

Notes to Financial Statements

> NOTE 1 **Basis of Presentation**

Financial statements for all periods presented herein have been prepared on a consolidated basis in accordance with generally accepted accounting principles consistently applied. All per-share information is presented on a diluted basis unless otherwise noted. Certain amounts in the prior years' financial statements have been reclassified to conform with the presentation used in 2003.

The company reports the results of its segments in accordance with Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information." During 2003, the company revised its segment reporting by separating its previously aggregated Consumer and Foodservice/Food Packaging segment. Accordingly, the company now has 4 reporting segments: Consumer Products, which relates principally to the manufacture and sale of disposable plastic, molded-fibre, pressed-paperboard, and aluminum packaging products such as waste bags, tableware, food-storage bags, and cookware for consumer markets such as grocery stores, mass merchandisers, and discount chains; Foodservice/Food

Packaging, which relates primarily to the manufacture and sale of various disposable plastic, molded-fibre, pressed-paperboard, and aluminum packaging products for foodservice and food-packaging markets such as restaurants and other institutional foodservice outlets, food processors, and grocery chains; Protective and Flexible Packaging, which relates to the manufacture and sale of plastic, paperboard, and molded-fibre products for protective-packaging markets such as electronics, automotive, furniture, and e-commerce, and for flexible-packaging applications in food, medical, pharmaceutical, chemical, and hygienic markets; and Other, which relates to corporate and administrative-service operations and retiree-benefit income and expense. The accounting policies of the reporting segments are the same as those for Pactiv as a whole. Where discrete financial information is not available by segment, reasonable allocations of expenses and assets are used. Previously reported segment information has been restated to conform to the current year's presentation.

> NOTE 2 **Summary of Accounting Policies**

Consolidation

The financial statements of the company include all majority-owned subsidiaries. Investments in 20%- to 50%-owned companies in which Pactiv has the ability to exert significant influence over operating and financial policies are carried at cost plus share of equity in undistributed earnings since date of acquisition. All intercompany transactions are eliminated.

Foreign-Currency Translation

Financial statements of international operations are translated into U.S. dollars using end-of-period exchange rates for assets and liabilities and the periods' weighted-average exchange rates for sales, expenses, gains, and losses. Translation adjustments are recorded as a component of shareholders' equity.

Cash and Temporary-Cash Investments

The company defines cash and temporary-cash investments as checking accounts, money-market accounts, certificates of deposit, and U.S. Treasury notes having an original maturity of 90 days or less.

Accounts and Notes Receivable

Trade accounts receivable are classified as current assets and are reported net of allowances for doubtful accounts. The company records such allowances based on a number of factors, including historical trends and specific customer liquidity.

On a recurring basis, the company sells an undivided interest in a pool of trade receivables meeting certain criteria to a third party as an alternative to debt financing. Amounts sold were \$10 million at December 31, 2003, and 2002. Such sales, which represent a form of

off-balance-sheet financing, are recorded as a reduction of accounts and notes receivable in the statement of financial position, and changes in such amounts are included in cash provided by operating activities in the statement of cash flows. Discounts and fees related to these sales were immaterial in 2003 and totaled \$1 million and \$5 million in 2002 and 2001, respectively, and were included in other income/expense in the statement of income. In the event that either Pactiv or the third-party purchaser of the trade receivables were to discontinue this program, the company's debt would increase or its cash balance would decrease by an amount corresponding to the level of sold receivables at such time.

Inventories

Inventories are stated at the lower of cost or market. A portion of inventories (53% and 56% at December 31, 2003, and 2002, respectively) are valued using the last-in, first-out method of accounting. All other inventories are valued using the first-in, first-out (FIFO) or average-cost methods. If FIFO or average-cost methods had been used to value all inventories, the total inventory balance would have been \$3 million higher at December 31, 2003, and \$11 million lower at December 31, 2002.

Property, Plant, and Equipment, Net

Depreciation is recorded on a straight-line basis over the estimated useful lives of assets. Useful lives range from 10 to 40 years for buildings and improvements and from 3 to 25 years for machinery and equipment. Depreciation expense totaled \$146 million, \$140 million, and \$145 million for the years ended December 31, 2003, 2002, and 2001, respectively.

The company capitalizes certain costs related to the purchase and development of software used in its business. Such costs are amortized over the estimated useful lives of the assets, ranging from 3 to 12 years. Capitalized software development costs, net of amortization, were \$53 million and \$57 million at December 31, 2003, and 2002, respectively.

The company periodically re-evaluates carrying values and estimated useful lives of long-lived assets to determine if adjustments are warranted. The company uses estimates of undiscounted cash flows from long-lived assets to determine whether the book value of such assets is recoverable over the assets' remaining useful lives.

Goodwill and Intangibles, Net

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 does not permit goodwill and indefinite-lived intangibles to be amortized and requires that these assets be reviewed at least annually for possible impairment. The company's annual review for possible impairment of goodwill and indefinite-lived intangibles is conducted in the quarter ending December 31, or earlier as warranted by events or changes in circumstances. Possible impairment of goodwill is determined using a two-step process. The first step requires that the fair value of individual reporting units be compared with their respective carrying values. If the carrying value of a reporting unit exceeds its fair value, a second step is performed to measure the amount of impairment, if any. This second step requires that the fair value of a reporting unit be allocated to all of the assets and liabilities of that unit, including definite- and indefinite-lived intangibles. Any remaining fair value is the implied goodwill of the reporting unit, which is then compared with the carrying value of goodwill to determine possible impairment. In determining the fair value of tangible assets, the company obtains appraisals from independent valuation firms. Similarly, the impairment test for definite- and indefinite-lived intangible assets requires that their fair values be compared with their carrying values. If the carrying value of an intangible asset exceeds its fair value, an impairment equal to the excess is recognized. Estimates of fair value used in testing goodwill and indefinite-lived intangible assets for possible impairment are primarily determined using projected discounted cash flows, along with other publicly available market information. These approaches use estimates and assumptions, including the amount and timing of projected cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, and appropriate market comparables. Intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. See Note 9 to the financial statements for additional information.

Environmental Liabilities

The company is subject to a variety of environmental and pollution-control laws and regulations in all jurisdictions in which it operates. Where it is probable that related liabilities exist and where reasonable estimates of such liabilities can be made, Pactiv establishes associated reserves. Estimated liabilities are subject to change as additional information becomes available regarding the magnitude of possible clean-up costs, the expense and effectiveness of alternative clean-up methods, and other possible liabilities associated with such situations. However, management believes that any additional costs that may be incurred as more information becomes available will not have a material adverse effect on the company's financial position, although such costs could have a material effect on the company's results of operations or cash flows in a particular period.

Revenue Recognition

The company recognizes sales when the risks and rewards of ownership have transferred to the customer, which is generally considered to have occurred as products are shipped.

Freight

The company records amounts billed to customers for shipping and handling as sales, and records shipping and handling expenses as cost of sales.

General and Administrative Expenses

The company records net pension income as an offset to selling, general, and administrative expenses. Such noncash income totaled \$64 million, \$109 million, and \$113 million in 2003, 2002, and 2001, respectively.

Research and Development

Research and development costs, which are expensed as incurred, totaled \$32 million, \$35 million, and \$40 million in 2003, 2002, and 2001, respectively.

Advertising

Advertising production costs are expensed as incurred, while advertising media costs are expensed in the period in which the related advertising first takes place. Advertising expenses were \$7 million, \$17 million, and \$11 million in 2003, 2002, and 2001, respectively.

Stock-Based Compensation

In accounting for stock-based employee compensation, the company uses the intrinsic-value method specified in Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Shown below are net income and basic and diluted earnings per share as reported and adjusted to reflect the use of the fair-value method in determining stock-based compensation costs, as prescribed in SFAS No. 123, "Accounting for Stock-Based Compensation."

(In millions, except for per-share data)	2003	2002	2001
Net income	\$ 183	\$ 148	\$ 193
After-tax adjustment of stock-based compensation costs			
Intrinsic-value method	4	4	2
Fair-value method	(14)	(13)	(11)
Pro forma	\$ 173	\$ 139	\$ 184
Earnings per share			
Basic	\$ 1.16	\$ 0.93	\$ 1.21
Adjustment of stock-based compensation costs			
Intrinsic-value method	0.03	0.02	0.01
Fair-value method	(0.09)	(0.08)	(0.07)
Pro forma	\$ 1.10	\$ 0.87	\$ 1.15
Diluted	\$ 1.14	\$ 0.92	\$ 1.20
Adjustment of stock-based compensation costs			
Intrinsic-value method	0.03	0.02	0.01
Fair-value method	(0.09)	(0.08)	(0.07)
Pro forma	\$ 1.08	\$ 0.86	\$ 1.14

Income Taxes

The company utilizes the asset and liability method of accounting for income taxes, which requires that deferred-tax assets and liabilities be recorded to reflect the future tax consequences of temporary timing differences between the tax and financial-statement basis of assets and liabilities. Deferred-tax assets are reduced by a valuation allowance if management determines that it is more likely than not that a portion of deferred-tax assets will not be realized in a future period. Estimates used to recognize deferred-tax assets are subject to revision in subsequent periods based on new facts or circumstances.

The company does not provide for U.S. federal income taxes on unremitted earnings of foreign subsidiaries in that it is management's present intention to reinvest those earnings in foreign operations. Unremitted earnings of foreign subsidiaries totaled \$128 million and \$110 million at December 31, 2003, and December 31, 2002, respectively. The unrecognized deferred-tax liability associated with unremitted earnings totaled approximately \$25 million and \$24 million at December 31, 2003, and 2002, respectively.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding. Diluted earnings per share is calculated in the same manner; however, adjustments are made to reflect the potential issuance of dilutive shares.

Risk Management

From time to time, the company uses derivative financial instruments, principally foreign-currency purchase and sale contracts with terms less than 1 year, to hedge its exposure to changes in foreign-currency exchange rates. Net gains or losses on such contracts are recognized in the income statement as offsets to foreign-currency gains or losses on the underlying transactions. In the statement of cash flows, cash receipts and payments related to hedge contracts are classified in the same way as cash flows from the transactions being hedged.

Interest-rate risk management is accomplished through the use of swaps. Gains and losses on the settlement of swaps are amortized over the remaining lives of underlying assets or liabilities.

From time to time, the company employs commodity forward or other derivative contracts to hedge its exposure to adverse changes in the price levels of certain commodities. These instruments are intended to limit the upside risk on purchases of such commodities used in the company's production processes

Gains and losses on derivative contracts were not material in 2003, 2002, and 2001. The company does not use derivative financial instruments for speculative purposes.

Changes in Accounting Principles

In July 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142. SFAS No. 141 requires that business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. SFAS No. 142 does not permit goodwill and certain intangibles to be amortized, but requires that an impairment loss be recognized if recorded amounts exceed fair values. Effective January 1, 2002, the company adopted SFAS No. 142, and recorded a goodwill-impairment charge of \$83 million, \$72 million after tax, or \$0.45 per share, in the first quarter of 2002. See Note 9 for additional information.

In January 2003, the FASB issued Financial Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 addresses accounting for variable interest entities (VIEs), defined as separate legal structures that either do not have equity investors with voting rights or have equity investors with voting rights that do not provide sufficient financial resources for entities to support their activities. FIN No. 46 requires that (1) companies consolidate VIEs if they are required to recognize the majority of such entities' gains and losses and (2) disclosures be made regarding VIEs that companies are not

required to consolidate but in which they have a significant variable interest. Consolidation requirements apply immediately to VIEs created after January 31, 2003, and to existing VIEs in the first fiscal year or interim period ending after December 15, 2003. Certain of the disclosure requirements apply to financial statements issued after January 31, 2003, regardless of when VIEs were created. Upon Pactiv's December 31, 2003, adoption of FIN No. 46, the company consolidated a VIE associated with properties covered by its synthetic-lease facility, resulting in an increase in long-term debt and property, plant, and equipment of \$169 million and \$150 million, respectively. Consolidation of the VIE also required the company to recognize, as a cumulative effect of change in accounting principles, depreciation expense on the leased assets from lease inception to December 31, 2003, of \$19 million,

\$12 million after tax, or \$0.07 per share. On a going-forward basis, consolidation of the VIE is expected to reduce net income by approximately \$3 million, or \$0.02 per share, annually.

Estimates

Financial-statement presentation requires management to make estimates and assumptions that affect reported amounts for assets, liabilities, sales, and expenses. Actual results may differ from such estimates.

Reclassifications

Certain prior-year amounts have been reclassified to conform with current-year presentation.

> NOTE 3 **Restructuring and Other**

In the fourth quarter of 2000, the company recorded a restructuring charge of \$71 million, \$47 million after tax, or \$0.29 per share. Of this amount, \$45 million was for the impairment of assets held for sale, including those related to the packaging-polyethylene business and the company's interest in Sentinel Polyolefins LLC (Sentinel), a protective-packaging joint venture. In January 2001, the company received cash proceeds of \$72 million from the disposition of these assets. The remaining \$26 million was related to the realignment of operations and the exiting of low-margin businesses in the company's Protective and Flexible Packaging segment. Specifically, this charge was for (1) plant closures in North America and Europe, including the elimination of 202 positions (\$6 million); (2) other workforce reductions (187 positions), mainly in Europe (\$6 million); (3) impairment of European long-lived assets held for sale (\$10 million); and (4) asset write-offs related to the elimination of certain low-margin product lines (\$4 million). The impairment charge for European assets was recorded following completion of an evaluation of strategic alternatives for the related businesses and represented the difference between the carrying value of the assets and their fair value based on market estimates. Restructuring-plan actions have been completed. Actual cash outlays for severance and other costs were \$3 million less than originally estimated, as 78 fewer positions were eliminated, while charges for asset write-offs were \$3 million more than initially estimated. Additionally, the company recognized a benefit of \$6 million, \$4 million after tax, or \$0.02 per share, in the fourth quarter of 2001, largely to reflect a lower loss than was originally recorded on the sale of the company's packaging-polyethylene business.

In the fourth quarter of 2001, the company recorded a restructuring charge of \$18 million, \$10 million after tax, or \$0.06 per share. Of this amount, \$5 million was related to higher-than-anticipated expenses associated with the exit of small, noncore European businesses announced in the fourth quarter of 2000. The remaining \$13 million reflected adoption of a restructuring plan to consolidate operations and reduce costs in the Foodservice/Food Packaging (\$5 million) and Protective and Flexible Packaging (\$8 million) segments. Specifically, this charge was for (1) plant closures and consolidations in North America and Europe, including the elimination of 283 positions (\$10 million); (2) other workforce reductions (99 positions – \$2 million); and (3) asset writedowns related to the exit of a North American product line (\$1 million).

In the second quarter of 2002, the company recognized a benefit of \$4 million, \$2 million after tax, or \$0.02 per share, related to the partial reversal of a previously recorded restructuring charge (netted against fixed assets), primarily as a result of incurring a lower-than-anticipated loss on the sale of a noncore European business.

In the fourth quarter of 2003, the company reversed \$1 million of a previously recorded restructuring charge in its Foodservice/Food Packaging segment, reflecting lower-than-anticipated lease-termination costs for a facility that was anticipated to be abandoned under the company's fourth-quarter 2001 restructuring plan, but which has been converted into a storage facility. Also in the fourth quarter of 2003, the company recorded \$1 million of restructuring expense in its Protective and Flexible Packaging segment, reflecting higher-than-anticipated costs associated with the fourth-quarter 2001 restructuring program, related mainly to higher-than-expected lease-termination costs.

Amounts related to restructuring activities are shown in the following table.

(In millions)	Severance	Asset impairment	Other	Total
Balance at December 31, 2000	\$ 12	\$ —	\$ 5	\$ 17
2001 restructuring charge	6	11	1	18
Cash payments	(7)	—	(1)	(8)
Charges to asset accounts	—	(11)	—	(11)
Reversal of prior charge	(3)	(3)	—	(6)
Changes in estimates	(2)	3	(1)	—
Balance at December 31, 2001	6	—	4	10
Cash payments	(6)	—	(2)	(8)
Balance at December 31, 2002	—	—	2	2
Cash payments	—	—	(2)	(2)
Reversal of prior charge	—	—	(1)	(1)
Changes in estimates	—	—	1	1
Balance at December 31, 2003	\$ —	\$ —	\$ —	\$ —

As of December 31, 2003, all restructuring activity related to the above programs was concluded.

> NOTE 4 **Acquisitions and Dispositions**

The company recorded a fourth-quarter 2000 charge of \$45 million, \$29 million after tax, or \$0.18 per share, to recognize the impairment of assets held for sale, including those related to the packaging-polyethylene business and the company's interest in Sentinel. In January 2001, the company received cash proceeds of \$72 million from the disposition of these assets. In the third quarter of 2001, the company refunded \$7 million to the purchaser of the packaging-polyethylene business to reflect the final determination of certain asset and liability amounts. Also, as part of the company's 2000 restructuring plan, certain small, noncore European businesses were disposed of in 2001 and 2002, for which cash proceeds totaling \$6 million and \$5 million were received in December 2001 and May 2002, respectively. See Note 3 for additional information.

On January 4, 2002, the company purchased MSP Schmeiser GmbH, a German medical-products company, for \$3 million. On February 13, 2002, the company acquired an egg-packaging production line from Amerpack S.A. de C.V., a Mexican company, for \$10 million.

In January 2002, the company purchased the assets of 2 small Italian protective-packaging companies, recording these transactions as capital expenditures. The outstanding shares of a third small Italian protective-packaging company, Forniture Industriali, were acquired in June 2002, for \$1 million.

On June 18, 2002, the company purchased Winkler Forming Inc., a leading thermoformer of amorphous polyethylene terephthalate (APET) products for food packaging, for \$78 million. During the third quarter of 2002, the company received \$3 million from the seller in interim settlement of working-capital amounts. Appraisals of the fair-market value of the assets and liabilities acquired were finalized

during the second quarter of 2003, resulting in related goodwill being reduced by \$14 million and property, plant, and equipment and intangible assets both being increased by \$7 million.

On October 21, 2002, Pactiv purchased a 70% interest in the stock of Mexico-based Central de Bolsas, S.A. de C.V. (Jaguar), a leading thermoformer of high-impact polystyrene (HIPS) cold cups and plates and polystyrene foam foodservice/food packaging. For this interest, Pactiv paid \$31 million to the shareholders of Jaguar and made a \$20 million equity investment in Jaguar. On August 8, 2003, the company acquired the remaining 30% of the stock of Jaguar for \$22 million, making it a wholly-owned subsidiary of Pactiv. At December 31, 2003, the allocation of the purchase price to the net assets of Jaguar and the related recognition of \$12 million of goodwill were based on preliminary estimates of the fair market value of the assets and liabilities acquired, and, therefore, are subject to revision upon receipt of final appraisals.

On November 13, 2002, Pactiv purchased the shares of Prvni Obalova SPOL S.R.O., a distributor and converter of protective-packaging products in the Czech Republic, for \$4 million.

On October 27, 2003, Pactiv purchased, for \$60 million, the plastic-packaging assets of Rock-Tenn Company (Rock-Tenn), which are used in the manufacture of APET and polypropylene products for food packaging. At December 31, 2003, the allocation of the purchase price to the net assets of Rock-Tenn and the related recognition of \$15 million of goodwill were based on preliminary estimates of the fair market value of the assets and liabilities acquired, and, therefore, are subject to revision upon receipt of final appraisals.

> NOTE 5 **Discontinued Operations**

In the first half of 2001, the company sold its interest in Packaging Corporation of America (PCA) for \$87 million, which was used primarily to repay debt, and recorded an associated gain of \$57 million, \$28 million after tax, or \$0.17 per share, as income from discontinued operations.

The company provides office space and certain administrative services to PCA under a transition-service agreement.

Pactiv has retained responsibility for certain contingent liabilities of its former paperboard-packaging businesses and has recorded related reserves where, in the judgment of management, it is probable that quantifiable liabilities exist. On November 3, 2003, the company

reached an agreement to settle a class-action lawsuit associated with certain of these liabilities. Management has established reserves for remaining liabilities not covered under the class-action settlement. Actual amounts paid in settlement of remaining liabilities, if any, may be different than amounts reserved. See Note 17 for further information.

In connection with the formation of the PCA joint venture, Pactiv entered into a 5-year agreement to purchase corrugated products from PCA on an arm's length basis. Effective January 2004, this contract was terminated, and the company has entered into a new 5-year supply agreement with PCA for the purchase of corrugated products.

> NOTE 6 **Long-Term Debt, Short-Term Debt, and Financing Arrangements**

Long-Term Debt

December 31 (In millions)	2003	2002
Pactiv Corporation		
Borrowings under 5-year, \$750 million revolving-credit agreement, effective interest rate based on LIBOR plus 0.7%	\$ —	\$ 36
Notes due 2005, effective interest rate of 7.2%, net of \$2 million of unamortized discount	297	296
Notes due 2007, effective interest rate of 8.0%	98	98
Debentures due 2017, effective interest rate of 8.1%	300	300
Debentures due 2025, effective interest rate of 7.9%, net of \$1 million of unamortized discount	275	275
Debentures due 2027, effective interest rate of 8.4%, net of \$4 million of unamortized discount	196	196
Debentures due 2005, effective interest rate based on LIBOR plus 1.1%	169	—
Subsidiaries		
Notes due 2004 through 2005, average effective interest rate of 4.9% in 2003 and 4.0% in 2002	2	31
Less current maturities	(1)	(8)
Total long-term debt	\$1,336	\$1,224

Aggregate maturities of debt outstanding at December 31, 2003, are \$1 million, \$469 million, \$99 million, and \$776 million for 2004, 2005, 2007, and thereafter, respectively.

As December 31, 2003, the company was in full compliance with financial and other covenants in its various credit agreements.

Short-Term Debt

December 31 (In millions)	2003	2002
Current maturities of long-term debt	\$ 1	\$ 8
Other	4	5
Total short-term debt	\$ 5	\$ 13

The company uses lines of credit and overnight borrowings to finance certain of its short-term capital requirements. Information regarding short-term debt is shown below.

(Dollars in millions)	2003 (a)	2002 (a)
Borrowings at end of year	\$ 4	\$ 5
Weighted-average interest rate on borrowings at end of year	7.2%	10.0%
Maximum month-end borrowings during year	6	7
Average month-end borrowings during year	4	3
Weighted-average interest rate on average month-end borrowings during year	8.5%	8.1%

(a) Includes borrowings under committed credit facilities and uncommitted lines of credit.

In conjunction with the 1999 realignment of Tenneco Inc. (Tenneco) debt, the company paid bank-facility fees of \$10 million and entered into an interest-rate swap to hedge its exposure to interest-rate movement. The company settled this swap in November 1999 at a loss of \$43 million. Both the loss on the swap and the bank-facility fees are being recognized as additional interest expense over the average life of the underlying debt.

> NOTE 7 **Financial Instruments**

Asset and Liability Instruments

At December 31, 2003, and 2002, the fair value of cash and temporary-cash investments, short- and long-term receivables, accounts payable, and short-term debt were considered to be the same as, or not materially different than, amounts recorded for these assets and liabilities. The fair value of long-term debt at December 31, 2003, and 2002, was approximately \$1,535 million and \$1,427 million, respectively, compared with recorded amounts of \$1,336 million and \$1,224 million, respectively. The fair value of long-term debt was based on quoted market prices for the company's debt instruments.

**Instruments with Off-Balance-Sheet Risk
(Including Derivatives)**

The company utilizes derivative instruments, principally swaps, forward contracts, and options, to manage and mitigate its exposure to movements in foreign-currency values, interest rates, and commodity prices. These derivatives are either designated primarily as cash-flow hedges, in that the company's strategy in entering into such transactions is to limit the variability of expected future cash flows, or not designated as hedging instruments. Changes in the fair value of the company's cash-flow hedges are reported as other comprehensive income and are recognized in earnings in the period in which the hedging transactions affect earnings. Net gains or losses on derivatives not designated as hedges are recognized in the income statement as offsets to gains or losses on the underlying transactions. Amounts recognized in earnings related to the company's hedging transactions were not material in 2003, 2002, or 2001.

From time to time, Pactiv enters into foreign-currency forward contracts with terms of less than 1 year to mitigate its exposure to exchange-rate changes related to third-party trade receivables and accounts payable. The following table summarizes open foreign-currency contracts as of December 31, 2003.

(In millions)	Notional amount	
	Purchase	Sell
Foreign-currency contracts		
Euros	\$ 73	\$ 41
British pounds	41	71
Czech korunas	—	1
	<u>\$ 114</u>	<u>\$ 113</u>

Based on exchange rates at December 31, 2003, the cost of replacing these contracts in the event of nonperformance by counter parties would not be material.

In the first quarter of 2001, the company entered into interest-rate swap agreements to convert floating-rate debt on its synthetic-lease obligations to fixed-rate debt. This action was taken to reduce the company's exposure to interest-rate risk. During the first quarter of 2002, the company exited these swap agreements, and the resulting accumulated net loss (\$1 million at December 31, 2003,) is being expensed over the remaining life of the underlying obligations.

During the third quarter of 2003, the company entered into natural-gas forward contracts to hedge its exposure to adverse changes in the price levels of natural gas during the period from November 2003 to March 2004. These instruments limit the upside risk on purchases of natural gas used in the production process at certain of the company's plants. In this connection, the company paid an option premium that is being amortized over the November 2003 to March 2004 period. The option does not obligate the company to purchase natural gas, but limits upward price exposure, while allowing the company to benefit fully from downward price movements. Changes in the market value of these natural-gas hedges are recorded in other comprehensive income on the balance sheet.

Lines of Credit and Guarantees

The company, from time to time, utilizes various lines of credit to finance operations of its foreign subsidiaries that are backed by payment and performance guarantees. These lines of credit are mainly used as overdraft and foreign-exchange settlement facilities and are in effect until cancelled by one or both parties. Performance under the guarantees would be required if subsidiaries failed to satisfy their obligations. Total available lines of credit were \$24 million, and there were no borrowings under the company's guaranteed lines of credit at December 31, 2003.

> NOTE 8 **Inventories**

December 31 (In millions)	2003	2002
Finished goods	\$ 245	\$ 244
Work in process	57	47
Raw materials	69	48
Other materials and supplies	28	29
	<u>\$ 399</u>	<u>\$ 368</u>

> NOTE 9 Goodwill and Intangible Assets

On January 1, 2002, the company adopted SFAS No. 142. Following this adoption, the company reviewed recorded goodwill for possible impairment by comparing the fair value and carrying value of goodwill for each reporting unit. Fair value was determined using the income approach. Goodwill was found to be impaired for certain Protective and Flexible Packaging businesses that were acquired prior to the company's spin-off from Tenneco. Faced with increased competition, these businesses experienced lower operating margins, and, as a result, the company recorded a goodwill-impairment charge of \$83 million, \$72 million after tax, or \$0.45 per share, in the first quarter of 2002. Subsequent impairment tests of goodwill as of the company's annual testing date of October 31 showed that no further impairment occurred in either 2002 or 2003.

In accordance with requirements of SFAS No. 142, the company discontinued the amortization of goodwill and certain intangible assets effective January 1, 2002. Shown below is a comparison of income from continuing operations, net income, and earnings per share (EPS) for 2003 and 2002 with corresponding amounts recorded in 2001 adjusted to exclude the amortization of goodwill and intangible assets that is no longer required to be recorded.

(In millions, except per-share data)	2003	2002	2001
Income from continuing operations	\$ 195	\$ 220	\$ 165
Goodwill amortization, net of tax	—	—	14
Intangible asset amortization, net of tax	—	—	2
Adjusted income from continuing operations	195	220	181
Income from discontinued operations, net of tax	—	—	28
Cumulative effect of changes in accounting principles, net of tax	(12)	(72)	—
Pro forma net income	\$ 183	\$ 148	\$ 209
Basic EPS			
Continuing operations	\$ 1.23	\$ 1.38	\$ 1.04
Goodwill amortization	—	—	0.09
Intangible asset amortization	—	—	0.01
Adjusted continuing operations	1.23	1.38	1.14
Discontinued operations	—	—	0.17
Cumulative effect of changes in accounting principles	(0.07)	(0.45)	—
Pro forma EPS	\$ 1.16	\$ 0.93	\$ 1.31

Diluted EPS

Continuing operations	\$ 1.21	\$ 1.37	\$ 1.03
Goodwill amortization	—	—	0.09
Intangible asset amortization	—	—	0.01
Adjusted continuing operations	1.21	1.37	1.13
Discontinued operations	—	—	0.17
Cumulative effect of changes in accounting principles	(0.07)	(0.45)	—
Pro forma EPS	\$ 1.14	\$ 0.92	\$ 1.30

Changes in the carrying value of goodwill during 2003 by operating segment are shown in the following table.

(In millions)	Consumer Products	Foodservice/ Food Packaging	Protective and Flexible Packaging	Total
Balance, December 31, 2002	\$ 136	\$ 302	\$ 174	\$ 612
Goodwill additions	—	28	1	29
Goodwill adjustment – prior acquisitions	—	(14)	(1)	(15)
Currency-translation adjustment	—	4	13	17
Balance, December 31, 2003	\$ 136	\$ 320	\$ 187	\$ 643

Intangible assets at December 31, 2003, are shown in the following table.

(Dollars in millions)	Weighted average life (years)	Carrying amount	Accumulated amortization	Total
Intangible assets subject to amortization				
Patents	21.4	\$ 192	\$ 70	\$ 122
Other	11.9	72	26	46
		264	96	168
Intangible assets not subject to amortization (primarily trademarks)	—	130	—	130
Total intangible assets		\$ 394	\$ 96	\$ 298

Amortization expense for intangible assets was \$17 million for the year ended December 31, 2003. Amortization expense is estimated to total \$15 million, \$15 million, \$13 million, \$13 million, and \$12 million for 2004, 2005, 2006, 2007, and 2008, respectively.

> NOTE 10 Property, Plant, and Equipment, Net

December 31 (In millions)	2003	2002
Original cost		
Land, buildings, and improvements	\$ 735	\$ 573
Machinery and equipment	1,653	1,441
Other, including construction in progress	102	153
	2,490	2,167
Less accumulated depreciation and amortization	(968)	(801)
	\$1,522	\$1,366

The company recorded capitalized interest of \$4 million in each of 2003, 2002, and 2001.

> NOTE 11 **Income Taxes**

The domestic and foreign components of income from continuing operations before income taxes were as follows:

(In millions)	2003	2002	2001
U.S. income before income taxes	\$ 280	\$ 325	\$ 276
Foreign income before income taxes	33	42	8
Total income before income taxes	\$ 313	\$ 367	\$ 284

Following is a comparative analysis of the components of income-tax expense applicable to continuing operations.

(In millions)	2003	2002	2001
Current			
Federal	\$ 62	\$ 25	\$ 2
State and local	10	10	5
Foreign	13	9	(1)
	85	44	6
Deferred			
Federal	31	88	98
State and local	1	6	9
Foreign	1	8	5
	33	102	112
Total income-tax expense	\$ 118	\$ 146	\$ 118

A reconciliation of the difference between the U.S. statutory federal income-tax rate and the company's effective income-tax rate is shown in the following table.

	2003	2002	2001
U.S. federal income-tax rate	35.0%	35.0%	35.0%
Increase in income-tax rate resulting from:			
Foreign income taxed at various rates	0.7	0.5	0.4
State and local taxes on income, net of U.S. federal income-tax benefit	2.1	2.9	3.1
Amortization of nondeductible goodwill	—	—	1.1
Research and development credit	(0.5)	—	—
Other	0.4	1.6	1.9
Effective income tax rate	37.7%	40.0%	41.5%

> NOTE 12 **Common Stock**

The company has 350 million shares of common stock (\$0.01 par value) authorized, of which 156,335,967 shares were issued and outstanding as of December 31, 2003.

Reserves

Reserved shares (In thousands)	
Thrift plans	1,868
2002 incentive-compensation plan	25,876
Employee stock-purchase plan	2,419
	<u>30,163</u>

Summarized below are the components of the company's net deferred-tax liability.

December 31 (In millions)	2003	2002
Deferred-tax assets		
Tax-loss carryforwards		
State and local	\$ 1	\$ 1
Foreign	16	13
Pensions	111	130
Postretirement benefits	33	28
Restructuring reserves	—	1
Other items	52	57
Valuation allowance	(14)	(12)
Total deferred-tax assets	199	218
Deferred-tax liabilities		
Property and equipment	282	250
Other items	83	85
Total deferred-tax liabilities	365	335
Net deferred-tax liabilities	\$ 166	\$ 117

The \$15 million of state tax-loss carryforwards at December 31, 2003, will expire at various dates from 2004 to 2013. There is \$57 million of foreign tax-loss carryforwards at December 31, 2003, of which \$29 million will expire at various dates from 2004 to 2015, with the remainder having unlimited lives. The valuation allowance at December 31, 2003, (\$14 million) and 2002, (\$12 million) represented unrecognized tax benefits related to foreign tax-loss carry forwards.

Stock Plans

2002 Incentive-Compensation Plan – In November 1999, the company initiated a stock-ownership plan that permits the granting of a variety of awards, including common stock, restricted stock, performance shares, stock-appreciation rights, and stock options to directors, officers, and employees. In May 2002, the 1999 plan was succeeded by the 2002 incentive-compensation plan, and all share balances under the 1999 plan were transferred to the new plan, which will remain in effect until amended or terminated. Under the 2002 plan, up to 27 million shares of common stock can be issued (including shares issued under the prior plan), of which 17 million were issued or granted as of December 31, 2003.

Restricted-stock, performance-share, and stock-option awards generally require that, among other things, grantees remain with the company for certain periods of time. Performance shares granted under the plan vest upon the attainment of specified performance goals in the 3 years following the date of grant.

Details of performance- and restricted-stock balances are shown below.

	Performance shares	Restricted shares
Outstanding, January 1, 2002	527,892	30,238
Granted	100,433	2,500
Canceled	(11,733)	—
Vested	—	(32,738)
Outstanding, December 31, 2002	616,592	—
Granted	366,242	—
Canceled	(12,000)	—
Vested	(265,508)	—
Outstanding, December 31, 2003	705,326	—

The weighted-average grant date fair value of performance shares issued in 2003, 2002, and 2001 was \$20.72, \$16.88, and \$14.76 per share, respectively.

Summarized below are stock options issued by Pactiv.

	Shares under option	Weighted-average exercise price
Outstanding, January 1, 2002	13,428,505	\$22.29
Granted	2,288,917	17.65
Exercised	(420,064)	12.79
Canceled	(1,109,985)	30.41
Outstanding, December 31, 2002	14,187,373	21.19
Exercisable, December 31, 2002	9,324,775	23.23
Outstanding, January 1, 2003	14,187,373	21.19
Granted	2,315,714	20.25
Exercised	(972,551)	13.27
Canceled	(559,667)	32.48
Outstanding, December 31, 2003	14,970,869	21.13
Exercisable, December 31, 2003	10,518,208	22.13

Stock options expire 10 to 20 years following date of grant and vest over periods ranging from 1 to 3 years.

The weighted-average fair value of options granted by the company in 2003 (\$6.90), 2002 (\$6.17), and 2001 (\$6.15) was determined using the Black-Scholes option-pricing model with the following assumptions:

	2003	2002	2001
Actuarial assumptions			
Risk-free interest rate	3.0%	3.0%	4.3%
Life (years)	4.4	4.4	4.4
Volatility	36.9%	38.7%	41.1%

Summarized below is information about stock options outstanding at December 31, 2003.

Range of exercise price	Outstanding options			Exercisable options	
	Number	Weighted-average remaining contractual life	Weighted-average exercise price	Number	Weighted-average exercise price
\$ 7 to \$12	1,621,001	6.8 years	\$ 11.63	1,621,001	\$ 11.63
\$13 to \$21	9,696,414	7.9	16.65	5,259,517	14.87
\$22 to \$29	20,764	7.9	22.93	5,000	22.79
\$30 to \$37	1,685,524	10.2	34.15	1,685,524	34.15
\$38 to \$45	1,947,166	6.9	40.06	1,947,166	40.06
	14,970,869			10,518,208	

See Note 2 for additional information regarding accounting for stock-based employee compensation.

Employee Stock-Purchase Plan – The company has a stock-purchase plan that allows U.S. and Canadian employees to purchase Pactiv common stock at a 15% discount, subject to an annual limitation of \$21,240. In 2003, 2002, and 2001, employees purchased 333,239, 401,469, and 448,910 shares, respectively, of Pactiv stock at a weighted-average price of \$17.38, \$14.68, and \$10.46 per share, respectively.

Employee 401(k) Plans – The company has qualified 401(k) plans for employees under which eligible participants may make contributions equal to a percentage of their total cash compensation. A portion of such contributions are matched by the company in the form of Pactiv common stock. The company or plan participants may contribute additional amounts in accordance with the plans' terms. In 2003, 2002, and 2001, the company recorded 401(k) plan expenses of \$13 million, \$12 million, and \$10 million, respectively.

Grantor Trust – In November 1999, the company established a grantor trust and reserved 3,200,000 shares of Pactiv common stock for the trust. These shares were issued to the trust in January 2000. This so-called "rabbi trust" is designed to assure the payment of deferred-compensation and supplemental pension benefits. These shares are not considered to be outstanding for purposes of financial reporting.

Qualified Offer Rights Plan

In November 1999, Pactiv adopted a qualified offer rights plan (QORP) to deter coercive takeover tactics and to prevent a potential acquirer from gaining control of the company in a transaction that would not be in the best interest of shareholders. Under the plan, if a person becomes the beneficial owner of 20% or more of the company's outstanding common stock, other than pursuant to a qualified offer, each right entitles its holder, other than the 20% or more holder, to purchase common stock having a market value of twice the right's exercise price.

Rights are not exercisable in connection with a qualified offer, which is defined as an all-cash tender offer for all outstanding shares of common stock that is fully financed, remains open for a period of at least 60 business days, results in the offeror owning at least 85% of the common stock after consummation of the offer, assures a prompt second-step acquisition of shares not purchased in the initial offer at the same price as in the initial offer, and meets certain other requirements.

In connection with the adoption of the QORP, the board of directors also adopted an evaluation mechanism that calls for an independent board committee to review, on an ongoing basis, the QORP and developments in rights plans in general and, if it deems appropriate, to recommend modification or termination of the plan. The independent committee is required to report to the board at least every 3 years as to whether the QORP continues to be in the best interest of shareholders.

Earnings Per Share

Earnings from continuing operations per share of common stock outstanding were computed as follows:

(In millions, except share and per-share data)

	2003	2002	2001
Basic earnings per share			
Income from continuing operations	\$ 195	\$ 220	\$ 165
Average number of shares of common stock outstanding	157,932,323	158,618,274	158,833,296
Basic earnings from continuing operations per share	\$ 1.23	\$ 1.38	\$ 1.04
Diluted earnings per share			
Income from continuing operations	\$ 195	\$ 220	\$ 165
Average number of shares of common stock outstanding	157,932,323	158,618,274	158,833,296
Effect of dilutive securities			
Restricted stock	—	—	18,097
Stock options	1,726,512	1,579,885	498,634
Performance shares	484,765	414,916	177,143
Average number of shares of common stock outstanding including dilutive securities	160,143,600	160,613,075	159,527,170
Diluted earnings from continuing operations per share	\$ 1.21	\$ 1.37	\$ 1.03

In 2002, the company acquired 2,119,009 shares of its common stock at an average price of \$19.20 per share, for a total outlay of \$40 million. During 2003, the company repurchased 4,312,600 shares at an average

price of \$20.24 per share, for a total outlay of \$87 million. Of the 2003 repurchases, 945,600 shares were authorized under the stock-repurchase plan announced in December 2003.

> NOTE 13 **Preferred Stock**

Pactiv has 50 million shares of preferred stock (\$0.01 par value) authorized, none of which were issued at December 31, 2003. The company has reserved 750,000 shares of preferred stock for the QORP.

> NOTE 14 **Minority Interest**

In October 2002, the company acquired a 70% interest in Jaguar and recorded a related minority interest of \$13 million. In August 2003, the company acquired the remaining 30% interest in Jaguar, thereby making it a wholly-owned subsidiary.

> NOTE 15 **Pension Plans and Other Postretirement Benefits**

The company has pension plans that cover substantially all of its employees. Benefits are based on years of service and, for most salaried employees, final-average compensation. The company's funding policy is to contribute to the plans amounts necessary to satisfy requirements of applicable laws and regulations. Plan assets consist principally of equity and fixed-income securities and included 4,112,358 shares of Pactiv stock with a fair-market value of \$98 million at December 31, 2003. These shares were contributed by Tenneco prior to the spin-off. Effective with the spin-off, Pactiv became the sponsor of Tenneco's retirement plans, receiving related assets and assuming the obligation to provide pension benefits to participating employees of Tenneco Automotive Inc. and certain former subsidiaries and affiliates of Tenneco. For Tenneco Automotive Inc. employees, benefits accrued under these plans were frozen as of November 30, 1999. The company uses a September 30 measurement date for its plans.

The company has postretirement health-care and life-insurance plans that cover certain of its salaried and hourly employees who retire in accordance with the various provisions of such plans. Benefits may be subject to deductibles, copayments, and other limitations. The company reserves the right to change postretirement plans, which are not funded. The Medicare Prescription Drug, Improvement and Modernization Act ("the Act"), which was signed into law on December 8, 2003, provides prescription-drug benefits under Medicare Part D and a federal subsidy to sponsors of retiree health-care benefit plans that provide benefits that are at least actuarially equivalent to those provided under Medicare Part D. The company is currently studying the impact of the Act on its plans. Authoritative accounting guidance for the federal-subsidy feature of the Act is pending, and, upon issuance, may require modification of amounts reported for postretirement-benefit costs and accumulated projected benefit obligations.

In developing assumptions regarding the rate of return on pension-plan assets, the company receives independent input on asset-allocation strategies and projections of long-term rates of return on various asset classes, risk-free rates of return, and long-term inflation rates. Since inception in 1971, the pension plans' annual rate of return on assets has averaged 10.9%. Historically, the plans have invested approximately 65% of assets in equities and 35% in fixed-income investments. After consideration of all of these factors, the company concluded that a 9% rate of return on assets assumption was appropriate for 2003.

The company's discount-rate assumption is based on the composite yield on a portfolio of high-quality corporate bonds constructed with durations to match the plans' future benefit obligations (approximately 6.25% at September 30, 2003). Consequently, the company lowered its discount-rate assumption for 2004 to 6.25% from 6.75% in 2003.

The company utilizes a market-related method for calculating the value of plan assets. This method recognizes the difference between actual and expected returns on plan assets over 5 years. The resulting unrecognized gains or losses, along with other actuarial gains and losses, are amortized using the "corridor approach" outlined in SFAS No. 87.

Financial data pertaining to the company's pension- and postretirement-benefit plans appear below.

(In millions)	Pension plans		Postretirement plans	
	2003	2002	2003	2002
Changes in projected benefit obligations				
Benefit obligations at September 30 of the previous year	\$3,644	\$3,390	\$ 102	\$ 96
Currency-rate conversion	10	7	—	—
Service cost of benefits earned	33	35	1	1
Interest cost on benefit obligations	237	237	7	7
Plan amendments	1	—	—	(10)
Actuarial losses	241	216	3	18
Benefits paid	(256)	(239)	(11)	(12)
Participant contributions	—	—	3	2
Divestitures	(1)	(2)	—	—
Benefit obligations at September 30	\$3,909	\$3,644	\$ 105	\$ 102
Changes in fair value of plan assets				
Fair value at September 30 of the previous year	\$3,057	\$3,561	\$ —	\$ —
Currency-rate conversion	5	5	—	—
Actual return on plan assets	566	(269)	—	—
Employer contributions	9	(1)	8	10
Participant contributions	1	1	3	2
Benefits paid	(256)	(239)	(11)	(12)
Divestitures	—	(1)	—	—
Fair value at September 30	\$3,382	\$3,057	\$ —	\$ —
Development of amounts recognized in the statement of financial position				
Funded status at September 30	\$ (527)	\$ (587)	\$ (105)	\$ (102)
Contributions during the fourth quarter	2	1	2	3
Unrecognized cost				
Actuarial losses	1,737	1,722	45	45
Prior-service costs	16	20	(3)	(2)
Net amount recognized at December 31	\$1,228	\$1,156	\$ (61)	\$ (56)
Amounts recognized in the statement of financial position				
Prepaid benefit cost	\$ 187	\$ 170	\$ —	\$ —
Contributions during the fourth quarter	2	—	2	—
Accrued benefit cost	(528)	(542)	(63)	(56)
Intangible assets	15	18	—	—
Accumulated other comprehensive income	1,552	1,510	—	—
Net amount recognized at December 31	\$1,228	\$1,156	\$ (61)	\$ (56)

The impact of pension plans on pretax income from continuing operations was as follows.

(In millions)	2003	2002	2001
Components of net periodic-benefit costs			
Service cost of benefits earned	\$ (33)	\$ (35)	\$ (30)
Interest cost on benefit obligations	(237)	(237)	(231)
Expected return on plan assets	354	385	373
Amortization of:			
Unrecognized net losses	(15)	—	—
Unrecognized prior-service cost	(5)	(5)	(5)
Unrecognized net transition obligation	—	1	6
Total net periodic-benefit income	\$ 64	\$ 109	\$ 113

Pension-plan actuarial assumptions are shown below.

September 30	2003	2002	2001
Actuarial assumptions			
Discount rate	6.25%	6.75%	7.25%
Compensation increases	4.0	4.9	4.9
Return on assets	9.0	9.0	9.5

For all of the company's worldwide pension plans, the accumulated benefit obligation was \$3,847 million and \$3,570 million at December 31, 2003, and 2002, respectively. For pension plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligations, accumulated benefit obligations, and fair value of plan assets were \$3,594 million, \$3,532 million, and \$3,006 million, respectively, at September 30, 2003, and \$3,326 million, \$3,252 million, and \$2,711 million, respectively, at September 30, 2002.

The pretax impact of postretirement-benefit plans on continuing operations was as follows:

(In millions)	2003	2002	2001
Service cost of benefits earned	\$ 1	\$ 1	\$ 1
Interest cost on benefit obligations	7	6	6
Prior-service cost	1	2	—
Losses	3	2	5
Total postretirement-benefit plan costs	\$ 12	\$ 11	\$ 12

Actuarial assumptions used to determine postretirement-benefit obligations follow.

	2003	2002	2001
Actuarial assumptions			
Health-care cost inflation (a)	11.0%	12.0%	10.0%
Discount rate	6.25	6.75	7.25

(a) Assumed to decline to 5% in 2009.

A one percentage-point change in assumed health-care cost trend rates would have the following effects:

(In millions)	1% increase	1% decrease
Effect on total service and interest costs	\$ —	\$ —
Effect on postretirement-benefit obligation	2	2

The company contributed \$8 million and \$10 million in 2003 and 2002, respectively, to fund postretirement medical-plan benefit obligations. As permitted under Employee Retirement Income Security Act (ERISA) regulations, the company used pension-plan assets to fund \$9 million of postretirement medical obligations in 2001. The company expects to contribute \$8 million to fund its postretirement medical-plan benefit obligations in 2004.

The weighted-average asset allocations for the company's U.S. pension plans at September 30, 2003, and 2002, are summarized below.

	2003	2002
Equity securities	65.4%	60.5%
Fixed-income securities	34.6	39.5
Total	100.0%	100.0%

The company employs a total return investment approach whereby a mixture of equity and fixed-income investments are used to maximize the long-term return on plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and company financial condition. The investment portfolio contains a diversified blend of equity and fixed-income investments. Furthermore, equity investments include U.S. and non-U.S. stocks, as well as growth, value, and small- and large-capitalization investments. Other asset classes, such as private equity investments, are used judiciously to enhance long-term returns while increasing portfolio diversification. Investment risk is measured and monitored on an ongoing basis through quarterly investment-portfolio reviews, annual liability measurements, and periodic asset/liability studies. The company does not expect to be required to contribute cash to its U.S. qualified pension plans until at least 2013. The company makes contributions of approximately \$4 million annually to its nonqualified retirement plans for supplemental benefits paid to retirees. The company's foreign subsidiaries contributed approximately \$5 million to various pension plans in 2003.

> NOTE 16 Segment and Geographic-Area Information

The company reports the results of its segments in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." During 2003, the company revised its segment reporting by separating its previously aggregated Consumer and Foodservice/Food Packaging segment. Accordingly, the company now has 4 reporting segments: Consumer Products, which relates principally to the manufacture and sale of disposable plastic, molded-fibre, pressed-paperboard, and aluminum packaging products such as waste bags, tableware, food-storage bags, and cookware for consumer markets such as grocery stores, mass merchandisers, and discount chains; Foodservice/Food Packaging, which relates primarily to the manufacture and sale of various disposable plastic, molded-fibre, pressed-paperboard, and aluminum packaging products for foodservice and food-packaging markets such as restaurants and other institutional-foodservice outlets, food processors, and grocery chains; Protective and Flexible Packaging, which relates to the manufacture and sale of plastic, paperboard, and molded-fibre products for protective-packaging

markets such as electronics, automotive, furniture, and e-commerce, and for flexible-packaging applications in food, medical, pharmaceutical, chemical, and hygienic markets; and Other, which relates to corporate and administrative-service operations and retiree-benefit income and expense. The accounting policies of the reporting segments are the same as those for Pactiv as a whole. Where discrete financial information is not available by segment, reasonable allocations of expenses and assets are used. Previously reported segment information has been restated to conform to the current year's presentation.

The accounting policies of the segments are the same as those described in Note 2. Products are transferred between segments and among geographic areas at, as nearly as possible, market value. In 2003 and 2002, Wal-Mart Stores, Inc. accounted for 11.4% and 10.0%, respectively, of the company's sales, which were recorded in the Consumer Products and Foodservice/Food Packaging segments. In general, the company's backlog of orders is not material.

The following table sets forth certain segment information.

(In millions)	Segment					Total
	Consumer Products	Foodservice/ Food Packaging	Protective and Flexible Packaging	Other	Reclassifications and eliminations	
At December 31, 2003, and for the year then ended						
Sales to external customers	\$ 888	\$1,371	\$ 879	\$ —	\$ —	\$3,138
Depreciation and amortization	51	71	34	7	—	163
Operating income	195	178(a)	58(b)	35(c)	—	466
Cumulative effect of change in accounting principles	(3)	(6)	(1)	(2)	—	(12)
Total assets	1,005	1,199	773	729(d)	—	3,706
Investment in affiliated companies	—	1	4	—	—	5
Capital expenditures	24	55	29	4	—	112
Noncash items other than depreciation and amortization	—	(1)	1	(64)(e)	—	(64)
At December 31, 2002, and for the year then ended						
Sales to external customers	\$ 841	\$1,221	\$ 818	\$ —	\$ —	\$2,880
Depreciation and amortization	52	69	30	7	—	158
Operating income	188	158	62(b)	55(c)	—	463
Cumulative effect of change in accounting principles	—	—	(72)	—	—	(72)
Total assets	960	1,097	713	642(d)	—	3,412
Investment in affiliated companies	—	1	3	—	—	4
Capital expenditures	19	65	39	3	—	126
Noncash items other than depreciation and amortization	—	—	(4)	(109)(e)	—	(113)
At December 31, 2001, and for the year then ended						
Sales to external customers	\$ 815	\$1,182	\$ 815	\$ —	\$ —	\$2,812
Depreciation and amortization	54	75	38	10	—	177
Operating income	154	134(a)	29(b)	74(c)	—	391
Income from discontinued operations	—	—	—	28	—	28
Total assets	961	1,044	729	1,451(d)	(125)	4,060
Investment in affiliated companies	—	1	1	—	—	2
Capital expenditures	31	81	27	6	—	145
Noncash items other than depreciation and amortization	—	(7)	14	(106)(e)	—	(99)

(a) Includes restructuring and other credits of \$1 million in 2003 and 2001.

(b) Includes restructuring and other charges (credits) of \$1 million, \$(4) million, and \$13 million, in 2003, 2002, and 2001, respectively.

(c) Includes pension-plan income, unallocated corporate expenses, and spin-off transaction-cost reversals of \$12 million in 2001.

(d) Includes assets related to pension plans and administrative-service operations.

(e) Includes pension-plan income.

The following table sets forth certain geographic-area information.

(In millions)	Geographic area			Total
	United States	Foreign(a)	Reclassifications and eliminations	
At December 31, 2003, and for the year then ended				
Sales to external customers (b)	\$2,412	\$ 726	\$ —	\$3,138
Long-lived assets (c)	1,464	319	—	1,783
Total assets	2,938	768	—	3,706
At December 31, 2002, and for the year then ended				
Sales to external customers (b)	\$2,286	\$ 594	\$ —	\$2,880
Long-lived assets (c)	1,298	304	—	1,602
Total assets	2,756	656	—	3,412
At December 31, 2001, and for the year then ended				
Sales to external customers (b)	\$2,262	\$ 550	\$ —	\$2,812
Long-lived assets (c)	2,203	186	—	2,389
Total assets	3,560	537	(37)	4,060

(a) Sales to external customers and long-lived assets for individual countries (primarily in Europe) were not material.

(b) Geographic assignment is based on location of selling business.

(c) Long-lived assets include all long-term assets other than net assets of discontinued operations, goodwill, intangibles, and deferred taxes.

Capital Commitments

The company estimates that the completion of projects authorized at December 31, 2003, for which commitments have been made will require expenditures of approximately \$71 million in 2004.

Lease Commitments

Certain of the company's facilities, equipment, and other assets are leased under long-term arrangements. Minimum lease payments under noncancelable operating leases with lease terms in excess of 1 year are expected to total \$31 million, \$21 million, \$17 million, \$14 million, and \$11 million for 2004, 2005, 2006, 2007, and 2008, respectively, and \$30 million for subsequent years.

Commitments under capital leases are not significant. Total rental costs for continuing operations for 2003, 2002, and 2001 were \$41 million, \$42 million, and \$40 million, respectively, which included minimum rentals under noncancelable operating leases of \$37 million, \$36 million, and \$35 million for the respective periods.

Litigation

In May 1999, Tenneco, Pactiv (through Tenneco's former containerboard business), and a number of other containerboard manufacturers were named as defendants in a consolidated, class-action complaint brought on behalf of purchasers of corrugated containers that alleged a civil violation of Section I of the Sherman Act. The company also was named as a defendant in a related class-action antitrust lawsuit. Tenneco sold its containerboard business in April 1999, prior to the spin-off of Pactiv in November 1999. In connection with the spin-off, Pactiv was assigned responsibility for defending related claims against Tenneco and for any liability resulting therefrom.

The lawsuits (In Re: Linerboard Litigation, U.S.D.C., E.D. of Pennsylvania, MDL no. 1261) alleged that the defendants, during the period from October 1, 1993, through November 30, 1995, conspired to limit the supply of linerboard, and that the purpose and effect of the alleged conspiracy was to artificially increase prices of corrugated containers and corrugated sheets. The lawsuits sought treble damages of unspecified amounts, plus attorneys' fees.

Several entities have opted out of the classes, and the company has been named as a defendant in 12 direct-action complaints that have been filed in various federal courts across the country by opt-out entities. These cases effectively have been consolidated for pretrial purposes before the Federal District Court in the Eastern District of Pennsylvania, which is overseeing the class actions, and it is expected that they will be transferred formally to that court. All of the opt-out complaints included allegations against the defendants that are substantially similar to those made in the class actions.

On November 3, 2003, the company reached an agreement to settle the class-action lawsuits. The settlement, which must be approved by the court, resulted in the company recording a charge of \$56 million pretax, \$35 million after tax, or \$0.22 per share, in the third quarter of 2003. This charge included the establishment of a reserve for the estimated liability associated with the opt-out complaints. Actual amounts paid in settlement of these opt-out liabilities, if any, may be different than amounts reserved. No trial date has been set for any of the opt-out lawsuits.

The company is party to other legal proceedings arising from its operations. Related reserves are recorded when it is probable that liabilities exist and where reasonable estimates of such liabilities can be made. While it is not possible to predict the outcome of any of these proceedings, the company's management, based on its assessment of the facts and circumstances now known, does not believe that any of these proceedings, individually or in the aggregate, will have a material adverse effect on the company's financial position. However, actual outcomes may be different than expected and could have a material effect on the company's results of operations or cash flows in a particular period.

Environmental Matters

In early 2003, the company discovered that certain air emissions at one of its California plants exceeded permitted levels. The company reported this matter to the San Joaquin Valley Air Pollution Control District, and, effective November 2003, has entered into a settlement agreement with that agency regarding the appropriate actions to be taken to address the matter, which settlement agreement is subject to the approval of the U.S. Environmental Protection Agency. The company expects to resolve this matter through discussions with the agency and does not believe that the costs involved, including any monetary sanctions, will have a material adverse effect on the company's financial position, results of operations, or cash flows.

The company is subject to a variety of environmental and pollution-control laws and regulations in all jurisdictions in which it operates. Where it is probable that related liabilities exist and where reasonable estimates of such liabilities can be made, Pactiv establishes associated reserves. Estimated liabilities are subject to change as additional information becomes available regarding the magnitude of possible clean-up costs, the expense and effectiveness of alternative clean-up methods, and other possible liabilities associated with such situations. However, management believes that any additional costs that may be incurred as more information becomes available will not have a material adverse effect on the company's financial position, although such costs could have a material effect on the company's results of operations or cash flows in a particular period.

> NOTE 18 **Quarterly Financial Data (Unaudited)**

(In millions)	Sales	Cost of sales	Restructuring and other	Tenneco Packaging litigation settlement and other	Income from continuing operations	Cumulative effect of changes in accounting principles	Net income
2003							
First quarter	\$ 717	\$ 508	\$ —	\$ —	\$ 44	\$ —	\$ 44
Second quarter	810	571	—	—	59	—	59
Third quarter	793	550	—	56	26	—	26
Fourth quarter	818	577	—	—	66	(12)	54
	\$3,138	\$2,206	\$ —	\$ 56	\$ 195	\$ (12)	\$ 183
2002							
First quarter	\$ 647	\$ 438	\$ —	\$ —	\$ 42	\$ (72)	\$ (30)
Second quarter	728	494	(4)	—	60	—	60
Third quarter	727	499	—	—	59	—	59
Fourth quarter	778	536	—	—	59	—	59
	\$2,880	\$1,967	\$ (4)	\$ —	\$ 220	\$ (72)	\$ 148

(Per share)	Basic earnings per share of common stock (a)			Diluted earnings per share of common stock (a)			Stock price / share	
	Continuing operations	Cumulative effect of changes in accounting principles	Net income	Continuing operations	Cumulative effect of changes in accounting principles	Net income	High	Low
2003								
First quarter	\$ 0.27	\$ —	\$ 0.27	\$ 0.27	\$ —	\$ 0.27	\$22.65	\$17.55
Second quarter	0.37	—	0.37	0.37	—	0.37	21.25	18.13
Third quarter	0.17	—	0.17	0.16	—	0.16	20.90	17.95
Fourth quarter	0.42	(0.07)	0.35	0.41	(0.07)	0.34	24.03	20.28
Total year	1.23	(0.07)	1.16	1.21	(0.07)	1.14		
2002								
First quarter	\$ 0.26	\$ (0.45)	\$ (0.19)	\$ 0.26	\$ (0.45)	\$ (0.19)	\$21.00	\$16.60
Second quarter	0.38	—	0.38	0.38	—	0.38	24.47	19.05
Third quarter	0.37	—	0.37	0.37	—	0.37	23.80	15.95
Fourth quarter	0.37	—	0.37	0.37	—	0.37	22.52	15.35
Total year	1.38	(0.45)	0.93	1.37	(0.45)	0.92		

(a) The sum of amounts shown for individual quarters may not equal the total for the year because of changes in the weighted-average number of shares outstanding throughout the year.

> NOTE 19 **Subsequent Events**

As discussed in Note 12, Pactiv's board of directors, in December 2003, authorized the company to repurchase up to 5 million shares of its common stock. Since December 31, 2003, the company has acquired approximately 3 million shares at an average price of \$21.76 per share (\$64 million) under this authorization. In March 2004, the company's board of directors authorized it to repurchase an additional 5 million shares of its common stock.

Capitalizing on productivity opportunities, the company will rationalize and consolidate certain manufacturing operations. Among the actions being considered are termination of production at a molded fibre plant in Great Yarmouth, U.K., and limited consolidation of North American

operations. These rationalizations involve asset writeoffs, equipment removal, severance, and abatement of asbestos insulation at Great Yarmouth.

As a result of these actions, the company plans to take an after-tax charge of approximately \$60 million, of which approximately \$48 million is expected to be recorded in the first quarter of 2004, with the balance recognized throughout the remainder of the year. The after-tax cash cost of executing the program will be approximately \$36 million. The ultimate amount and timing of the charges will depend upon the final costs of facility closures and employee benefits, and conclusion of statutorily required discussions.

The preceding notes are an integral part of the foregoing financial statements.

Selected Financial Data

For the years ended December 31 (In millions, except per-share data)

	2003	2002	2001	2000	1999
Statement of Income (Loss)					
Sales					
Consumer Products	\$ 888	\$ 841	\$ 815	\$ 785	\$ 699
Foodservice/Food Packaging	1,371	1,221	1,182	1,416	1,433
Protective and Flexible Packaging	879	818	815	851	896
	<u>3,138</u>	<u>2,880</u>	<u>2,812</u>	<u>3,052</u>	<u>3,028</u>
Operating income (loss)	466	463	391	341	(23)
Tenneco Packaging litigation settlement and other	56	—	—	—	—
Interest expense, net of interest capitalized	96	96	107	134	146
Income-tax expense (benefit)	118	146	118	91	(50)
Minority interest	1	1	1	3	—
Income (loss) from continuing operations	195	220	165	113	(119)
Income (loss) from discontinued operations, net of income tax	—	—	28	134	(193)
Cumulative effect of changes in accounting principles, net of income tax	(12)	(72)	—	—	(32)
Net income (loss)	<u>\$ 183</u>	<u>\$ 148</u>	<u>\$ 193</u>	<u>\$ 247</u>	<u>\$ (344)</u>
Average number of shares of common stock outstanding					
Basic	157.932	158.618	158.833	161.722	167.405
Diluted	160.144	160.613	159.527	161.779	167.663
Earnings (loss) per share					
Basic					
Continuing operations	\$ 1.23	\$ 1.38	\$ 1.04	\$ 0.70	\$ (0.71)
Discontinued operations	—	—	0.17	0.83	(1.15)
Cumulative effect of changes in accounting principles	(0.07)	(0.45)	—	—	(0.19)
	<u>\$ 1.16</u>	<u>\$ 0.93</u>	<u>\$ 1.21</u>	<u>\$ 1.53</u>	<u>\$ (2.05)</u>
Diluted					
Continuing operations	\$ 1.21	\$ 1.37	\$ 1.03	\$ 0.70	\$ (0.71)
Discontinued operations	—	—	0.17	0.83	(1.15)
Cumulative effect of changes in accounting principles	(0.07)	(0.45)	—	—	(0.19)
	<u>\$ 1.14</u>	<u>\$ 0.92</u>	<u>\$ 1.20</u>	<u>\$ 1.53</u>	<u>\$ (2.05)</u>
Statement of Financial Position					
Net assets of discontinued operations	\$ —	\$ —	\$ —	\$ 72	\$ 195
Total assets	3,706	3,412	4,060	4,341	4,588
Short-term debt including current maturities of long-term debt	5	13	7	13	325
Long-term debt	1,336	1,224	1,211	1,560	1,741
Minority interest	8	21	8	22	20
Shareholders' equity	1,061	897	1,689	1,539	1,350
Statement of Cash Flows					
Cash provided (used) by operating activities	\$ 336	\$ 384	\$ 371	\$ 290	\$ (31)
Cash provided (used) by investing activities	(194)	(244)	(1)	302	(994)
Cash provided (used) by financing activities	(134)	(57)	(354)	(578)	1,030
Expenditures for property, plant, and equipment	(112)	(126)	(145)	(135)	(173)

Other Information

The company has not paid a cash dividend in any of the past 5 years.

The notes to the financial statements cover changes in accounting principles in Note 2 and reclassifications to components of sales in Note 16. Also, a new accounting pronouncement required that a 1999 charge for debt extinguishment be included in income (loss) from continuing operations.