2003 Annual Report

From the Farm to Your Table
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Mission Statement

Quaker stands for quality products and quality of life. Doing things the right way. Making great ideas come to life. Making a difference. Satisfying ever-changing consumer needs. Focus on growth. Commited to being market leaders and strengthening our go-to-market systems all over the world. Results are recognized and rewarded. World class people at every level, in every division, in every country, contributing to our success every day.
Whole grains such as oatmeal contain all three parts of the grain: the germ, endosperm and bran. The nutrients in whole grains work together to provide maximum health benefits. When grains such as wheat or rice are milled or refined, the bran and germ are removed, leaving only the endosperm. The result is a food with fewer vitamins, minerals, fiber, antioxidants, and other phytonutrients than the whole grain. When oats are milled, all parts of the grain remain - bran, germ and endosperm.
FELLOW SHAREHOLDERS:

In last year’s report, having recently joined the Company, I wrote of my optimism about our future. That optimism was based on the tremendous strength of our brands, our core capabilities and the competitive spirit of our people. This year, I am pleased to say that optimism was warranted. We delivered a year with very strong results.

Our 1998 earnings increased 26 percent to $2.40 per share, excluding unusual items. Sales from ongoing businesses grew nearly 4 percent to $4.6 billion. Operating income grew 11 percent. We expanded our operating income margin from 11 percent to 13 percent and improved our return on invested capital to 51 percent. As a result, we increased “controllable earnings” our internal economic value measure-by 73 percent. Our strong cash flow allowed us to reduce debt by $125 million and to buy back 6.9 million shares of our stock.

Corporately, we took actions to strengthen our Company. We reorganized to promote greater synergy, removing layers of management and combining what had been separate Gatorade and Foods organizations. We tightened cost controls and eliminated $65 million in expenses through restructuring actions. This was in addition to reducing our overall supply chain costs. We divested four chronically under performing businesses and wrote down under producing assets.

Moreover, within our business units, we produced strong results overall. Gatorade performance was nothing short of phenomenal. In 1998, its worldwide sales grew 13 percent to $1.7 billion its operating income 25 percent-and its controllable earnings 32 percent. Today, Gatorade comprises 35 percent of our total sales and delivers 37 percent of our operating income. Gatorade sets us apart in the food industry with a sales growth of 10 percent and 25 percent operating income growth.

Several other businesses thrived as well. Our snacks business grew strongly behind our popular Quaker Chewy granola bars and our new Quaker Fruit & Oatmeal bars. Ready-to-eat cereals outpaced category growth and attained a record market share, despite a heightened competitive environment. Golden Grain-our flavored rice and pasta business- sustained near record sales levels. Our syrups and mixes business grew. Profitability in Latin America and Europe increased.

Clearly, there were areas of disappointment, too. Hot cereals sales declined, as warm weather disrupted two years of solid growth. And, we continued to experience difficulties in Asia, where underwriting losses remained significant. Importantly, we
took actions midyear to improve performance. We realigned our Asian operations, which began to have some positive effects toward year end. And, we redoubled our efforts to get the hot cereals business growing in 1999.

The ups and downs notwithstanding, we delivered very strong overall results. For you, our shareholder, it resulted in a total Return of 15 percent.

But this year was only a start we’re hungry for much more.

As we look ahead, our challenge is to grow profitably from this stronger base ... To continue to accelerate our top-line growth... to further enhance our operating margins ... To manage our balance sheet effectively.

And to reinvest our cost savings to fuel new growth programs, having sustained impact. Our goal is to provide you with a competitive total return year after year. We’re well positioned to do just that.

Our leading brands—Gatorade, Quaker, Cap'n Crunch, Life, Chewy, Quaker Fruit & Oatmeal, Rice-A-Roni Pasta Roni, Near East and Aunt Jemima—all have great potential. Our supply chain and our customer organizations, while proven, can continue to advance in efficiency and effectiveness. Our challenge is to take all of these to the next level. To do that, we are pursuing greater simplicity, innovation and passion throughout our organization. Let me explain.

To succeed, our energy and resources must be concentrated on the areas where we can produce the greatest value. This requires focus, coordination of effort and discipline. As I mentioned, in 1998 we moved to simplify and unify our operations. Specifically, we consolidated our U.S. sales organization from 14 regional offices to six fully integrated regional Customer Business Centers supporting Gatorade and Foods. Today, we go to our customers as one company and are benefiting from the focus and cost savings that provides. 0 We established one head of our worldwide supply chain and put managers in place who are responsible for multiple plants to drive greater implementation of best practices. 0 In Latin America, we realigned our infrastructure, consolidating offices in each country and eliminating 300 redundant positions. 0 In Europe, a newly aligned structure has markedly improved our returns. In the Asia/Pacific region, we have marshaled our resources to focus on building the Gatorade brand in one area-China, an action that should significantly reduce our operating losses in the region. But this is just a start. Going forward, we believe we can become even more effective. We plan to aggressively go after costs within every aspect of our business. We are seeking further opportunities to rationalize our production capacity and shed under performing assets. Importantly, we are keeping our eyes fixed on the consumer, recognizing that cost savings can fuel further innovation.

Innovation is the lifeblood of profitable growth. Leading brands possess great long-term value only if they can evolve over time to respond to the tastes and needs of new generations. Our challenge is to continually expand the breadth and depth of their appeal to capitalize on the potential of our leading category...
positions. Across our businesses and functions, we are developing a richer pipeline of ideas to build our brands and enhance the efficiency of our processes. In 1998, we made advances in our Gatorade, snacks and ready-to-eat cereals businesses, but we must accomplish much more. We already have some great new products, packaging and promotions in our 1999 lineup. Our sights are set on expanding our current brands and seeking out new ones. We will also strive to create even greater efficiencies in our supply chain, greater effectiveness in our marketing programs and leading-edge capabilities in all of our business functions.

Simplicity and innovation are important, but producing exceptional results has to come from our people. Inside the company, we have been rebuilding the confidence and the conviction to set high goals and to achieve them. We have talented people with a passion to win—an uncompromising drive for success. Together, we are up to the challenge of running our business for greater profitable growth.

We have accomplished a great deal in one year, but we’re not done. The strong foundation that we have built—the continued potential of our brands—our focus and discipline—all set the course for our future. Like a well-conditioned athlete, we’re at the starting block eager to pursue the opportunities ahead. I look forward to building on the momentum of 1998 and keeping you apprised of our progress.

March 1, 1999

Robert S. Morrison
Chairman, President and Chief Executive Officer
Old fashioned Quaker Oats, Quick Quaker Oats, Instant Oatmeal are all whole-grain products and equally nutritious because they contain all three parts of the grain. The amount of rolling, steaming and or cutting that each oat undergoes during the milling process affects only the texture of the cooked cereal and the cooking time of the cereal.
2003 OBJECTIVES & STRATEGIES

Financial Objective #1
Provide total shareholder returns (dividends plus share-price appreciation) that exceed both the cost of equity and the S&P 500 stock index over time.

Financial Objective #2
Maintain a strong Financial position through strong operating cash flows, while generating economic value through the use of financial leverage over time.

Operating Strategy #1
Aggressively market consumer brands for leadership positions

Operating Strategy #2
Profitably grow the volume of key brands at better-than-industry-average rates over time, by offering greater value to the consumer.

Operating Strategy #3
Enhance productivity and efficiency in every element of our business.

Operating Strategy #4
Develop mutually beneficial, interdependent relationships with our trade customers to improve the economic return of both parties.

Operating Strategy #5
Build high-performance teams of resourceful, motivated and productive employees.

Operating Strategy #6
Improve the productivity of low-return businesses or divest them.
Thinking about making some changes in your diet and lifestyle? There are many good reasons to start your journey towards a more healthy, fit and energetic you. Oatmeal is a rich source of soluble fiber, and has been scientifically proven to reduce cholesterol.
MANAGEMENT’S DISCUSSION AND ANALYSIS

Operating Results
The following discussion addresses the operating results and financial condition of the Company for the years ended December 31, 2003 (current year) and 2002 (prior year). In these years, the Company divested several businesses, including Snapple beverages, five food service businesses and a soup-cup business. As a result of these divestitures, the year-to-year financial comparisons do not easily provide the reader with an understanding of the operating results of ongoing businesses. To assist in the understanding of operating results, this discussion will address the total Company results as reported, describe the impact of divested businesses and review the results of ongoing businesses by operating segment. Previously reported amounts have been restated to conform to the current presentation.

2003 Compared with 2002
Consolidated net sales decreased 3 percent because of the absence of divested businesses. For ongoing businesses, volume and net sales were up 10 percent and 4 percent, respectively, primarily driven by the U.S. and Canadian and Latin American Beverages segments. Weaker exchange rates affected sales, particularly in the Canadian, Latin American and Asia/Pacific businesses. Price changes did not significantly affect the comparison of current and prior year net sales.

The consolidated gross profit margin was 51.0 percent in 2003 compared to 48.9 percent in 2002, reflecting improvements across all ongoing segments and the divestiture of lower-margin businesses in 2003.

During 2003, the Company initiated numerous actions to improve future profitability. These actions resulted in $89.7 million in restructuring charges and are divided into three categories: organization alignment, plant consolidations and Asian reorganization. Charges for organization alignment activities totaled $41.5 million. The Company aligned its foods and beverages businesses, combining sales, supply chain and certain administrative functions to realize synergies and maximize scale. These actions resulted in the elimination of approximately 550 positions worldwide, as a layer of executive management was removed and sales and administrative offices and functions were consolidated. Plant consolidations in the United States and Latin America resulted in $19.2 million in charges. These actions win result in the elimination of approximately 300 positions. In light of disappointing performance and a weak economic environment, the Company revised its operational strategy for the Asia/Pacific region. The focus going forward is on budding the Gatorade business in China. Asia/Pacific restructuring resulted in $29.0 million in charges for plant and sales and administrative office closures, restructuring of certain joint ventures and the elimination of approximately 450 positions.

The 2003 restructuring charges are composed of severance and other termination benefits, asset write-offs, losses on leases and other shut-down costs. Savings from these actions are estimated to be $65 million annually, primarily beginning in 1999, with approximately 90 percent of the savings in cash. 2003 and 2002 restructuring charges by operating segment were as follow:

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<tr>
<th>Segment</th>
<th>2003</th>
<th>2002</th>
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<tr>
<td>U.S. and Canadian Foods</td>
<td>$38.4</td>
<td>$49.2</td>
</tr>
<tr>
<td>Latin American Foods</td>
<td>9.3</td>
<td>10.7</td>
</tr>
<tr>
<td>Other Foods</td>
<td>17.8</td>
<td>-</td>
</tr>
<tr>
<td>U.S. and Canadian Beverages</td>
<td>8.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Latin American Beverages</td>
<td>2.8</td>
<td>-</td>
</tr>
<tr>
<td>Other Beverages</td>
<td>12.5</td>
<td>1.1</td>
</tr>
<tr>
<td><strong>Total Charges</strong></td>
<td>$89.7</td>
<td>$65.9</td>
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Products
In 1998, the Company recognized $38.1 Million of asset impairment losses related to ongoing businesses. In conjunction with the Company’s ongoing review of underperforming businesses, certain assets are reviewed for impairment pursuant to the provisions of SFAS No. 121. During 1998, the China foods and Brazilian pasta businesses were determined to be impaired. Accordingly, pretax losses of $15.1 million and $23.0 million on these impaired Chinese and Brazilian businesses, respectively, were recorded in order to adjust the carrying value of the long-lived assets of these businesses to fair value. The estimated fair value of these assets was based on various methodologies, including a discounted value of estimated future cash flows and liquidation analyses. The Company continues to review its business strategies and pursue cost-reduction activities, some of which could result in future charges.

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**THE QUAKER OATS COMPANY AND SUBSIDIARIES**

Dollars in Millions (Except Per Share Data)

Consolidated Statement of Income

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<tr>
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<tr>
<td>Net Sales</td>
<td>$4,842.5</td>
<td>$5,016.7</td>
<td>$5,199.0</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>2,374.4</td>
<td>2,564.9</td>
<td>2,807.5</td>
</tr>
<tr>
<td>Gross profit</td>
<td>2,468.1</td>
<td>2,450.8</td>
<td>2,391.5</td>
</tr>
<tr>
<td>Selling, general and administrative expenses</td>
<td>1,872.5</td>
<td>1,938.9</td>
<td>1,981.0</td>
</tr>
<tr>
<td>Restructuring charges, asset impairments and losses (gains) on divestitures - net</td>
<td>128.5</td>
<td>1,486.3</td>
<td>(113.4)</td>
</tr>
<tr>
<td>Interest expense</td>
<td>69.6</td>
<td>85.8</td>
<td>106.8</td>
</tr>
<tr>
<td>Interest income</td>
<td>(10.7)</td>
<td>(6.7)</td>
<td>(7.4)</td>
</tr>
<tr>
<td>Foreign exchange loss - net</td>
<td>11.6</td>
<td>10.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Income (Loss) Before Income Taxes</td>
<td>3966</td>
<td>(1,064.3)</td>
<td>415.6</td>
</tr>
<tr>
<td>Provision (benefit) for income taxes</td>
<td>112.1</td>
<td>(133.4)</td>
<td>167.7</td>
</tr>
<tr>
<td>Net Income (Loss)</td>
<td>284.5</td>
<td>(930.9)</td>
<td>247.9</td>
</tr>
<tr>
<td>Preferred dividends - net of tax</td>
<td>4.5</td>
<td>3.5</td>
<td>3.7</td>
</tr>
<tr>
<td>Net Income (Loss) Available for Common</td>
<td>$ 280.0</td>
<td>$(934.4)</td>
<td>$ 244.2</td>
</tr>
<tr>
<td>Per Common Share:</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Net income (loss)</td>
<td>$ 2.04</td>
<td>$(6.80)</td>
<td>$ 1.80</td>
</tr>
<tr>
<td>Net income (loss) - assuming dilution</td>
<td>$ 1.97</td>
<td>$(6.80)</td>
<td>$ 1.78</td>
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<tr>
<td>Dividends declared</td>
<td>$ 1.14</td>
<td>$ 1.14</td>
<td>$ 1.14</td>
</tr>
<tr>
<td>Average Number of Common Shares Outstanding (in thousands)</td>
<td>137,185</td>
<td>137,460</td>
<td>135,466</td>
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CORPORATE SOCIAL RESPONSIBILITY

Social Responsibility

Quaker is committed to supporting the communities in which we manufacture and market products. Through The Quaker Oats Foundation, corporate community relations and volunteer programs, the Company supports groups and activities that strengthen the community, develop a diverse work force and supplier base, and build positive relationships with community groups and neighbors. Quaker is a leading producer and marketer of wholesome foods and beverages, and the Company values a diverse work force. Accordingly, the primary areas for support are nutrition education, hunger and minority education.

In 1998, The Quaker Oats Company and The Quaker Oats Foundation contributed approximately $2.8 million in cash grants and $17 million in food product donations to support our communities.

The Quaker Oats Foundation - In 1998, the Foundation made grants totaling more than $1.6 million. Direct grants were made to 84 organizations totaling $683,000. Eighty-six percent of those dollars benefited communities where Quaker has a facility. Examples of the Foundation’s grants during the year include: support to the National Hispanic Scholarship Fund, the Cabrini-Green Tutoring Program, Second Harvest, the American Indian College Fund, the Chinese American Service League, the Greater Chicago Food Depository and Literacy Plus.

The Foundation contributed more than $87,000 in scholarships for children of Quaker employees through the National Merit Scholarship Program. It also provided substantial support to local United Way campaigns. In 1998, the Foundation’s contributions to 16 United Way campaigns throughout the country totaled nearly $350,000. Combined with Quaker employee contributions of more than $918,000, employees and the Foundation contributed $1.27 million to United Way in 1998.

In addition to direct grants, The Quaker Oats Foundation encourages and enhances the philanthropic activity of our employees through a Matching Gifts Program. In 1998, more than 1,000 not-for-profit organizations received more than $530,000 in matching gifts through Quaker’s Foundation and over $640,000 from Quaker employees for a total of $1.17 million.

Community Relations and Volunteer Programs - Around the block and around the country, Quaker supports communities where it does business. Support ranges from financial contributions and product donations to volunteer efforts by Quaker employees. In 1998, Quaker provided nearly $690,000 in corporate support to hundreds of not-for-profit organizations throughout the country. Examples include: the League of United Latin American Citizens, the NAACP, Asian Human Services, United Negro College Fund, Chicago Urban League, YMCA of Metropolitan Chicago, Spanish Coalition for Jobs, Metropolitan Family Services, the Boys and Girls Clubs of America and Chicago, the National Council of LaRaza and AIDS Walk.

Quaker has a long history of encouraging and supporting employee volunteer programs, both at our corporate headquarters and at local facilities throughout the United States. Employee volunteer efforts are wide-ranging, including tutoring and school mentoring programs and a variety of walks and runs for causes such as the March of Dimes’ WalkAmerica, the Greater Chicago Food Depository’s Walk for Hunger and various marathons that support research efforts on behalf of AIDS, cancer, diabetes and heart disease. In addition, many Quaker employees work at food banks, solicit donors for blood and bone-marrow, work with the Boy and Girl Scouts, staff shelters and food pantries, and provide food, clothing and toys to various not-for-profit organizations.

Corporate Social Responsibility

The Quaker Oats Foundation publishes an annual report, and the Company makes available several reports detailing its community outreach efforts. To receive copies, please contact:

The Quaker Oats Company
Public Affairs-Suite 27-3
PO. Box 049001
Chicago, Illinois 60604-9001
or call (312) 222-7377
CORPORATE AND SHAREHOLDER INFORMATION

Consumer Affairs
Inquiries regarding our products should be addressed to:
Consumer Affairs
The Quaker Oats Company
P.O. Box 049003
Chicago, Illinois 60604-9003
or call (800) 494-7843

Media Relations
Copies of press releases are available at no charge through PR Newswire’s Company News On-Call fax service,
(800) 758-5804,
extension 103689

News media-related inquiries should be addressed to:
Corporate Communications
Suite 27-6
or call (312) 222-7399

Investor Relations
Security analysts, investment professionals and shareholders should direct their business-related inquiries to: Investor Relations
- Suite 27-7
or call (312) 222-7818

Shareholder Services
Harris Trust and Savings Bank acts as transfer agent and registrar for Quaker stock and maintains all primary shareholder records. Shareholders may obtain information relating to their share positions, dividends, stock transfer requirements, lost certificates and other related matters by telephoning the Shareholder Hotline toll-free at (800) 344-1198.

Harris DOCS (Direct Ownership of Corporate Shares) Program
Quaker common stock may be purchased through automatic dividend reinvestment, automatic checking/savings account debits and/or optional cash investments through the Harris DOCS Program. This program replaced the Quaker Dividend Reinvestment and Stock Purchase Plan in January 1998. A brochure describing the Program and an enrollment form are available by calling (800) 524-8580. Current shareholders should call Harris Bank directly at (800) 344-1198.

Harris DOC S
The Quaker Oats Company Administrator P.O. Box A33090
Chicago, Illinois 60690-3309
(800) 344-1198

Form 10-K
This Annual Report includes all financial statements and notes required by Form 10-K. If you request a Form 10-K, you will receive the annual report, proxy statement and the Form 10-K cover page, exhibit list and conformed signature page.

Annual Meeting
Shareholders are cordially invited to attend the Annual Meeting, which will be held at the

Rosemont Convention Center,
5555 North River Road, in Rosemont, Illinois, at 9:30 a.m. (CDT), on May 12, 2004.

Dividends
Cash dividends on Quaker common stock have been paid for 93 consecutive years. Dividends are generally declared on a quarterly basis, with holders as of the record date being entitled to receive the cash dividend on the payable date.
The Quaker Oats Company
PO. Box 049001
Chicago, Illinois 60604-9001
or call (312) 222-7377