

Operations Review.

Pactiv Corporation is a leader in the specialty packaging industry, recognized for providing advanced solutions for everyday packaging needs. The strengths we bring to our mission are significant and include brand leadership, broad and innovative product lines, market leadership, channel access and distribution, and industry cost leadership.

The key to our growth and progress, however, is our commitment to understanding customers' business requirements, operating through two business segments in which we have deep knowledge and expertise: Hefty® Consumer Products and Foodservice/Food Packaging, and Protective and Flexible Packaging.

Hefty® Consumer Products and Foodservice/Food Packaging

This business segment accounted for 71 percent of the company's sales in 2001. Hefty® products experienced good volume growth during the year, despite the recession and other events. The Foodservice/Food Packaging business also showed resilience in a challenging environment, posting an improved volume trend throughout the second half of the year. The segment's operating margin expanded to 14.4 percent from 12.7 percent in 2000, as a result of the group's focus on cost control, productivity, and optimizing the business and product mix.

Hefty® Consumer Products

The Hefty® brand is one of the nation's best known and most respected brands and one of Pactiv's highest-value assets. Products marketed to consumers in the United States include the full line of Hefty® waste bags, including the new Hefty® The Gripper™ waste bags; Hefty® OneZip® storage and freezer bags; Hefty® tableware, including foam and molded fiber plates and bowls; and Hefty® E-Z Foil® disposable aluminum cookware. Pactiv also makes consumer products under the Kordite® brand, as well as private label consumer products.

In this business we made strong progress in 2001, increasing margins and volumes in almost every product line. At the same time, we positioned the business for future growth by stepping up investments in research and new product development and by increasing our promotion and advertising spending to support new product launches and the overall Hefty® brand.

In 2001, we introduced the new Hefty® The Gripper™ waste bag with its unique Stretch & Grip Top® – one of the most significant innovations in the waste bag market since the Hefty® brand introduced the first drawstring waste bag, CinchSak®, in 1984. Late in the year, we began shipping new Hefty® Zoo Pals™ assorted animal plates. Zoo Pals™ everyday animal plates combine fun and function in a new shape designed just for kids. Both products capitalize on important consumer trends – notably the demand for products that bring new levels of ease and convenience to everyday tasks.

Going forward, we will focus firmly on three goals:

- > Driving growth through new product introductions and accelerating existing product momentum
- > Improving consumer marketing, targeting high-value consumers and demographic markets with optimum pricing, advertising, and promotional strategies
- > Leveraging our scale and service capabilities to become the preferred supplier for strategic customers

With our progress over the past year, we are positioned well to grow our consumer products' presence and profitability.

Foodservice/Food Packaging

In 2001, approximately half of what U.S. consumers spent on food and beverages was spent on food prepared in whole or in part outside the home, and we capitalized on that trend. Pactiv is a leading provider to the foodservice/food packaging market, producing and selling approximately 3,500 items under approximately 18,000 unique labels across North America. Our diverse foodservice/food packaging product line includes many kinds of plastic containers, foam clamshells and trays, packer/processor packaging, ovenable paperboard, aluminum, molded fiber, and other products used by the supermarket, institutional, foodservice, and restaurant industries.

Despite difficult economic conditions, Foodservice/ Food Packaging continued to make progress in improving its market position during the year, reflecting three major strengths.

The first is our scale. In a fragmented industry where most competitors specialize in one or a few products or materials, the breadth of our product line sets us apart. We stand as a top-quality, highly efficient, single-source supplier able to meet customers' broad and expanding functional and merchandising needs.

A second strength is our position as one of the industry's lowest cost providers. In 2001, we launched a program in our manufacturing and logistics operations to further improve productivity. We expect this program to produce significant results.

A third advantage is our leadership in innovation—the ability to create specialized packaging that meets mounting market demand for differentiation, food safety, and business efficiency and allows us to expand our relationships with existing customers and attract new ones.

For example, our new salad bowl for Wendy's® helps to differentiate the restaurant chain in its highly competitive market, while also increasing salad sales and profitability. To help consumers handle hot food purchases with ease and confidence, we introduced new containers for carry-out roasted chicken featuring our unique SmartTote™ handles and the SmartVent™ steam-release system. We introduced a new line of ovenable pizza containers. And we augmented a wide range of other product lines, for example, by adding to our line of Classic Carry-Out® containers and Signature® steam table pans; introducing new nine-inch Hexware™ shallow containers; rolling out a new and improved line of disposable tableware domes to make handling multiple carry-out orders more convenient; and bringing new black foam hinged-lid containers to market. In addition, we nearly doubled revenues from the Hefty® SlideRite® Advanced Closure System by extending its applications to food, pet food, and agricultural products applications, and winning new customers including Groupe Entremont, one of Europe's largest cheese processors.

Central to our continued leadership and growth is our commitment to making Pactiv the easiest company in the industry with which to do business. We are pursuing this goal through our “One Face to the Customer” strategy, aimed at delivering our total product line and service capabilities to customers as simply as possible—with one sales representative, one order, one-truck delivery, and one invoice. Today, the systems and information management infrastructure and distribution network are largely in place to support this strategy and are beginning to produce tangible benefits for our customers and our bottom line. For example, we are advancing with major customers as food-related industries consolidate, and are gaining strength and market share with mid-sized and smaller companies as well.

Going forward, efforts in this business will be focused on improvements in three key areas:

- > Long-term growth, building market share and sales through new product introductions, strategic outsourcing, and acquisitions
- > Productivity, including manufacturing asset effectiveness, by maximizing uptime, line speed, and material yields
- > Logistics, including reducing total freight costs and inventory levels

Protective and Flexible Packaging

Composed of businesses that hold leadership positions in high-potential niche markets in North America and Europe, our Protective and Flexible Packaging products include air cushioning, air padded mailers, foam, Hexacomb® kraft honeycomb, molded fiber, specialty films, medical products, and other film applications. This segment accounted for 29 percent of the company’s 2001 sales.

Earnings in this segment declined 5 percent in 2001, as progress in our restructuring efforts and improved performance in Europe were more than offset by the impact of the weak economy on the North American business.

During the year we consolidated manufacturing operations, closing six plants; exited several low-margin product lines, mainly in Europe; reduced staff levels; integrated operations; and leveraged skills and capabilities across the organization. We expect sales to grow at healthy rates as the economy recovers and as a result of product innovation and better leveraging of existing products.

Among 2001 highlights, we:

- > Introduced the Pactiv Air 2000™ inflatable pouch, designed to help shippers protect products against damage from shock or vibration
- > Introduced a wide range of new medical products, including prefillable, multi-chamber IV bags to improve health-care delivery quality and productivity, and gloves and gowns designed specifically for hand-surgery specialists

With our focus on cost reduction, productivity improvement, and continuing innovation, we are well positioned to grow profitably in the most attractive niches of the protective and flexible packaging market going forward.