Kraft Foods Inc. 2003 Annual Report

How we will **grow our future.**

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

We are committed to delivering sustainable growth – top

must delight the world with the right benefits at the right

a step ahead of tomorrow. We must expand our global

We must be organized to leverage our strengths. And

That's exactly what we intend to do.

price. We must continuously transform our products

scale. We must capture cost savings to fuel our growth.

we must act responsibly throughout the world community.

Fellow Shareholders,

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Louis C. Camilleri
Chairman

Roger K. Deromedi
Chief Executive Officer

February 27, 2004

Value. **The ultimate measure** of a brand.

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

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

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

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

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

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

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

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

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

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

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

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

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

Scale. Extending **our global reach.**

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

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

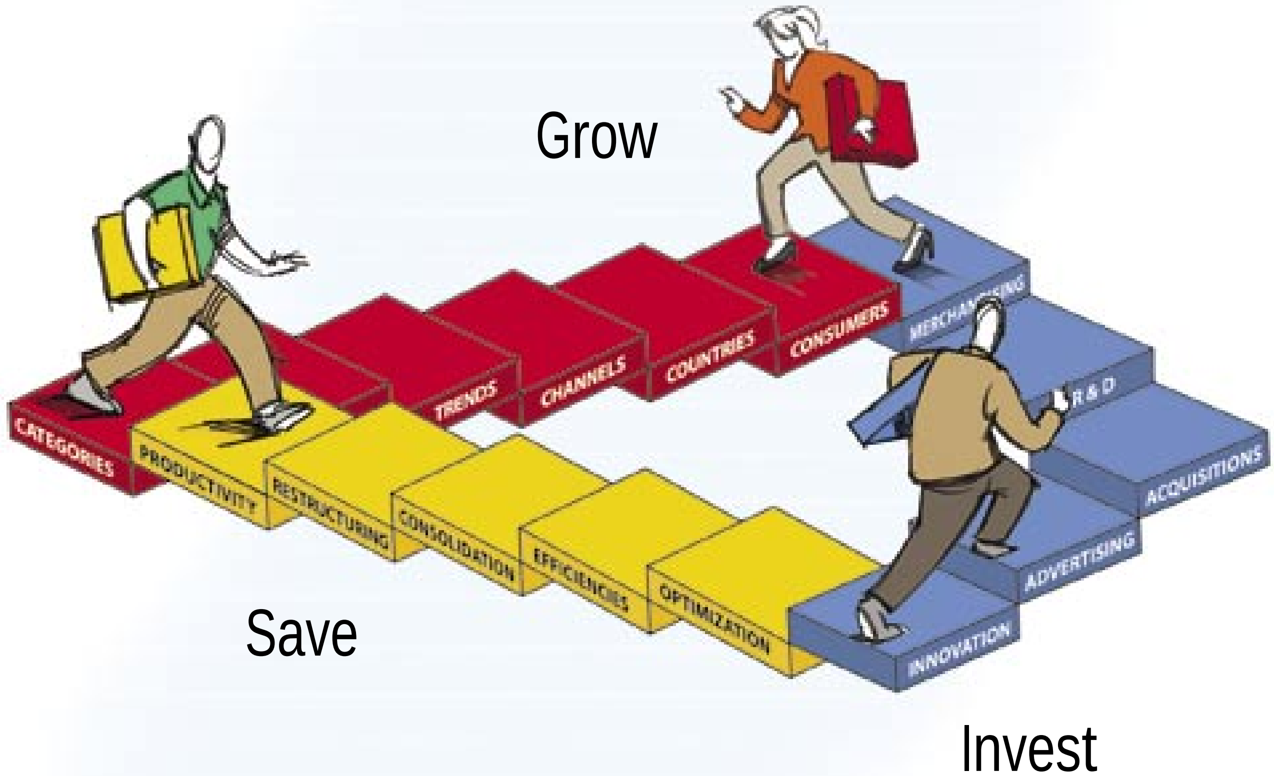
We're focusing first on countries like Russia, China, Brazil and Mexico, where we have the scale and efficiency to grow most profitably. We're growing by expanding our core categories where they already exist. So, for example, in China we are building our biscuits business with new introductions that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

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

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

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

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



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

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

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

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

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

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

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

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

world.
company.
team.

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

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

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

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

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

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

Responsibility. **Helping people** eat and live better.

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

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

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

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

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

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

Snacks
Net Revenues $9.2 Billion

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

Beverages
Net Revenues $6.1 Billion

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

Cheese & Dairy
Net Revenues $5.6 Billion

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

Grocery
Net Revenues $5.2 Billion

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

Convenient Meals
Net Revenues $4.9 Billion

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

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

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

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

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

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

Financial Contents

Kraft Foods Inc. Guide to Select Disclosures

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