

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 2004.

The company has 4 reporting segments: Consumer Products, which relates principally to the manufacture and sale of disposable plastic, molded-fiber, 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-

fiber, 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-fiber 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.

> 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 both December 31, 2004, and 2003. The remainder of the pool (\$94 million at December 31, 2004) is pledged as collateral in the event any of the sold receivables were to be uncollectible. 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 2004 and 2003 and totaled \$1 million in 2002, 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 (52% and 53% at December 31, 2004, and 2003, respectively) are valued using the last-in, first-out method of accounting. All other inventories are valued using 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 \$54 million higher at December 31, 2004, and \$3 million higher at December 31, 2003.

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 \$152 million, \$146 million, and \$140 million for the years ended December 31, 2004, 2003, and 2002, 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 \$47 million and \$53 million at December 31, 2004, and 2003, respectively.

The company periodically reevaluates 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 Statement of Financial Accounting Standards (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 8 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 \$48 million, \$64 million, and \$109 million in 2004, 2003, and 2002, respectively.

Research and Development

Research and development costs, which are expensed as incurred, totaled \$33 million, \$32 million, and \$35 million in 2004, 2003, and 2002, 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 \$12 million, \$7 million, and \$17 million in 2004, 2003, and 2002, 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)	2004	2003	2002
Net income	\$ 155	\$ 183	\$ 148
After-tax adjustment of stock-based compensation costs			
Intrinsic-value method	3	4	4
Fair-value method	(13)	(14)	(13)
Pro forma	\$ 145	\$ 173	\$ 139
Earnings per share			
Basic	\$ 1.02	\$ 1.16	\$ 0.93
Adjustment of stock-based compensation costs			
Intrinsic-value method	0.02	0.03	0.02
Fair-value method	(0.08)	(0.09)	(0.08)
Pro forma	\$ 0.96	\$ 1.10	\$ 0.87
Diluted	\$ 1.01	\$ 1.14	\$ 0.92
Adjustment of stock-based compensation costs			
Intrinsic-value method	0.02	0.03	0.02
Fair-value method	(0.08)	(0.09)	(0.08)
Pro forma	\$ 0.95	\$ 1.08	\$ 0.86

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 \$157 million and \$128 million at December 31, 2004, and December 31, 2003, respectively. The unrecognized deferred-tax liability associated with unremitted earnings totaled approximately \$42 million and \$25 million at December 31, 2004, and December 31, 2003, respectively.

In October 2004, the American Jobs Creation Act of 2004 was enacted. The Act provides a temporary incentive to U.S. corporations to repatriate accumulated income earned abroad by allowing them to claim a deduction of 85% of dividends received for certain dividends from controlled foreign corporations. The provision is subject to several limitations, and, uncertainty currently exists with respect to how to interpret numerous provisions in the Act. As a result, the company is not yet able to determine whether, and to what extent, it will repatriate foreign earnings that have not yet been remitted to the United States.

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 of 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 2004, 2003, and 2002. 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 8 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. Consolidation of the VIE associated with the company's synthetic-lease facility lowered 2004 net income by approximately \$3 million, or \$0.02 per share.

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment." SFAS No. 123(R) requires that the fair value of all share-based payments to employees, including grants of stock options, be recognized in the financial statements, and supercedes APB No. 25, which required that the "intrinsic value" method be used in determining compensation expense for share-based payments to employees. Under SFAS No. 123(R), employee-compensation expense is based on the grant-date fair value of the award and is recognized in the statement of

income over the period during which an employee is required to provide service (normally the vesting period). SFAS No. 123(R) is effective as of the beginning of the first interim or annual period after June 30, 2005. The impact of adopting SFAS 123(R) cannot be predicted at this time, since it depends on levels of future share-based payments. However, if the company had adopted SFAS 123(R) in prior periods, the impact of adoption would have paralleled impacts described under the caption "Stock-Based Compensation" of this footnote. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost be reported as cash flow from financing activities, rather than its current classification in cash flow from operating activities. It is not possible to predict these amounts, since they depend on the timing of employee stock option exercises. Amounts recognized for such excess tax deduction benefits were \$6 million, \$3 million, and \$1 million in 2004, 2003, and 2002, respectively.

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 to current-year presentation.

> NOTE 3 Restructuring and Other

In the first quarter of 2004, the company announced a restructuring program to rationalize excess manufacturing capacity and reduce overhead costs, and to reinvest a portion of the related savings in strategic growth initiatives. In this connection, the company recorded restructuring and other charges totaling \$93 million, \$58 million after tax, or \$0.38 per share in 2004. The principal strategic objectives of the program are to (1) rationalize inefficient manufacturing assets, primarily certain molded-fiber facilities in North America and the United Kingdom; (2) reduce overhead in several areas of the business, thereby eliminating non-value-added activities; (3) increase the number of new product launches over the next several years; and (4) increase the value of the Hefty® brand. Implementation of the program resulted in the elimination of approximately 1,000 salaried and hourly positions worldwide. The total cost of the restructuring program is expected to be approximately \$96 million, \$60 million after tax, or \$0.39 per share, covering severance, asset write-offs, and other, which consists principally of asset removal costs, including asbestos insulation abatement and associated expenses at the company's closed molded-fiber facility in the United Kingdom. The majority of the program was executed in the second quarter of 2004, with the balance expected to be completed in 2005.

After-tax cash payments related to the restructuring and other actions totaled \$12 million for full-year 2004.

The following summarizes actual and expected impacts of restructuring and related actions.

(In millions)	Severance	Asset write-offs	Other (1)	Total
Accrued restructuring balance at January 1, 2004	\$ —	\$ —	\$ —	\$ —
Additions/adjustments to the account				
Consumer Products	4	—	—	4
Foodservice/Food Packaging	8	18	5	31
Protective and Flexible Packaging	12	9	34	55
Other	—	—	3	3
Total additions/adjustments	24	27	42	93
Cash payments	(21)	—	(34)	(55)
Charges against asset accounts	—	(27)	—	(27)
Accrued restructuring balance at December 31, 2004	\$ 3	\$ —	\$ 8	\$ 11
Projected total restructuring program costs				
Consumer Products	\$ 4	\$ —	\$ —	\$ 4
Foodservice/Food Packaging	8	18	6	32
Protective and Flexible Packaging	12	9	36	57
Other	—	—	3	3
Total	\$ 24	\$ 27	\$ 45	\$ 96

(1) Consists principally of asset removal costs, including asbestos insulation abatement and associated expenses at the company's closed molded-fiber facility in the United Kingdom.

> NOTE 4 Acquisitions and Dispositions

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, were subject to revision upon receipt of final appraisals. Appraisals of the fair-market value of the assets acquired were finalized during the 2004, resulting in related goodwill being increased by \$10 million, and property, plant, and equipment being decreased by \$10 million.

On October 27, 2003, Pactiv purchased, for \$60 million, the plastic-packaging assets of Rock-Tenn Company, which are used in the manufacture of APET and polypropylene products for food packaging. Appraisals of the fair-market value of the assets acquired were finalized during the second quarter of 2004, resulting in related goodwill being reduced by \$6 million, and property, plant, and equipment and intangible assets being increased by \$5 million and \$1 million, respectively.

> NOTE 5 Long-Term Debt, Short-Term Debt, and Financing Arrangements

Long-Term Debt

December 31 (In millions)	2004	2003
Pactiv Corporation		
Notes due 2005, effective interest rate of 7.2%	\$ 299	\$ 297
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	169
Subsidiaries		
Notes due 2005 through 2006, average effective interest rate of 3.6% in 2004 and 4.9% in 2003	—	2
Less current maturities	(468)	(1)
Total long-term debt	\$ 869	\$ 1,336

Aggregate maturities of debt outstanding at December 31, 2004, were \$468 million, \$99 million, and \$776 million for 2005, 2007, and thereafter, respectively.

As December 31, 2004, the company was in full compliance with financial and other covenants in its various credit agreements.

Short-Term Debt

December 31 (In millions)	2004	2003
Current maturities of long-term debt	\$ 468	\$ 1
Other	4	4
Total short-term debt	\$ 472	\$ 5

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

(Dollars in millions)	2004 (a)	2003 (a)
Borrowings at end of year	\$ 4	\$ 4
Weighted-average interest rate on borrowings at end of year	5.3%	7.2%
Maximum month-end borrowings during year	6	6
Average month-end borrowings during year	4	4
Weighted-average interest rate on average month-end borrowings during year	5.8%	8.5%

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

In 1999, the company's former parent, Tenneco Inc. (Tenneco) realigned certain of its debt in preparation for the spin-off of Pactiv. In conjunction with this realignment, 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 6 **Financial Instruments**

Asset and Liability Instruments

At December 31, 2004, and 2003, 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, 2004, and 2003, was approximately \$1.071 billion and \$1.535 billion, respectively, compared with recorded amounts of \$869 million and \$1.336 billion, 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 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 the income statement 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 2004, 2003, or 2002.

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, 2004.

(In millions)	Notional amount	
	Purchase	Sell
Foreign-currency contracts		
Euros	\$ 72	\$ 36
British pounds	34	67
Czech korunas	—	1
Hungarian forints	2	3
	<u>\$ 108</u>	<u>\$ 107</u>

Based on exchange rates at December 31, 2004, the cost of replacing these contracts in the event of nonperformance by counter parties would not be material.

Lines of Credit and Guarantees

From time to time, the company utilizes various lines of credit, backed by payment and performance guarantees, to finance operations of its foreign subsidiaries. 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. At December 31, 2004, total available lines of credit were \$19 million; however, no amounts were outstanding under the company's guaranteed lines of credit at that date.

> NOTE 7 **Inventories**

December 31 (In millions)	2004	2003
Finished goods	\$ 216	\$ 245
Work in process	69	57
Raw materials	82	69
Other materials and supplies	39	28
	<u>\$ 406</u>	<u>\$ 399</u>

> NOTE 8 **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. Further impairment of goodwill did not occur in either 2003 or 2004.

Changes in the carrying value of goodwill during 2003 and 2004 by operating segment are shown in the following table.

(In millions)	Foodservice/ Protective			Total
	Consumer Products	Food Packaging	and Flexible Packaging	
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
Goodwill adjustment – prior acquisitions	—	4	—	4
Currency-translation adjustment	—	2	8	10
Balance, December 31, 2004	\$ 136	\$ 326	\$ 195	\$ 657

Details of intangible assets at December 31, 2004, and 2003, are shown in the following table.

December 31 (In millions)	2004		2003	
	Carrying amount	Accumulated amortization	Carrying Amount	Accumulated amortization
Intangible assets subject to amortization				
Patents	\$ 85	\$ 47	\$ 85	\$ 42
Other	177	66	179	54
	<u>262</u>	<u>113</u>	<u>264</u>	<u>96</u>
Intangible assets not subject to amortization (primarily trademarks)	131	—	130	—
Total intangible assets	<u>\$ 393</u>	<u>\$ 113</u>	<u>\$ 394</u>	<u>\$ 96</u>

The weighted-average amortization period used for patents and other intangible assets subject to amortization is 15.9 years and 20.9 years, respectively. Amortization of intangible assets was \$17 million for the year ended December 31, 2004. Amortization expense is estimated to total \$15 million, \$13 million, \$13 million, \$12 million, and \$12 million for 2005, 2006, 2007, 2008, and 2009, respectively.

> NOTE 9 Property, Plant, and Equipment, Net

December 31 (In millions)	2004	2003
Original cost		
Land, buildings, and improvements	\$ 745	\$ 735
Machinery and equipment	1,654	1,653
Other, including construction in progress	111	102
	<u>2,510</u>	<u>2,490</u>
Less accumulated depreciation and amortization	(1,065)	(968)
	<u>\$1,445</u>	<u>\$1,522</u>

Capitalized interest was \$2 million in 2004 and \$4 million in both 2003 and 2002.

> NOTE 10 Income Taxes

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

(In millions)	2004	2003	2002
U.S. income before income taxes	\$ 256	\$ 280	\$ 325
Foreign income (loss) before income taxes	(12)	34	42
Total income from continuing operations before income taxes	<u>\$ 244</u>	<u>\$ 314</u>	<u>\$ 367</u>

Following is a comparative analysis of income-tax expense related to continuing operations.

(In millions)	2004	2003	2002
Current			
Federal	\$ 30	\$ 62	\$ 26
State and local	1	10	10
Foreign	25	13	9
	<u>56</u>	<u>85</u>	<u>45</u>
Deferred			
Federal	40	31	87
State and local	6	1	6
Foreign	(12)	1	8
	<u>34</u>	<u>33</u>	<u>101</u>
Total income-tax expense – continuing operations	<u>\$ 90</u>	<u>\$ 118</u>	<u>\$ 146</u>

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.

	2004	2003	2002
U.S. statutory federal income-tax rate	35.0%	35.0%	35.0%
Increase (decrease) in income-tax rate resulting from:			
Foreign income taxed at various rates	6.4	0.7	0.5
State and local taxes on income, net of U.S. federal income-tax benefit	2.0	2.1	2.9
Foreign branch losses	(4.8)	—	—
Research and development credit	(2.5)	(0.5)	—
Other	0.6	0.4	1.6
Effective income-tax rate	36.7%	37.7%	40.0%

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

December 31 (In millions)	2004	2003
Deferred-tax assets		
Tax-loss carryforwards		
State and local	\$ 5	\$ 1
Foreign	46	16
Pensions	76	111
Post-retirement benefits	34	33
Other items	57	52
Valuation allowance (1)	(38)	(14)
Total deferred-tax assets	180	199
Deferred-tax liabilities		
Property and equipment	318	282
Other items	81	83
Total deferred-tax liabilities	399	365
Net deferred-tax liabilities	\$ 219	\$ 166

(1) Related to state and foreign tax-loss carryforwards.

State tax-loss carryforwards at December 31, 2004, (\$58 million) will expire at various dates from 2005 to 2011. Foreign tax-loss carryforwards at December 31, 2004, totaled \$154 million, of which \$74 million will expire at various dates from 2006 to 2015, with the balance having unlimited lives.

> NOTE 11 Common Stock

The company has 350 million shares of common stock (\$0.01 par value) authorized, of which 148,711,815 shares were issued and outstanding as of December 31, 2004.

Reserves

Reserved shares at December 31, 2004 were as follows:

(In thousands)

Thrift plans	1,397
2002 incentive-compensation plan	24,107
Employee stock-purchase plan	2,135
	<u>27,639</u>

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 19 million were issued or granted as of December 31, 2004.

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.

Changes in performance-share balances were as follows:

	Performance shares
Outstanding, January 1, 2003	616,592
Granted	366,242
Canceled	(12,000)
Vested	(265,508)
Outstanding, December 31, 2003	705,326
Granted	218,761
Canceled	(31,648)
Vested	(260,053)
Outstanding, December 31, 2004	<u>632,386</u>

The weighted-average grant date fair value of performance shares issued in 2004, 2003, and 2002 was \$22.06, \$20.72, and \$16.88 per share, respectively.

Summarized below are changes in stock-option balances.

	Shares under option	Weighted- average exercise price
Outstanding, January 1, 2003	14,187,373	\$21.19
2003 activity		
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
Outstanding, January 1, 2004	14,970,869	21.13
2004 activity		
Granted	2,049,676	23.97
Exercised	(1,720,752)	14.30
Canceled	(982,205)	27.91
Outstanding, December 31, 2004	14,317,588	21.89
Exercisable, December 31, 2004	10,376,435	21.94

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 in 2004 (\$7.83), 2003 (\$6.90), and 2002 (\$6.17) was determined using the Black-Scholes option-pricing model with the following assumptions:

	2004	2003	2002
Actuarial assumptions			
Risk-free interest rate	3.4%	3.0%	3.0%
Life (years)	4.5	4.4	4.4
Volatility	34.1%	36.9%	38.7%

Summarized below is information regarding stock options outstanding and exercisable at December 31, 2004.

	Outstanding options			Exercisable options	
	Number	Weighted- average remaining contractual life	Weighted- average exercise price	Number	Weighted- average exercise price
Range of exercise price					
\$7 to \$12	1,059,792	5.8 years	\$11.59	1,059,792	\$11.59
\$13 to \$21	8,044,770	6.9	16.69	6,131,082	15.83
\$22 to \$29	2,039,012	9.7	23.98	11,547	23.24
\$30 to \$37	1,522,434	9.1	34.20	1,522,434	34.20
\$38 to \$45	1,651,580	6.5	39.97	1,651,580	39.97
	14,317,588			10,376,435	

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 \$25,000. In 2004, 2003, and 2002, employees purchased 270,298, 333,239, and 401,469 shares of stock, respectively, at a weighted-average price of \$19.52, \$17.38, and \$14.68 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 annual salary. 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 2004, 2003, and 2002, the company incurred 401(k) plan expenses of \$11 million, \$13 million, and \$12 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)	2004	2003	2002
Basic earnings per share			
Income from continuing operations	\$ 155	\$ 195	\$ 220
Average number of shares of common stock outstanding	151,289,798	157,932,323	158,618,274
Basic earnings from continuing operations per share	\$ 1.02	\$ 1.23	\$ 1.38
Diluted earnings per share			
Income from continuing operations	\$ 155	\$ 195	\$ 220
Average number of shares of common stock outstanding	151,289,798	157,932,323	158,618,274
Effect of dilutive securities			
Stock options	2,033,810	1,726,512	1,579,885
Performance shares	439,548	484,765	414,916
Average number of shares of common stock outstanding including dilutive securities	153,763,156	160,143,600	160,613,075
Diluted earnings from continuing operations per share	\$ 1.01	\$ 1.21	\$ 1.37

In 2004, the company acquired 10,148,500 shares of its common stock at an average price of \$22.71 per share (total outlay of \$230 million). During 2003, the company repurchased 4,312,600 shares at an average

price of \$20.24 per share (total outlay of \$87 million). 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.

> NOTE 12 Preferred Stock

Pactiv has 50 million shares of preferred stock (\$0.01 par value) authorized, none of which were issued at December 31, 2004. The company has reserved 750,000 shares of preferred stock for the QORP.

> NOTE 13 Minority Interest

In October 2002, Pactiv acquired a 70% interest in Central de Bolsas, S.A. de C.V. (Jaguar), and purchased the remaining 30% interest in that company in August 2003.

> NOTE 14 Pension Plans and Other Post-retirement 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 4,110,058 shares of Pactiv stock with a fair-market value of \$104 million at December 31, 2004. These shares were contributed to the plans 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. Effective December 31, 2004, after the company's September 30, 2004, measurement date, the company's two U.S. qualified pension plans were merged. The merger had no effect on the participants' benefits or any other substantive feature of the plans. The impact of this merger on the company's financial statements has not yet been measured and will be reflected in the 2005 financial statements. The company has post-retirement 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, co-payments, and other limitations. The company reserves the right to change post-retirement plans, which are not funded.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was enacted. The Act expands Medicare coverage, primarily by adding a prescription-drug benefit for Medicare-eligible participants, starting in 2006. The Act provides employers currently sponsoring prescription drug programs for Medicare-eligible participants with a range of options for coordination with the new government-sponsored program to potentially reduce employers' costs. These options include supplementing the government

program on a secondary payor basis or accepting a direct subsidy from government to support a portion of the cost of employer programs.

Pactiv's plans currently provide prescription-drug benefits that will coordinate with the related Medicare benefits. As a result, at September 30, 2004, the plans accumulated benefit obligation was reduced by \$8 million. For accounting purposes, this amount will be treated as an actuarial gain. The enactment of the Act will also reduce 2005's net periodic benefit cost by approximately \$1 million.

Financial data pertaining to the company's pension- and post-retirement benefit plans appears below.

(In millions)	Pension plans		Post-retirement plans	
	2004	2003	2004	2003
Accumulated benefit obligation, September 30	\$3,901	\$3,847	\$ —	\$ —
Changes in projected benefit obligations				
Benefit obligations at September 30 of the previous year	3,909	3,644	105	102
Currency-rate conversion	9	10	—	—
Service cost of benefits earned	30	33	1	1
Interest cost on benefit obligations	236	237	6	7
Plan amendments	1	1	—	—
Actuarial losses	31	241	(6)	3
Benefits paid	(261)	(256)	(12)	(11)
Employee contributions	1	—	—	—
Participant contributions	—	—	4	3
Impact of SFAS No. 88 (1)	(2)	(1)	—	—
Benefit obligations at September 30	\$3,954	\$3,909	\$ 98	\$ 105
Changes in fair value of plan assets				
Fair value at September 30 of the previous year	\$3,382	\$3,057	\$ —	\$ —
Currency-rate conversion	5	5	—	—
Actual return on plan assets	404	566	—	—
Employer contributions (2)	21	9	8	8
Participant contributions	1	1	4	3
Benefits paid	(261)	(256)	(12)	(11)
Fair value at September 30	\$3,552	\$3,382	\$ —	\$ —
Development of amounts recognized in the statement of financial position				
Funded status at September 30	\$ (402)	\$ (527)	\$ (98)	\$ (105)
Contributions during the fourth quarter	2	2	2	2
Unrecognized costs				
Actuarial losses	1,685	1,737	38	45
Prior-service costs	13	16	(3)	(3)
Net amounts recognized at December 31	\$1,298	\$1,228	\$ (61)	\$ (61)
Amounts recognized in the statement of financial position				
Prepaid benefit costs	\$ 203	\$ 187	\$ —	\$ —
Contributions during the fourth quarter	2	2	2	2
Accrued benefit costs	(441)	(528)	(63)	(63)
Intangible assets	12	15	—	—
Accumulated other comprehensive income	1,522	1,552	—	—
Net amount recognized at December 31	\$1,298	\$1,228	\$ (61)	\$ (61)

(1) SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"

(2) 2004 employer contributions included \$12 million contributed by another participating employer.

The additional minimum liability for the company's pension plans was \$1.534 billion and \$1.567 billion at December 31, 2004, and 2003, respectively. Other comprehensive income of \$19 million after tax was recognized in 2004 as a result of the decrease in the additional minimum liability during 2004. The total additional minimum liability recorded in accumulated other comprehensive income was \$975 million after tax at December 31, 2004.

Benefit payments expected to be made under the pension plans and post-retirement benefit plans over the next 10 years are summarized below.

(In millions)	Pension plans	Post-retirement plans
2005	\$ 266	\$ 9
2006	265	7
2007	267	8
2008	269	8
2009	270	8
2010-2014	1,415	42

The company expects to contribute \$10 million to its foreign and non-qualified pension plans and \$9 million to its post-retirement benefit plans in 2005.

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

(In millions)	2004	2003	2002
Components of periodic benefit income (expense)			
Service cost of benefits earned	\$ (30)	\$ (33)	\$ (35)
Interest cost on benefit obligations	(236)	(237)	(237)
Expected return on plan assets	351	354	385
Amortization of:			
Unrecognized net losses	(33)	(15)	—
Unrecognized prior-service costs	(4)	(5)	(5)
Unrecognized net transition obligations	—	—	1
Total net periodic benefit income	\$ 48	\$ 64	\$ 109

Pension-plan actuarial assumptions are shown below.

September 30	2004	2003	2002
Actuarial assumptions			
Discount rate	6.23%	6.23%	6.75%
Compensation increases	4.0	4.0	4.9
Return on assets	9.0	9.0	9.0

For all of the company's worldwide pension plans, accumulated benefit obligations totaled \$3.901 billion and \$3.847 billion at December 31, 2004, and 2003, respectively. For pension plans with accumulated benefit obligations in excess of plan assets, projected benefit obligations, accumulated benefit obligations, and fair value of plan assets were \$3.653 billion, \$3.601 billion, and \$3.163 billion, respectively, at September 30, 2004, and \$3.594 billion, \$3.532 billion, and \$3.006 billion, respectively, at September 30, 2003.

The company's discount-rate assumption for its U.S. plans is based on the composite yield on a portfolio of high-quality corporate bonds constructed with durations to match the plans' future benefit obligations. In this connection, the company's discount-rate assumption for its U.S. plans was 6.25% for both 2004 and 2003.

In developing actuarial assumptions for the return on pension-plan assets, the company receives independent input on asset-allocation strategies, projections regarding 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 11%. Historically, the plans have invested approximately 70% of assets in equity securities and 30% in fixed-income investments. After considering all of these factors, the company concluded that a 9% rate of return on assets assumption for its U.S. plans was appropriate for 2004 and 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. Resulting unrecognized gains or losses, along with other actuarial gains and losses, are amortized using the "corridor approach" discussed in SFAS No. 87.

The weighted-average asset allocations for the company's U.S. pension plans at September 30, 2004, and 2003, are summarized below.

	2004	2003
Equity securities	70.0%	65.4%
Fixed-income securities	30.0	34.6
Total	100.0%	100.0%

A mixture of equity and fixed-income investments are used to maximize the long-term return on pension-plan assets for a prudent level of risk. Risk tolerances are 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. 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. Based on long-term projections and regulations in existence at December 31, 2004, the company does not expect to be required to contribute cash to its U.S. qualified pension plans until at least 2014. 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 \$6 million to various pension plans in 2004.

The impact of post-retirement benefit plans on pretax income from continuing operations was as follows:

(In millions)	2004	2003	2002
Service cost of benefits earned	\$ 1	\$ 1	\$ 1
Interest cost on benefit obligations	6	7	6
Prior-service costs	—	1	2
Losses	4	3	2
Total post-retirement benefit-plan costs	\$ 11	\$ 12	\$ 11

Actuarial assumptions used to determine post-retirement benefit obligations follow.

	2004	2003	2002
Actuarial assumptions			
Health-care cost inflation(a)	10.0%	11.0%	12.0%
Discount rate	6.25	6.25	6.75

(a) Assumed to decline to 5% in 2008.

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

(In millions)	1% increase	1% decrease
Effect on total service and interest costs	\$ 1	\$ (1)
Effect on post-retirement benefit obligations	7	(7)

The company contributed \$8 million in both 2004 and 2003 to fund post-retirement medical-plan obligations. The company expects to contribute \$9 million to fund its post-retirement medical-plan obligations in 2005.

> NOTE 15 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." The company has 4 reporting segments: Consumer Products, which relates principally to the manufacture and sale of disposable plastic, molded-fiber, 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-fiber, 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 principally to the manufacture and sale of plastic, paperboard, and molded-fiber 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.

Products are transferred between segments and among geographic areas at, as nearly as possible, market value. In both 2004 and 2003, Wal-Mart Stores, Inc. accounted for 11.4% of the company's consolidated sales. These sales were reflected in the results of 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	
At December 31, 2004, and for the year then ended					
Sales to external customers	\$ 934	\$ 1,490	\$ 958	\$ —	\$ 3,382
Depreciation and amortization	53	77	32	7	169
Operating income	175(a)	138(b)	20(c)	12(d)	345
Total assets	1,022	1,090	806	823(e)	3,741
Investment in affiliated companies	—	2	4	—	6
Capital expenditures	16	52	28	4	100
Noncash items other than depreciation and amortization	—	18	18	(48)(f)	(12)
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(b)	58(c)	35(d)	466
Cumulative effect of changes in accounting principles	(3)	(6)	(1)	(2)	(12)
Total assets	1,005	1,199	773	729(e)	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)(f)	(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(c)	55(d)	463
Cumulative effect of changes in accounting principles	—	—	(72)	—	(72)
Total assets	960	1,097	713	642(e)	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)(f)	(113)

(a) Includes restructuring and other charges of \$4 million in 2004.

(b) Includes restructuring and other charges of \$31 million and \$1 million in 2004, and 2003, respectively.

(c) Includes restructuring and other charges (credits) of \$55 million, \$1 million, and \$(4) million, in 2004, 2003, and 2002, respectively.

(d) Includes pension-plan income, unallocated corporate expense, and \$3 million restructuring and other charges in 2004.

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

(f) Includes pension-plan income.

The following table sets forth certain geographic area information.

(In millions)	Geographic area		Total
	United States	Foreign (a)	
At December 31, 2004, and for the year then ended			
Sales to external customers (b)	\$ 2,607	\$ 775	\$ 3,382
Long-lived assets (c)	1,419	306	1,725
Total assets	2,951	790	3,741
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

(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, 2004, for which commitments have been made, will require expenditures of approximately \$156 million, of which approximately \$141 million is expected to be spent in 2005.

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 \$32 million, \$25 million, \$22 million, \$18 million, and \$15 million for 2005, 2006, 2007, 2008, and 2009, respectively, and \$34 million for subsequent years.

Commitments under capital leases are not significant. Total rental costs for continuing operations for 2004, 2003, and 2002 were \$40 million, \$41 million, and \$42 million, respectively, which included minimum rentals under noncancelable operating leases of \$31 million, \$37 million, and \$36 million for the respective periods.

Litigation

On November 3, 2003, the company reached an agreement to settle a civil, class-action lawsuit filed in 1999 against Tenneco, Tenneco Packaging Inc., and Packaging Corporation of America (PCA), Tenneco's former containerboard business (Tenneco Packaging litigation). The settlement resulted in Pactiv recording a pretax charge of \$56 million, \$35 million after tax, or \$0.22 per share. This charge included the establishment of a reserve for the estimated liability associated with lawsuits filed by certain members of the original class-action who opted out of the class and filed their own lawsuits. 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 materially 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.

The company is party to 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 materially 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, entered into a settlement agreement with that agency regarding the appropriate actions to be taken to address the matter. This 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 possible monetary sanctions, will have a materially 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 materially 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 17 **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
2004							
First quarter	\$ 775	\$ 552	\$ 70	\$ —	\$ —	\$ —	\$ —
Second quarter	858	611	14	—	52	—	52
Third quarter	865	630	2	—	56	—	56
Fourth quarter	884	657	7	—	47	—	47
	\$3,382	\$2,450	\$ 93	\$ —	\$ 155	\$ —	\$ 155
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

(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
2004								
First quarter	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$23.96	\$19.80
Second quarter	0.34	—	0.34	0.33	—	0.33	25.28	21.55
Third quarter	0.38	—	0.38	0.37	—	0.37	25.16	22.10
Fourth quarter	0.32	—	0.32	0.31	—	0.31	25.73	22.30
Total year	1.02	—	1.02	1.01	—	1.01		
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		

(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 18 **Subsequent Events**

On January 21, 2005, the company voluntarily prepaid its \$169 million synthetic-lease financing arrangements, which had a maturity date of November 4, 2005. The synthetic-lease arrangements covered the company's headquarters in Lake Forest, Illinois, and distribution centers in Romeoville, Illinois; Jacksonville, Illinois; Covington, Georgia; Temple, Texas; and Canandaigua, New York. The company elected to prepay this amount to reduce interest costs. No prepayment or early termination penalty was incurred as a result of this action.

On March 15, 2005, the company acquired Newspring Industrial Corp., a leading manufacturer of thin-wall injection molded polypropylene products for use in the take-out, delicatessen, and foodservice markets, for \$98 million.

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)

	2004	2003	2002	2001	2000
Statement of Income					
Sales					
Consumer Products	\$ 934	\$ 888	\$ 841	\$ 815	\$ 785
Foodservice/Food Packaging	1,490	1,371	1,221	1,182	1,416
Protective and Flexible Packaging	958	879	818	815	851
	3,382	3,138	2,880	2,812	3,052
Operating income	345	466	463	391	341
Tenneco Packaging litigation settlement and other	—	56	—	—	—
Interest expense, net of interest capitalized	101	96	96	107	134
Income-tax expense	90	118	146	118	91
Minority interest	(1)	1	1	1	3
Income from continuing operations	155	195	220	165	113
Income from discontinued operations, net of income tax	—	—	—	28	134
Cumulative effect of changes in accounting principles, net of income tax	—	(12)	(72)	—	—
Net income	\$ 155	\$ 183	\$ 148	\$ 193	\$ 247
Average number of shares of common stock outstanding					
Basic	151.290	157.932	158.618	158.833	161.722
Diluted	153.763	160.144	160.613	159.527	161.779
Earnings per share					
Basic					
Continuing operations	\$ 1.02	\$ 1.23	\$ 1.38	\$ 1.04	\$ 0.70
Discontinued operations	—	—	—	0.17	0.83
Cumulative effect of changes in accounting principles	—	(0.07)	(0.45)	—	—
	\$ 1.02	\$ 1.16	\$ 0.93	\$ 1.21	\$ 1.53
Diluted					
Continuing operations	\$ 1.01	\$ 1.21	\$ 1.37	\$ 1.03	\$ 0.70
Discontinued operations	—	—	—	0.17	0.83
Cumulative effect of changes in accounting principles	—	(0.07)	(0.45)	—	—
	\$ 1.01	\$ 1.14	\$ 0.92	\$ 1.20	\$ 1.53
Statement of Financial Position					
Net assets of discontinued operations	\$ —	\$ —	\$ —	\$ —	\$ 72
Total assets	3,741	3,706	3,412	4,060	4,341
Short-term debt including current maturities of long-term debt	472	5	13	7	13
Long-term debt	869	1,336	1,224	1,211	1,560
Minority interest	9	8	21	8	22
Shareholders' equity	1,083	1,061	897	1,689	1,539
Statement of Cash Flows					
Cash provided by operating activities	\$ 367	\$ 336	\$ 384	\$ 371	\$ 290
Cash provided (used) by investing activities	(91)	(194)	(244)	(1)	302
Cash used by financing activities	(197)	(134)	(57)	(354)	(578)
Expenditures for property, plant, and equipment	(100)	(112)	(126)	(145)	(135)

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 15.