels and the growth of the multicultural population in the United States.
- The competitive need for global scale has never been greater.
- Costs will continue to rise.

With these realities in mind, we decided to realign our organizational structure, reenergize our performance with a Sustainable Growth Plan and set new financial targets.

Our new global structure links three organizational dimensions – a Global Marketing & Category Development group to create global category strategies and new-product growth platforms; North America Commercial and International Commercial units to drive sales and marketing execution country by country; and global functions to foster best practices around the world in a cost-effective manner.

With a "best of global, best of local" organization, we're set up to deliver our four-point Sustainable Growth Plan.

First, to *build superior brand value*, we must deliver more product benefits for the price paid than our competitors.

We have an exceptional portfolio of brands. To ensure we continue to grow our leading brands, we are targeting an increase in our marketing spending in 2004 of $500 million to $600 million. This stepped-up rate of spending, based on a category-by-category, country-by-country analysis, will give us the resources we need to market and price our products competitively.

Second, to *transform our portfolio*, we are aligning our products with key consumer and customer trends, retail channels and demographic groups.

As more consumers focus on health and wellness, we're responding with products like *Triscuit* crackers with zero grams trans fat; *Kool-Aid Jammers* 10 with only 10 calories per serving; and *Tang Plus* with fortification and flavors tailored to the nutritional needs and taste preferences of different countries.

We're meeting the growing need for convenience with products like single-serve *Philadelphia Minis* in Europe, nutritionally balanced *Lunchables Fun Fuel* in the U.S., and the launch in France later in 2004 of *Tassimo*, our innovative new, on-demand, hot beverage system.

Third, to *expand our global scale*, particularly in fast-growing developing countries, we are capturing the growth potential of our core categories in markets where we already operate, and we are building our infrastructure in new high-potential markets.

And fourth, to *reduce our costs and asset base*, we announced in January 2004 a major cost restructuring program that goes beyond our ongoing productivity efforts and that will help fund our growth initiatives. Over the next three years, we anticipate exiting or closing up to 20 production facilities and reducing our global work force by approximately 6%, or about 6,000 positions across all levels of the organization.

The program is expected to result in pre-tax charges of about $1.2 billion, with the majority occurring in 2004 and 2005. We expect to generate approximately $400 million in annual pre-tax savings by 2006, which is more than 50% of the cash outlays required to implement the program.

It's never easy to close a plant or eliminate a job because of the impact it has on the people who have worked hard to make this company successful. However difficult these steps may be, achieving sustainable growth is ultimately the best way to build a stronger company and meet our responsibilities to the greatest number of employees, investors and communities.

We believe our Sustainable Growth Plan will deliver consistent results over the long term. In 2004, we expect constant currency revenue growth to be around 3%, including tack-on acquisitions and excluding divestitures, driven by volume growth of 2%-3%. However, the step-up in marketing spending and an anticipated $0.30 per share in restructuring charges will lower diluted earnings per share to a projected range of $1.63-$1.70, versus $2.01 in 2003.

On a longer-term basis, we believe we can grow constant currency revenues, including tack-on acquisitions and excluding divestitures, in the 3% range, supported by volume growth of 2%-3%. And we expect to deliver long-term annual earnings per share growth of 6%-9%.

We believe these results, combined with an attractive dividend, should provide a satisfying return for investors over the long term. We are committed to achieving these results, reliably and consistently, year after year. And that commitment will be a defining characteristic of this company and the thousands of talented and dedicated people who are the source of our success.

As we look forward to the future, we'd like to thank our employees for their unwavering efforts on behalf of our business, and our investors for their continued confidence in Kraft.

Louis C. Camilleri
Chairman

Roger K. Deromedi
Chief Executive Officer

February 27, 2004

Value. The ultimate measure of a brand.

Food may be a trillion-dollar business, but every dollar of sales is still earned one purchase at a time. And nothing determines a buying decision more than brand value – delivering the right benefits at the right price.

It usually takes only an instant for consumers to weigh the benefits each brand offers, consider the price, then reach for what they want. At that moment of choice, we want to be the choice they make.

That's why our highest priority – the thing we must do first, quickest and best – is invest in brand value. We are fixing the value equation wherever it's out of balance and continuing to build brand value across our entire portfolio.

The bundle of benefits each brand offers may include superior taste, more convenient packaging or simple availability wherever people expect to find a product. Or it may be nutrition or even the service a brand provides. Supported by our world-class R&D capabilities, we must innovate constantly and refresh the benefits we offer.

Whatever those benefits are, they must come at an attractive price. We must anticipate market forces and manage our costs to ensure our pricing is competitive. And we must support our brands with the optimal level of marketing. The additional funds we reinvested in marketing and price management in 2003 helped restore brand value in our focus categories. The progress was encouraging, and we're planning on an increase in spending of $500 million to $600 million in 2004.

There's no better long-term investment we can make than building the value of our brands.

Transformation. Growing **the next generation** of products.

In a world of change, we have to run just to stand still. To achieve sustainable growth, we must stay a step ahead of tomorrow.

We are accelerating a shift in our portfolio to satisfy the growing demand for health and wellness, and convenience. We are developing additional products and packages that fit fast-growing distribution channels. And we are deepening our connection to multicultural households with more products and services tailored to their needs.

We are bringing to market a generation of new products to help consumers meet a range of health and wellness needs – weight management, natural and organic foods, performance nutrition, health management and general nutrition. To answer the call for convenience, we're introducing products that are easier to prepare, more portable and pre-portioned.

As more volume shifts to newer and broader retail channels, we are customizing our portfolio and programs to build our share. We're placing our brands in fast-growing food-away-from-home venues, not only to gain volume but also to create billions of consumer brand impressions.

And in the U.S., where the Hispanic population continues to grow rapidly, our on-the-ground dedicated marketing teams are introducing more specialty products, bilingual packaging and outreach programs to suit local preferences, local culture and local community needs.

Tomorrow, the world will want something different than it wants today. We need to anticipate, identify, develop and market it faster and better than ever before.

Scale. Extending **our global reach.**

We must become a more global company. The greater our scale, the more profitable our growth. And nowhere is that more true than in the developing world, where faster population and income growth rates are driving increased demand for branded consumer goods.

Today, developing markets account for 84% of the world's population, 30% of its packaged food consumption and 23% of its gross domestic product. Yet, these markets account for only 11% of our revenues.

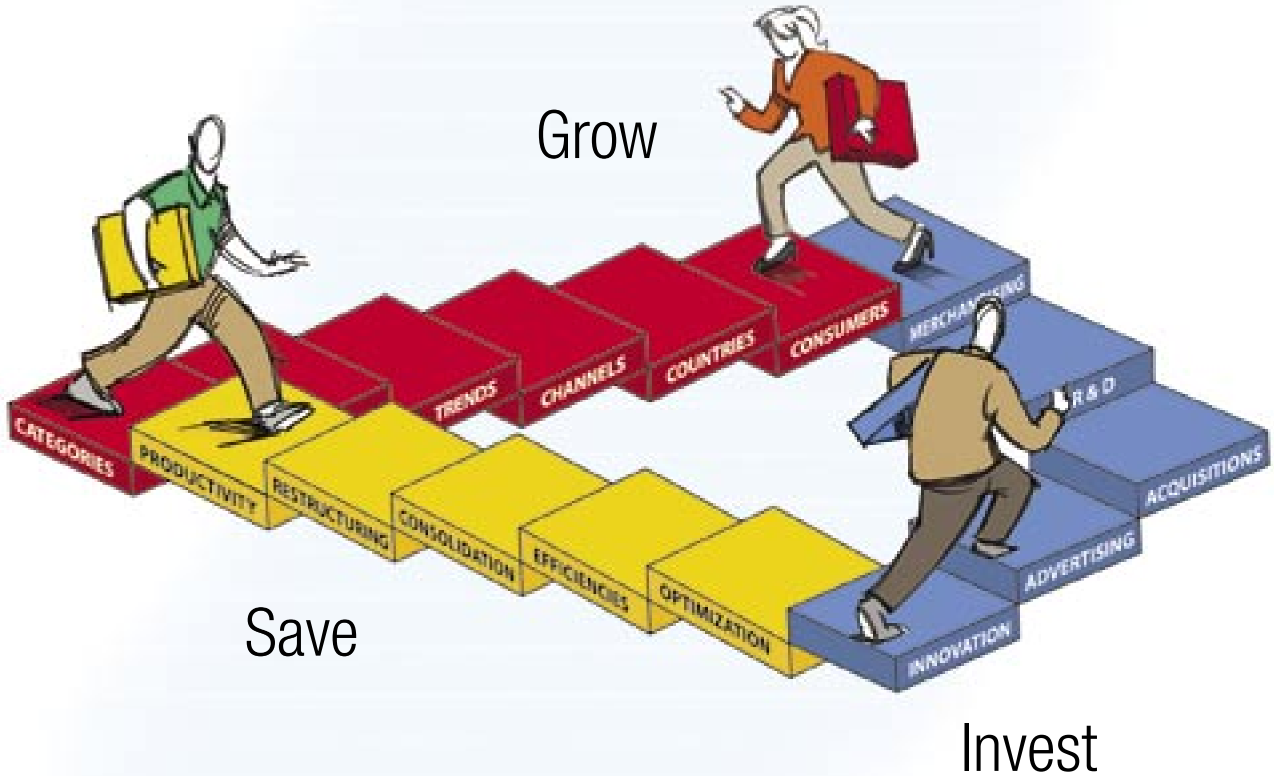
We're focusing first on countries like Russia, China, Brazil and Mexico, where we have the scale and efficiency to grow most profitably. We're growing by expanding our core categories where they already exist. So, for example, in China we are building our biscuits business with new introductions that leverage our global technologies but deliver a local taste.

We're also expanding our core categories into current markets where they don't yet exist. For instance, we added *Philadelphia* cream cheese to our established portfolio of products in Brazil last year, and after only six months, we became the number one cream cheese in the country.

But we're also targeting new markets where we can build scale and ultimately accelerate growth. Our acquisition a couple of years ago in Russia of the Stollwerck confectionery business is a good example. With the scale we gained, not only did we grow the confectionery business we acquired, we also were able to expand our coffee business as well and drive more than 14% growth in overall volume in Russia in 2003.

We're now at home in more than 150 countries around the world. But we've only begun to reach our global growth potential.

Cost. How we **fund our future.**



Save, invest, grow. It's the continuous cycle that drives long-term, sustainable results.

Productivity – and the steady flow of savings it creates – will continue to be a hallmark of Kraft. While it comes from many sources, we see two areas that offer particular opportunity for ongoing cost savings.

The first is supply chain initiatives, where we will further leverage our procurement scale on a global basis and rationalize less profitable product variations to help us achieve greater production and distribution efficiencies.

The second is through advances in technology. We will continue to automate our plants and distribution centers, formulate our products in lower-cost ways that improve or maintain our product quality, and seek out alternative, lower-cost packaging materials.

Beginning in 2004, we're taking additional steps that are right for the future but difficult in the present. To increase our investment in growth, we must become an even more efficient company. So we are beginning an estimated $1.2 billion pre-tax, three-year cost restructuring program.

By leveraging our global scale, lowering our cost structure and optimizing our capacity utilization, we expect this program to generate about $400 million in annual pre-tax savings by 2006 to invest back in our brands and accelerate top-line-driven earnings growth.

We know the actions we take to reduce our costs today will give us the financial flexibility to fund our success tomorrow.

Organization. The best of **global**, best of **local.**

world.
company.
team.

With one world to serve, we are now organized into a unified, global team. But in going global, we're still ready to meet the local needs of consumers and customers around the world.

Our new structure brings together three organizational dimensions – a new global marketing and category development group, our geographic-based commercial units and our key global functions.

The power of this new organizational structure lies in its ability to accelerate the flow of innovation from market to market, create true worldwide category and functional expertise, ensure superior local execution and develop our management strength—all at a faster pace than ever before.

This new structure is also more efficient. It eliminates duplication within functions and provides the opportunity to further consolidate facilities.

Of course, an organizational structure is nothing more than lines and boxes on a page without the people who bring it alive. We believe we have one of the strongest and most experienced leadership teams in the food industry. From the 12 senior leaders on the new Kraft Executive Team to the tens of thousands of dedicated employees around the world who put quality into every Kraft product, it's their talent, insight, experience and passion that make the difference.

No matter what else changes, one thing will remain the same. We can create a new organizational structure, we can develop a new plan, we can set any growth target we wish, but we can do nothing without our people.

Responsibility. Helping people eat and live better.

Achieving sustainable growth is not enough. We must do it in a responsible way. In fact, we think business success is not sustainable if it ignores the economic, social and environmental consequences on which it is built.

To ensure we meet our responsibilities as a public company and global citizen, we have formed a Corporate Responsibility Council of senior leaders from across the company. The council is focused on three primary areas. First, we strengthened our already rigorous governance programs by updating our corporate code of conduct and providing training for employees around the world. Second, we provided more than $90 million in food and financial support to communities worldwide. And third, we took important steps to address key societal issues relevant to our business. Two initiatives were of particular note.

With the help of an advisory council of experts, we increased our response to the rise in obesity by initiating an ongoing program to modify the nutritional profile of our products, revise our marketing policies and practices, increase nutrition labeling and advocate for constructive public policy changes.

Recognizing the importance of a viable supply chain, we joined with the Rainforest Alliance to strengthen Kraft's decade-long commitment to promoting sustainable coffee production. The goals: to improve conditions on coffee farms, provide a better economic return for coffee growers and help move sustainable coffee from market niche to the mainstream.

Ultimately, the success of any business depends on the public's trust. We are committed to earning that trust every day.

Innovation. Creating what **consumers want next.**

Snacks
Net Revenues $9.2 Billion

As the pace of life quickens, the snacking trend continues to grow. People want snacks that taste good, but they also want convenient, better-for-you snacks that bridge the growing mealtime gap.

Beverages
Net Revenues $6.1 Billion

Kraft offers more than just "something to drink." We have beverages that refresh, relax, energize and help people meet their nutritional needs. More and more, people are looking to Kraft to quench their thirst.

Cheese & Dairy
Net Revenues $5.6 Billion

Carb-conscious consumers are choosing the calcium-rich goodness of cheese. And Kraft is there to offer it to them – their way. Around the world, we meet local needs to satisfy the global appetite for cheese.

Grocery
Net Revenues $5.2 Billion

At Kraft, sometimes innovation means thinking outside the box – and inside the cup, bottle, packet or jar. No matter what form or flavor, Kraft innovations in quality and taste are as close as the nearest grocery aisle.

Convenient Meals
Net Revenues $4.9 Billion

To help take the stress out of mealtime, Kraft offers a wide variety of easy meal options for the whole family. With our broad menu of meals, we've got the great tastes that make even the most finicky, time-pressed eater run to the table.

- *Ritz*, America's number-one-selling cracker has an oven-toasted chip with less fat than regular fried potato chips. Since its introduction in August 2003, *Ritz* Chips has achieved a 2.8% share of the U.S. cracker category.
- New crispy, aromatic *Pacific Soda* Seaweed crackers helped grow total *Pacific Soda* share of the biscuits category in China. The cracker is well aligned with the health and wellness trend.
- There's good news in nuts. Not only did consumption of *Planters* nuts in the U.S. grow double digits in 2003, but a new heart health claim and a good fit with carb-conscious diets pave the way for future growth.
- The U.K. launch of fun and convenient *Terry's* Chocolate Orange Segsations twist-wrapped chocolates drove a 3% increase in U.K. confectionery volume.
- With its launch in September 2003, *In A Biskit* crackers' new *Vegemite* flavor built on the strong *Vegemite* franchise, expanding it into the snacks category and capturing 7.2% of the Australian flavored snacks segment.

- Ready-to-drink beverages continued their rapid volume growth in the U.S. with strong performances from new products, including *Capri Sun* Refreshers, packaged in an innovative bottle-can.
- We successfully launched *Tang Plus* fortified with vitamins and minerals in 10 developing markets in 2003.
- In Brazil, we introduced *Maguary Vit*, a combination of three fruits, which, when added to milk, becomes a tasty and nutritious drink for the whole family.
- Our *Maxwell House* coffee easy-open Fresh Seal can in the U.S. eliminated an important "dissatisfier" in coffee – the need for a can opener.
- Designed especially to quench the thirsty Hispanic market, *Kool-Aid* Aguas Frescas, a new line of *Kool-Aid* powdered soft drinks, was launched in the U.S.
- In France, *Carte Noire* Voluptuoso soft pods offer the deep *Carte Noire* flavor topped with a smooth foam. It's designed for the coffee-machine owner looking for on-demand convenience.

- *Kraft* Singles with "Double the Calcium" taps into parents' need to get more calcium in kids' diets. Its debut in the U.S. helped grow consumption by more than four points and share by nearly two points.
- Introduced in the second quarter of 2003 in the U.K., Ireland and Italy, *Philadelphia Minis* offer four individually sealed tubs of cream cheese in one package – perfect for a fresh and portable snack. It helped increase U.K. *Philadelphia* share by 2.5 points to more than 60% for the year.
- Designed for easy use, new *Kraft* Cracker Cuts feature 18 pre-cut, cracker-sized slices. This innovation has helped grow the natural cheese business and maintain our number one branded share position in chunk cheese in the U.S.
- Launched in Australia in August, two new *Kraft* Individually Wrapped Singles flavors – Swiss Style and Tasty Style – have captured 5.6% of the singles segment.

- Introduced in the U.S., *Jell-O* Smoothies – a wholesome, 100-calorie treat – is the first fruit-based product from the *Jell-O* brand and the first packaged smoothie you eat with a spoon.
- In 2003, Kraft Canada launched *Miracle Whip*, *Miracle Whip* Light and *Miracle Whip* Hot 'n Spicy Dressing in an easy-to-use upside-down squeeze bottle.
- In the fast-growing nutritional and energy bar category, we took our most popular *Balance* sub-line in the U.S. and extended it with the launch of four great *Balance* Gold Crunch items.
- *A.1.* Chicago Steakhouse Marinade has become the number one item in the brand's marinades line and one of the top selling in the category. In the U.S., *A.1.* Marinades consumption is up nearly 35%, and share is up about two points.
- In Brazil, we recently introduced *Fresh* Gelatin, using a hybrid sweetener system that delivers more servings per easy-to-use pouch. *Fresh* Gelatin is available in four flavors – strawberry, lemon, pineapple and grape.

- Since its U.S. national introduction in April, *Oscar Mayer* Deli Style Shaved Ham & Turkey has gained a dollar share point of the large cold cuts category. The fast-selling Deli Style Shaved line will be expanded in 2004.
- Kraft acquired *Back to Nature* cereal and granola in the U.S. as a platform for expansion into a range of fast-growing, natural and organic food categories.
- *Lunchables Fun Fuel*, a new nutritionally balanced meal combination, drove *Lunchables* U.S. pound share to more than 89%.
- Since its U.S. national launch in April, *Boca* Rising Crust Supreme Pizza has become the number one item in dollar share in the meat alternatives pizza segment.
- *Dairylea Lunchables* Pitta Pouches launched in the U.K. and is available in regular and Funpack formats.
- Our *Kraft Dinner* Macaroni and Cheese continued its leading performance in Canada, with 2.4 points of pound share growth and a 6.6% jump in consumption.

Financial Contents

Kraft Foods Inc. Guide to Select Disclosures

For easy reference, areas that may be of interest to investors are highlighted in the index below.

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, Kraft was a wholly-owned subsidiary of Altria Group, Inc. On June 13, 2001, Kraft 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 Altria Group, Inc., incurred in connection with the acquisition of Nabisco Holdings Corp. ("Nabisco"). After the IPO, Altria Group, Inc. owned approximately 83.9% of the outstanding shares of Kraft's capital stock through its ownership of 49.5% of Kraft's Class A common stock and 100% of Kraft's Class B common stock. Kraft's Class A common stock has one vote per share, while Kraft's Class B common stock has ten votes per share. At December 31, 2003, Altria Group, Inc. held 97.9% of the combined voting power of Kraft's outstanding capital stock and owned approximately 84.6% of the outstanding shares of Kraft's capital stock.

The Company conducts its global business through two subsidiaries: Kraft Foods North America, Inc. ("KFNA") and Kraft Foods International, Inc. ("KFI"). KFNA manages its operations principally by product category, while KFI manages its operations by geographic region. During 2003, 2002 and 2001, KFNA's segments were 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, Mexico and Puerto Rico were reported through the Cheese, Meals and Enhancers segment. KFI's segments were Europe, Middle East and Africa; and Latin America and Asia Pacific.

During January 2004, the Company announced a new global organizational structure, which will result in new segments for financial reporting purposes. Beginning in 2004, the Company's new segments will be U.S. Beverages & Grocery; U.S. Snacks; U.S. Cheese, Canada & North America Foodservice; U.S. Convenient Meals; Europe, Middle East & Africa; and Latin America & Asia Pacific. The new segment structure in North America reflects a shift of certain divisions and brands between segments to align businesses with consumer targets. Results for the Mexico and Puerto Rico businesses will be reported in the Latin America and Asia Pacific segment.

The Company's 2003, 2002 and 2001 results by segment are discussed herein under the reporting structure in place during 2003. The Company will report financial results in the new segment structure beginning with the results for the first quarter of 2004, and historical amounts will be restated.

Critical Accounting Policies

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 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 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 income taxes. The Company bases its estimates on historical experience and other assumptions that it believes are reasonable. If actual amounts are ultimately different from previous estimates, the revisions are included in the Company's consolidated results of operations 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.

The selection and disclosure of the Company's critical accounting policies and estimates have been discussed with the Company's Audit Committee. The following is a review of the more significant assumptions and estimates, as well as the accounting policies and methods used in the preparation of the Company's consolidated financial statements:

Employee Benefit Plans: As discussed in Note 14 to the consolidated financial statements, the Company provides a range of benefits to its employees and retired employees, including pensions, postretirement health care benefits and postemployment benefits (primarily severance). The Company records 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 on plan assets, 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 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.

During the years ended December 31, 2003, 2002 and 2001, the Company recorded the following amounts in the consolidated statement of earnings for employee benefit plans:

(in millions)

	2003	2002	2001
U.S. pension plan income	**$ (46)**	$ (33)	$(227)
Non-U.S. pension plan cost	**74**	47	35
Postretirement healthcare cost	**229**	217	199
Postemployment benefit plan cost	**6**	35	12
Employee savings plan cost	**84**	64	63
Net expense for employee benefit plans	**$347**	$330	$ 82

The 2003 net expense for employee benefit plans of $347 million increased by $17 million over the 2002 amount. This cost increase primarily relates to higher settlement losses in the U.S. pension plan, a lowering of the Company's discount rate assumption on its pension and postretirement benefit plans, increased amortization of deferred losses, as well as higher matching of employee contributions in the savings plan, partially offset by $148 million of costs in 2002 associated with voluntary early retirement and integration programs. The 2002 net expense for employee benefit plans of $330 million increased by $248 million over the 2001 amount. This increase includes the costs associated with voluntary early retirement and integration programs ($148 million), which were recorded during 2002. The remainder of the cost increase in 2002 primarily relates to a lowering of the Company's discount rate assumption on its pension and postretirement benefit plans, and lower than expected returns on invested pension assets.

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act establishes a prescription drug benefit under Medicare, known as "Medicare Part D," and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

In January 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-1"). The Company has elected to defer accounting for the effects of the Act, as permitted by FSP 106-1. Therefore, in accordance with FSP 106-1, the Company's accumulated postretirement benefit obligation and net postretirement health care costs included in the consolidated financial statements and accompanying notes do not reflect the effects of the Act on the plans. Specific authoritative guidance on the accounting for the federal subsidy is pending.

At December 31, 2003, for the U.S. pension and postretirement plans, the Company reduced its discount rate assumption from 6.5% to 6.25%, maintained its expected return on asset assumption at 9.0%, and increased its health care cost trend rate assumption. The Company presently anticipates that these assumption changes, coupled with the amortization of lower returns on pension fund assets in prior years, will result in an increase in 2004 pre-tax benefit expense of approximately $130 million, or approximately $0.05 per share. The expected increase in benefit expense is prior to the consideration of any cost reduction derived from the implementation of the Act, discussed above, and any impact of the three-year restructuring program announced in January 2004. The Company's long-term rate of return assumption remains at 9.0% based on the investment of its pension assets primarily in U.S. equity securities. While the Company does not presently anticipate a change in its 2004 assumptions, a fifty-basis-point decline in the Company's discount rate would increase the

Company's pension and postretirement expense by approximately $65 million, while a fifty-basis-point increase in the discount rate would decrease pension and postretirement expense by approximately $55 million. Similarly, a fifty-basis-point decrease (increase) in the expected return on plan assets would increase (decrease) the Company's pension expense for the U.S. pension plans by approximately $30 million. See Note 14 to the consolidated financial statements for a sensitivity discussion of the assumed health care cost trend rates.

Revenue Recognition: As required by U.S. GAAP, the Company recognizes revenues, net of sales incentives, and including shipping and handling charges billed to customers, upon shipment of goods when title and risk of loss pass to customers. Shipping and handling costs are classified as part of cost of sales. Provisions and allowances for estimated 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.

Depreciation and Amortization: The Company depreciates property, plant and equipment and amortizes definite life intangibles using straight-line methods over the estimated useful lives of the assets. As discussed in Note 2 to the consolidated financial statements, on January 1, 2002, the Company adopted the provisions of a new accounting standard and, as a result, stopped recording the amortization of goodwill as a charge to earnings as of January 1, 2002.

Marketing and Advertising 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 amounts on its year-end consolidated balance sheet with respect to marketing costs. The Company expenses advertising costs in the year incurred. The Company records consumer incentive and trade promotion costs as a reduction of revenues in the year in which these programs are offered, based on estimates of utilization and redemption rates that are developed from historical information.

Related Party Transactions: As discussed in Note 3 to the consolidated financial statements, Altria Group, Inc.'s subsidiary, Altria Corporate Services, Inc., provides 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. Billings for these services, which were based on the cost to Altria Corporate Services, Inc. to provide such services and a management fee, were $318 million, $327 million and $339 million for the years ended December 31, 2003, 2002 and 2001, respectively. Although the cost of these services cannot be quantified on a stand-alone basis, management has assessed that the billings are reasonable based on the level of support provided by Altria Corporate Services, Inc., and that they reflect all services provided. The cost and nature of the services are reviewed annually by the Company's Audit Committee, which consists solely of independent directors. The effects of these transactions are included in operating cash flows in the Company's consolidated statements of cash flows.

The Company had long-term notes payable to Altria Group, Inc. and its affiliates as follows:

(in millions)

At December 31,	**2003**	2002
Notes payable in 2009, interest at 7.0%	**$—**	$1,150
Short-term due to Altria Group, Inc. and affiliates reclassified as long-term		1,410
	$—	$2,560

During 2003, the Company repaid Altria Group, Inc. the remaining $1,150 million on the 7.0% note, as well as the $1,410 million of short-term borrowings reclassified to long-term. In addition, at December 31, 2003 and 2002, the Company had short-term amounts payable to Altria Group, Inc. of $543 million and $895 million, respectively. Interest on these borrowings is based on the applicable London Interbank Offered Rate.

Income Taxes: The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." The accounts of the Company are included in the consolidated federal income tax return of Altria Group, Inc. 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 currently be utilized on a separate company basis, are utilized in Altria Group, Inc.'s consolidated federal income tax return, the benefit is recognized in the calculation of the Company's provision for income taxes. Based on the Company's current estimate, this benefit is calculated to be approximately $100 million, $240 million and $220 million for the years ended December 31, 2003, 2002 and 2001, respectively. The benefit is dependent on a variety of tax attributes which have a tendency to vary year to year. The Company makes payments to, or is reimbursed by, Altria Group, Inc. for the tax effects resulting from its inclusion in Altria Group, Inc.'s consolidated federal income tax return. The provision for income taxes is based on domestic and international statutory income tax rates and tax planning opportunities available to the Company in the jurisdictions in which it operates. Significant judgment is required in determining income tax provisions and in evaluating tax positions. The Company establishes additional provisions for income taxes when, despite the belief that existing tax positions are fully supportable, there remain certain positions that are likely to be challenged and that may not be sustained on review by tax authorities. The Company adjusts these additional accruals in light of changing facts and circumstances. The consolidated tax provision includes the impact of changes to accruals that are considered appropriate, as well as the related net interest. If the Company's filing positions are ultimately upheld under audits by respective taxing authorities, it is possible that the provision for income taxes in future years may reflect favorable adjustments.

Business Environment

The Company is subject to a number of challenges that may adversely affect its businesses. These challenges, which are discussed below and under the "Forward-Looking and Cautionary Statements" section include:

- fluctuations in commodity prices;
- movements of foreign currencies against the U.S. dollar;
- competitive challenges in various products and markets, including price gaps with competitor products and the increasing price-consciousness of consumers;
- a rising cost environment;
- a trend toward increasing consolidation in the retail trade and consequent inventory reductions;
- changing consumer preferences;
- competitors with different profit objectives and less susceptibility to currency exchange rates; and
- consumer concerns about food safety, quality and health, including concerns about genetically modified organisms, trans-fatty acids and obesity.

To confront these challenges, the Company continues to take steps to build the value of its brands, to improve its food business portfolio with new product and marketing initiatives, to reduce costs through productivity and to address consumer concerns about food safety, quality and health. In July 2003, the Company announced a range of initiatives addressing product nutrition, marketing practices, consumer information, and public advocacy and dialogue.

During 2003, several factors contributed to lower than anticipated volume growth. These factors included higher price gaps in some key categories and countries, trade inventory reductions resulting from several customers experiencing financial difficulty, warehouse consolidations, store closings and retailers' stated initiatives to reduce working capital, as well as the combined adverse effect of global economic weakness. To improve volume and share trends, the Company increased spending behind certain businesses during the second half of 2003 by approximately $200 million more than had previously been planned. The Company also anticipates $500 million to $600 million of increased spending in 2004 over 2003 across all its businesses.

In January 2004, the Company announced its adoption of a four-point plan to achieve sustainable growth. The first element of the plan is to build brand value by continuing to improve its products, to use more value-added packaging, to develop innovative new products, to effectively manage price gaps and to build closer relationships with consumers.

The second element of the plan is to accelerate the shift in the Company's brand portfolio to address growing consumer demand for products meeting their health and wellness concerns and their desire for convenience. The Company is reducing trans-fat in its products, identifying its products that are low in carbohydrates, introducing more sugar-free products, and emphasizing positive nutrition products. The Company is addressing convenience needs by offering more convenient packaging, such as single-serve and resealable packaging, and products requiring reduced preparation. The Company is also offering packaging that is customized to suit the needs of growing alternate channels of distribution such as supercenters, mass merchandisers, drugstores and club stores. The Company also plans to shift its portfolio to reflect changing demographics, for example, by expanding the availability of Hispanic products and bilingual packaging.

The third component of the plan is to expand the Company's global scale through international growth, particularly in developing markets. These markets account for 84% of the world's population and 30% of its packaged food consumption, but only 11% of the Company's net revenues. The plan calls for the Company to capture the growth potential of its core categories in existing markets and to expand its core categories into new markets.

As the final component of its plan, the Company announced a three-year restructuring program with the objectives of leveraging the Company's global scale, realigning and lowering the cost structure, and optimizing capacity utilization. As part of this program, the Company anticipates the exit or closing of up to twenty plants and the elimination of approximately six thousand positions. Over the next three years, the Company expects to incur up to $1.2 billion in pre-tax charges, reflecting asset disposals, severance and other implementation costs, including an estimated range of $750 million to $800 million in 2004. Approximately one-half of the pre-tax charges are expected to require cash payments. In addition, the Company expects to spend approximately $140 million in capital over the next three years to implement the program, including approximately $50 million in 2004. Cost savings as a result of this program in 2004 are expected to be approximately $120 million to $140 million and are anticipated to reach annual cost savings of approximately $400 million by 2006, all of which are expected to be used in supporting brand-building initiatives.

Fluctuations in commodity prices can lead to retail price volatility and intensive price competition, and can influence consumer and trade buying patterns. KFNA's and KFI's businesses are subject to fluctuating commodity costs, including dairy, coffee and cocoa costs. In 2003, the Company's commodity costs on average were higher than those incurred in 2002 and adversely affected earnings.

The Company's performance in 2003 was also affected by a rising cost environment, which is expected to continue. In particular, the Company experienced increased pension, medical, packaging and energy costs.

During 2003, the Company acquired a biscuits business in Egypt and trademarks associated with a small U.S.-based natural foods business. The total cost of these and other smaller acquisitions was $98 million. During 2002, the Company acquired a snacks business in Turkey and a biscuits business in Australia. The total cost of these and other smaller acquisitions was $122 million. 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 effects of these acquisitions were not material to the Company's consolidated financial position, results of operations or cash flows in any of the periods presented.

During 2003, the Company sold a European rice business and a branded fresh cheese business in Italy. The aggregate proceeds received from sales of businesses were $96 million, on which the Company recorded pre-tax gains of $31 million.

During 2002, the Company sold several small North American food businesses, some of which were previously classified as businesses held for sale. The net revenues and operating results of the businesses held for sale, which were not significant, were excluded from the Company's consolidated statements of earnings, and no gain or loss was recognized on these sales. In addition, the Company sold its Latin American yeast and industrial bakery ingredients business for $110 million and recorded a pre-tax gain of $69 million. The aggregate proceeds received from sales of businesses during 2002 were $219 million, on which the Company recorded pre-tax gains of $80 million.

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

The operating results of the businesses sold were not material to the Company's consolidated financial position, results of operations or cash flows in any of the periods presented.

In November 2003, the Company was advised by the Fort Worth District Office of the Securities and Exchange Commission ("SEC") that the staff is considering recommending that the SEC bring a civil injunctive action against the Company charging it with aiding and abetting Fleming Companies ("Fleming") in violations of the securities laws. District staff alleges that a Company employee, who received a similar "Wells" notice, signed documents requested by Fleming, which Fleming used in order to accelerate its revenue recognition. The notice does not contain any allegations or statements regarding the Company's accounting for transactions with Fleming. The Company believes that it properly recorded the transactions in accordance with U.S. GAAP. The Company has submitted a response to the staff indicating why it believes that no enforcement action should be brought against it. The Company has cooperated fully with the SEC with respect to this matter and the SEC's investigation of Fleming.

Consolidated Operating Results

(in millions, except per share data)

Year Ended December 31,	**2003**	2002	2001
Volume (in pounds):			
Cheese, Meals and Enhancers	**6,183**	6,082	5,404
Biscuits, Snacks and Confectionery	**2,083**	2,185	2,165
Beverages, Desserts and Cereals	**3,905**	3,708	3,421
Oscar Mayer and Pizza	**1,570**	1,554	1,519
Total Kraft Foods North America	**13,741**	13,529	12,509
Europe, Middle East and Africa	**2,971**	2,961	2,826
Latin America and Asia Pacific	**1,969**	2,059	2,057
Total Kraft Foods International	**4,940**	5,020	4,883
Volume (in pounds)	**18,681**	18,549	17,392
Net revenues:			
Cheese, Meals and Enhancers	**$ 9,439**	$ 9,172	$ 9,014
Biscuits, Snacks and Confectionery	**4,801**	4,887	4,789
Beverages, Desserts and Cereals	**4,567**	4,412	4,237
Oscar Mayer and Pizza	**3,100**	3,014	2,930
Total Kraft Foods North America	**21,907**	21,485	20,970
Europe, Middle East and Africa	**7,045**	6,203	5,936
Latin America and Asia Pacific	**2,058**	2,035	2,328
Total Kraft Foods International	**9,103**	8,238	8,264
Net revenues	**$31,010**	$29,723	$29,234
Operating income:			
Operating companies income:			
Cheese, Meals and Enhancers	**$ 2,230**	$ 2,210	$ 2,132
Biscuits, Snacks and Confectionery	**887**	1,051	933
Beverages, Desserts and Cereals	**1,247**	1,136	1,192
Oscar Mayer and Pizza	**556**	556	539
Europe, Middle East and Africa	**1,012**	962	861
Latin America and Asia Pacific	**270**	368	378
Amortization of intangibles	**(9)**	(7)	(962)
General corporate expenses	**(182)**	(162)	(189)
Operating income	**$ 6,011**	$ 6,114	$ 4,884
Net earnings	**$ 3,476**	$ 3,394	$ 1,882
Weighted average shares for diluted earnings per share	**1,728**	1,736	1,610
Diluted earnings per share	**$ 2.01**	$ 1.96	$ 1.17

Operating income was affected by the following items during 2003, 2002 and 2001:

Integration Costs and a Loss on Sale of a Food Factory: During 2003, the Company reversed $13 million related to previously recorded integration charges. During 2002, the Company recorded pre-tax integration related charges of $115 million to consolidate production lines in North America, close a Kraft facility and for other consolidation programs. In addition, during 2002, the Company reversed $4 million related to the loss on sale of a food factory. 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 items were included in the operating companies income of the following segments:

(in millions)

For the Years Ended December 31,	2003	2002	2001
Cheese, Meals and Enhancers	**$(10)**	$ 30	$63
Biscuits, Snacks and Confectionery		1	2
Beverages, Desserts and Cereals	**(3)**	56	12
Oscar Mayer and Pizza		7	5
Latin America and Asia Pacific		17	
Integration costs and a loss on sale of a food factory	**$(13)**	$111	$82

Asset Impairment and Exit Costs: During 2003, the Company recorded a pre-tax charge of $6 million for asset impairment and exit costs related to the closure of a Nordic snacks plant. During 2002, the Company recorded a pre-tax charge of $142 million related to employee acceptances under a voluntary retirement program. Approximately 700 employees elected to retire or terminate employment under the program. During 2001, there were no asset impairment and exit costs. These charges were included in the operating companies income of the following segments:

(in millions)

For the Years Ended December 31,	2003	2002
Cheese, Meals and Enhancers		$ 60
Biscuits, Snacks and Confectionery		3
Beverages, Desserts and Cereals		47
Oscar Mayer and Pizza		25
Europe, Middle East and Africa	**$6**	5
Latin America and Asia Pacific		2
Asset impairment and exit costs	**$6**	$142

Gains on Sales of Businesses: During 2003, the Company sold a European rice business and a branded fresh cheese business in Italy for aggregate pre-tax gains of $31 million. During 2002, the Company sold its Latin American yeast and industrial bakery ingredients business, resulting in a pre-tax gain of $69 million, and several small food businesses, resulting in pre-tax gains of $11 million. During 2003, 2002 and 2001, total gains on sales of businesses were included in the operating companies income of the following segments:

(in millions)

For the Years Ended December 31,	2003	2002	2001
Biscuits, Snacks and Confectionery		$ 8	
Europe, Middle East and Africa	**$31**		
Latin America and Asia Pacific		72	$8
Gains on sales of businesses	**$31**	$80	$8

Amortization of Intangibles: As previously discussed, the Company stopped recording the amortization of goodwill as a charge to earnings as of January 1, 2002.

Businesses Held for Sale: During 2001, certain small Nabisco businesses were reclassified to businesses held for sale, including their estimated results of operations through anticipated dates of sales. These businesses have subsequently been sold, with the exception of one business that had been held for sale since the acquisition of Nabisco. This business, which is no longer held for sale, has been included in the 2003 and 2002 consolidated operating results of KFNA.

As discussed in Note 13 to the consolidated financial statements, the Company's management uses operating companies income, which is defined as operating income before general corporate expenses and amortization of intangibles, to evaluate segment performance and allocate resources. Management believes it is appropriate to disclose this measure to help investors analyze the business performance and trends of the various business segments.

2003 compared with 2002

The following discussion compares consolidated operating results for 2003 with 2002.

Volume increased 132 million pounds (0.7%), due primarily to increased shipments in the Beverages, Desserts and Cereals segment and the Cheese, Meals and Enhancers segment, growth in developing markets and the impact of acquisitions, partially offset by the impact of divested businesses, lower consumption in certain categories, particularly U.S. cookies, trade inventory reductions, price competition and the impact of a weaker global economy.

Net revenues increased $1,287 million (4.3%), due to favorable currency ($730 million), higher pricing ($471 million, reflecting higher commodity and currency devaluation-driven cost increases, partially offset by higher promotional spending), higher volume/mix ($114 million) and the impact of acquisitions ($59 million), partially offset by the impact of divested businesses ($87 million).

Operating income decreased $103 million (1.7%), due primarily to higher fixed manufacturing costs ($110 million, including higher benefit costs), higher marketing, administration and research costs ($104 million), unfavorable costs, net of higher pricing ($94 million, due primarily to higher commodity costs and increased promotional spending), unfavorable volume/mix ($66 million), the impact of gains on sales of businesses ($49 million) and the impact of divestitures ($18 million), partially offset by the impact of lower pre-tax charges for asset impairment and exit costs ($136 million) and the impact from integration costs and a loss on sale of a food factory ($124 million) and favorable currency ($94 million). The higher benefit costs were primarily related to pension and stock compensation costs.

Currency movements increased net revenues by $730 million and operating income by $94 million. These increases were due primarily to the further weakening of the U.S. dollar against the euro, the Canadian dollar and other currencies, partially offset by the strength of the U.S. dollar against certain Latin American currencies.

Interest and other debt expense, net, decreased $182 million. This decrease is due to the Company's refinancing of notes payable to Altria Group, Inc. and the use of free cash flow to pay down debt.

The Company's reported effective tax rate decreased by 0.6 percentage points to 34.9%, due primarily to rate differences from foreign operations.

Net earnings of $3,476 million increased $82 million (2.4%), due primarily to lower interest expense and a lower effective tax rate, partially offset by lower operating income. Diluted and basic earnings per share ("EPS"), which were both $2.01, increased by 2.6%.

2002 compared with 2001

The following discussion compares consolidated operating results for 2002 with 2001.

Volume increased 1,157 million pounds (6.7%), due primarily to the inclusion in 2002 of a business previously considered held for sale, new product introductions, geographic expansion and acquisitions.

Net revenues increased $489 million (1.7%), due primarily to higher volume/mix ($401 million), the inclusion in 2002 of a business previously considered held for sale ($252 million) and the impact of acquisitions ($191 million), partially offset by the adverse effect of currency exchange rates ($291 million) and lower sales prices on cheese and coffee products (driven by commodity-related declines).

Operating income increased $1,230 million (25.2%), due primarily to the elimination of substantially all goodwill amortization, volume growth and favorable margins.

Currency movements decreased net revenues by $291 million and operating income by $4 million. These decreases in net revenues and operating income were due primarily to the strength of the U.S. dollar against certain Latin American currencies, partially offset by the weakness of the U.S. dollar against the euro and other currencies.

Interest and other debt expense, net, decreased $590 million. This decrease was due primarily to lower debt levels after the repayment of Nabisco acquisition borrowings with the proceeds from the Company's IPO, as well as the Company's refinancing of notes payable to Altria Group, Inc. and lower short-term interest rates.

The Company's effective tax rate decreased by 9.9 percentage points to 35.5%, due primarily to the adoption of SFAS No. 141 and SFAS No. 142, under which the Company is no longer required to amortize goodwill as a charge to earnings.

Net earnings of $3,394 million increased $1,512 million (80.3%), due primarily to growth in operating income and lower interest expense. Diluted and basic EPS, which were both $1.96, increased by 67.5%.

Operating Results by Reportable Segment

Kraft Foods North America

(in millions)

For the Years Ended December 31,	**2003**	2002	2001
Volume (in pounds):			
Cheese, Meals and Enhancers	**6,183**	6,082	5,404
Biscuits, Snacks and Confectionery	**2,083**	2,185	2,165
Beverages, Desserts and Cereals	**3,905**	3,708	3,421
Oscar Mayer and Pizza	**1,570**	1,554	1,519
Volume (in pounds)	**13,741**	13,529	12,509
Net revenues:			
Cheese, Meals and Enhancers	**$ 9,439**	$ 9,172	$ 9,014
Biscuits, Snacks and Confectionery	**4,801**	4,887	4,789
Beverages, Desserts and Cereals	**4,567**	4,412	4,237
Oscar Mayer and Pizza	**3,100**	3,014	2,930
Net revenues	**$21,907**	$21,485	$20,970
Operating companies income:			
Cheese, Meals and Enhancers	**$ 2,230**	$ 2,210	$ 2,132
Biscuits, Snacks and Confectionery	**887**	1,051	933
Beverages, Desserts and Cereals	**1,247**	1,136	1,192
Oscar Mayer and Pizza	**556**	556	539
Operating companies income	**$ 4,920**	$ 4,953	$ 4,796

2003 compared with 2002

The following discussion compares KFNA's operating results for 2003 with 2002.

During the first quarter of 2003, the Company transferred management responsibility of its Canadian Biscuits and Pet Snacks operations from the Biscuits, Snacks and Confectionery segment to the Cheese, Meals and Enhancers segment, which contains the Company's other Canadian businesses. Accordingly, all prior period amounts have been reclassified to reflect the transfer.

Volume increased 1.6%, due primarily to contributions from new products and increased shipments in the Beverages, Desserts and Cereals segment and the Cheese, Meals and Enhancers segment, partially offset by the divestiture of a small confectionery business in 2002, consumption weakness in certain categories, primarily cookies, and trade inventory reductions.

Net revenues increased $422 million (2.0%), due primarily to higher volume/mix ($170 million), higher pricing, net of increased promotional spending ($151 million), and favorable currency ($120 million), partially offset by the divestiture of a small confectionery business in 2002 ($21 million).

Operating companies income decreased $33 million (0.7%), due primarily to unfavorable costs, net of higher pricing ($161 million, including higher commodity costs and increased promotional spending), higher fixed manufacturing costs ($79 million, including higher benefit costs) and unfavorable volume/mix ($37 million), partially offset by 2002 pre-tax charges for asset impairment and exit costs ($135 million) and the impact of lower integration costs and a loss on sale of a food factory ($107 million).

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

Cheese, Meals and Enhancers: Volume increased 1.7%, due primarily to higher shipments in cheese, food service, Canada and Mexico. Cheese volume increased due primarily to improved consumption and share trends resulting from the investment program that began in the third quarter of 2003. Volume for the food service business in the United States also increased, due to higher shipments to national accounts. Volume in Canada and Mexico increased, driven by new beverage product introductions.

Net revenues increased $267 million (2.9%), due to favorable currency ($120 million), higher volume/mix ($82 million) and higher pricing ($65 million, including the impact of increased promotional spending).

Operating companies income increased $20 million (0.9%), due primarily to the 2002 pre-tax charges for asset impairment and exit costs ($60 million), the impact of lower integration costs and a loss on the sale of a food factory ($40 million) and favorable currency ($22 million), partially offset by unfavorable costs, net of higher pricing ($72 million, including higher commodity costs and increased promotional spending), higher fixed manufacturing costs ($23 million, including higher benefit costs) and unfavorable volume/mix.

Biscuits, Snacks and Confectionery: Volume decreased 4.7%, due primarily to lower shipments in biscuits and the divestiture of a small confectionery business in 2002. In biscuits, volume declined, due primarily to reduced consumption in cookies, reflecting higher pricing, lower impact of new products, and consumer health and wellness concerns. Snacks volume increased, benefiting from category and consumption gains in snack nuts.

Net revenues decreased $86 million (1.8%), due to lower volume/mix ($56 million), the divestiture of a small confectionery business in 2002 ($21 million) and higher promotional spending, net of higher pricing ($9 million).

Operating companies income decreased $164 million (15.6%), due primarily to lower volume/mix ($84 million), higher fixed manufacturing costs ($77 million) and unfavorable costs, net of higher pricing ($71 million, including higher commodity costs and increased promotional spending), partially offset by lower marketing, administration and research costs ($77 million).

Beverages, Desserts and Cereals: Volume increased 5.3%, due primarily to higher shipments of ready-to-drink beverages, which were aided by new product introductions. Desserts volume also increased, due primarily to higher shipments of sugar-free items and increased merchandising programs. In coffee, volume declined, impacted by competitive activity and a category decline due to higher prices.

Net revenues increased $155 million (3.5%), due to higher volume/mix ($100 million) and higher pricing ($55 million).

Operating companies income increased $111 million (9.8%), due primarily to the impact of lower integration costs ($59 million), the 2002 asset impairment and exit costs ($47 million) and higher volume/mix ($43 million), partially offset by higher marketing, administration and research costs ($31 million), unfavorable costs, net of higher pricing ($13 million, including higher commodity costs) and higher benefit costs.

Oscar Mayer and Pizza: Volume increased 1.0%, due primarily to gains in cold cuts, hot dogs, bacon, soy-based meat alternatives and frozen pizza.

Net revenues increased $86 million (2.9%), due primarily to higher volume/mix ($44 million) and higher pricing ($40 million, including the impact of increased promotional spending).

Operating companies income was equal to the prior year's, as the impact of 2002 pre-tax charges for asset impairment and exit costs ($25 million) and integration costs ($7 million), lower fixed manufacturing costs ($14 million) and higher volume/mix ($10 million) was offset by higher marketing, administration and research costs ($51 million), unfavorable costs, net of higher pricing ($5 million, including higher commodity costs and increased promotional spending) and higher benefit costs.

2002 compared with 2001

The following discussion compares KFNA's operating results for 2002 with 2001.

KFNA's volume increased 8.2%, due primarily to the inclusion in 2002 of a business that was previously held for sale and contributions from new products.

Net revenues increased $515 million (2.5%), due primarily to higher volume/mix ($437 million) and the inclusion in 2002 of a business that was previously held for sale ($252 million), partially offset by lower selling prices in response to lower commodity costs ($154 million).

Operating companies income increased $157 million (3.3%), due primarily to higher volume/mix ($174 million), favorable margins ($176 million, driven by lower commodity-related costs and productivity) and Nabisco synergy savings, partially offset by higher benefit expense, including the 2002 charge for asset impairment and exit costs ($135 million).

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

Cheese, Meals and Enhancers: Volume increased 12.5%, due primarily to the inclusion in 2002 of a business that was previously held for sale and volume gains in enhancers, meals and food service, partially offset by a decline in cheese. Volume gains in enhancers and meals were led by *Kraft* pourable dressings, barbecue sauce, macaroni & cheese dinners and the 2001 acquisition of *It's Pasta Anytime.* In cheese, volume declined as lower dairy costs resulted in aggressive competitive activity by private label manufacturers as they reduced prices and increased merchandising levels.

Net revenues increased $158 million (1.8%), due primarily to the inclusion in 2002 of a business that was previously held for sale ($252 million) and higher volume/mix ($34 million), partially offset by lower net pricing ($118 million, primarily related to lower dairy commodity costs).

Operating companies income increased $78 million (3.7%), due primarily to favorable margins ($63 million, due primarily to lower cheese commodity costs and productivity savings), lower integration related costs in 2002 ($33 million), higher volume/mix ($31 million) and the inclusion in 2002 of a business that was previously held for sale ($23 million), partially offset by higher benefit expenses, including the 2002 charge for asset impairment and exit costs ($60 million).

Biscuits, Snacks and Confectionery: Volume increased 0.9%, as volume gains in biscuits and snacks were partially offset by a decline in confectionery shipments. In biscuits, volume increased, driven by new product initiatives in both cookies and crackers. In snacks, volume also increased, due primarily to promotional initiatives. Confectionery volume declined, resulting primarily from competitive activity in the breath-freshening category, partially offset by new product introductions in the non-chocolate confectionery business.

Net revenues increased $98 million (2.0%), due primarily to higher volume/mix ($61 million) and higher net pricing ($35 million).

Operating companies income increased $118 million (12.6%), due primarily to favorable margins ($81 million, due primarily to higher net pricing and lower commodity costs for nuts), Nabisco synergy savings and higher volume/mix.

Beverages, Desserts and Cereals: Volume increased 8.4%, due primarily to growth in ready-to-drink beverages. In coffee, volume increased, driven by merchandising programs and packaging innovation. In the desserts business, volume increases were led by dry packaged desserts and frozen toppings, which benefited from holiday programs, and in ready-to-eat desserts, aided by new products.

Net revenues increased $175 million (4.1%), due primarily to higher volume/mix ($245 million), partially offset by lower net pricing ($58 million).

Operating companies income decreased $56 million (4.7%), primarily reflecting the 2002 charge for asset impairment and exit costs ($47 million), higher integration-related costs ($44 million), higher marketing, administration and research costs ($36 million, including higher benefit costs) and lower margins ($18 million), partially offset by higher volume/mix ($98 million) and productivity savings.

Oscar Mayer and Pizza: Volume increased 2.3%, due to volume gains in processed meats and pizza. The increase in processed meats was driven by gains in hot dogs, bacon and soy-based meat alternatives, aided by new product introductions. The pizza business also benefited from new products.

Net revenues increased $84 million (2.9%), due to higher volume/mix ($97 million), partially offset by lower net pricing ($13 million).

Operating companies income increased $17 million (3.2%), primarily reflecting favorable costs ($50 million, due primarily to lower meat and cheese commodity costs and productivity savings) and higher volume/mix ($30 million), partially offset by the 2002 charge for asset impairment and exit costs ($25 million), higher marketing, administration and research costs ($24 million, including higher benefit costs) and higher manufacturing costs.

Kraft Foods International

(in millions)

For the Years Ended December 31,	**2003**	2002	2001
Volume (in pounds):			
Europe, Middle East and Africa	**2,971**	2,961	2,826
Latin America and Asia Pacific	**1,969**	2,059	2,057
Volume (in pounds)	**4,940**	5,020	4,883
Net revenues:			
Europe, Middle East and Africa	**$7,045**	$6,203	$5,936
Latin America and Asia Pacific	**2,058**	2,035	2,328
Net revenues	**$9,103**	$8,238	$8,264
Operating companies income:			
Europe, Middle East and Africa	**$1,012**	$ 962	$ 861
Latin America and Asia Pacific	**270**	368	378
Operating companies income	**$1,282**	$1,330	$1,239

2003 compared with 2002

The following discussion compares KFI's operating results for 2003 with 2002.

Volume decreased 1.6%, due to the divestiture of a Latin American bakery ingredients business in 2002 and a rice business and a branded fresh cheese business in Europe in 2003, the impact of price competition, particularly in Germany and France, and the adverse impact of a summer heat wave across Europe on the chocolate and coffee businesses. These declines were partially offset by growth in developing markets, including Russia, Brazil and China, and the acquisitions of a snacks business in Turkey and a biscuits business in Egypt.

Net revenues increased $865 million (10.5%), due to favorable currency ($610 million), higher pricing ($320 million, reflecting higher commodity and currency devaluation-driven cost increases in Latin America) and the impact of acquisitions ($57 million), partially offset by the impact of divestitures ($66 million) and lower volume/mix ($56 million).

Operating companies income decreased $48 million (3.6%), due primarily to higher marketing, administration and research costs ($98 million, including higher benefit costs and infrastructure investment in developing markets), the net impact of lower gains on sales of businesses ($41 million), lower volume/mix ($29 million) and the impact of divestitures ($13 million), partially offset by favorable currency ($72 million), higher pricing, net of cost increases ($36 million, including fixed manufacturing costs), the 2002 pre-tax charges for integration costs ($17 million) and the impact of acquisitions ($7 million).

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

Europe, Middle East and Africa: Volume increased 0.3%, due to volume growth in the Central and Eastern Europe, Middle East and Africa region, which benefited from the acquisition of a biscuits business in Egypt in 2003 as well as a snacks business acquisition in Turkey during the third quarter of 2002, and new product introductions. These gains were partially offset by the impact of the summer heat wave across Europe on the chocolate and coffee businesses, price competition in Germany and France, and the divestiture of a rice business and a branded fresh cheese business in Europe in 2003. In snacks, volume increased in biscuits and salted snacks, benefiting from acquisitions, partially offset by lower confectionery volume due to the summer heat wave across Europe and price competition. In beverages, volume declined, due primarily to the summer heat wave across Europe (which had an adverse impact on coffee shipments) and price competition. These declines were partially offset by increased coffee shipments in Russia, benefiting from expanded distribution, and Poland, aided by new product introductions. Convenient meals volume also declined, due to the divestiture of a rice business in Europe, partially offset by higher shipments of canned meats in Italy. Cheese volume declined, due primarily to the impact of price competition in Germany and Spain, partially offset by gains in cream cheese in Italy.

Net revenues increased $842 million (13.6%), due primarily to favorable currency ($808 million), the impact of acquisitions ($57 million) and higher pricing ($18 million), partially offset by unfavorable volume/mix ($43 million).

Operating companies income increased $50 million (5.2%), due primarily to favorable currency ($100 million) and the gain on the sale of a rice business and a branded fresh cheese business in Europe ($31 million), partially offset by unfavorable costs, net of higher pricing ($39 million, including higher commodity costs and increased promotional spending), unfavorable volume/mix ($28 million) and higher marketing, administration and research costs ($17 million, including higher benefit costs and infrastructure investment in eastern Europe).

Latin America and Asia Pacific: Volume decreased 4.4%, due to the divestiture of a Latin American bakery ingredients business in 2002, partially offset by growth in Argentina, Brazil, China and Australia. In grocery, volume declined in Latin America, due primarily to the sale of a bakery ingredients business in the fourth quarter of 2002. In beverages, volume increased, due primarily to growth in Brazil, Venezuela and China, aided by new product introductions. Snacks volume also increased, as biscuits volume growth in Brazil, Argentina, China and Australia, aided by new product introductions, was partially offset by a decline in confectionery, which was impacted by economic weakness, trade inventory reductions and price competition in Brazil. In cheese, volume increased, due to higher shipments in Asia Pacific, benefiting from new products in Australia and promotional programs in the Philippines, partially offset by declines in Latin America. In convenient meals, volume grew, benefiting from gains in Argentina.

Net revenues increased $23 million (1.1%), due to higher pricing ($302 million, reflecting higher commodity and currency devaluation-driven costs), partially offset by unfavorable currency ($198 million), the divestiture of a Latin American bakery ingredients business in 2002 ($68 million) and lower volume/mix ($13 million).

Operating companies income decreased $98 million (26.6%), due primarily to higher marketing, administration and research costs ($81 million), gains on sales of businesses in 2002 ($72 million), unfavorable currency ($28 million) and the divestiture of a Latin American bakery ingredients business in 2002 ($10 million), partially offset by higher pricing, net of cost increases ($75 million) and the 2002 pre-tax charges for integration costs ($17 million).

2002 compared with 2001

The following discussion compares KFI's operating results for 2002 with 2001.

KFI's volume increased 2.8% due primarily to acquisitions, new product introductions, geographic expansion and marketing programs. This increase in volume was partially offset by the impact of economic weakness in several Latin American countries and the impact of businesses sold.

Net revenues decreased $26 million (0.3%), due primarily to unfavorable currency movements ($271 million), lower volume/mix ($36 million) and revenues of divested businesses ($22 million), partially offset by the impact of acquisitions ($181 million) and higher net pricing ($122 million).

Operating companies income increased $91 million (7.3%), due primarily to gains on sales of businesses ($64 million), favorable margins ($37 million, including productivity savings), lower marketing, administration and research costs ($23 million, including synergy savings) and the impact of acquisitions ($18 million), partially offset by lower volume/mix ($19 million), 2002 integration costs ($17 million) and income of divested businesses ($8 million).

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

Europe, Middle East and Africa: Volume increased 4.8%, driven by acquisitions and volume growth across most markets including Italy, the United Kingdom, Sweden, the Ukraine, the Middle East and Poland, partially offset by declines in Germany and Romania. Snacks volume increased, benefiting from confectionery acquisitions in Russia and Poland, a snacks acquisition in Turkey and new product introductions across the segment. Snacks volume growth was moderated by a decline in Germany, reflecting aggressive competitive activity, and in Romania, due to lower consumer purchasing power. In beverages, volume increased in both coffee and refreshment beverages. Coffee volume grew in most markets, driven by new product introductions, and acquisitions in Romania, Morocco and Bulgaria. In Germany, coffee volume decreased, reflecting market softness and increased price competition. Refreshment beverages volume also increased, driven by the geographic expansion of powdered beverages and new product introductions. Cheese volume increased with gains in *Philadelphia* cream cheese, benefiting from advertising and new product introductions. In convenient meals, volume increased, due primarily to higher canned meats volume in Italy against a weak comparison in 2001, and new product introductions of lunch combinations in the United Kingdom.

Net revenues increased $267 million (4.5%), due primarily to favorable currency movements ($197 million), the acquisitions of coffee, confectionery and snacks businesses ($147 million) and higher volume/mix ($22 million), partially offset by lower net pricing ($99 million, due primarily to commodity-driven coffee price declines).

Operating companies income increased $101 million (11.7%), due primarily to favorable margins ($42 million), favorable currency movements ($37 million), higher volume/mix ($19 million) and acquisitions ($16 million), partially offset by higher marketing, administration and research costs.

Latin America and Asia Pacific: Volume increased slightly, as the acquisition of a biscuits business in Australia and gains across numerous markets were partially offset by a volume decline in Argentina due to economic weakness, lower results in China and the impact of businesses sold. In snacks, volume growth was driven by gains in biscuits, benefiting from geographic expansion of cookies and crackers in Latin America, new product introductions and the acquisition of a biscuits business in Australia. Snacks volume growth was partially offset by the negative impact of the continued economic weakness in Argentina and distributor inventory reductions in China. Beverages volume also increased, due primarily to growth in powdered beverages in numerous markets across Latin America and Asia Pacific, which benefited from new product introductions. In grocery, volume declined in both Latin America and Asia Pacific.

Net revenues decreased $293 million (12.6%), due primarily to unfavorable currency movements ($468 million), lower volume/mix ($58 million) and revenues from divested businesses ($22 million), partially offset by higher net pricing ($221 million) and the 2002 acquisition of a biscuits business in Australia ($34 million).

Operating companies income decreased $10 million (2.6%), due primarily to lower volume/mix ($38 million), unfavorable currency movements ($37 million), 2002 integration costs ($17 million) and the operating companies income of disposed businesses, partially offset by gains on sales of businesses ($64 million) and lower marketing, administration and research costs ($31 million, including synergy savings).

Financial Review

Net Cash Provided by Operating Activities

Net cash provided by operating activities was $4.1 billion in 2003, $3.7 billion in 2002 and $3.3 billion in 2001. The increase in 2003 operating cash flows over 2002 was due primarily to a lower use of cash to fund working capital, partially offset by increased pension contributions. The increase in 2002 operating cash flows over 2001 primarily reflected cash flow from increased net earnings.

Net Cash Used in Investing Activities

One element of the growth strategy of the Company is to strengthen its brand portfolios through disciplined programs of selective acquisitions and divestitures. The Company is constantly investigating potential acquisition candidates and from time to time sells businesses that are outside its core categories or that do not meet its growth or profitability targets.

During 2003, 2002 and 2001, net cash used in investing activities was $1.0 billion, $1.1 billion and $1.2 billion, respectively. The decrease in 2003 primarily reflected lower capital expenditures and lower purchases of businesses, partially offset by the reduction in the cash received from the sales of businesses. The decrease in 2002 primarily reflected lower purchases of businesses and an increase in the cash received from the sales of businesses, partially offset by higher capital expenditures related to the integration of Nabisco.

Capital expenditures, which were funded by operating activities, were $1.1 billion, $1.2 billion and $1.1 billion in 2003, 2002 and 2001, respectively. The capital expenditures were primarily to modernize manufacturing facilities, lower cost of production and expand production capacity for growing product lines. In 2004, capital expenditures are currently expected to be at or slightly above 2003 expenditures, including capital expenditures required for the restructuring program announced in January 2004. These expenditures are expected to be funded from operations.

Net Cash Used in Financing Activities

During 2003, net cash of $2.8 billion was used in financing activities, compared with $2.6 billion during 2002. The increase in cash used in 2003 was due primarily to an increase in the Company's Class A share repurchases and an increase in dividend payments, partially offset by a decrease in net debt repayments in 2003 (including amounts due to Altria Group, Inc. and affiliates). During 2003, the Company issued $1.5 billion of third-party long-term debt, the net proceeds of which were used to repay outstanding related party indebtedness. Financing activities included net debt repayments of approximately $1.4 billion in 2003.

During 2002, net cash of $2.6 billion was used in financing activities, compared with $2.1 billion during 2001. The increase in cash used was due primarily to dividends paid during 2002 and repurchases of the Company's Class A common stock. During 2002, Kraft issued $2.5 billion of global bonds and $750 million of floating rate notes, the net proceeds of which were used to repay outstanding related party indebtedness. Financing activities included net debt repayments of approximately $1.5 billion in 2002.

Debt and Liquidity

Financial Reporting Release No. 61 sets forth the views of the Securities and Exchange Commission ("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 amounts due to Altria Group, Inc. and affiliates, was $13.5 billion at December 31, 2003 and $14.4 billion at December 31, 2002. The decrease in total debt is due primarily to the repayment of amounts due to Altria Group, Inc. and affiliates, partially offset by an increase in third-party borrowings. The Company's debt-to-equity ratio was 0.47 at December 31, 2003 and 0.56 at December 31, 2002.

During 2003, the Company repaid the remaining $1,150 million of the 7.0% long-term notes payable to Altria Group, Inc. and affiliates, as well as the $1,410 million of short-term borrowings reclassified to long-term. In September 2003, Kraft issued $1.5 billion of third-party long-term debt, including $700 million of 5-year notes bearing interest at a rate of 4.0% and $800 million of 10-year notes bearing interest at 5.25%. The net proceeds from the offering were used to repay outstanding related party indebtedness. At December 31, 2003 and 2002, the Company had short-term amounts payable to Altria Group, Inc. of $543 million and $895 million, respectively. Interest on these borrowings is based on the applicable London Interbank Offered Rate.

Credit Ratings: Following a $10.1 billion judgment on March 21, 2003 against Altria Group, Inc.'s domestic tobacco subsidiary, Philip Morris USA Inc., the three major credit rating agencies took a series of ratings actions resulting in the lowering of the Company's short-term and long-term debt ratings, despite the fact the Company is neither a party to, nor has exposure to, this litigation. Moody's lowered the Company's short-term debt rating from "P-1" to "P-2" and its long-term debt rating from "A2" to "A3," with stable outlook. Standard & Poor's lowered the Company's short-term debt rating from "A-1" to "A-2" and its long-term debt rating from "A-" to "BBB+," with stable outlook. Fitch Rating Services lowered the Company's short-term debt rating from "F-1" to "F-2" and its long-term debt rating from "A" to "BBB+," with stable outlook. As a result of the credit rating agencies' actions, the Company temporarily lost access to the commercial paper market, and borrowing costs increased. None of the Company's debt agreements requires accelerated repayment in the event of a decrease in credit ratings.

Credit Lines: The Company maintains revolving credit facilities that have historically been used to support the issuance of commercial paper. At December 31, 2003, credit lines for the Company and the related activity were as follows:

(in billions of dollars)

Type	Credit Lines	Amount Drawn	Commercial Paper Outstanding
364-day (expires July 2004)	$2.5	$—	$0.3
Multi-year (expires July 2006)	2.0		1.9
	$4.5	$—	$2.2

The Company's revolving credit facilities, which are for its sole use, require the maintenance of a minimum net worth of $18.2 billion. The Company met this covenant at December 31, 2003 and expects to continue to meet this covenant. The foregoing revolving credit facilities do not include any other financial tests, any credit rating triggers or any provisions that could require the posting of collateral. The multi-year revolving credit facility enables the Company to reclassify short-term debt on a long-term basis. At December 31, 2003, $1.9 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.

In addition to the above, certain international subsidiaries of Kraft maintain uncommitted credit lines to meet the short-term working capital needs of the international businesses. These credit lines, which amounted to approximately $658 million as of December 31, 2003, are for the sole use of the Company's international businesses. Borrowings on these lines were approximately $220 million at December 31, 2003 and 2002.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

The Company has no off-balance sheet arrangements other than the guarantees and contractual obligations that are discussed below.

Guarantees: As discussed in Note 17 to the consolidated financial statements, the Company had third-party guarantees, which are primarily derived from acquisition and divestiture activities, of approximately $38 million at December 31, 2003. Substantially all of these guarantees expire through 2014, with $13 million expiring during 2004. The Company is required to perform under these guarantees in the event that a third party fails to make contractual payments or achieve performance measures. The Company has a liability of $26 million on its consolidated balance sheet at December 31, 2003, relating to these guarantees.

In addition, at December 31, 2003, the Company was contingently liable for $123 million of guarantees related to its own performance. These include surety bonds related to dairy commodity purchases and guarantees related to the payment of customs duties and taxes, and letters of credit.

Guarantees do not have, and are not expected to have, a significant impact on the Company's liquidity.

Aggregate Contractual Obligations: The following table summarizes the Company's contractual obligations at December 31, 2003:

	Payments Due				
(in millions)	Total	2004	2005–06	2007–08	2009 and Thereafter
Long-term debt(1)	$10,510	$ 775	$1,994	$2,100	$5,641
Operating leases(2)	1,187	307	397	247	236
Purchase obligations(3):					
Inventory and production costs	5,611	2,643	1,162	578	1,228
Other	781	617	111	46	7
	6,392	3,260	1,273	624	1,235
Other long-term liabilities(4)	41		20	11	10
	$18,130	$4,342	$3,684	$2,982	$7,122

(1) Amounts represent the expected cash payments of the Company's long-term debt and do not include short-term borrowings reclassified as long-term debt, bond premiums or discounts.

(2) Operating leases represent the minimum rental commitments under non-cancelable operating leases. The Company has no significant capital lease obligations.

(3) Purchase obligations for inventory and production costs (such as raw materials, indirect materials and supplies, packaging, co-manufacturing arrangements, storage and distribution) are commitments for projected needs to be utilized in the normal course of business. Other purchase obligations include commitments for marketing, advertising, capital expenditures, information technology and professional services. Arrangements are considered purchase obligations if a contract specified all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice (usually 30 days). Any amounts reflected on the consolidated balance sheet as accounts payable and accrued liabilities are excluded from the table above.

(4) Other long-term liabilities primarily consist of certain specific severance and incentive compensation arrangements. The following long-term liabilities included on the consolidated balance sheet are excluded from the table above: accrued pension, postretirement health care and postemployment costs, income taxes, minority interest, insurance accruals and other accruals. The Company is unable to estimate the timing of the payments for these items. Currently, the Company anticipates making U.S. pension contributions of approximately $70 million in 2004, based on current tax law (as discussed in Note 14 to the consolidated financial statements).

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

Equity and Dividends

In 2002, Kraft's Board of Directors approved the repurchase from time to time of up to $500 million of Kraft's Class A common stock solely to satisfy the obligations of Kraft to provide shares under its 2001 Performance Incentive Plan, 2001 Director Plan for non-employee directors, and other plans where options to purchase Kraft's Class A common stock are granted to employees of the Company. On December 3, 2003, Kraft completed the $500 million Class A common stock repurchase program, acquiring 15,308,458 Class A shares at an average price of $32.66 per share. On December 8, 2003, Kraft commenced repurchasing shares under a new $700 million Class A common stock repurchase authority approved by its Board of Directors in 2003. Through December 31, 2003, repurchases under the $700 million program were 1,583,600 shares at a cost of $50 million, or $31.57 per share. During 2003, Kraft repurchased 12.5 million shares at a cost of $380 million, and in 2002 Kraft repurchased 4.4 million shares at a cost of $170 million.

Concurrently with the IPO, certain employees of Altria Group, Inc. and its subsidiaries received a one-time grant of options to purchase shares of Kraft's Class A common stock held by Altria Group, Inc. at the IPO price of $31.00 per share. In order to completely satisfy this obligation, Altria Group, Inc. purchased 1.6 million shares of Kraft's Class A common stock in open market transactions during 2002.

During the first quarter of 2003, the Company granted shares of restricted stock and rights to receive shares of stock to eligible employees, giving them in most instances all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights. Such shares and rights are subject to forfeiture if certain employment conditions are not met. During the first quarter of 2003, the Company granted approximately 3.7 million restricted Class A shares to eligible U.S.-based employees and also issued to eligible non-U.S. employees rights to receive approximately 1.6 million Class A equivalent shares. Restrictions on the stock and rights lapse in the first quarter of 2006. The market value per restricted share or right was $36.56 on the date of grant.

The fair value of the shares of restricted stock and rights to receive shares of stock at the date of grant is amortized to expense ratably over the restriction period. The Company recorded compensation expense related to the restricted stock and rights of $57 million for the year ended December 31, 2003. The unamortized portion, which is reported on the consolidated balance sheet as a reduction of earnings reinvested in the business, was $129 million at December 31, 2003.

Dividends paid in 2003 and 2002 were $1,089 million and $936 million, respectively, reflecting a higher dividend rate in 2003, partially offset by lower shares outstanding as a result of Class A share repurchases. During the third quarter of 2003, Kraft's Board of Directors approved a 20% increase in the quarterly dividend rate to $0.18 per share on its Class A and Class B common stock. As a result, the present annualized dividend rate is $0.72 per common share. The declaration of dividends is subject to the discretion of Kraft'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 Kraft's Board of Directors.

Market Risk

The Company operates globally, 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. Derivative financial instruments are used by the Company, principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates and commodity prices by creating offsetting exposures. The Company is not a party to leveraged derivatives and, by policy, does not use financial instruments for speculative purposes.

Substantially all of the Company's derivative financial instruments are effective as hedges. During the year ended December 31, 2003, ineffectiveness related to cash flow hedges resulted in a gain of $13 million, which was recorded in cost of sales on the consolidated statement of earnings. Ineffectiveness related to cash flow hedges during the year ended December 31, 2002 was not material. At December 31, 2003, the Company was hedging forecasted transactions for periods not exceeding twelve months and expects substantially all amounts reported in accumulated other comprehensive earnings (losses) to be reclassified to the consolidated statement of earnings within the next twelve months.

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, based on the size and location of its businesses, include the euro, Swiss franc, British pound and Canadian dollar. At December 31, 2003 and 2002, the Company had option and forward foreign exchange contracts with aggregate notional amounts of $2,486 million and $575 million, respectively, which are comprised of contracts for the purchase and 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 earnings (losses) until the underlying hedged transactions are reported on the Company's consolidated statement of earnings.

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 and cheese. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar and soybean oil. 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, 2003 and 2002, the Company had net long commodity positions of $255 million and $544 million, respectively. Unrealized gains or losses on net commodity positions were immaterial at December 31, 2003 and 2002. The effective portion of unrealized gains and losses on commodity futures and option contracts is deferred as a component of accumulated other comprehensive earnings (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.

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, 2003 and 2002, 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 12/31/03	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	**$21**	**$ 8**	**$ 21**	**$ 3**
Commodity prices	**5**	**5**	**7**	**3**

	Fair Value Impact			
(in millions)	At 12/31/03	Average	High	Low
Instruments sensitive to:				
Interest rates	**$77**	**$97**	**$114**	**$77**

	Pre-Tax Earnings Impact			
(in millions)	At 12/31/02	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	$ 5	$ 2	$ 5	$ 1
Commodity prices	4	6	9	4

	Fair Value Impact			
(in millions)	At 12/31/02	Average	High	Low
Instruments sensitive to:				
Interest rates	$76	$74	$ 76	$70

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

See Note 2 to the consolidated financial statements for a discussion of recently adopted accounting standards.

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 ("SEC") and in its reports to shareholders. One can identify these forward-looking statements by use of words such as "strategy," "expects," "plans," "anticipates," "believes," "will," "continues," "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. These statements are based on our assumptions and estimates and are subject to risks and uncertainties. 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 and demand for its products, the effects of changing prices for its raw materials and local economic and market 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, to broaden brand portfolios, 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 consummate and successfully integrate acquisitions and to realize the cost savings and improved asset utilization contemplated by its restructuring program. In addition, the Company is subject to the effects of foreign economies, currency movements, fluctuations in levels of customer inventories and credit and other business risks related to its customers operating in a challenging economic and competitive environment. The Company's results are affected by its access to credit markets, borrowing costs and credit ratings, which may in turn be influenced by the credit ratings of Altria Group, Inc. The Company's benefit expense is subject to the investment performance of pension plan assets, interest rates and cost increases for medical benefits offered to employees and retirees. The food industry continues to be subject to recalls if products become adulterated or misbranded, liability if product consumption causes injury, ingredient disclosure and labeling laws and regulations and the possibility that consumers could lose confidence in the safety and quality of certain food products. The food industry is also subject to consumer concerns regarding genetically modified organisms and the health implications of obesity and trans-fatty acids. Developments in any of these areas, which are more fully described elsewhere in this document 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. Any forward-looking statements are made as of the date of the document in which they appear. 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.

(in millions of dollars, except per share data)

	2003	2002	2001	2000	1999
Summary of Operations:					
Net revenues	**$31,010**	$29,723	$29,234	$22,922	$23,430
Cost of sales	**18,828**	17,720	17,566	13,959	14,615
Operating income	**6,011**	6,114	4,884	4,012	3,579
Interest and other debt expense, net	**665**	847	1,437	597	539
Earnings before income taxes and minority interest	**5,346**	5,267	3,447	3,415	3,040
Pre-tax profit margin	**17.2%**	17.7%	11.8%	14.9%	13.0%
Provision for income taxes	**1,866**	1,869	1,565	1,414	1,287
Net earnings	**3,476**	3,394	1,882	2,001	1,753
Basic EPS	**2.01**	1.96	1.17	1.38	1.20
Diluted EPS	**2.01**	1.96	1.17	1.38	1.20
Dividends declared per share	**0.66**	0.56	0.26	—	—
Weighted average shares (millions)—Basic	**1,727**	1,734	1,610	1,455	1,455
Weighted average shares (millions)—Diluted	**1,728**	1,736	1,610	1,455	1,455
Capital expenditures	**1,085**	1,184	1,101	906	860
Depreciation	**804**	709	680	499	491
Property, plant and equipment, net	**10,155**	9,559	9,109	9,405	6,526
Inventories	**3,343**	3,382	3,026	3,041	2,563
Total assets	**59,285**	57,100	55,798	52,071	30,336
Long-term debt	**11,591**	10,416	8,134	2,695	433
Notes payable to Altria Group, Inc. and affiliates	**—**	2,560	5,000	21,407	6,602
Total debt	**13,462**	14,443	16,007	25,826	7,828
Total deferred income taxes	**5,175**	4,917	4,565	942	789
Shareholders' equity	**28,530**	25,832	23,478	14,048	13,461
Common dividends declared as a % of Basic EPS	**32.8%**	28.6%	22.2%	—	—
Common dividends declared as a % of Diluted EPS	**32.8%**	28.6%	22.2%	—	—
Book value per common share outstanding	**16.57**	14.92	13.53	9.65	9.25
Market price per Class A common share—high/low	**39.40-26.35**	43.95-32.50	35.57-29.50	—	—
Closing price of Class A common share at year end	**32.22**	38.93	34.03	—	—
Price/earnings ratio at year end—Basic	**16**	20	29	—	—
Price/earnings ratio at year end—Diluted	**16**	20	29	—	—
Number of common shares outstanding at year end (millions)	**1,722**	1,731	1,735	1,455	1,455
Number of employees	**106,000**	109,000	114,000	117,000	71,000

(in millions of dollars)

At December 31,	**2003**	2002
Assets		
Cash and cash equivalents	**$ 514**	$ 215
Receivables (less allowances of $114 and $119)	**3,369**	3,116
Inventories:		
Raw materials	**1,375**	1,372
Finished product	**1,968**	2,010
	3,343	3,382
Deferred income taxes	**681**	511
Other current assets	**217**	232
Total current assets	**8,124**	7,456
Property, plant and equipment, at cost:		
Land and land improvements	**407**	387
Buildings and building equipment	**3,422**	3,153
Machinery and equipment	**11,293**	10,108
Construction in progress	**683**	802
	15,805	14,450
Less accumulated depreciation	**5,650**	4,891
	10,155	9,559
Goodwill	**25,402**	24,911
Other intangible assets, net	**11,477**	11,509
Prepaid pension assets	**3,243**	2,814
Other assets	**884**	851
Total Assets	**$59,285**	$57,100
Liabilities		
Short-term borrowings	**$ 553**	$ 220
Current portion of long-term debt	**775**	352
Due to Altria Group, Inc. and affiliates	**543**	895
Accounts payable	**2,005**	1,939
Accrued liabilities:		
Marketing	**1,500**	1,474
Employment costs	**699**	610
Other	**1,335**	1,316
Income taxes	**451**	363
Total current liabilities	**7,861**	7,169
Long-term debt	**11,591**	10,416
Deferred income taxes	**5,856**	5,428
Accrued postretirement health care costs	**1,894**	1,889
Notes payable to Altria Group, Inc. and affiliates		2,560
Other liabilities	**3,553**	3,806
Total liabilities	**30,755**	31,268
Contingencies (Note 17)		
Shareholders' Equity		
Class A common stock, no par value (555,000,000 shares issued in 2003 and 2002)		
Class B common stock, no par value (1,180,000,000 shares issued and outstanding)		
Additional paid-in capital	**23,704**	23,655
Earnings reinvested in the business	**7,020**	4,814
Accumulated other comprehensive losses (primarily currency translation adjustments)	**(1,792)**	(2,467)
	28,932	26,002
Less cost of repurchased stock (13,062,876 and 4,381,150 Class A shares)	**(402)**	(170)
Total shareholders' equity	**28,530**	25,832
Total Liabilities and Shareholders' Equity	**$59,285**	$57,100

See notes to consolidated financial statements.

(in millions of dollars, except per share data)

For the years ended December 31,	**2003**	2002	2001
Net revenues	**$31,010**	$29,723	$29,234
Cost of sales	**18,828**	17,720	17,566
Gross profit	**12,182**	12,003	11,668
Marketing, administration and research costs	**6,200**	5,709	5,748
Integration costs and a loss on sale of a food factory	**(13)**	111	82
Asset impairment and exit costs	**6**	142	
Gains on sales of businesses	**(31)**	(80)	(8)
Amortization of intangibles	**9**	7	962
Operating income	**6,011**	6,114	4,884
Interest and other debt expense, net	**665**	847	1,437
Earnings before income taxes and minority interest	**5,346**	5,267	3,447
Provision for income taxes	**1,866**	1,869	1,565
Earnings before minority interest	**3,480**	3,398	1,882
Minority interest in earnings, net	**4**	4	
Net earnings	**$ 3,476**	$ 3,394	$ 1,882
Per share data:			
Basic earnings per share	**$ 2.01**	$ 1.96	$ 1.17
Diluted earnings per share	**$ 2.01**	$ 1.96	$ 1.17

See notes to consolidated financial statements.

(in millions of dollars)

For the years ended December 31,	**2003**	2002	2001
Cash Provided By (Used In) Operating Activities			
Net earnings	**$ 3,476**	$ 3,394	$ 1,882
Adjustments to reconcile net earnings to operating cash flows:			
Depreciation and amortization	**813**	716	1,642
Deferred income tax provision	**244**	278	414
Gains on sales of businesses	**(31)**	(80)	(8)
Integration costs and a loss on sale of a food factory, net of cash paid	**(26)**	91	79
Asset impairment and exit costs, net of cash paid	**6**	128	
Cash effects of changes, net of the effects from acquired and divested companies:			
Receivables, net	**(45)**	116	23
Inventories	**197**	(220)	(107)
Accounts payable	**(116)**	(116)	(73)
Income taxes	**(125)**	277	74
Amounts due to Altria Group, Inc. and affiliates	**169**	(244)	138
Other working capital items	**(167)**	(330)	(290)
Change in pension assets and postretirement liabilities, net	**(419)**	(217)	(305)
Other	**143**	(73)	(141)
Net cash provided by operating activities	**4,119**	3,720	3,328
Cash Provided By (Used In) Investing Activities			
Capital expenditures	**(1,085)**	(1,184)	(1,101)
Purchases of businesses, net of acquired cash	**(98)**	(122)	(194)
Proceeds from sales of businesses	**96**	219	21
Other	**38**	35	52
Net cash used in investing activities	**(1,049)**	(1,052)	(1,222)
Cash Provided By (Used In) Financing Activities			
Net issuance (repayment) of short-term borrowings	**819**	(1,036)	2,505
Long-term debt proceeds	**1,577**	3,325	4,077
Long-term debt repaid	**(491)**	(609)	(705)
Repayment of notes payable to Altria Group, Inc. and affiliates	**(2,757)**	(3,850)	(16,350)
(Decrease) increase in amounts due to Altria Group, Inc. and affiliates	**(525)**	660	142
Repurchase of Class A common stock	**(372)**	(170)	
Dividends paid	**(1,089)**	(936)	(225)
Net proceeds from sale of Class A common stock			8,425
Other	**52**		
Net cash used in financing activities	**(2,786)**	(2,616)	(2,131)
Effect of exchange rate changes on cash and cash equivalents	**15**	1	(4)
Cash and cash equivalents:			
Increase (decrease)	**299**	53	(29)
Balance at beginning of year	**215**	162	191
Balance at end of year	**$ 514**	$ 215	$ 162
Cash paid:			
Interest	**$ 642**	$ 825	$ 1,433
Income taxes	**$ 1,726**	$ 1,368	$ 1,058

See notes to consolidated financial statements.

(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 Earnings (Losses): Currency Translation Adjustments	Accumulated Other Comprehensive Earnings (Losses): Other	Accumulated Other Comprehensive Earnings (Losses): Total	Cost of Repurchased Stock	Total Shareholders' Equity
Balances, January 1, 2001	$—	$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
Cash dividends declared ($0.26 per share)			(483)					(483)
Balances, December 31, 2001	—	23,655	2,391	(2,436)	(132)	(2,568)	—	23,478
Comprehensive earnings:								
Net earnings			3,394					3,394
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				187		187		187
Additional minimum pension liability					(117)	(117)		(117)
Change in fair value of derivatives accounted for as hedges					31	31		31
Total other comprehensive earnings								101
Total comprehensive earnings								3,495
Cash dividends declared ($0.56 per share)			(971)					(971)
Class A common stock repurchased							(170)	(170)
Balances, December 31, 2002	—	23,655	4,814	(2,249)	(218)	(2,467)	(170)	25,832
Comprehensive earnings:								
Net earnings			**3,476**					**3,476**
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				**755**		**755**		**755**
Additional minimum pension liability					**(68)**	**(68)**		**(68)**
Change in fair value of derivatives accounted for as hedges					**(12)**	**(12)**		**(12)**
Total other comprehensive earnings								**675**
Total comprehensive earnings								**4,151**
Exercise of stock options and issuance of other stock awards		**49**	**(129)**				**148**	**68**
Cash dividends declared ($0.66 per share)			**(1,141)**					**(1,141)**
Class A common stock repurchased							**(380)**	**(380)**
Balances, December 31, 2003	**$—**	**$23,704**	**$ 7,020**	**$(1,494)**	**$(298)**	**$(1,792)**	**$(402)**	**$28,530**

See 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. Kraft, through its subsidiaries (Kraft and its subsidiaries are hereinafter referred to as the "Company"), is engaged in the manufacture and sale of branded foods and beverages in the United States, Canada, Europe, Latin America, Asia Pacific and Middle East and Africa.

Prior to June 13, 2001, the Company was a wholly-owned subsidiary of Altria Group, Inc. 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 Altria Group, Inc., incurred in connection with the acquisition of Nabisco Holdings Corp. ("Nabisco"). After the IPO, Altria Group, Inc. owned 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. At December 31, 2003, Altria Group, Inc. held 97.9% of the combined voting power of the Company's outstanding capital stock and owned approximately 84.6% of the outstanding shares of the Company's capital stock.

Basis of presentation: The consolidated financial statements include Kraft, as well as its wholly-owned and majority-owned subsidiaries. Investments in which the Company exercises significant influence (20%–50% ownership interest) are accounted for under the equity method of accounting. Investments in which the Company has an ownership interest of less than 20%, or does not exercise significant influence, are accounted for with the cost method of accounting. All intercompany transactions and balances between and among Kraft's subsidiaries have been eliminated. Transactions between any of the Company's businesses and Altria Group, Inc. and its affiliates are included in these financial statements.

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 liabilities at the dates of the financial statements and the reported amounts of net revenues and expenses during the reporting periods. Significant estimates and assumptions include, among other things, pension and benefit plan assumptions and income taxes. Actual results could differ from those estimates. The Company's operating subsidiaries report year-end results as of the Saturday closest to the end of each year.

Certain prior years' amounts have been reclassified to conform with the current year's presentation, due primarily to the disclosure of more detailed information on the consolidated balance sheets and the consolidated statements of cash flows, as well as the transfer of Canadian Biscuits and Pet Snacks from the Biscuits, Snacks and Confectionery segment to the Cheese, Meals and Enhancers segment, which contains the Company's other Canadian businesses.

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.

Depreciation, amortization and goodwill valuation: Property, plant and equipment are stated at historical cost and depreciated by the straight-line method over the estimated useful 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.

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." As a result, the Company stopped recording the amortization of goodwill as a charge to earnings as of January 1, 2002. Net earnings and diluted earnings per share ("EPS") would have been as follows had the provisions of the new standards been applied as of January 1, 2001:

(in millions, except per share amounts)

For the year ended December 31,	20
Net earnings, as previously reported	$1,882
Adjustment for amortization of goodwill	955
Net earnings, as adjusted	2,837
Diluted EPS, as previously reported	$ 1.17
Adjustment for amortization of goodwill	0.59
Diluted EPS, as adjusted	$ 1.76

In addition, the Company is required to conduct an annual review of goodwill and intangible assets for potential impairment. Goodwill impairment testing requires a comparison between the carrying value and fair value of a reportable goodwill asset. If the carrying value exceeds the fair value, goodwill is considered impaired. The amount of impairment loss is measured as the difference between the carrying value and implied fair value of goodwill, which is determined using discounted cash flows. Impairment testing for non-amortizable intangible assets requires a comparison between fair value and carrying value of the intangible asset. If the carrying value exceeds fair value, the intangible asset is considered impaired and is reduced to fair value. In 2003, the Company did not have to record a charge to earnings for an impairment of goodwill or other intangible assets as a result of its annual review.

At December 31, 2003 and 2002, goodwill by reportable segment was as follows:

(in millions)

	2003	2002
Cheese, Meals and Enhancers	**$ 8,834**	$ 8,803
Biscuits, Snacks and Confectionery	**8,963**	9,015
Beverages, Desserts and Cereals	**2,143**	2,143
Oscar Mayer and Pizza	**613**	616
Total Kraft Foods North America	**20,553**	20,577
Europe, Middle East and Africa	**4,562**	4,082
Latin America and Asia Pacific	**287**	252
Total Kraft Foods International	**4,849**	4,334
Total goodwill	**$25,402**	$24,911

Intangible assets at December 31, 2003 and 2002, were as follows:

(in millions)

	2003		2002	
	Gross Carrying Amount	**Accumulated Amortization**	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	**$11,432**		$11,485	
Amortizable intangible assets	**84**	**$39**	54	$30
Total intangible assets	**$11,516**	**$39**	$11,539	$30

Non-amortizable intangible assets are substantially comprised of brand names purchased through the Nabisco acquisition. Amortizable intangible assets consist primarily of certain trademark licenses and non-compete agreements. Pre-tax amortization expense for intangible assets was $9 million and $7 million for the years ended December 31, 2003 and 2002, respectively. Amortization expense for each of the next five years is currently estimated to be $10 million or less.

The movement in goodwill and intangible assets from December 31, 2002, is as follows:

(in millions)

	Goodwill	Intangible Assets
Balance at December 31, 2002	$24,911	$11,539
Changes due to:		
Acquisitions	49	30
Currency	520	(40)
Other	(78)	(13)
Balance at December 31, 2003	**$25,402**	**$11,516**

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 on an undiscounted basis 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.

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 are recorded in marketing, administration and research costs on the consolidated statements of earnings and were not significant for any of the periods presented.

Guarantees: Effective January 1, 2003, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Interpretation No. 45 required the disclosure of certain guarantees existing at December 31, 2002. In addition, Interpretation No. 45 required the recognition of a liability for the fair value of the obligation of qualifying guarantee activities that are initiated or modified after December 31, 2002. Accordingly, the Company has applied the recognition provisions of Interpretation No. 45 to guarantees initiated after December 31, 2002. Adoption of Interpretation No. 45 as of January 1, 2003 did not have a material impact on the Company's consolidated financial statements. See Note 17. *Contingencies* for a further discussion of guarantees.

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." These standards require that all derivative financial instruments be recorded at fair value on the consolidated balance sheets as either assets or liabilities. Changes in the fair value of derivatives are recorded each period either in accumulated other comprehensive earnings (losses) or in earnings, 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 earnings (losses) are reclassified to the consolidated statement of earnings in the periods in which operating results are affected by the hedged item. Cash flow hedging instruments are classified in the same manner as the affected hedged item in the consolidated statements of cash flows. 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).

Effective July 1, 2003, the Company adopted SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. The adoption of SFAS No. 149 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows. Collectively, SFAS No. 133, SFAS No. 138 and SFAS No. 149 are referred to as "SFAS No. 133."

Impairment of long-lived assets: The Company reviews long-lived assets, including amortizable 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.

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 Altria Group, Inc. 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 currently be utilized on a separate company basis, are utilized in Altria Group, Inc.'s consolidated federal income tax return, the benefit is recognized in the calculation of the Company's provision for income taxes. Based on the Company's current estimate, this benefit is calculated to be approximately $100 million, $240 million and $220 million for the years ended December 31, 2003, 2002 and 2001, respectively. The Company makes payments to, or is reimbursed by, Altria Group, Inc., for the tax effects resulting from its inclusion in Altria Group, Inc.'s consolidated federal income tax return. Significant judgment is required in determining income tax provisions and in evaluating tax positions. The Company and its subsidiaries establish additional provisions for income taxes when, despite the belief that their tax positions are fully supportable, there remain certain positions that are likely to be challenged and that may not be sustained on review by tax authorities. The Company and its subsidiaries adjust these additional accruals in light of changing facts and circumstances. The consolidated tax provision includes the impact of changes to accruals that are considered appropriate, as well as the related net interest.

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

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

Revenue recognition: The Company recognizes revenues, net of sales incentives and including shipping and handling charges billed to customers, upon shipment of goods when title and risk of loss pass to customers. Shipping and handling costs are classified as part of cost of sales.

Effective July 1, 2003, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which addresses certain aspects of a vendor's accounting for arrangements under which it will perform multiple revenue-generating activities. Specifically, EITF Issue No. 00-21 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. The adoption of EITF Issue No. 00-21 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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 are included in property, plant and equipment on the consolidated balance sheets and amortized on a straight-line basis over the estimated useful lives of the software, which do not exceed five years.

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 did not result in compensation cost for stock options. The market value of restricted stock at date of grant is recorded as compensation expense over the period of restriction.

At December 31, 2003, the Company had stock-based employee compensation plans, which are described more fully in Note 10. *Stock Plans.* The Company applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for stock options. No compensation expense for employee stock options is reflected in net earnings, as all options granted under those plans had an exercise price equal to the market value of the common stock on the date of the grant.

Net earnings, as reported, includes pre-tax compensation expense related to restricted stock and rights to receive shares of stock of $57 million, $4 million and $39 million for the years ended December 31, 2003, 2002 and 2001, respectively. The following table illustrates the effect on net earnings and EPS if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the years ended December 31, 2003, 2002, and 2001:

(in millions, except per share data)

	2003	2002	2001
Net earnings, as reported	**$3,476**	$3,394	$1,882
Deduct:			
Total stock-based employee compensation expense determined under fair value method for all stock option awards, net of related tax effects	**12**	78	97
Pro forma net earnings	**$3,464**	$3,316	$1,785
Earnings per share:			
Basic—as reported	**$ 2.01**	$ 1.96	$ 1.17
Basic—pro forma	**$ 2.01**	$ 1.91	$ 1.11
Diluted—as reported	**$ 2.01**	$ 1.96	$ 1.17
Diluted—pro forma	**$ 2.00**	$ 1.91	$ 1.11

New accounting pronouncements: Several recent accounting pronouncements not previously discussed became effective during 2003. The adoption of these pronouncements did not have a material impact on the Company's consolidated financial position, results of operations or cash flows. The pronouncements were as follows:

- SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity";
- EITF Issue No. 03-3, "Applicability of EITF Abstracts, Topic No. D-79, 'Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises,' to Claims-Made Insurance Policies";
- EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease";
- SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities"; and
- FASB Interpretation No. 46, "Consolidation of Variable Interest Entities."

Note 3. Related Party Transactions:

Altria Group, Inc.'s subsidiary, Altria Corporate Services, Inc., provides 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. Billings for these services, which were based on the cost to Altria Corporate Services, Inc. to provide such services and a management fee, were $318 million, $327 million and $339 million for the years ended December 31, 2003, 2002 and 2001, respectively. These costs were paid to Altria Corporate Services, Inc. monthly. Although the cost of these services cannot be quantified on a stand-alone basis, management has assessed that the billings are reasonable based on the level of support provided by Altria Corporate Services, Inc., and that they reflect all services provided. The cost and nature of the services are reviewed annually by the Company's Audit Committee, which is comprised of independent directors. The effects of these transactions are included in operating cash flows in the Company's consolidated statements of cash flows.

The Company had long-term notes payable to Altria Group, Inc. and its affiliates as follows:

(in millions)

At December 31,	2003	2002
Notes payable in 2009, interest at 7.0%	**$ —**	$1,150
Short-term due to Altria Group, Inc. and affiliates reclassified as long-term		1,410
	$ —	$2,560

During 2003, the Company repaid Altria Group, Inc. the remaining $1,150 million on the 7.0% note as well as the $1,410 million of short-term reclassified to long-term. In addition, at December 31, 2003 and 2002, the Company had short-term amounts payable to Altria Group, Inc. of $543 million and $895 million, respectively. Interest on these borrowings is based on the applicable London Interbank Offered Rate.

The fair values of the Company's short-term amounts due to Altria Group, Inc. and affiliates approximate carrying amounts.

Note 4. Divestitures:

During 2003, the Company sold a European rice business and a branded fresh cheese business in Italy. The aggregate proceeds received from sales of businesses were $96 million, on which the Company recorded pre-tax gains of $31 million.

During 2002, the Company sold several small North American food businesses, some of which were previously classified as businesses held for sale. The net revenues and operating results of the businesses held for sale, which were not significant, were excluded from the Company's consolidated statements of earnings, and no gain or loss was recognized on these sales. In addition, the Company sold its Latin American yeast and industrial bakery ingredients business for approximately $110 million and recorded a pre-tax gain of $69 million. The aggregate proceeds received from sales of businesses were $219 million, on which the Company recorded pre-tax gains of $80 million.

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

The operating results of the businesses sold were not material to the Company's consolidated financial position, results of operations or cash flows in any of the periods presented.

Note 5. Acquisitions:

During 2003, the Company acquired a biscuits business in Egypt and trademarks associated with a small U.S.-based natural foods business. The total cost of these and other smaller acquisitions was $98 million.

During 2002, the Company acquired a snacks business in Turkey and a biscuits business in Australia. The total cost of these and other smaller acquisitions was $122 million.

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

Note 6. Inventories:

The cost of approximately 39% and 43% of inventories in 2003 and 2002, respectively, was determined using the LIFO method. The stated LIFO amounts of inventories were approximately $155 million and $215 million higher than the current cost of inventories at December 31, 2003 and 2002, respectively.

Note 7. Short-Term Borrowings and Borrowing Arrangements:

At December 31, 2003 and 2002, the Company had short-term borrowings of $2,453 million and $1,621 million, respectively, consisting principally of commercial paper borrowings with an average year-end interest rate of 1.4% and 1.3%, respectively. Of these amounts, the Company reclassified $1,900 million and $1,401 million, respectively, of the commercial paper borrowings to long-term debt based upon its intent and ability to refinance these borrowings on a long-term basis.

The fair values of the Company's short-term borrowings at December 31, 2003 and 2002, based upon current market interest rates, approximate the amounts disclosed above.

Following a $10.1 billion judgment on March 21, 2003 against Altria Group, Inc.'s domestic tobacco subsidiary, Philip Morris USA Inc., the three major credit rating agencies took a series of ratings actions resulting in the lowering of the Company's short-term and long-term debt ratings, despite the fact the Company is neither a party to, nor has exposure to, this litigation. Moody's lowered the Company's short-term debt rating from "P-1" to "P-2" and its long-term debt rating from "A2" to "A3," with stable outlook. Standard & Poor's lowered the Company's short-term debt rating from "A-1" to "A-2" and its long-term debt rating from "A–" to "BBB+," with stable outlook. Fitch Rating Services lowered the Company's short-term debt rating from "F-1" to "F-2" and its long-term debt rating from "A" to "BBB+," with stable outlook. As a result of the credit rating agencies' actions, the Company temporarily lost access to the commercial paper market, and borrowing costs increased. None of the Company's debt agreements requires accelerated repayment in the event of a decrease in credit ratings.

The Company maintains revolving credit facilities that have historically been used to support the issuance of commercial paper. At December 31, 2003, credit lines for the Company and the related activity were as follows:

(in billions of dollars)

Type	Credit Lines	Amount Drawn	Commercial Paper Outstanding
364-day (expires July 2004)	**$2.5**	**$ —**	**$0.3**
Multi-year (expires July 2006)	**2.0**		**1.9**
	$4.5	**$ —**	**$2.2**

The Company's revolving credit facilities, which are for its sole use, require the maintenance of a minimum net worth of $18.2 billion. The Company met this covenant at December 31, 2003 and expects to continue to meet this covenant. The foregoing revolving credit facilities do not include any other financial tests, any credit rating triggers or any provisions that could require the posting of collateral.

In addition to the above, certain international subsidiaries of the Company maintain uncommitted credit lines to meet the short-term working capital needs of the international businesses. These credit lines, which amounted to approximately $658 million as of December 31, 2003, are for the sole use of the Company's international businesses. Borrowings on these lines amounted to approximately $220 million at December 31, 2003 and 2002.

Note 8. Long-Term Debt:

At December 31, 2003 and 2002, the Company's long-term debt consisted of the following:

(in millions)

	2003	2002
Short-term borrowings, reclassified as long-term debt	**$1,900**	$ 1,401
Notes, 4.00% to 7.55% (average effective rate 5.37%), due through 2035	**10,256**	9,053
7% Debenture (effective rate 11.32%), $200 million face amount, due 2011	**157**	153
Foreign currency obligations	**16**	117
Other	**37**	44
	12,366	10,768
Less current portion of long-term debt	**(775)**	(352)
	$11,591	$10,416

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

	(in millions)
2004	$ 775
2005	737
2006	1,257
2007	1,398
2008	702
2009–2013	4,502
Thereafter	1,139

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, was $12,873 million and $11,544 million at December 31, 2003 and 2002, 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. On December 3, 2003, the Company completed a $500 million Class A common stock repurchase program, acquiring 15,308,458 Class A shares at an average price of $32.66 per share. On December 8, 2003, the Company commenced repurchasing shares under a new $700 million Class A common stock repurchase program. Through December 31, 2003, repurchases under the $700 million program were 1,583,600 shares at a cost of $50 million, or $31.57 per share.

Shares of Class A common stock issued, repurchased and outstanding were as follows:

	Shares Issued	Shares Repurchased	Shares Outstanding
Balance at January 1, 2002	555,000,000	—	555,000,000
Repurchase of shares		(4,383,150)	(4,383,150)
Exercise of stock options		2,000	2,000
Balance at December 31, 2002	555,000,000	(4,381,150)	550,618,850
Repurchase of shares		**(12,508,908)**	**(12,508,908)**
Exercise of stock options and issuance of other stock awards		**3,827,182**	**3,827,182**
Balance at December 31, 2003	**555,000,000**	**(13,062,876)**	**541,937,124**

In addition, 1.18 billion Class B common shares were issued and outstanding at December 31, 2003 and 2002. Altria Group, Inc. holds 276.6 million Class A common shares and all of the Class B common shares at December 31, 2003. 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, Altria Group, Inc. holds 97.9% of the combined voting power of the Company's outstanding capital stock at December 31, 2003. At December 31, 2003, 71,662,879 shares of common stock were reserved for stock options and other stock awards.

Concurrent with the IPO, certain employees of Altria Group, Inc. and its subsidiaries received a one-time grant of options to purchase shares of the Company's Class A common stock held by Altria Group, Inc. at the IPO price of $31.00 per share. In order to completely satisfy this obligation, Altria Group, Inc. purchased 1.6 million shares of the Company's Class A common stock in open market transactions during 2002.

Note 10. Stock Plans:

The Company's Board of Directors and shareholders approved 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. A maximum of 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) became 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) were scheduled to become exercisable based on total shareholder return for the Company's Class A common stock during the three years following the date of the grant, or were to become exercisable five years from the date of the grant. Based on total shareholder return, one-third of these shares became exercisable in June 2002 and one-third will become exercisable in June 2006. The remaining one-third could become exercisable in June 2004 or in June 2006, depending on shareholder return. These options will also expire ten years from the date of the grant. Shares available to be granted under the Plan at December 31, 2003, were 51,317,940.

The Company's Board of Directors and shareholders also approved 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 Altria Group, Inc., or their subsidiaries. Up to 500,000 shares of Class A common stock may be awarded under the Kraft Director Plan. Shares available to be granted under the Kraft Director Plan at December 31, 2003, were 470,705.

The Company applies the intrinsic value-based methodology in accounting for the various stock plans. Accordingly, no compensation expense has been recognized other than for restricted stock awards.

Stock option activity was as follows for the years ended December 31, 2001, 2002 and 2003:

	Shares Subject to Option	Weighted Average Exercise Price	Options Exercisable
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	—
Options granted	14,030	37.10	
Options exercised	(2,000)	31.00	
Options canceled	(1,490,660)	31.00	
Balance at			
December 31, 2002	19,291,672	31.00	696,615
Options exercised	**(346,868)**	**31.00**	
Options canceled	**(663,027)**	**31.00**	
Balance at			
December 31, 2003	**18,281,777**	**31.00**	**17,032,740**

The following table summarizes the status of the Company's stock options outstanding and exercisable as of December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$30.54 – $39.51	18,281,777	7 years	$31.00	17,032,740	
$31.00					

Prior to the IPO, certain employees of the Company participated in Altria Group, Inc.'s stock compensation plans. Altria Group, Inc. does not intend to issue additional Altria Group, Inc. stock compensation to the Company's employees, except for reloads of previously issued options. Altria Group, Inc. accounts for its plans in accordance with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," which did not result in compensation cost for stock options.

The Company's employees held options to purchase the following number of shares of Altria Group, Inc. stock: 39,241,651 shares at an average exercise price of $37.25 per share at December 31, 2003; 46,615,162 shares at an average exercise price of $35.78 per share at December 31, 2002; and 57,349,595 shares at an average exercise price of $34.66 per share at December 31, 2001. Of these amounts, the following were exercisable at each date: 39,025,325 at an average exercise price of $37.19 per share at December 31, 2003; 46,231,629 at an average exercise price of $35.69 per share at December 31, 2002; and 44,930,609 at an average exercise price of $31.95 per share at December 31, 2001.

Had compensation cost for stock option awards under the Kraft plans and Altria Group, Inc. plans been determined by using the fair value at the grant date, the Company's net earnings and basic and diluted EPS would have been $3,464 million, $2.01 and $2.00, respectively, for the year ended December 31, 2003; $3,316 million, $1.91 and $1.91, respectively, for the year ended December 31, 2002; and $1,785 million, $1.11 and $1.11, respectively, for the year ended December 31, 2001. 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
2003 Altria Group, Inc.	**2.68%**	**4 years**	**37.61%**	**6.04%**	**$ 8.76**
2002 Kraft	4.27	5	28.72	1.41	10.65
2002 Altria Group, Inc.	3.44	5	33.57	4.96	10.02
2001 Kraft	4.81	5	29.70	1.68	9.13
2001 Altria Group, Inc.	4.86	5	33.88	4.78	10.36

During the first quarter of 2003, the Company granted shares of restricted stock and rights to receive shares of stock to eligible employees, giving them in most instances all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights. Such shares and rights are subject to forfeiture if certain employment conditions are not met. During the first quarter of 2003, the Company granted approximately 3.7 million restricted Class A shares to eligible U.S.-based employees and also issued to eligible non-U.S. employees rights to receive approximately 1.6 million Class A equivalent shares. Restrictions on the stock and rights lapse in the first quarter of 2006. The market value per restricted share or right was $36.56 on the date of grant.

The fair value of the shares of restricted stock and rights to receive shares of stock at the date of grant is amortized to expense ratably over the restriction period. The Company recorded compensation expense related to the restricted stock and rights of $57 million for the year ended December 31, 2003. The unamortized portion, which is reported on the consolidated balance sheets as a reduction of earnings reinvested in the business, was $129 million at December 31, 2003.

In addition, certain of the Company's employees held shares of Altria Group, Inc. 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. These shares and rights are subject to forfeiture if certain employment conditions are not met. During 2001, Altria Group, Inc. granted to certain of the Company's U.S. employees restricted stock of 279,120 shares and to certain of the Company's non-U.S. employees rights to receive 31,310 equivalent shares. At December 31, 2003, there were no restrictions on the stock. The fair value of the restricted shares and rights at the date of grant was amortized to expense ratably over the restriction period through a charge from Altria Group, Inc. In 2002 and 2001, the Company recorded compensation expense related to these stock awards of $4 million and $39 million, respectively.

Note 11. Earnings Per Share:

Basic and diluted EPS were calculated using the following for the years ended December 31, 2003, 2002 and 2001:

(in millions)	2003	2002	2001
Net earnings	**$3,476**	$3,394	$1,882
Weighted average shares for basic EPS	**1,727**	1,734	1,610
Plus incremental shares from assumed conversions:			
Restricted stock and stock rights	**1**		
Stock options		2	
Weighted average shares for diluted EPS	**1,728**	1,736	1,610

For the 2003 computation, 18 million Class A common stock options were excluded from the calculation of weighted average shares for diluted EPS because their effects were antidilutive.

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, 2003, 2002 and 2001:

(in millions)	2003	2002	2001
Pre-tax earnings:			
United States	**$3,713**	$3,692	$2,282
Outside United States	**1,633**	1,575	1,165
Total pre-tax earnings	**$5,346**	$5,267	$3,447
Provision for income taxes:			
United States federal:			
Current	**$1,011**	$ 825	$ 594
Deferred	**153**	265	299
	1,164	1,090	893
State and local	**151**	138	112
Total United States	**1,315**	1,228	1,005
Outside United States:			
Current	**460**	628	445
Deferred	**91**	13	115
Total outside United States	**551**	641	560
Total provision for income taxes	**$1,866**	$1,869	$1,565

At December 31, 2003, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately $3.3 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested. It is not practical to estimate the amount of additional taxes that might be payable on such undistributed earnings.

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, 2003, 2002 and 2001:

	2003	2002	2001
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	**1.8**	1.7	2.0
Goodwill amortization			9.4
Other (including reversal of taxes no longer required)	**(1.9)**	(1.2)	(1.0)
Effective tax rate	**34.9%**	35.5%	45.4%

Rate differences from foreign operations, which are included in other, above, reduced the Company's effective tax rate by 0.8% in 2003 and 0.4% in 2001. Rate differences from foreign operations had no impact in 2002.

The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities consisted of the following at December 31, 2003 and 2002:

(in millions)	2003	2002
Deferred income tax assets:		
Accrued postretirement and postemployment benefits	**$ 809**	$ 759
Other	**392**	519
Total deferred income tax assets	**1,201**	1,278
Deferred income tax liabilities:		
Trade names	**(3,839)**	(3,839)
Property, plant and equipment	**(1,636)**	(1,515)
Prepaid pension costs	**(901)**	(841)
Total deferred income tax liabilities	**(6,376)**	(6,195)
Net deferred income tax liabilities	**$(5,175)**	$(4,917)

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 Kraft Foods North America, Inc. ("KFNA") and Kraft Foods International, Inc. ("KFI"). Reportable segments for KFNA are organized and managed principally by product category. 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 operations are organized and managed by geographic location. KFI's segments are Europe, Middle East and Africa; and Latin America and Asia Pacific.

The Company's management uses operating companies income, which is defined as operating income before general corporate expenses and amortization of intangibles, to evaluate segment performance and allocate resources. 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 not included in 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 Note 2. *Summary of Significant Accounting Policies*.

During the first quarter of 2003, the Company transferred management responsibility of its Canadian Biscuits and Pet Snacks operations from the Biscuits, Snacks and Confectionery segment to the Cheese, Meals and Enhancers segment, which contains the Company's other Canadian businesses. Accordingly, all prior period amounts have been reclassified to reflect the transfer. During January 2004, the Company announced a new global organizational structure, which will result in new segments for financial reporting purposes. Beginning in 2004, the Company's new segments will be U.S. Beverages & Grocery; U.S. Snacks; U.S. Cheese, Canada & North America Foodservice; U.S. Convenient Meals; Europe, Middle East and Africa; and Latin America and Asia Pacific.

Segment data were as follows:

(in millions)

For the Years Ended December 31,	2003	2002	2001
Net revenues:			
Cheese, Meals and Enhancers	**$ 9,439**	$ 9,172	$ 9,014
Biscuits, Snacks and Confectionery	**4,801**	4,887	4,789
Beverages, Desserts and Cereals	**4,567**	4,412	4,237
Oscar Mayer and Pizza	**3,100**	3,014	2,930
Total Kraft Foods North America	**21,907**	21,485	20,970
Europe, Middle East and Africa	**7,045**	6,203	5,936
Latin America and Asia Pacific	**2,058**	2,035	2,328
Total Kraft Foods International	**9,103**	8,238	8,264
Net revenues	**$31,010**	$29,723	$29,234
Earnings before income taxes and minority interest:			
Operating companies income:			
Kraft Foods North America:			
Cheese, Meals and Enhancers	**$2,230**	$2,210	$2,132
Biscuits, Snacks and Confectionery	**887**	1,051	933
Beverages, Desserts and Cereals	**1,247**	1,136	1,192
Oscar Mayer and Pizza	**556**	556	539
Kraft Foods International:			
Europe, Middle East and Africa	**1,012**	962	861
Latin America and Asia Pacific	**270**	368	378
Amortization of intangibles	**(9)**	(7)	(962)
General corporate expenses	**(182)**	(162)	(189)
Operating income	**6,011**	6,114	4,884
Interest and other debt expense, net	**(665)**	(847)	(1,437)
Earnings before income taxes and minority interest	**$ 5,346**	$ 5,267	$ 3,447

The Company's largest customer, Wal-Mart Stores, Inc. and its affiliates, accounted for approximately 12%, 12% and 11% of consolidated net revenues for 2003, 2002 and 2001, respectively. These net revenues occurred primarily in the United States and were across all segments.

As previously noted, the Company's international operations are managed by geographic location. Within its two geographic regions, KFI's brand portfolio spans five core consumer sectors. Net revenues by consumer sector for KFI were as follows:

Consumer Sector

(in millions)

For the Years Ended December 31,	2003	2002	2001
Snacks	**$3,622**	$3,179	$3,077
Beverages	**3,124**	2,832	2,900
Cheese	**1,302**	1,202	1,208
Grocery	**741**	752	826
Convenient Meals	**314**	273	253
Total	**$9,103**	$8,238	$8,264

Items affecting the comparability of the Company's results were as follows:

• *Integration Costs and a Loss on Sale of a Food Factory*—During 2003, the Company reversed $13 million related to the previously recorded integration charges. During 2002, the Company recorded pre-tax integration-related charges of $115 million to consolidate production lines in North America, close a Kraft facility and for other consolidation programs. In addition, during 2002, the Company reversed $4 million related to the loss on sale of a food factory. 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 items were included in the operating companies income of the following segments:

(in millions)

For the Years Ended December 31,	2003	2002	2001
Cheese, Meals and Enhancers	**$(10)**	$ 30	$63
Biscuits, Snacks and Confectionery		1	2
Beverages, Desserts and Cereals	**(3)**	56	12
Oscar Mayer and Pizza		7	5
Latin America and Asia Pacific		17	
Integration costs and a loss on sale of a food factory	**$(13)**	$111	$82

• *Asset Impairment and Exit Costs*—During 2003, the Company recorded a pre-tax charge of $6 million for asset impairment and exit costs related to the closure of a Nordic snacks plant. During 2002, the Company recorded a pre-tax charge of $142 million related to employee acceptances under a voluntary retirement program. Approximately 700 employees elected to retire or terminate employment under the program. These charges were included in the operating companies income of the following segments for the years ended December 31, 2003 and 2002:

(in millions)

	2003	2002
Cheese, Meals and Enhancers		$ 60
Biscuits, Snacks and Confectionery		3
Beverages, Desserts and Cereals		47
Oscar Mayer and Pizza		25
Europe, Middle East and Africa	**$6**	5
Latin America and Asia Pacific		2
Asset impairment and exit costs	**$6**	$142

• *Gains on Sales of Businesses*—During 2003, the Company sold a European rice business and a branded fresh cheese business in Italy for aggregate pre-tax gains of $31 million. These pre-tax gains were included in the operating companies income of the Europe, Middle East and Africa segment. During 2002, the Company sold its Latin American yeast and industrial bakery ingredients business, resulting in a pre-tax gain of $69 million, and several small food businesses, resulting in pre-tax gains of $11 million. These pre-tax gains were included in the operating companies income of the following segments: Biscuits, Snacks and Confectionery, $8 million; and Latin America and Asia Pacific, $72 million.

See Notes 4 and 5, respectively, regarding divestitures and acquisitions.

(in millions)

For the Years Ended December 31,	2003	2002	2001
Depreciation expense:			
Cheese, Meals and Enhancers	**$ 206**	$ 193	$ 180
Biscuits, Snacks and Confectionery	**150**	140	135
Beverages, Desserts and Cereals	**124**	115	113
Oscar Mayer and Pizza	**62**	58	55
Total Kraft Foods North America	**542**	506	483
Europe, Middle East and Africa	**223**	167	158
Latin America and Asia Pacific	**39**	36	39
Total Kraft Foods International	**262**	203	197
Total depreciation expense	**$ 804**	$ 709	$ 680
Capital expenditures:			
Cheese, Meals and Enhancers	**$ 226**	$ 268	$ 266
Biscuits, Snacks and Confectionery	**193**	213	162
Beverages, Desserts and Cereals	**184**	194	202
Oscar Mayer and Pizza	**110**	133	131
Total Kraft Foods North America	**713**	808	761
Europe, Middle East and Africa	**276**	265	231
Latin America and Asia Pacific	**96**	111	109
Total Kraft Foods International	**372**	376	340
Total capital expenditures	**$1,085**	$1,184	$1,101

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

(in millions)

For the Years Ended December 31,	2003	2002	2001
Net revenues:			
United States	**$19,545**	$19,395	$19,193
Europe	**6,752**	5,908	5,667
Other	**4,713**	4,420	4,374
Total net revenues	**$31,010**	$29,723	$29,234
Total assets:			
United States	**$44,674**	$44,406	$44,420
Europe	**10,114**	8,738	7,362
Other	**4,497**	3,956	4,016
Total assets	**$59,285**	$57,100	$55,798
Long-lived assets:			
United States	**$ 6,451**	$ 6,382	$ 6,360
Europe	**2,757**	2,432	2,132
Other	**1,831**	1,596	1,668
Total long-lived assets	**$11,039**	$10,410	$10,160

Note 14. Benefit Plans:

In December 2003, the FASB issued a revised SFAS No. 132, “Employers’ Disclosures about Pensions and Other Postretirement Benefits.” In 2003, the Company adopted the revised disclosure requirements of this pronouncement, except for certain disclosures about non-U.S. plans and estimated future benefit payments which are not required until 2004.

The Company sponsors 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.

The plan assets and benefit obligations of the Company’s U.S. pension plans are measured at December 31 of each year.

Pension Plans

Obligations and Funded Status

The benefit obligations, plan assets and funded status of the Company's pension plans at December 31, 2003 and 2002, were as follows:

(in millions)	U.S. Plans		Non-U.S. Plans	
	2003	2002	**2003**	2002
Benefit obligation at January 1	**$5,245**	$4,964	**$2,317**	$2,021
Service cost	**135**	120	**58**	49
Interest cost	**338**	339	**136**	120
Benefits paid	**(398)**	(624)	**(132)**	(115)
Settlements	**29**	127		
Actuarial losses	**199**	367	**124**	85
Currency			**392**	144
Other	**(2)**	(48)	**15**	13
Benefit obligation at December 31	**5,546**	5,245	**2,910**	2,317
Fair value of plan assets at January 1	**4,965**	6,359	**1,337**	1,329
Actual return on plan assets	**1,038**	(803)	**204**	(56)
Contributions	**219**	26	**209**	81
Benefits paid	**(414)**	(636)	**(100)**	(87)
Currency			**216**	70
Actuarial (losses) gains	**(6)**	19		
Fair value of plan assets at December 31	**5,802**	4,965	**1,866**	1,337
Funded status (plan assets in excess of (less than) benefit obligations) at December 31	**256**	(280)	**(1,044)**	(980)
Unrecognized actuarial losses	**2,292**	2,558	**848**	682
Unrecognized prior service cost	**23**	13	**55**	50
Additional minimum liability	**(85)**	(71)	**(367)**	(288)
Unrecognized net transition obligation			**7**	7
Net prepaid pension asset (liability) recognized	**$2,486**	$2,220	**$ (501)**	$ (529)

The combined U.S. and non-U.S. pension plans resulted in a net prepaid pension asset of $1,985 million and $1,691 million at December 31, 2003 and 2002, respectively. These amounts were recognized in the Company's consolidated balance sheets at December 31, 2003 and 2002, as prepaid pension assets of $3,243 million and $2,814 million, respectively, for those plans in which plan assets exceeded their accumulated benefit obligations, and as other liabilities of $1,258 million and $1,123 million, respectively, for plans in which the accumulated benefit obligations exceeded their plan assets.

For U.S. and non-U.S. pension plans, the change in the additional minimum liability in 2003 and 2002 was as follows:

(in millions)	U.S. Plans		Non-U.S. Plans	
	2003	2002	**2003**	2002
Increase in minimum liability included in other comprehensive earnings (losses), net of tax	**$(9)**	$(22)	**$(59)**	$(95)

The combined accumulated benefit obligation for the U.S. pension plans was $4,898 million and $4,562 million at December 31, 2003 and 2002, respectively.

At December 31, 2003 and 2002, certain of the Company's U.S. pension plans were underfunded, with projected benefit obligations, accumulated benefit obligations and the fair value of plan assets of $261 million, $208 million and $14 million, respectively, in 2003, and $269 million, $217 million and $45 million, respectively, in 2002. The majority of these relate to plans for salaried employees that cannot be funded under IRS regulations. 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 $1,648 million, $1,532 million and $588 million, respectively, as of December 31, 2003, and $1,375 million, $1,250 million and $424 million, respectively, as of December 31, 2002.

The following weighted-average assumptions were used to determine the Company's benefit obligations under the plans at December 31:

	U.S. Plans		Non-U.S. Plans	
	2003	2002	**2003**	2002
Discount rate	**6.25%**	6.50%	**5.41%**	5.56%
Rate of compensation increase	**4.00**	4.00	**3.11**	3.12

Components of Net Periodic Benefit Cost

Net periodic pension (income) cost consisted of the following for the years ended December 31, 2003, 2002 and 2001:

(in millions)	U.S. Plans			Non-U.S. Plans		
	2003	2002	2001	**2003**	2002	2001
Service cost	**$ 135**	$ 120	$ 107	**$ 58**	$ 49	$ 45
Interest cost	**338**	339	339	**136**	120	112
Expected return on plan assets	**(587)**	(631)	(648)	**(146)**	(134)	(126)
Amortization:						
Unrecognized net loss (gain) from experience differences	**15**	8	(21)	**18**	5	(1)
Prior service cost	**2**	1	8	**8**	7	5
Other expense (income)	**51**	130	(12)			
Net pension (income) cost	**$ (46)**	$ (33)	$(227)	**$ 74**	$ 47	$ 35

Retiring employees elected lump-sum payments, resulting in settlement losses of $51 million and $21 million in 2003 and 2002, respectively, and settlement gains of $12 million in 2001. In addition, during 2002, certain salaried employees in the United States left the Company under a voluntary early retirement program instituted in 2001. This resulted in special termination benefits and curtailment and settlement losses of $109 million in 2002.

The following weighted-average assumptions were used to determine the Company's net pension cost for the year ended December 31:

	U.S. Plans			Non-U.S. Plans		
	2003	2002	2001	**2003**	2002	2001
Discount rate	**6.50%**	7.00%	7.75%	**5.56%**	5.80%	5.88%
Expected rate of return on plan assets	**9.00**	9.00	9.00	**8.41**	8.49	8.51
Rate of compensation increase	**4.00**	4.50	4.50	**3.12**	3.36	3.55

The Company's expected rate of return on plan assets is determined by the plan assets' historical long-term investment performance, current asset allocation and estimates of future long-term returns by asset class.

Kraft 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 $84 million, $64 million and $63 million in 2003, 2002 and 2001, respectively.

Plan Assets

The Company's U.S. pension plan asset allocation at December 31, 2003 and 2002, was as follows:

	Percentage of Fair Value of Plan Assets at December 31	
U.S. Plans Asset Category	**2003**	2002
Equity securities	**70%**	63%
Debt securities	**26**	32
Real estate	**1**	1
Other	**3**	4
Total	**100%**	100%

The Company's investment strategy is based on an expectation that equity securities will outperform debt securities over the long term. Accordingly, the composition of the Company's plan assets is broadly characterized as a 70%/30% allocation between equity and debt securities. The strategy utilizes indexed U.S. equity securities and actively managed investment grade debt securities (which constitute 80% or more of debt securities) with lesser allocations to high yield and international debt securities.

The Company attempts to mitigate investment risk by rebalancing between equity and debt asset classes as the Company's contributions and monthly benefit payments are made.

The Company presently plans to make contributions, to the extent that they are tax deductible, in order to maintain plan assets in excess of the accumulated benefit obligation of its funded U.S. plans. Currently, the Company anticipates making contributions of approximately $70 million in 2004, based on current tax law. However, this estimate is subject to change as a result of current tax proposals before Congress, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets.

Postretirement Benefit Plans

Net postretirement health care costs consisted of the following for the years ended December 31, 2003, 2002 and 2001:

			(in millions)
	2003	2002	2001
Service cost	**$ 41**	$ 32	$ 34
Interest cost	**173**	168	168
Amortization:			
Unrecognized net loss from experience differences	**40**	21	5
Unrecognized prior service cost	**(25)**	(20)	(8)
Other expense		16	
Net postretirement health care costs	**$229**	$217	$199

During 2002, certain salaried employees in the United States left the Company under a voluntary early retirement program instituted in 2001. This resulted in curtailment losses of $16 million in 2002, which are included in other expense, above.

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act establishes a prescription drug benefit under Medicare, known as "Medicare Part D," and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

In January 2004, the FASB issued FASB Staff Position No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-1"). The Company has elected to defer accounting for the effects of the Act, as permitted by FSP 106-1. Therefore, in accordance with FSP 106-1, the Company's accumulated postretirement benefit obligation and net postretirement health care costs included in the consolidated financial statements and accompanying notes do not reflect the effects of the Act on the plans. Specific authoritative guidance on the accounting for the federal subsidy is pending, and that guidance, when issued, could require the Company to change previously reported information.

The following weighted-average assumptions were used to determine the Company's net postretirement cost for the years ended December 31:

	U.S. Plans			Canadian Plans		
	2003	2002	2001	**2003**	2002	2001
Discount rate	**6.50%**	7.00%	7.75%	**6.75%**	6.75%	7.00%
Health care cost trend rate	**8.00**	6.20	6.80	**7.00**	8.00	9.00

The Company's postretirement health care plans are not funded. The changes in the accumulated benefit obligation and net amount accrued at December 31, 2003 and 2002, were as follows:

(in millions)

	2003	2002
Accumulated postretirement benefit obligation at January 1	**$ 2,712**	$2,436
Service cost	**41**	32
Interest cost	**173**	168
Benefits paid	**(189)**	(199)
Curtailments		21
Plan amendments	**(28)**	(164)
Currency	**18**	
Assumption changes	**174**	193
Actuarial losses	**54**	225
Accumulated postretirement benefit obligation at December 31	**2,955**	2,712
Unrecognized actuarial losses	**(1,064)**	(848)
Unrecognized prior service cost	**202**	197
Accrued postretirement health care costs	**$ 2,093**	$2,061

The current portion of the Company's accrued postretirement health care costs of $199 million and $172 million at December 31, 2003 and 2002, respectively, are included in other accrued liabilities on the consolidated balance sheets.

The following weighted-average assumptions were used to determine the Company's postretirement benefit obligations at December 31:

	U.S. Plans		Canadian Plans	
	2003	2002	**2003**	2002
Discount rate	**6.25%**	6.50%	**6.50%**	6.75%
Health care cost trend rate assumed for next year	**10.00**	8.00	**8.00**	7.00
Ultimate trend rate	**5.00**	5.00	**5.00**	4.00
Year that the rate reaches the ultimate trend rate	**2006**	2006	**2010**	2006

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects as of December 31, 2003:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on total of service and interest cost	14.0%	(11.2)%
Effect on postretirement benefit obligation	10.2	(8.5)

Postemployment Benefit Plans

Kraft 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, 2003, 2002 and 2001:

(in millions)

	2003	2002	2001
Service cost	**$10**	$19	$20
Amortization of unrecognized net gains	**(5)**	(7)	(8)
Other expense	**1**	23	
Net postemployment costs	**$ 6**	$35	$12

During 2002, certain salaried employees in the United States left the Company under voluntary early retirement and integration programs. These programs resulted in incremental postemployment costs of $23 million, which are included in other expense, above.

The Company's postemployment plans are not funded. The changes in the benefit obligations of the plans at December 31, 2003 and 2002, were as follows:

(in millions)

	2003	2002
Accumulated benefit obligation at January 1	**$ 295**	$ 520
Service cost	**10**	19
Benefits paid	**(106)**	(141)
Actuarial (gains) losses	**42**	(103)
Accumulated benefit obligation at December 31	**241**	295
Unrecognized experience gains	**56**	112
Accrued postemployment costs	**$ 297**	$ 407

The accumulated benefit obligation was determined using an assumed ultimate annual turnover rate of 0.3% in 2003 and 2002, assumed compensation cost increases of 4.0% in 2003 and 2002, 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,	2003	2002	2001
Research and development expense	**$ 380**	$ 360	$ 358
Advertising expense	**$1,176**	$1,145	$1,190
Interest and other debt expense, net:			
Interest expense, Altria Group, Inc. and affiliates	**$ 31**	$ 243	$1,103
Interest expense, external debt	**647**	611	349
Interest income	**(13)**	(7)	(15)
	$ 665	$ 847	$1,437
Rent expense	**$ 452**	$ 437	$ 372

Minimum rental commitments under non-cancelable operating leases in effect at December 31, 2003, were as follows:

(in millions)

2004	$ 307
2005	227
2006	170
2007	134
2008	113
Thereafter	236
	$1,187

Note 16. Financial Instruments:

Derivative financial instruments: The Company operates globally, 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. Derivative financial instruments are used by the Company, principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates and commodity prices by creating offsetting exposures. The Company is not a party to leveraged derivatives and, by policy, does not use financial instruments for speculative purposes. 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 formally documents the nature of 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 the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it was deemed probable that the forecasted transaction will not occur, the gain or loss would be recognized in earnings currently.

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. Substantially all of the Company's derivative financial instruments are effective as hedges. The fair value of all derivative financial instruments has been calculated based on market quotes. The primary currencies to which the Company is exposed, based on the size and location of its businesses, include the euro, Swiss franc, British pound and Canadian dollar. At December 31, 2003 and 2002, the Company had option and forward foreign exchange contracts with aggregate notional amounts of $2,486 million and $575 million, respectively, which are comprised of contracts for the purchase and 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 earnings (losses) until the underlying hedged transactions are reported on the Company's consolidated statement of earnings.

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 and cheese. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar and soybean oil. 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, 2003 and 2002, the Company had net long commodity positions of $255 million and $544 million, respectively. Unrealized gains or losses on net commodity positions were immaterial at December 31, 2003 and 2002. The effective portion of unrealized gains and losses on commodity futures and option contracts is deferred as a component of accumulated other comprehensive earnings (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.

Derivative gains or losses reported in accumulated other comprehensive earnings (losses) are a result of qualifying hedging activity. Transfers of these gains or losses from accumulated other comprehensive earnings (losses) to earnings are offset by corresponding gains or losses on the underlying hedged items. During the year ended December 31, 2003, ineffectiveness related to cash flow hedges was a gain of $13 million, which was recorded in cost of sales on the consolidated statement of earnings. Ineffectiveness related to cash flow hedges during the year ended December 31, 2002 was not material. At December 31, 2003, the Company was hedging forecasted transactions for periods not exceeding twelve months and expects substantially all amounts reported in accumulated other comprehensive earnings (losses) to be reclassified to the consolidated statement of earnings within the next twelve months.

Hedging activity affected accumulated other comprehensive earnings (losses), net of income taxes, during the years ended December 31, 2003, 2002 and 2001, as follows:

(in millions)

	2003	2002	2001
Gain (loss) as of January 1	**$ 13**	$(18)	$ —
Derivative (gains) losses transferred to earnings	**(17)**	21	15
Change in fair value	**5**	10	(33)
Gain (loss) at December 31	**$ 1**	$ 13	$(18)

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, 2003.

Fair value: The aggregate fair value, based on market quotes, of the Company's third-party debt at December 31, 2003, was $13,426 million as compared with its carrying value of $12,919 million. The aggregate fair value of the Company's third-party debt at December 31, 2002, was $11,764 million as compared with its carrying value of $10,988 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 Altria Group, Inc. and its affiliates were $2,764 million and $2,560 million, respectively, at December 31, 2002.

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. 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.

Guarantees: At December 31, 2003, the Company's third-party guarantees, which are primarily derived from acquisition and divestiture activities, approximated $38 million. Substantially all of these guarantees expire through 2014, with $13 million expiring during 2004. The Company is required to perform under these guarantees in the event that a third party fails to make contractual payments or achieve performance measures. The Company has a liability of $26 million on its consolidated balance sheet at December 31, 2003, relating to these guarantees.

Note 18. Subsequent Event:

In January 2004, the Company announced a three-year restructuring program with the objective to leverage the Company's global scale, realign and lower the cost structure and optimize capacity utilization. As part of this program, the Company anticipates the exit or closing of up to 20 plants and the elimination of approximately six thousand positions. Over the next three years, the Company expects to incur up to $1.2 billion in pre-tax charges, reflecting asset disposals, severance and other implementation costs, including an estimated range of $750 million to $800 million
in 2004. Approximately one-half of the pre-tax charges are expected to require cash payments.

Note 19. Quarterly Financial Data (Unaudited):

(in millions, except per share data)	**2003 Quarters**			
	First	**Second**	**Third**	**Fourth**
Net revenues	**$7,359**	**$7,841**	**$7,480**	**$8,330**
Gross profit	**$3,010**	**$3,146**	**$2,921**	**$3,105**
Net earnings	**$ 848**	**$ 949**	**$ 810**	**$ 869**
Weighted average shares for diluted EPS	**1,730**	**1,728**	**1,728**	**1,723**
Per share data:				
Basic EPS	**$ 0.49**	**$ 0.55**	**$ 0.47**	**$ 0.50**
Diluted EPS	**$ 0.49**	**$ 0.55**	**$ 0.47**	**$ 0.50**
Dividends declared	**$ 0.15**	**$ 0.15**	**$ 0.18**	**$ 0.18**
Market price—high	**$39.40**	**$33.96**	**$32.79**	**$32.50**
—low	**$26.35**	**$27.76**	**$27.60**	**$28.50**

(in millions, except per share data)	2002 Quarters			
	First	Second	Third	Fourth
Net revenues	$7,147	$7,513	$7,216	$7,847
Gross profit	$2,864	$3,127	$2,971	$3,041
Net earnings	$ 693	$ 901	$ 869	$ 931
Weighted average shares for diluted EPS	1,737	1,738	1,737	1,734
Per share data:				
Basic EPS	$ 0.40	$ 0.52	$ 0.50	$ 0.54
Diluted EPS	$ 0.40	$ 0.52	$ 0.50	$ 0.54
Dividends declared	$ 0.13	$ 0.13	$ 0.15	$ 0.15
Market price—high	$39.70	$43.95	$41.70	$41.30
—low	$32.50	$38.32	$33.87	$36.12

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.

During 2003 and 2002, the Company recorded the following pre-tax charges or (gains):

(in millions)	**2003 Quarters**			
	First	**Second**	**Third**	**Fourth**
Asset impairment and exit costs			**$ 6**	
Integration costs				**$(13)**
Gains on sales of businesses			**(23)**	**(8)**
	$—	**$—**	**(17)(21**	

(in millions)	2002 Quarters			
	First	Second	Third	Fourth
Asset impairment and exit costs	$142			
Integration costs and a loss on sale of a food factory	27	$92		$ (8)
Gains on sales of businesses		(3)		(77)
	$169	$89	$—	$(85)

The principal stock exchange, on which the Company's Class A common stock is listed, is the New York Stock Exchange. At January 30, 2004, there were approximately 2,400 holders of record of the Company's Class A common stock.

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, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, 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.

As discussed in Note 2 to the consolidated financial statements, on January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

PricewaterhouseCoopers LLP

Chicago, Illinois
January 23, 2004

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 auditors, 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

Louis C. Camilleri
Chairman of the Board, Kraft Foods Inc., and Chairman and Chief Executive Officer, Altria Group, Inc.

Roger K. Deromedi
Chief Executive Officer, Kraft Foods Inc.

Dinyar S. Devitre
Senior Vice President and Chief Financial Officer, Altria Group, Inc.

W. James Farrell *1,2*

Chairman and Chief Executive Officer, Illinois Tool Works Inc.
Glenview, IL

Betsy D. Holden
President, Global Marketing & Category Development
Kraft Foods Inc.

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

Mary L. Schapiro *1,2*
Vice Chairman, NASD, Inc.
President, Regulatory Policy and Oversight
Washington, D.C.

Charles R. Wall
Senior Vice President and General Counsel
Altria Group, 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
W. James Farrell, Chair
2 Member of Audit Committee
John C. Pope, Chair

Kraft Foods Executive Team

Roger K. Deromedi
Chief Executive Officer

Betsy D. Holden
President, Global Marketing & Category Development

David S. Johnson
President, North America Commercial

Hugh H. Roberts
President, International Commercial

James P. Dollive
Executive Vice President & Chief Financial Officer

Terry M. Faulk
Executive Vice President, Global Human Resources

Marc S. Firestone
Executive Vice President, General Counsel & Corporate Secretary

Alene M. Korby
Executive Vice President & Chief Information Officer

Michael Mudd
Executive Vice President, Global Corporate Affairs

David G. Owens
Executive Vice President, Global Strategy & Business Development

Jean E. Spence
Executive Vice President, Global Technology & Quality

Franz-Josef Vogelsang
Executive Vice President, Global Supply Chain

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

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:
1-781-575-3500

Postal address:
EquiServe Trust Company, N.A.
P.O. Box 43069
Providence, RI 02940-3069

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 and reports available to its shareholders. These include the Annual Report, proxy statement, news releases and other publications. For copies, please visit our website at: www.kraft.com.

Legal Filings
Kraft Foods Inc. also makes a variety of legal filings (10-K, 10-Q) available to its shareholders free of charge and as soon as practicable. For copies, please visit our website at www.kraft.com and click on *SEC filings* in the *Investors* section.

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
LISTED
NYSE

2004 Annual Meeting
The Annual Meeting of Shareholders will be held at 9:00 a.m. EDT on Tuesday, April 27, 2004, at Kraft Foods Inc., Robert M. Schaeberle Technology Center, 188 River Road, East Hanover, NJ 07936.
For further information, call toll-free: 1-800-295-1255.

Independent Auditors
PricewaterhouseCoopers LLP
One North Wacker Drive
Chicago, IL 60606-2807

Trademarks
Trademarks and service marks in this report are the registered property of or licensed by the subsidiaries of Kraft Foods Inc. and are italicized or shown in their logo form.

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.

c *Printed in the U.S.A. on Recycled Paper*

Concept and design: Genesis, Inc.

Tang

Capri Sun
All Natural

sugus

A.1.
Steak Sauce

Lacta

Club Social

Miracoli

Est. 1853
Gevalia
Kaffe

Terry's

Milka

Vegemite
Kraft

Grey Poupon

Ritz
Crackers

Terrab

Oreo
Chocolate Sandwich Cookies

Kraft
Dairylea

Figaro

Freia

Suchard

Nabisco

Altoids

Café Hag

DiGiorno
Rising Crust Pizza

Estrella

Triscuit

Royal

Kraft
Macaroni & Cheese

Carte Noire

Plante

Good to the Last Drop!
Maxwell House

Kenco

Kraft
Philadelph

Jell-O

Kraft
Miracle Whip

Boca

Cracker Bar

Trakinas

Oscar Mayer
Lunchables

Claussen

Kraft
Singl

Wheat Thins

Kraft
Cheez Whiz

Post

Chips Ahoy!
Real Chocolate Chip

Clight

Kraft
Velveeta

Jacques Vabre

Jacobs

OnkO

The Nabob
Coffee Co.

Cool Whip
Whipped Topping

Côte d'Or
— Since 1883 —

Kool-Aid

Kraft
Stov Top

Toblerone

El Caserio

Simmentha

Life Savers

Louis Rich

Tombstone
Pizza

Oscar Mayer

Marabo

Delivering **sustainable growth.**

www.**kraft**.com