

Philip Morris International Inc.  
Form 10-Q  
October 26, 2017  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended September 30, 2017  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 001-33708  
Philip Morris  
International  
Inc.

(Exact name of registrant as specified in its charter)

Virginia 13-3435103  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

120 Park Avenue 10017  
New York, New York  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (917) 663-2000

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

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Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At October 23, 2017, there were 1,553,202,587 shares outstanding of the registrant's common stock, no par value per share.

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In this report, "PMI," "we," "us" and "our" refer to Philip Morris International Inc. and its subsidiaries.	

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

## Philip Morris International Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	September 30, 2017	December 31, 2016
<b>ASSETS</b>		
Cash and cash equivalents	\$ 7,667	\$ 4,239
Receivables (less allowances of \$43 in 2017 and \$42 in 2016)	3,985	3,499
Inventories:		
Leaf tobacco	2,678	2,498
Other raw materials	1,512	1,569
Finished product	4,093	4,950
	8,283	9,017
Other current assets	924	853
Total current assets	20,859	17,608
Property, plant and equipment, at cost	13,972	12,360
Less: accumulated depreciation	7,115	6,296
	6,857	6,064
Goodwill (Note 4)	7,681	7,324
Other intangible assets, net (Note 4)	2,501	2,470
Investments in unconsolidated subsidiaries (Note 14)	1,080	1,011
Deferred income taxes	1,138	859
Other assets	1,835	1,515
<b>TOTAL ASSETS</b>	<b>\$ 41,951</b>	<b>\$ 36,851</b>

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
Condensed Consolidated Balance Sheets (Continued)  
(in millions of dollars, except share data)  
(Unaudited)

	September 30, 2017	December 31, 2016
<b>LIABILITIES</b>		
Short-term borrowings (Note 10)	\$ 2,905	\$ 643
Current portion of long-term debt (Note 10)	3,005	2,573
Accounts payable	1,973	1,666
Accrued liabilities:		
Marketing and selling	680	575
Taxes, except income taxes	5,491	6,204
Employment costs	825	800
Dividends payable	1,669	1,621
Other	1,503	1,553
Income taxes	463	832
Total current liabilities	18,514	16,467
Long-term debt (Note 10)	28,065	25,851
Deferred income taxes	1,037	1,897
Employment costs	2,868	2,800
Other liabilities	1,100	736
Total liabilities	51,584	47,751
Contingencies (Note 8)		
<b>STOCKHOLDERS' (DEFICIT) EQUITY</b>		
Common stock, no par value (2,109,316,331 shares issued in 2017 and 2016)	—	—
Additional paid-in capital	1,942	1,964
Earnings reinvested in the business	30,831	30,397
Accumulated other comprehensive losses	(8,797)	(9,559)
	23,976	22,802
Less: cost of repurchased stock (556,120,940 and 557,930,784 shares in 2017 and 2016, respectively)	35,383	35,490
Total PMI stockholders' deficit	(11,407)	(12,688)
Noncontrolling interests	1,774	1,788
Total stockholders' deficit	(9,633)	(10,900)
<b>TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>	<b>\$ 41,951</b>	<b>\$ 36,851</b>

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Earnings  
 (in millions of dollars, except per share data)  
 (Unaudited)

	For the Nine Months Ended September 30,	
	2017	2016
Net revenues	\$56,513	\$55,764
Cost of sales	7,431	6,892
Excise taxes on products	36,059	36,050
Gross profit	13,023	12,822
Marketing, administration and research costs	4,773	4,563
Amortization of intangibles	65	56
Operating income	8,185	8,203
Interest expense, net	655	690
Earnings before income taxes	7,530	7,513
Provision for income taxes	2,042	2,110
Equity (income)/loss in unconsolidated subsidiaries, net	(57 )	(72 )
Net earnings	5,545	5,475
Net earnings attributable to noncontrolling interests	204	219
Net earnings attributable to PMI	\$5,341	\$5,256
Per share data (Note 6):		
Basic earnings per share	\$3.43	\$3.38
Diluted earnings per share	\$3.43	\$3.38
Dividends declared	\$3.15	\$3.08

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
Condensed Consolidated Statements of Earnings  
(in millions of dollars, except per share data)  
(Unaudited)

	For the Three Months Ended September 30,	
	2017	2016
Net revenues	\$20,638	\$19,935
Cost of sales	2,735	2,432
Excise taxes on products	13,165	12,953
Gross profit	4,738	4,550
Marketing, administration and research costs	1,649	1,554
Amortization of intangibles	21	19
Operating income	3,068	2,977
Interest expense, net	223	220
Earnings before income taxes	2,845	2,757
Provision for income taxes	812	764
Equity (income)/loss in unconsolidated subsidiaries, net	(12 )	(35 )
Net earnings	2,045	2,028
Net earnings attributable to noncontrolling interests	75	90
Net earnings attributable to PMI	\$1,970	\$1,938
Per share data (Note 6):		
Basic earnings per share	\$1.27	\$1.25
Diluted earnings per share	\$1.27	\$1.25
Dividends declared	\$1.07	\$1.04

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Comprehensive Earnings  
 (in millions of dollars)  
 (Unaudited)

	For the Nine Months Ended September 30,	
	2017	2016
Net earnings	\$5,545	\$5,475
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustment:		
Unrealized gains (losses), net of income taxes of \$790 in 2017 and \$131 in 2016	631	544
(Gains)/losses transferred to earnings, net of income taxes of \$- in 2017 and \$- in 2016	(2	) —
Change in net loss and prior service cost:		
Net losses and prior service costs, net of income taxes of \$- in 2017 and \$3 in 2016	—	(10
Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$31) in 2017 and (\$27) in 2016	166	164
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of \$7 in 2017 and \$31 in 2016	(48	) (184
(Gains) losses transferred to earnings, net of income taxes of \$1 in 2017 and (\$6) in 2016	4	19
Total other comprehensive earnings (losses)	751	533
Total comprehensive earnings	6,296	6,008
Less comprehensive earnings attributable to:		
Noncontrolling interests	193	239
Comprehensive earnings attributable to PMI	\$6,103	\$5,769

See notes to condensed consolidated financial statements



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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Comprehensive Earnings  
 (in millions of dollars)  
 (Unaudited)

	For the Three Months Ended September 30,	
	2017	2016
Net earnings	\$2,045	\$2,028
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustments:		
Unrealized gains (losses), net of income taxes of \$244 in 2017 and \$84 in 2016	201	6
(Gains) losses transferred to earnings, net of income taxes of \$- in 2017 and \$- in 2016	(2	) —
Change in net loss and prior service cost:		
Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$12) in 2017 and (\$10) in 2016	55	54
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of (\$1) in 2017 and \$1 in 2016	5	(11 )
(Gains) losses transferred to earnings, net of income taxes of \$- in 2017 and (\$3) in 2016	6	16
Total other comprehensive earnings (losses)	265	65
Total comprehensive earnings	2,310	2,093
Less comprehensive earnings attributable to:		
Noncontrolling interests	67	89
Comprehensive earnings attributable to PMI	\$2,243	\$2,004

See notes to condensed consolidated financial statements

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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Stockholders' (Deficit) Equity  
 For the Nine Months Ended September 30, 2017 and 2016  
 (in millions of dollars, except per share amounts)  
 (Unaudited)

	PMI Stockholders' (Deficit) Equity						Total
	Common Stock Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Loss	Cost of Repurchased Stock	Noncontrolling Interests		
Balances, January 1, 2016	\$-1,929	\$ 29,842	\$ (9,402 )	\$ (35,613 )	\$ 1,768		\$(11,476)
Net earnings		5,256			219		5,475
Other comprehensive earnings (losses), net of income taxes			513		20		533
Issuance of stock awards	8			121			129
Dividends declared (\$3.08 per share)		(4,793 )					(4,793 )
Payments to noncontrolling interests					(187 )		(187 )
Other	(3 )				5		2
Balances, September 30, 2016	\$-1,934	\$ 30,305	\$ (8,889 )	\$ (35,492 )	\$ 1,825		\$(10,317)
Balances, January 1, 2017	\$-1,964	\$ 30,397	\$ (9,559 )	\$ (35,490 )	\$ 1,788		\$(10,900)
Net earnings		5,341			204		5,545
Other comprehensive earnings (losses), net of income taxes			762		(11 )		751
Issuance of stock awards	(12 )			107			95
Dividends declared (\$3.15 per share)		(4,907 )					(4,907 )
Payments to noncontrolling interests					(222 )		(222 )
Other	(10 )				15		5
Balances, September 30, 2017	\$-1,942	\$ 30,831	\$ (8,797 )	\$ (35,383 )	\$ 1,774		\$(9,633 )

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Cash Flows  
 (in millions of dollars)  
 (Unaudited)

	For the Nine Months Ended September 30, 2017    2016	
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Net earnings	\$5,545	\$5,475
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	632	548
Deferred income tax (benefit) provision	(355 )	50
Asset impairment and exit costs, net of cash paid	(8 )	(26 )
Cash effects of changes:		
Receivables, net	(118 )	(398 )
Inventories	1,243	1,245
Accounts payable	247	180
Income taxes	(420 )	(259 )
Accrued liabilities and other current assets	(718 )	(985 )
Pension plan contributions	(52 )	(80 )
Other	(5 )	178
Net cash provided by operating activities	5,991	5,928
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>		
Capital expenditures	(995 )	(734 )
Investments in unconsolidated subsidiaries	(40 )	(26 )
Net investment hedges and other	(1,257 )	(183 )
Net cash used in investing activities	(2,292 )	(943 )

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
 Condensed Consolidated Statements of Cash Flows (Continued)  
 (in millions of dollars)  
 (Unaudited)

	For the Nine Months Ended September 30, 2017    2016	
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>		
Short-term borrowing activity by original maturity:		
Net issuances (repayments) - maturities of 90 days or less	\$646	\$(55 )
Issuances - maturities longer than 90 days	1,634	—
Long-term debt proceeds	3,721	3,536
Long-term debt repaid	(2,053 )	(2,072 )
Dividends paid	(4,854 )	(4,759 )
Sale (purchase) of subsidiary shares to/(from) noncontrolling interests	5	5
Other	(331 )	(215 )
Net cash used in financing activities	(1,232 )	(3,560 )
Effect of exchange rate changes on cash and cash equivalents	961	42
Cash and cash equivalents:		
Increase	3,428	1,467
Balance at beginning of period	4,239	3,417
Balance at end of period	\$7,667	\$4,884

See notes to condensed consolidated financial statements.

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Philip Morris International Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Note 1. Background and Basis of Presentation:

Background

Philip Morris International Inc. is a holding company incorporated in Virginia, U.S.A., whose subsidiaries and affiliates, and their licensees, are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside of the United States of America. Throughout these financial statements, the term “PMI” refers to Philip Morris International Inc. and its subsidiaries.

Basis of Presentation

The interim condensed consolidated financial statements of PMI are unaudited. These interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and such principles are applied on a consistent basis. It is the opinion of PMI’s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings attributable to PMI for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the audited consolidated financial statements and related notes, which appear in PMI’s Annual Report on Form 10-K for the year ended December 31, 2016.

Note 2. Stock Plans:

In May 2017, PMI’s shareholders approved the Philip Morris International Inc. 2017 Performance Incentive Plan (the “2017 Plan”). The 2017 Plan replaced the 2012 Performance Incentive Plan, and there will be no additional grants under the replaced plan. Under the 2017 Plan, PMI may grant to eligible employees restricted shares and restricted share units, performance-based cash incentive awards and performance-based equity awards. Up to 25 million shares of PMI’s common stock may be issued under the 2017 Plan. At September 30, 2017, shares available for grant under the 2017 Plan were 24,992,830.

In May 2017, PMI’s shareholders also approved the Philip Morris International Inc. 2017 Stock Compensation Plan for Non-Employee Directors (the “2017 Non-Employee Directors Plan”). The 2017 Non-Employee Directors Plan replaced the 2008 Stock Compensation Plan for Non-Employee Directors, and there will be no additional grants under the replaced plan. A non-employee director is defined as a member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1 million shares of PMI common stock may be awarded under the 2017 Non-Employee Directors Plan. At September 30, 2017, shares available for grant under the plan were 1,000,000.

Accounting Policy

PMI’s accounting policy is to estimate the number of awards expected to be forfeited and adjust the expense when it is no longer probable that the employee will fulfill the service condition.

Restricted share unit (RSU) awards

During the nine months ended September 30, 2017 and 2016, shares granted to eligible employees and the weighted-average grant date fair value per share related to RSU awards were as follows:

Number of Shares Granted	Weighted-Average Grant Date Fair Value Per RSU Award Granted
2017 1,209,230	\$ 98.58
2016 1,212,600	\$ 89.03

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Philip Morris International Inc. and Subsidiaries  
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Compensation expense related to RSU awards was as follows:

(in millions)	Compensation Expense Related to RSU Awards For the Nine Months Ended September 30,	
	For the Three Months Ended September 30,	For the Three Months Ended September 30,
2017	\$ 84	\$ 24
2016	\$ 97	\$ 28

As of September 30, 2017, PMI had \$134 million of total unrecognized compensation cost related to non-vested RSU awards. The cost is recognized over the original restriction period of the awards, which is typically three years after the date of the award, or upon death, disability or reaching the age of 58.

During the nine months ended September 30, 2017, 1,999,045 RSU awards vested. The grant date fair value of all the vested awards was approximately \$156 million. The total fair value of RSU awards that vested during the nine months ended September 30, 2017 was approximately \$206 million.

#### Performance share unit (PSU) awards

During the nine months ended September 30, 2017 and 2016, PMI granted PSU awards to certain executives. The PSU awards require the achievement of certain performance factors, which are predetermined at the time of grant, over a three-year performance cycle. PMI's performance metrics consist of PMI's Total Shareholder Return (TSR) relative to a predetermined peer group and on an absolute basis, PMI's currency-neutral compound annual adjusted operating companies income growth rate, excluding acquisitions, and PMI's performance against specific measures of PMI's innovation and transformation. The aggregate of the weighted performance factors for the three metrics determines the percentage of PSUs that will vest at the end of the three-year performance cycle. The minimum percentage of PSUs that can vest is zero, with a target percentage of 100 and a maximum percentage of 200. Each vested PSU entitles the participant to one share of common stock. An aggregate weighted PSU performance factor of 100 will result in the targeted number of PSUs being vested. At the end of the performance cycle, participants are entitled to an amount equivalent to the accumulated dividends paid on common stock during the performance cycle for the number of shares earned.

During the nine months ended September 30, 2017 and 2016, shares granted to eligible employees and the grant date fair value per share related to PSU awards were as follows:

Number of Shares Granted	Grant Date Fair Value Subject to TSR Performance	Grant Date Fair Value Subject to Other Performance
-----------------------------------	--	--



	Factor Per Share <sup>(a)</sup>	Factors Per Share <sup>(b)</sup>
2017	393,460 \$ 128.72	\$ 98.29
2016	428,400 \$ 104.60	\$ 89.02

<sup>(a)</sup> The grant date fair value of the PSU market based awards subject to the TSR performance factor was determined by using the Monte Carlo simulation model.

<sup>(b)</sup> The grant date fair value of the PSU awards subject to the other performance factors was determined by using the average of the high and low market price of PMI's stock at the date of grant.

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Philip Morris International Inc. and Subsidiaries  
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(Unaudited)

Compensation expense related to PSU awards was as follows:

(in millions)	Compensation Expense Related to PSU Awards	
	For the Nine Months Ended September 30,	For the Three Months Ended September 30,
2017	\$ 31	\$ 6
2016	\$ 24	\$ 4

As of September 30, 2017, PMI had \$40 million of total unrecognized compensation cost related to non-vested PSU awards. The cost is recognized over the performance cycle of the awards, or upon death, disability or reaching the age of 58.

During the nine months ended September 30, 2017, there were no PSU awards that vested.

### Note 3. Benefit Plans:

Pension coverage for employees of PMI's subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. In addition, PMI provides health care and other benefits to substantially all U.S. retired employees and certain non-U.S. retired employees. In general, health care benefits for non-U.S. retired employees are covered through local government plans.

### Pension Plans

#### Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

(in millions)	U.S. Plans		Non-U.S. Plans	
	For the Nine Months Ended September 30,	For the Nine Months Ended September 30,	For the Nine Months Ended September 30,	For the Nine Months Ended September 30,
	2017	2016	2017	2016
Service cost	\$ 3	\$ 3	\$ 152	\$ 151
Interest cost	10	12	69	96
Expected return on plan assets	(10)	(10)	(231)	(247)
Amortization:				
Net loss	—	2	132	133
Prior service cost	6	4	4	3

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Net periodic pension cost	\$ 9	\$ 11	\$ 126	\$ 136
	U.S. Plans		Non-U.S. Plans	
	For the Three Months Ended		For the Three Months Ended	
	September 30,		September 30,	
(in millions)	2017	2016	2017	2016
Service cost	\$ 1	\$ 1	\$ 52	\$ 51
Interest cost	3	4	23	32
Expected return on plan assets	(3 )	(3 )	(78 )	(83 )
Amortization:				
Net loss	—	—	44	45
Prior service cost	2	1	1	1
Net periodic pension cost	\$ 3	\$ 3	\$ 42	\$ 46

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Philip Morris International Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Employer Contributions

PMI makes, and plans to make, contributions, to the extent that they are tax deductible and to meet specific funding requirements of its funded U.S. and non-U.S. plans. Employer contributions of \$52 million were made to the pension plans during the nine months ended September 30, 2017. Currently, PMI anticipates making additional contributions during the remainder of 2017 of approximately \$13 million to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest and currency rates.

Note 4. Goodwill and Other Intangible Assets, net:

Goodwill and other intangible assets, net, by segment were as follows:

(in millions)	Goodwill		Other Intangible Assets, net	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
European Union	\$1,397	\$ 1,238	\$ 471	\$ 479
Eastern Europe, Middle East & Africa	408	372	195	200
Asia	3,578	3,596	1,055	1,074
Latin America & Canada	2,298	2,118	780	717
Total	\$7,681	\$ 7,324	\$ 2,501	\$ 2,470

Goodwill primarily reflects PMI's acquisitions in Canada, Colombia, Greece, Indonesia, Mexico, Pakistan and Serbia, as well as the business combination in the Philippines. The movements in goodwill from December 31, 2016, were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
		September 30, 2017	December 31, 2016	September 30, 2017	
Balances, December 31, 2016	\$ 1,238	\$ 372	\$3,596	\$ 2,118	\$7,324
Changes due to:					
Currency	159	36	(18 )	180	357
Balances, September 30, 2017	\$ 1,397	\$ 408	\$3,578	\$ 2,298	\$7,681

Additional details of other intangible assets were as follows:

(in millions)	September 30, 2017		December 31, 2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	\$1,362		\$1,455	
Amortizable intangible assets	1,808	\$ 669	1,598	\$ 583
Total other intangible assets	\$3,170	\$ 669	\$3,053	\$ 583

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Philip Morris International Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets primarily consist of certain trademarks and distribution networks associated with business combinations. During the first quarter of 2017, PMI reclassified three trademarks with a gross carrying amount of \$153 million from non-amortizable intangible assets to amortizable intangible assets. The gross carrying amount, the range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at September 30, 2017, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	\$ 1,569	2 - 40 years	19 years
Distribution networks	151	5 - 30 years	9 years
Other (including farmer contracts and intellectual property rights)	88	4 - 17 years	9 years
	\$ 1,808		

Pre-tax amortization expense for intangible assets during the nine months ended September 30, 2017 and 2016 was \$65 million and \$56 million, respectively, and \$21 million and \$19 million for the three months ended September 30, 2017 and 2016, respectively. Amortization expense for each of the next five years is estimated to be \$87 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The increase in the gross carrying amount of other intangible assets from December 31, 2016, was primarily due to currency movements.

During the second quarter of 2017, PMI completed its annual review of goodwill and non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review. Additionally, PMI elected to early adopt Accounting Standards Update ASU 2017-04 "Intangibles-Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment," which had no impact on PMI's impairment review or conclusion.

#### Note 5. Financial Instruments:

##### Overview

PMI operates in markets outside of the United States of America, with manufacturing and sales facilities in various locations around the world. PMI utilizes certain financial instruments to manage foreign currency and interest rate exposure. Derivative financial instruments are used by PMI principally to reduce exposures to market risks resulting from fluctuations in foreign currency exchange and interest rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss would be recognized in earnings. PMI reports its net transaction gains or losses in marketing, administration and research costs on the condensed consolidated statements of earnings.

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts ("foreign exchange contracts"), and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At September 30, 2017, PMI had contracts with aggregate notional amounts of \$32.7 billion of which \$5.0 billion related to cash flow hedges, \$12.8 billion related to hedges of net investments in foreign operations and \$14.9 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

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The fair value of PMI's foreign exchange contracts included in the condensed consolidated balance sheets as of September 30, 2017 and December 31, 2016, were as follows:

(in millions)	Asset Derivatives Balance Sheet Classification	Fair Value		Liability Derivatives Balance Sheet Classification	Fair Value	
		At September 30, 2017	At December 31, 2016		At September 30, 2017	At December 31, 2016
Foreign exchange contracts designated as hedging instruments	Other current assets	\$ 100	\$ 207	Other accrued liabilities	\$ 279	\$ 66
	Other assets	79	436	Other liabilities	718	36
Foreign exchange contracts not designated as hedging instruments	Other current assets	76	161	Other accrued liabilities	64	61
	Other assets	—	9	Other liabilities	6	—
Total derivatives		\$ 255	\$ 813		\$ 1,067	\$ 163

For the nine months and three months ended September 30, 2017 and 2016, PMI's cash flow and net investment hedging instruments impacted the condensed consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, in millions)	For the Nine Months Ended September 30,		Amount of	
	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives 2017	2016	Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings 2017
Derivatives in Cash Flow Hedging Relationship				
Foreign exchange contracts	\$(55 )	\$(215)	Net revenues	\$ 28
			Cost of sales	\$ (29 )
			Marketing, administration and research costs	1
			Interest expense, net	41
				(5 )
				2
				(27 )
				(39 )
Derivatives in Net Investment Hedging Relationship				
Foreign exchange contracts	(1,432 )	(209 )		
Total	\$(1,487)	\$(424)		\$ (3 )
				\$ (25 )

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(pre-tax, in millions)	For the Three Months Ended September 30,		Amount of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings	
	2017	2016		
Derivatives in Cash Flow Hedging Relationship				
Foreign exchange contracts	\$6	\$(12 )		
			Net revenues	\$ 13 \$ (28 )
			Cost of sales	1 16
			Marketing, administration and research costs	(5 ) 3
			Interest expense, net	(15 ) (10 )
Derivatives in Net Investment Hedging Relationship				
Foreign exchange contracts	(492 )	(150 )		
Total	\$(486)	\$(162)		\$ (6 ) \$ (19 )

## Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to certain forecasted transactions. The effective portion of gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's condensed consolidated statements of earnings. During the nine months and three months ended September 30, 2017 and 2016, ineffectiveness related to cash flow hedges was not material. As of September 30, 2017, PMI has hedged forecasted transactions for periods not exceeding the next fifteen months with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is primarily included in operating cash flows on PMI's condensed consolidated statements of cash flows.

## Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges of its foreign operations. For the nine months ended September 30, 2017 and 2016, these hedges of net investments resulted in losses, net of income taxes, of \$1,504 million and \$232 million, respectively. For the three months ended September 30, 2017 and 2016, these hedges of net investments resulted in losses, net of income taxes, of \$478 million and \$153 million, respectively. These losses were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the nine months and three months ended September 30, 2017 and 2016, ineffectiveness related to net investment hedges was not material. The premiums paid for, and settlements of, net investment hedges are included in net investment hedges and other investing cash flows on PMI's condensed consolidated statements of cash flows.

## Other Derivatives



PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in PMI's condensed consolidated statements of earnings. For the nine months ended September 30, 2017 and 2016, the gains from contracts for which PMI did not apply hedge accounting were \$344 million and \$101 million, respectively. For the three months ended September 30, 2017 and 2016, the gains from contracts for which PMI did not apply hedge accounting were \$195 million and \$32 million, respectively. The gains from these contracts substantially offset the losses generated by the underlying intercompany and third-party loans being hedged.

For the nine months and three months ended September 30, 2017 and 2016, the net impact of these contracts on the condensed consolidated statements of earnings was not material.

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## Qualifying Hedging Activities Reported in Accumulated Other Comprehensive Losses

Derivative gains or losses reported in accumulated other comprehensive losses are a result of qualifying hedging activity. Transfers of these gains or losses to earnings are offset by the corresponding gains or losses on the underlying hedged item. Hedging activity affected accumulated other comprehensive losses, net of income taxes, as follows:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2017	2016	2017	2016
Gain/(loss) at beginning of period	\$97	\$59	\$42	\$(111)
Derivative (gains)/losses transferred to earnings	4	19	6	16
Change in fair value	(48 )	(184 )	5	(11 )
Gain/(loss) at of September 30,	\$53	\$(106)	\$53	\$(106)

At September 30, 2017, PMI expects \$42 million of derivative gains that are included in accumulated other comprehensive losses to be reclassified to the condensed consolidated statement of earnings within the next 12 months. These gains are expected to be substantially offset by the statement of earnings impact of the respective hedged transactions.

## Contingent Features

PMI's derivative instruments do not contain contingent features.

## Credit Exposure and Credit Risk

PMI is exposed to credit loss in the event of non-performance by counterparties. While PMI does not anticipate non-performance, its risk is limited to the fair value of the financial instruments less any cash collateral received or pledged. PMI actively monitors its exposure to credit risk through the use of credit approvals and credit limits, and by selecting and continuously monitoring a diverse group of major international banks and financial institutions as counterparties.

## Fair Value

See Note 11. Fair Value Measurements and Note 13. Balance Sheet Offsetting for additional discussion of derivative financial instruments.

## Note 6. Earnings Per Share:

Basic and diluted earnings per share ("EPS") were calculated using the following:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2017	2016	2017	2016
Net earnings attributable to PMI	\$5,341	\$5,256	\$1,970	\$1,938
Less distributed and undistributed earnings attributable to share-based payment awards	12	15	4	5
Net earnings for basic and diluted EPS	\$5,329	\$5,241	\$1,966	\$1,933
Weighted-average shares for basic EPS	1,552	1,551	1,553	1,551
Plus contingently issuable performance stock units (PSUs)	1	—	1	—
Weighted-average shares for diluted EPS	1,553	1,551	1,554	1,551

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and therefore are included in PMI's earnings per share calculation pursuant to the two-class method.

For the 2017 and 2016 computations, there were no antidilutive stock awards.

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## Note 7. Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside of the United States of America. Reportable segments for PMI are organized and managed by geographic region. PMI's reportable segments are the European Union; Eastern Europe, Middle East & Africa; Asia; and Latin America & Canada. PMI records net revenues and operating companies income to its segments based upon the geographic area in which the customer resides.

PMI's management evaluates segment performance and allocates resources based on operating companies income, which PMI defines as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. Interest expense, net, and provision for income taxes are centrally managed and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management.

Segment data were as follows:

(in millions)	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2017	2016	2017	2016
Net revenues:				
European Union	\$20,156	\$20,664	\$7,346	\$7,387
Eastern Europe, Middle East & Africa	13,177	13,650	4,990	5,122
Asia	16,051	15,014	5,846	5,113
Latin America & Canada	7,129	6,436	2,456	2,313
Net revenues	\$56,513	\$55,764	\$20,638	\$19,935
Earnings before income taxes:				
Operating companies income:				
European Union	\$2,783	\$3,096	\$1,042	\$1,120
Eastern Europe, Middle East & Africa	2,188	2,389	765	962
Asia	2,753	2,288	1,065	761
Latin America & Canada	709	677	264	224
Amortization of intangibles	(65 )	(56 )	(21 )	(19 )
General corporate expenses	(126 )	(119 )	(35 )	(36 )
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(57 )	(72 )	(12 )	(35 )
Operating income	8,185	8,203	3,068	2,977
Interest expense, net	(655 )	(690 )	(223 )	(220 )
Earnings before income taxes	\$7,530	\$7,513	\$2,845	\$2,757

## Note 8. Contingencies:

## Tobacco-Related Litigation

Legal proceedings covering a wide range of matters are pending or threatened against us, and/or our subsidiaries, and/or our indemnitees in various jurisdictions. Our indemnitees include distributors, licensees, and others that have been named as parties in certain cases and that we have agreed to defend, as well as to pay costs and some or all of judgments, if any, that may be entered against them. Pursuant to the terms of the Distribution Agreement between

Altria Group, Inc. ("Altria") and PMI, PMI will indemnify Altria and Philip Morris USA Inc. ("PM USA"), a U.S. tobacco subsidiary of Altria, for tobacco product claims based in substantial part on products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for tobacco product claims based in substantial part on products manufactured by PM USA, excluding tobacco products contract manufactured for PMI. It is possible that there could be adverse developments in pending cases against us and our subsidiaries. An unfavorable outcome

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or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation. Damages claimed in some of the tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome. Much of the tobacco-related litigation is in its early stages, and litigation is subject to uncertainty. However, as discussed below, we have to date been largely successful in defending tobacco-related litigation.

We and our subsidiaries record provisions in the consolidated financial statements for pending litigation when we determine that an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, after assessing the information available to it (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss for any of the pending tobacco-related cases; and (iii) accordingly, no estimated loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Nevertheless, although litigation is subject to uncertainty, we and each of our subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that we have valid defenses to the litigation pending against us, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be, vigorously defended. However, we and our subsidiaries may enter into settlement discussions in particular cases if we believe it is in our best interests to do so.

To date, no tobacco-related case has been finally resolved in favor of a plaintiff against us, our subsidiaries or indemnitees.

The table below lists the number of tobacco-related cases pending against us and/or our subsidiaries or indemnitees as of October 23, 2017, October 21, 2016 and October 27, 2015:

Type of Case	Number of Cases Pending as of October 23, 2017	Number of Cases Pending as of October 21, 2016	Number of Cases Pending as of October 27, 2015
Individual Smoking and Health Cases	65	67	69
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	16	16
Label-Related Class Actions	1	—	—
Individual Label-Related Cases	1	3	3
Public Civil Actions	2	2	2

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 465 Smoking and Health, Label-Related, Health Care Cost Recovery, and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees were a defendant have been terminated in our favor. Thirteen cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and four remain on appeal.

The table below lists the verdict and significant post-trial developments in the four pending cases where a verdict was returned in favor of the plaintiff:



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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2004	Brazil/The Smoker Health Defense Association	Class Action	The Civil Court of São Paulo found defendants liable without hearing evidence. In April 2004, the court awarded “moral damages” of R\$1,000 (approximately \$312) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not assess actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling.	Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff appealed the decision. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. This appeal is still pending.
May 27, 2015	Canada/Cecilia Létourneau	Class Action	On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Létourneau class on liability and awarded a total of CAD 131 million (approximately \$104 million) in punitive damages, allocating CAD 46 million (approximately \$36 million) to our subsidiary. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days. The court did not order the payment of compensatory	In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal covering both the Létourneau case and the Blais case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$179 million) to cover both the



damages.

Létourneau and Blais cases. The hearing for the merits appeal took place in November 2016. (See below for further detail.)

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 27, 2015	Canada/Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais	Class Action	<p>On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the Blais class on liability and found the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately \$12.3 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion including pre-judgment interest (approximately \$2.45 billion)). The trial court awarded CAD 90,000 (approximately \$71,200) in punitive damages, allocating CAD 30,000 (approximately \$23,700) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately \$791 million) of the compensatory damage award, CAD 200 million (approximately \$158 million) of which is our subsidiary's portion, into a trust within 60 days.</p>	<p>In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling, together with the Létourneau case, CAD 226 million (approximately \$179 million). The hearing for the merits appeal took place in November 2016. (See below for further detail.)</p>

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
August 5, 2016	Argentina/Hugo Lespada	Individual Action	On August 5, 2016, the Civil Court No. 14 - Mar del Plata, issued a verdict in favor of plaintiff, an individual smoker, and awarded him ARS 110,000 (approximately \$6,312), plus interest, in compensatory and moral damages. The Court found that our subsidiary failed to warn plaintiff of the risk of becoming addicted to cigarettes.	On August 23, 2016, our subsidiary filed its notice of appeal.

Pending claims related to tobacco products generally fall within the following categories:

**Smoking and Health Litigation:** These cases primarily allege personal injury and are brought by individual plaintiffs or on behalf of a class or purported class of individual plaintiffs. Plaintiffs' allegations of liability in these cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, violations of deceptive trade practice laws and consumer protection statutes. Plaintiffs in these cases seek various forms of relief, including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include licit activity, failure to state a claim, lack of defect, lack of proximate cause, assumption of the risk, contributory negligence, and statute of limitations.

As of October 23, 2017, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

65 cases brought by individual plaintiffs in Argentina (32), Brazil (14), Canada (4), Chile (7), Costa Rica (1), Italy (3), the Philippines (1), Russia (1), Turkey (1) and Scotland (1), compared with 67 such cases on October 21, 2016, and 69 cases on October 27, 2015; and

- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on October 21, 2016 and 11 such cases on October 27, 2015.

In the first class action pending in Brazil, *The Smoker Health Defense Association (ADESF) v. Souza Cruz, S.A. and Philip Morris Marketing, S.A.*, Nineteenth Lower Civil Court of the Central Courts of the Judiciary District of São Paulo, Brazil, filed July 25, 1995, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer organization, is seeking damages for all addicted smokers and former smokers, and injunctive relief. In 2004, the trial court found defendants liable without hearing evidence and awarded "moral damages" of R\$1,000 (approximately \$312) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In February 2017, the Chief Justice of the Supreme Court of Justice denied plaintiff's appeal. In March 2017, plaintiff filed an en banc appeal to the Supreme Court of Justice. In addition, the defendants previously filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. Both appeals are still pending.

In the second class action pending in Brazil, Public Prosecutor of São Paulo v. Philip Morris Brasil Industria e Comercio Ltda., Civil Court of the City of São Paulo, Brazil, filed August 6, 2007, our subsidiary is a defendant. The plaintiff, the Public Prosecutor of the State of São Paulo, is seeking (i) damages on behalf of all smokers nationwide, former smokers, and their relatives; (ii) damages on behalf of people exposed to environmental tobacco smoke nationwide, and their relatives; and (iii) reimbursement of the health care costs allegedly incurred for the treatment of tobacco-related diseases by all Brazilian States and Municipalities,

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and the Federal District. In an interim ruling issued in December 2007, the trial court limited the scope of this claim to the State of São Paulo only. In December 2008, the Seventh Civil Court of São Paulo issued a decision declaring that it lacked jurisdiction because the case involved issues similar to the ADESF case discussed above and should be transferred to the Nineteenth Lower Civil Court in São Paulo where the ADESF case is pending. The court further stated that these cases should be consolidated for the purposes of judgment. In April 2010, the São Paulo Court of Appeals reversed the Seventh Civil Court's decision that consolidated the cases, finding that they are based on different legal claims and are progressing at different stages of proceedings. This case was returned to the Seventh Civil Court of São Paulo, and our subsidiary filed its closing arguments in December 2010. In March 2012, the trial court dismissed the case on the merits. In January 2014, the São Paulo Court of Appeals rejected plaintiff's appeal and affirmed the trial court decision. In July 2014, plaintiff appealed to the Superior Court of Justice.

In the first class action pending in Canada, *Cecilia Létourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in September 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiff, an individual smoker, sought compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and awarded a total of CAD 131 million (approximately \$104 million) in punitive damages, allocating CAD 46 million (approximately \$36 million) to our subsidiary. The trial court found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' addiction. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the size of the addiction class at 918,000 members but declined to award compensatory damages to the addiction class because the evidence did not establish the claims with sufficient accuracy. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days and found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered a briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking security in both the Létourneau case and the Blais case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$179 million), in the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$29.8 million) beginning in December 2015 through March 2017. See the Blais description for further detail concerning the security order. The Court of Appeal heard oral arguments on the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption,

without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) holding that the addiction class members' claims for punitive damages were not time-barred even though the case was filed more than three years after a prominent addiction warning appeared on all packages, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the second class action pending in Canada, Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp., Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, sought compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and found that the class members' compensatory damages totaled approximately CAD 15.5 billion, including pre-judgment interest (approximately \$12.3 billion). The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion, including pre-judgment

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interest (approximately \$2.45 billion)). In addition, the trial court awarded CAD 90,000 (approximately \$71,200) in punitive damages, allocating CAD 30,000 (approximately \$23,700) to our subsidiary and found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' diseases. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the disease class at 99,957 members. The trial court ordered defendants to pay CAD 1 billion (approximately \$791 million) of the compensatory damage award into a trust within 60 days, CAD 200 million (approximately \$158 million) of which is our subsidiary's portion and ordered briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking an order that defendants place irrevocable letters of credit totaling CAD 5 billion (approximately \$3.96 billion) into trust, to secure the judgments in both the Létourneau and Blais cases. Plaintiffs subsequently withdrew their motion for security against JTI-MacDonald Corp. and proceeded only against our subsidiary and Imperial Tobacco Canada Ltd. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$179 million) to cover both the Létourneau and Blais cases. Such security may take the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$29.8 million) beginning in December 2015 through March 2017. The Court of Appeal ordered Imperial Tobacco Canada Ltd. to furnish security totaling CAD 758 million (approximately \$600 million) in seven equal consecutive quarterly installments of approximately CAD 108 million (approximately \$85.5 million) beginning in December 2015 through June 2017. In March 2017, our subsidiary made its sixth and final quarterly installment of security for approximately CAD 37.6 million (approximately \$29.8 million) into a court trust. This payment is included in other assets on the condensed consolidated balance sheets and in cash used in operating activities in the condensed consolidated statements of cash flows. The Court of Appeal ordered that the security is payable upon a final judgment of the Court of Appeal affirming the trial court's judgment or upon further order of the Court of Appeal. The Court of Appeal heard oral arguments on the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) relying on epidemiological evidence that did not meet recognized scientific standards, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the third class action pending in Canada, *Kunta v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Winnipeg, Canada, filed June 12, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic obstructive pulmonary disease ("COPD"), severe asthma, and mild reversible lung disease resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a

proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. In September 2009, plaintiff's counsel informed defendants that he did not anticipate taking any action in this case while he pursues the class action filed in Saskatchewan (see description of Adams, below).

In the fourth class action pending in Canada, *Adams v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Saskatchewan, Canada, filed July 10, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have allegedly suffered, or suffer, from COPD, emphysema, heart disease, or cancer, as well as restitution of profits. Preliminary motions are pending.

In the fifth class action pending in Canada, *Semple v. Canadian Tobacco Manufacturers' Council, et al.*, The Supreme Court (trial court), Nova Scotia, Canada, filed June 18, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and



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COPD resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).

In the sixth class action pending in Canada, *Dorion v. Canadian Tobacco Manufacturers' Council, et al.*, The Queen's Bench, Alberta, Canada, filed June 15, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic bronchitis and severe sinus infections resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. To date, we, our subsidiaries, and our indemnitees have not been properly served with the complaint. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of Adams, above).

In the seventh class action pending in Canada, *McDermid v. Imperial Tobacco Canada Limited, et al.*, Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and heart disease resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from heart disease allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed.

In the eighth class action pending in Canada, *Bourassa v. Imperial Tobacco Canada Limited, et al.*, Supreme Court, British Columbia, Canada, filed June 25, 2010, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, the heir to a deceased smoker, alleges that the decedent was addicted to tobacco products and suffered from emphysema resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who were alive on June 12, 2007, and who suffered from chronic respiratory diseases allegedly caused by smoking, their estates, dependents and family members, plus disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. In December 2014, plaintiff filed an amended statement of claim.

In the ninth class action pending in Canada, *Suzanne Jacklin v. Canadian Tobacco Manufacturers' Council, et al.*, Ontario Superior Court of Justice, filed June 20, 2012, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and COPD resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers who have smoked a minimum of 25,000 cigarettes and have allegedly suffered, or suffer, from COPD, heart disease, or cancer, as well as restitution of profits. Plaintiff's counsel has indicated that he does not intend to take any action in this case in the near future.

**Health Care Cost Recovery Litigation:** These cases, brought by governmental and non-governmental plaintiffs, seek reimbursement of health care cost expenditures allegedly caused by tobacco products. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including unjust enrichment, negligence, negligent design, strict liability, breach of express and implied warranties, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, defective product, failure to warn, sale of cigarettes to minors, and claims under statutes governing competition and deceptive trade practices. Plaintiffs in these cases seek various forms of relief including compensatory and other damages, and injunctive and equitable relief. Defenses

raised in these cases include lack of proximate cause, remoteness of injury, failure to state a claim, adequate remedy at law, “unclean hands” (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), and statute of limitations.

As of October 23, 2017, there were 16 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (10), Korea (1) and Nigeria (5), compared with 16 such cases on October 21, 2016 and 16 such cases on October 27, 2015.

In the first health care cost recovery case pending in Canada, Her Majesty the Queen in Right of British Columbia v. Imperial Tobacco Limited, et al., Supreme Court, British Columbia, Vancouver Registry, Canada, filed January 24, 2001, we, our subsidiaries, our indemnitee (PM USA), and other members of the industry are defendants. The plaintiff, the government of the province of British Columbia, brought a claim based upon legislation enacted by the province authorizing the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, resulting from a “tobacco related

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wrong.” The Supreme Court of Canada has held that the statute is constitutional. We and certain other non-Canadian defendants challenged the jurisdiction of the court. The court rejected the jurisdictional challenge. Pre-trial discovery is ongoing.

In the second health care cost recovery case filed in Canada, Her Majesty the Queen in Right of New Brunswick v. Rothmans Inc., et al., Court of Queen's Bench of New Brunswick, Trial Court, New Brunswick, Fredericton, Canada, filed March 13, 2008, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of New Brunswick based on legislation enacted in the province. This legislation is similar to the law introduced in British Columbia that authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing. In June 2017, the trial court set a trial date for November 4, 2019.

In the third health care cost recovery case filed in Canada, Her Majesty the Queen in Right of Ontario v. Rothmans Inc., et al., Ontario Superior Court of Justice, Toronto, Canada, filed September 29, 2009, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Ontario based on legislation enacted in the province. This legislation is similar to the laws introduced in British Columbia and New Brunswick that authorize the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing.

In the fourth health care cost recovery case filed in Canada, Attorney General of Newfoundland and Labrador v. Rothmans Inc., et al., Supreme Court of Newfoundland and Labrador, St. Johns, Canada, filed February 8, 2011, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Newfoundland and Labrador based on legislation enacted in the province that is similar to the laws introduced in British Columbia, New Brunswick and Ontario. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing.

In the fifth health care cost recovery case filed in Canada, Attorney General of Quebec v. Imperial Tobacco Limited, et al., Superior Court of Quebec, Canada, filed June 8, 2012, we, our subsidiary, our indemnitee (PM USA), and other members of the industry are defendants. The claim was filed by the government of the province of Quebec based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing.

In the sixth health care cost recovery case filed in Canada, Her Majesty in Right of Alberta v. Altria Group, Inc., et al., Supreme Court of Queen's Bench Alberta, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Alberta based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Pre-trial discovery is ongoing.

In the seventh health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Manitoba v. Rothmans, Benson & Hedges, Inc., et al., The Queen's Bench, Winnipeg Judicial Centre, Canada, filed May 31, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Manitoba based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in September 2014. Pre-trial discovery is ongoing.

In the eighth health care cost recovery case filed in Canada, *The Government of Saskatchewan v. Rothmans, Benson & Hedges Inc., et al.*, Queen's Bench, Judicial Centre of Saskatchewan, Canada, filed June 8, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Saskatchewan based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the ninth health care cost recovery case filed in Canada, *Her Majesty the Queen in Right of the Province of Prince Edward Island v. Rothmans, Benson & Hedges Inc., et al.*, Supreme Court of Prince Edward Island (General Section), Canada, filed

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September 10, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Prince Edward Island based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. Discovery is scheduled to begin in 2017.

In the tenth health care cost recovery case filed in Canada, Her Majesty the Queen in Right of the Province of Nova Scotia v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Nova Scotia, Canada, filed January 2, 2015, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Nova Scotia based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in July 2015. Discovery is scheduled to begin in 2017.

In the first health care cost recovery case in Nigeria, The Attorney General of Lagos State v. British American Tobacco (Nigeria) Limited, et al., High Court of Lagos State, Lagos, Nigeria, filed March 13, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.

In the second health care cost recovery case in Nigeria, The Attorney General of Kano State v. British American Tobacco (Nigeria) Limited, et al., High Court of Kano State, Kano, Nigeria, filed May 9, 2007, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We are in the process of making challenges to service and the court's jurisdiction. Currently, the case is stayed in the trial court pending the appeals of certain co-defendants relating to service objections.

In the third health care cost recovery case in Nigeria, The Attorney General of Gombe State v. British American Tobacco (Nigeria) Limited, et al., High Court of Gombe State, Gombe, Nigeria, filed October 17, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In February 2011, the court ruled that the plaintiff had not complied with the procedural steps necessary to serve us. As a result of this ruling, plaintiff must re-serve its claim. We have not yet been re-served.

In the fourth health care cost recovery case in Nigeria, The Attorney General of Oyo State, et al., v. British American Tobacco (Nigeria) Limited, et al., High Court of Oyo State, Ibadan, Nigeria, filed May 25, 2007, we and other members of the industry are defendants. Plaintiffs seek reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. We challenged service as improper. In June 2010, the court ruled that plaintiffs did not have leave to serve the writ of summons on the defendants and that they must re-serve the writ. We have not yet been re-served.

In the fifth health care cost recovery case in Nigeria, The Attorney General of Ogun State v. British American Tobacco (Nigeria) Limited, et al., High Court of Ogun State, Abeokuta, Nigeria, filed February 26, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related

diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In May 2010, the trial court rejected our service objections. We have appealed.

In the health care cost recovery case in Korea, the National Health Insurance Service v. KT&G, et. al., filed April 14, 2014, our subsidiary and other Korean manufacturers are defendants. Plaintiff alleges that defendants concealed the health hazards of smoking, marketed to youth, added ingredients to make their products more harmful and addictive, and misled consumers into believing that Lights cigarettes are safer than regular cigarettes. The National Health Insurance Service seeks to recover approximately \$53.7 million allegedly incurred in treating 3,484 patients with small cell lung cancer, squamous cell lung cancer, and squamous cell laryngeal cancer from 2003 to 2012. The case is now in the evidentiary phase.

Label-Related Cases: These cases, brought by individual plaintiffs, or on behalf of a class or purported class of individual plaintiffs, allege that the use of the descriptor “Lights” or other alleged misrepresentations or omissions of labeling information constitute fraudulent and misleading conduct. Plaintiffs' allegations of liability in these cases are based on various theories of recovery

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including misrepresentation, deception, and breach of consumer protection laws. Plaintiffs seek various forms of relief including restitution, injunctive relief, and compensatory and other damages. Defenses raised include lack of causation, lack of reliance, assumption of the risk, and statute of limitations.

As of October 23, 2017, there was 1 case brought by an individual plaintiff in Italy (1) pending against our subsidiaries, compared with 3 such cases on October 21, 2016 and 3 such cases on October 27, 2015, and one purported class action in Israel (1).

An individual plaintiff filed the purported class action, Aharon Ringer v. Philip Morris Ltd. and Globrands Ltd., on July 18, 2017, in the Central District Court of Israel. Our Israeli affiliate and an Israeli importer and distributor for other multinational tobacco companies are defendants. Plaintiff seeks to represent a class of smokers in Israel who have purchased cigarettes imported by defendants since July 18, 2010. Plaintiff estimates the class size to be 7,000,000 smokers. Plaintiff alleges that defendants misled consumers by not disclosing sufficient information about carbon monoxide, tar, and nicotine yields of, and tobacco contained in, the imported cigarettes. Plaintiff seeks various forms of relief, including an order for defendants to label cigarette packs in accordance with plaintiff's demands, and damages for misleading consumers, breach of autonomy and unjust enrichment.

Public Civil Actions: Claims have been filed either by an individual, or a public or private entity, seeking to protect collective or individual rights, such as the right to health, the right to information or the right to safety. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including product defect, concealment, and misrepresentation. Plaintiffs in these cases seek various forms of relief including injunctive relief such as banning cigarettes, descriptors, smoking in certain places and advertising, as well as implementing communication campaigns and reimbursement of medical expenses incurred by public or private institutions.

As of October 23, 2017, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 2 such cases on October 21, 2016, and 2 such cases on October 27, 2015.

In the public civil action in Argentina, Asociación Argentina de Derecho de Danos v. Massalin Particulares S.A., et al., Civil Court of Buenos Aires, Argentina, filed February 26, 2007, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer association, seeks the establishment of a relief fund for reimbursement of medical costs associated with diseases allegedly caused by smoking. Our subsidiary filed its answer in September 2007. In March 2010, the case file was transferred to the Federal Court on Administrative Matters after the Civil Court granted plaintiff's request to add the national government as a co-plaintiff in the case. The case is currently in the evidentiary stage.

In the public civil action in Venezuela, Federation of Consumers and Users Associations ("FEVACU"), et al. v. National Assembly of Venezuela and the Venezuelan Ministry of Health, Constitutional Chamber of the Venezuelan Supreme Court, filed April 29, 2008, we were not named as a defendant, but the plaintiffs published a notice pursuant to court order, notifying all interested parties to appear in the case. In January 2009, our subsidiary appeared in the case in response to this notice. The plaintiffs purport to represent the right to health of the citizens of Venezuela and claim that the government failed to protect adequately its citizens' right to health. The claim asks the court to order the government to enact stricter regulations on the manufacture and sale of tobacco products. In addition, the plaintiffs ask the court to order companies involved in the tobacco industry to allocate a percentage of their "sales or benefits" to establish a fund to pay for the health care costs of treating smoking-related diseases. In October 2008, the court ruled that plaintiffs have standing to file the claim and that the claim meets the threshold admissibility requirements. In December 2012, the court admitted our subsidiary and BAT's subsidiary as interested third parties. In February 2013,

our subsidiary answered the complaint.

#### Other Litigation

The Department of Special Investigations of the government of Thailand ("DSI") conducted an investigation into alleged underpayment by our subsidiary, Philip Morris (Thailand) Limited ("PM Thailand"), of customs duties and excise taxes relating to imports from the Philippines covering the period 2003-2007. On January 18, 2016, the Public Prosecutor filed charges against our subsidiary and seven former and current employees in the Bangkok Criminal Court alleging that PM Thailand and the individual defendants jointly and with the intention to defraud the Thai government, under-declared import prices of cigarettes to avoid full payment of taxes and duties in connection with 272 import entries of cigarettes from the Philippines during the period of July 2003 to June 2006. The government is seeking a fine of approximately THB 80.8 billion (approximately \$2.43 billion). The case is in the pre-trial evidentiary phase. Trial is scheduled to begin during the last quarter of 2017. PM Thailand believes that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law and that

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the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

The DSI also conducted an investigation into alleged underpayment by PM Thailand of customs duties and excise taxes relating to imports from Indonesia covering the period 2000-2003. On January 26, 2017, the Public Prosecutor filed charges against PM Thailand and its former Thai employee in the Bangkok Criminal Court alleging that PM Thailand and its former employee jointly and with the intention to defraud the Thai government under-declared import prices of cigarettes to avoid full payment of taxes and duties in connection with 780 import entries during the period from January 2002 to July 2003. The government is seeking a fine of approximately THB 19.8 billion (approximately \$596 million). The case is in pre-trial proceedings and has not yet been set for trial. PM Thailand believes that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law, and that the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and a Thai court. In May 2017, the King of Thailand signed a new customs act. The new act, which is scheduled to take effect in November 2017, would substantially limit the amount of fines that Thailand could seek in these proceedings.

The South Korean Board of Audit and Inspection (“BAI”) conducted an audit of certain Korean government agencies and the tobacco industry into whether inventory movements ahead of the January 1, 2015 increase of cigarette-related taxes by tobacco companies, including Philip Morris Korea Inc. (“PM Korea”), our South Korean affiliate, were in compliance with South Korean tax laws. In November 2016, the tax authorities completed their audit and assessed allegedly underpaid taxes and penalties. In order to avoid nonpayment financial costs, PM Korea paid approximately KRW 272 billion (approximately \$240 million), of which KRW 100 billion (approximately \$88 million) was paid in 2016 and KRW 172 billion (approximately \$152 million) was paid in the first quarter of 2017. These amounts are included in other assets in the condensed consolidated balance sheets and in cash used in operating activities in the condensed consolidated statements of cash flows. PM Korea is appealing the assessments. The tax authorities have also referred the matter to the Public Prosecutor, who will further investigate and decide whether to file criminal charges against PM Korea and/or other alleged co-offenders. If the Public Prosecutor decides to prosecute, it may seek up to three times the underpaid tax for company criminal penalties and up to five times the underpaid tax for individual criminal penalties. PM Korea believes that it has paid cigarette-related taxes in compliance with the South Korean tax laws. In addition, the South Korean Ministry of Strategy and Finance (“MOSF”) filed a criminal complaint with the Public Prosecutor against PM Korea and its managing director. In its criminal complaint, the MOSF alleged that PM Korea exceeded the monthly product withdrawal limits that the MOSF had set in its notice. The Public Prosecutor will investigate the MOSF’s criminal complaint and decide whether to prosecute. PM Korea disagrees with the MOSF’s allegations.

We are also involved in additional litigation arising in the ordinary course of our business. While the outcomes of these proceedings are uncertain, management does not expect that the ultimate outcomes of other litigation, including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our consolidated results of operations, cash flows or financial position.

Note 9. Income Taxes:

Income tax provisions for jurisdictions outside the United States of America, as well as state and local income tax provisions, were determined on a separate company basis, and the related assets and liabilities were recorded in PMI’s condensed consolidated balance sheets.

PMI's effective tax rates for the nine months and three months ended September 30, 2017 were 27.1% and 28.5%, respectively. PMI's effective tax rates for the nine months and three months ended September 30, 2016 were 28.1% and 27.7%, respectively. PMI estimates that its full-year 2017 effective tax rate will be approximately 28%. The effective tax rate for the nine months ended September 30, 2017 was favorably impacted by the tax benefit of a legal entity restructuring (\$61 million). Excluding the effect of the legal entity restructuring, the change in the effective tax rate for the nine months ended September 30, 2017, as compared to the nine months ended September 30, 2016, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

The effective tax rates are based on PMI's full-year earnings mix projections by taxing jurisdiction and cash repatriation plans. Changes in currency exchange rates, earnings mix by taxing jurisdiction, or cash repatriation plans could have an impact on the effective tax rates, which PMI monitors each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

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PMI is regularly examined by tax authorities around the world and is currently under examination in a number of jurisdictions. The U.S. federal statute of limitations remains open for the years 2013 and onward. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from three to five years.

It is reasonably possible that within the next 12 months certain tax examinations will close, which could result in a change in unrecognized tax benefits, along with related interest and penalties. An estimate of any possible change cannot be made at this time.

## Note 10. Indebtedness:

## Short-term Borrowings:

PMI's short-term borrowings, consisting of commercial paper and bank loans to certain PMI subsidiaries at September 30, 2017, and bank loans to certain PMI subsidiaries at December 31, 2016, had a carrying value of \$2,905 million and \$643 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

## Long-term Debt:

At September 30, 2017 and December 31, 2016, PMI's long-term debt consisted of the following:

(in millions)	September 30, 2017	December 31, 2016
U.S. dollar notes, 1.250% to 6.375% (average interest rate 3.609%), due through 2044	\$ 21,802	\$ 19,857
Foreign currency obligations:		
Euro notes, 1.750% to 3.125% (average interest rate 2.402%), due through 2036	7,717	6,828
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.269%), due through 2024	1,387	1,312
Other (average interest rate 3.674%), due through 2024	164	427
	31,070	28,424
Less current portion of long-term debt	3,005	2,573
	\$ 28,065	\$ 25,851

Other foreign currency debt above includes mortgage debt in Switzerland and capital lease obligations at September 30, 2017 and December 31, 2016. Other foreign currency debt above also includes a bank loan in the Philippines at December 31, 2016.

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PMI's debt issuances in the first nine months of 2017 were as follows:  
(in millions)

Type	Face Value	Interest Rate	Issuance	Maturity
U.S. dollar notes <sup>(a)</sup>	\$700	1.625%	February 2017	February 2019
U.S. dollar notes <sup>(b)</sup>	\$300	Floating	February 2017	February 2020
U.S. dollar notes <sup>(a)</sup>	\$1,000	2.000%	February 2017	February 2020
U.S. dollar notes <sup>(a)</sup>	\$500	2.625%	February 2017	February 2022
U.S. dollar notes <sup>(c)</sup>	\$750	2.375%	August 2017	August 2022
U.S. dollar notes <sup>(c)</sup>	\$500	3.125%	August 2017	August 2027

<sup>(a)</sup> Interest on these notes is payable semi-annually in arrears beginning in August 2017.

<sup>(b)</sup> Interest on these notes is payable quarterly in arrears beginning in May 2017.

<sup>(c)</sup> Interest on these notes is payable semi-annually in arrears beginning in February 2018.

The net proceeds from the sale of the securities listed in the table above have been and will be used for general corporate purposes.

Credit Facilities:

On January 27, 2017, PMI entered into an agreement to extend the term of its \$2.0 billion 364-day revolving credit facility from February 7, 2017 to February 6, 2018.

At September 30, 2017, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 6, 2018	\$ 2.0
Multi-year revolving credit, expiring February 28, 2021	2.5
Multi-year revolving credit, expiring October 1, 2021	3.5
Total facilities	\$ 8.0

At September 30, 2017, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

On August 29, 2017, PMI entered into an agreement, effective October 1, 2017, to extend the term of its \$3.5 billion multi-year revolving credit facility, for an additional year covering the period October 1, 2021 to October 1, 2022.

Note 11. Fair Value Measurements:

The authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of input that may be used to measure fair value, which are as follows:



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- Level 1 - Quoted prices in active markets for identical assets or liabilities;  
 Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and  
 Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

PMI's policy is to reflect transfers between hierarchy levels at the end of the reporting period.

**Derivative Financial Instruments**

PMI assesses the fair value of its foreign exchange contracts and interest rate contracts using standard valuation models that use, as their basis, readily observable market inputs. The fair value of PMI's foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI's currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities and maturity dates. PMI's derivative financial instruments have been classified within Level 2 in the table shown below. See Note 5. Financial Instruments for additional discussion of derivative financial instruments.

**Debt**

The fair value of PMI's outstanding debt, which is utilized solely for disclosure purposes, is determined using quotes and market interest rates currently available to PMI for issuances of debt with similar terms and remaining maturities. The aggregate carrying value of PMI's debt, excluding short-term borrowings and \$14 million of capital lease obligations, was \$31,056 million at September 30, 2017. The fair value of PMI's outstanding debt, excluding the aforementioned short-term borrowings and capital lease obligations, was classified within Level 1 and Level 2 in the table shown below.

The aggregate fair values of PMI's derivative financial instruments and debt as of September 30, 2017, were as follows:

(in millions)	Fair Value at September 30, 2017	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Foreign exchange contracts	\$ 255	\$ —	\$ 255	\$ —
Total assets	\$ 255	\$ —	\$ 255	\$ —
<b>Liabilities:</b>				
Debt	\$ 33,133	\$ 32,961	\$ 172	\$ —
Foreign exchange contracts	1,067	—	1,067	—
Total liabilities	\$ 34,200	\$ 32,961	\$ 1,239	\$ —

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## Note 12. Accumulated Other Comprehensive Losses:

PMI's accumulated other comprehensive losses, net of taxes, consisted of the following:

(in millions)	At September 30, 2017	At December 31, 2016	At September 30, 2016
Currency translation adjustments	\$ (5,451 )	\$ (6,091 )	\$ (5,605 )
Pension and other benefits	(3,399 )	(3,565 )	(3,178 )
Derivatives accounted for as hedges	53	97	(106 )
Total accumulated other comprehensive losses	\$ (8,797 )	\$ (9,559 )	\$ (8,889 )

## Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that are due to current period activity and reclassifications to the income statement are shown on the condensed consolidated statements of comprehensive earnings for the nine months and three months ended September 30, 2017 and 2016. For additional information, see Note 3. Benefit Plans and Note 5. Financial Instruments for disclosures related to PMI's pension and other benefits, and derivative financial instruments, respectively.

## Note 13. Balance Sheet Offsetting:

## Derivative Financial Instruments

PMI uses foreign exchange contracts and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. Substantially all of PMI's derivative financial instruments are subject to master netting arrangements, whereby the right to offset occurs in the event of default by a participating party. While these contracts contain the enforceable right to offset through close-out netting rights, PMI elects to present them on a gross basis in the condensed consolidated balance sheets. Collateral associated with these arrangements is in the form of cash and is unrestricted. See Note 5. Financial Instruments for disclosures related to PMI's derivative financial instruments.

The effects of these derivative financial instrument assets and liabilities on PMI's condensed consolidated balance sheets were as follows:

(in millions)	Gross Amount Recognized	Gross Amount Offset in the Condensed Consolidated Balance Sheet	Net Amounts Presented in the Condensed Consolidated Balance Sheet	Gross Amounts Offset in the Condensed Consolidated Balance Sheet	Financial Instruments	Cash Received	Collateral Pledged	Net Amount
At September 30, 2017								
Assets								
Foreign exchange contracts	\$ 255	\$	—\$ 255	\$ (148)	\$ (96	)	\$ 11	
Liabilities								

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Foreign exchange contracts	\$ 1,067	\$	—\$ 1,067	\$(148)\$	(904	)	\$ 15
At December 31, 2016							
Assets							
Foreign exchange contracts	\$ 813	\$	—\$ 813	\$(126)\$	(607	)	\$ 80
Liabilities							
Foreign exchange contracts	\$ 163	\$	—\$ 163	\$(126)\$	(31	)	\$ 6

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## Note 14. Investments in Unconsolidated Subsidiaries:

At September 30, 2017 and December 31, 2016, PMI had total investments in unconsolidated subsidiaries of \$1,080 million and \$1,011 million, respectively, which were accounted for under the equity method of accounting. Equity method investments are initially recorded at cost. Under the equity method of accounting, the investment is adjusted for PMI's proportionate share of earnings or losses and movements in currency translation adjustments. The carrying value of our equity method investments at September 30, 2017 and December 31, 2016 exceeded our share of the unconsolidated subsidiaries' book value by \$874 million and \$867 million, respectively. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding \$825 million and \$810 million attributable to goodwill as of September 30, 2017 and December 31, 2016, respectively, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 10 to 20 years. At September 30, 2017 and December 31, 2016, PMI received year-to-date dividends from unconsolidated subsidiaries of \$43 million and \$117 million, respectively.

PMI holds a 49% equity interest in United Arab Emirates-based Emirati Investors-TA (FZC) ("EITA"). PMI holds an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie ("STAEM"), an Algerian joint venture that is 51% owned by EITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of PMI's brands.

At September 30, 2017, PMI held a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis, PMI's distributor in Russia.

The initial investments in EITA and Megapolis Distribution BV were recorded at cost and are included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

PMI's earnings activity from unconsolidated subsidiaries was as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
(in millions)	2017	2016	2017	2016
Net revenues	\$3,342	\$2,856	\$1,249	\$1,090

PMI's balance sheet activity related to unconsolidated subsidiaries was as follows:

	At September 30, 2017	At December 31, 2016
(in millions)		

Receivables	\$ 422	\$ 289
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The activity primarily related to agreements with PMI's unconsolidated subsidiaries within the Eastern Europe, Middle East & Africa segment. These agreements, which are in the ordinary course of business, are primarily for distribution, contract manufacturing and licenses. PMI eliminated its respective share of all significant intercompany transactions with the equity method investees.

Note 15. Sale of Accounts Receivable:

To mitigate risk and enhance cash and liquidity management PMI sells trade receivables to unaffiliated financial institutions. These arrangements allow PMI to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the condensed consolidated balance sheets. PMI sells trade receivables under two types of arrangements, servicing and non-servicing. For servicing arrangements, PMI continues to service the sold trade receivables on an administrative basis and does not act on behalf of the unaffiliated financial institutions. When applicable, a servicing liability is recorded for the estimated fair value of the servicing. The amounts associated with the servicing liability were not material as of September 30, 2017 and September 30, 2016. Under the non-servicing arrangements, PMI does not provide any administrative support or servicing after the trade receivables have been sold to the unaffiliated financial institutions.

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Cumulative trade receivables sold, including excise taxes, for the nine months ended September 30, 2017 and 2016, were \$7.1 billion and \$7.0 billion, respectively. PMI's operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the condensed consolidated balance sheets, which remained outstanding with the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of September 30, 2017 and September 30, 2016, were \$0.6 billion, and \$0.7 billion, respectively. The net proceeds received are included in cash provided by operating activities in the condensed consolidated statements of cash flows. The difference between the carrying amount of the trade receivables sold and the sum of the cash received is recorded as a loss on sale of trade receivables within marketing, administration and research costs in the condensed consolidated statements of earnings. For the nine months and three months ended September 30, 2017 and 2016, the loss on sale of trade receivables was immaterial.

Note 16. New Accounting Standards:

On February 25, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ASU 2016-02, "Leases" ("ASU 2016-02"). ASU 2016-02 requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Additionally, ASU 2016-02 modifies current guidance for lessors' accounting. ASU 2016-02 is effective for interim and annual reporting periods beginning on or after January 1, 2019, with early adoption permitted. PMI is currently assessing the impact that the adoption of ASU 2016-02 will have on its financial position and results of operations.

On January 5, 2016, the FASB issued Accounting Standard Update ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). ASU 2016-01 will require equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Additionally, ASU 2016-01 also changes certain disclosure requirements and other aspects of current U.S. GAAP. ASU 2016-01 is effective for interim and annual reporting periods beginning on or after January 1, 2018. PMI has identified certain cost investments, which are applicable to ASU 2016-01 and is currently assessing the impact that the adoption of ASU 2016-01 will have on its financial position and results of operations.

On May 28, 2014, the FASB issued Accounting Standards Update ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 contains principles that an entity will need to apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

ASU 2014-09 is effective for interim and annual reporting periods beginning on or after January 1, 2017. In July 2015, the FASB approved a proposal, which allows for a deferral of the implementation until January 1, 2018, and permits early application, but not before the original effective date of January 1, 2017. In addition to the guidance in ASU 2014-09, PMI has evaluated ASU 2016-12, which was issued in May 2016 and provides some practical expedients to the original standard. As a result of this evaluation, PMI intends to make an accounting policy election to exclude excise taxes collected from customers from the measurement of the transaction price, thereby presenting revenues, net of excise taxes. PMI plans to adopt ASU 2014-09 on January 1, 2018 retrospectively to each prior period presented. PMI has elected this transition method solely to reflect the change in excise tax presentation in all prior periods. Based on PMI's assessment to date, the underlying principles of the new standard, relating to the measurement of revenue and the timing of recognition, are closely aligned with PMI's current business model and

practices. As a result, PMI does not expect that the adoption of ASU 2014-09 will have other material impacts on its consolidated financial position or results of operations.

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Description of Our Company

We are a holding company whose subsidiaries and affiliates, and their licensees, are engaged in the manufacture and sale of cigarettes, other tobacco products and other nicotine-containing products in markets outside the United States of America. Currently, we manage our business in four segments:

- European Union;
- Eastern Europe, Middle East & Africa ("EEMA");
- Asia; and
- Latin America & Canada.

To provide a greater focus on both parts of our business -- combustible and reduced-risk products -- and to support our transformation toward a smoke-free future, effective January 1, 2018, we will be managing our business in six reportable segments as follows:

- European Union - Will cover all the European Union countries and also Switzerland, Norway and Iceland, which are linked to the European Union through trade agreements;
- Eastern Europe - Will include Southeast Europe, Central Asia, Ukraine, Israel and Russia;
- Middle East, Africa and Duty Free - Will cover the African continent, the Middle East, Turkey and PMI Duty Free;
- South & Southeast Asia - Will include Indonesia, the Philippines and other markets in this region;
- East Asia & Australia - Will include Australia, Japan, South Korea, the People's Republic of China and other markets in this region, as well as Malaysia and Singapore; and
- Latin America & Canada - Will cover the South American continent, Central America, Mexico, the Caribbean and Canada.

Our products are sold in more than 180 markets, and in many of these markets they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands. In addition to the manufacture and sale of cigarettes and other tobacco products, we are engaged in the development and commercialization of reduced-risk products ("RRPs"). RRPs is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRPs in various stages of development, scientific assessment and commercialization. Because our RRPs do not burn tobacco, they produce significantly lower levels of harmful or potentially harmful constituents than found in cigarette smoke.

We use the term net revenues to refer to our operating revenues from the sale of our products, net of sales and promotion incentives. Our net revenues and operating income are affected by various factors, including the volume of products we sell, the price of our products, changes in currency exchange rates and the mix of products we sell. Mix is a term used to refer to the proportionate value of premium-price brands to mid-price or low-price brands in any given market (product mix). Mix can also refer to the proportion of shipment volume in more profitable markets versus shipment volume in less profitable markets (geographic mix). We often collect excise taxes from our customers and then remit them to governments, and, in those circumstances, we include the excise taxes in our net revenues and in excise taxes on products. Our cost of sales consists principally of tobacco leaf, non-tobacco raw materials, labor and manufacturing costs.

Our marketing, administration and research costs include the costs of marketing and selling our products, other costs generally not related to the manufacture of our products (including general corporate expenses), and costs incurred to develop new products. The most significant components of our marketing, administration and research costs are marketing and sales expenses and general and administrative expenses.

Philip Morris International Inc. is a legal entity separate and distinct from its direct and indirect subsidiaries. Accordingly, our right, and thus the right of our creditors and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the prior rights of creditors of such subsidiary, except to the extent that claims of our company itself as a creditor may be recognized. As a holding company, our principal sources of funds, including funds to make payment on our debt securities, are from the receipt of dividends and repayment of debt from our subsidiaries. Our principal wholly-owned and majority-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or to make other distributions with respect to their common stock.

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## Executive Summary

The following executive summary provides significant highlights from the "Discussion and Analysis" that follows.

Consolidated Operating Results for the Nine Months Ended September 30, 2017 – The changes in our reported diluted earnings per share ("diluted EPS") for the nine months ended September 30, 2017, from the comparable 2016 amounts, were as follows:

	Diluted EPS	% Growth
For the nine months ended September 30, 2016	\$ 3.38	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
2017 Asset impairment and exit costs	—	
2017 Tax items	0.04	
Subtotal of 2017 items	0.04	
Currency	(0.23	)
Interest	0.03	
Change in tax rate	0.01	
Operations	0.20	
For the nine months ended September 30, 2017	\$ 3.43	1.5 %

Currency – The unfavorable currency impact during the reporting period results from the fluctuations of the U.S. dollar, especially against the Brazilian real, Egyptian pound, Euro, Japanese yen and Turkish lira, partially offset by the Russian ruble. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The favorable impact of interest was due primarily to lower effective interest rates on debt and higher interest income.

Income Taxes – Our effective income tax rate for the nine months ended September 30, 2017 decreased by 1.0 percentage point to 27.1%. The 2017 tax items that increased our diluted EPS by \$0.04 per share in the table above was due to a legal entity restructuring (\$61 million). The change in the effective tax rate that increased our diluted EPS by \$0.01 per share in the table above was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences. We estimate that our full-year 2017 effective tax rate will be approximately 28%.

Operations – The increase in diluted EPS of \$0.20 from our operations in the table above was due primarily to the following segments:

• Asia: Higher pricing and favorable volume/mix, partially offset by higher marketing, administration and research costs; and

• Latin America & Canada: Higher pricing, partially offset by unfavorable volume/mix and higher manufacturing costs; partially offset by

• European Union: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by higher pricing and lower manufacturing costs; and

• EEMA: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by higher pricing.





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Consolidated Operating Results for the Three Months Ended September 30, 2017 – The changes in our reported diluted EPS for the three months ended September 30, 2017, from the comparable 2016 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended September 30, 2016	\$ 1.25	
2016 Asset impairment and exit costs	—	
2016 Tax items	—	
Subtotal of 2016 items	—	
2017 Asset impairment and exit costs	—	
2017 Tax items	—	
Subtotal of 2017 items	—	
Currency	(0.12 )	
Interest	—	
Change in tax rate	(0.02 )	
Operations	0.16	
For the three months ended September 30, 2017	\$ 1.27	1.6 %

Currency – The unfavorable currency impact of \$0.12 per share during the reporting period results from the fluctuations of the U.S. dollar, especially against the Egyptian pound (approximately \$0.08 per share of the unfavorable impact), Euro and Japanese yen, partially offset by the Russian ruble. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Income Taxes – Our effective income tax rate for the three months ended September 30, 2017 increased by 0.8 percentage points to 28.5%. The change in the effective tax rate that decreased our diluted EPS by \$0.02 per share in the table above was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

Operations – The increase in diluted EPS of \$0.16 from our operations in the table above was due primarily to the following segments:

• Asia: Favorable volume/mix, higher pricing and lower manufacturing costs; and

• Latin America & Canada: Higher pricing, partially offset by unfavorable volume/mix; partially offset by

• EEMA: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by higher pricing; and

• European Union: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by higher pricing and lower manufacturing costs.

For further details, see the “Consolidated Operating Results” and “Operating Results by Business Segment” sections of the following “Discussion and Analysis.”

2017 Forecasted Results - On October 19, 2017, we revised our 2017 full-year reported diluted EPS forecast to a range of \$4.75 to \$4.80, at prevailing exchange rates at that time, versus \$4.48 in 2016. Excluding an unfavorable currency impact, at then-prevailing exchange rates, of approximately \$0.17 per share for the full-year 2017, as well as the favorable tax item of \$0.04 recorded in the first quarter of 2017, the forecast range represents a projected increase of approximately 9% to 10% versus adjusted diluted earnings per share of \$4.48 in 2016. This forecast anticipates net revenue growth, excluding excise taxes, of over 7%, excluding currency and acquisitions. This forecast does not include any share repurchases in 2017.

Our 2016 reported and adjusted diluted EPS was \$4.48. During 2016, we did not have an EPS impact related to asset impairment and exit costs, and tax items.

Adjusted diluted EPS is not a measure under accounting principles generally accepted in the United States of America ("U.S. GAAP"). We define adjusted diluted EPS as reported diluted EPS adjusted for asset impairment and exit costs, tax items and

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unusual items. We believe it is appropriate to disclose this measure as it represents core earnings, improves comparability and helps investors analyze business performance and trends. Adjusted diluted EPS should be considered neither in isolation nor as a substitute for reported diluted EPS prepared in accordance with U.S. GAAP. This 2017 guidance excludes the impact of any future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in the "Cautionary Factors That May Affect Future Results" section of the following "Discussion and Analysis" represent continuing risks to this forecast.

## Discussion and Analysis

## Consolidated Operating Results

See pages 77-81 for a discussion of our "Cautionary Factors That May Affect Future Results." Our net revenues, excise taxes on products and operating companies income by segment are shown in the table below:

(in millions)	For the Nine		For the Three	
	Months Ended		Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net revenues:				
European Union	\$20,156	\$20,664	\$7,346	\$7,387
Eastern Europe, Middle East & Africa	13,177	13,650	4,990	5,122
Asia	16,051	15,014	5,846	5,113
Latin America & Canada	7,129	6,436	2,456	2,313
Net revenues	\$56,513	\$55,764	\$20,638	\$19,935
Excise taxes on products:				
European Union	\$14,102	\$14,446	\$5,142	\$5,187
Eastern Europe, Middle East & Africa	8,242	8,448	3,207	3,186
Asia	8,696	8,777	3,116	2,977
Latin America & Canada	5,019	4,379	1,700	1,603
Excise taxes on products	\$36,059	\$36,050	\$13,165	\$12,953
Operating income:				
Operating companies income:				
European Union	\$2,783	\$3,096	\$1,042	\$1,120
Eastern Europe, Middle East & Africa	2,188	2,389	765	962
Asia	2,753	2,288	1,065	761
Latin America & Canada	709	677	264	224
Amortization of intangibles	(65)	(56)	(21)	(19)
General corporate expenses	(126)	(119)	(35)	(36)
Less:				
Equity (income)/loss in unconsolidated subsidiaries, net	(57)	(72)	(12)	(35)
Operating income	\$8,185	\$8,203	\$3,068	\$2,977

As discussed in Note 7. Segment Reporting to our condensed consolidated financial statements, we evaluate segment performance and allocate resources based on operating companies income, which we define as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. We believe it is appropriate to disclose this measure to help investors analyze the business performance and trends of our various business segments.



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Our shipment volume by segment for cigarettes and heated tobacco units is shown in the table below:

## PMI Shipment Volume (Million Units)

	For the Nine Months Ended September 30, 2017		For the Three Months Ended September 30, 2016	
<b>Cigarettes</b>				
European Union	141,412	148,393	49,114	52,001
Eastern Europe, Middle East & Africa	189,825	203,630	68,837	72,172
Asia	173,019	196,214	60,062	61,693
Latin America & Canada	61,301	64,144	20,452	21,185
<b>Total Cigarettes</b>	<b>565,557</b>	<b>612,381</b>	<b>198,465</b>	<b>207,051</b>
<b>Heated Tobacco Units</b>				
European Union	1,040	103	464	56
Eastern Europe, Middle East & Africa	761	37	427	27
Asia	18,697	3,558	8,826	2,006
Latin America & Canada	12	—	8	—
<b>Total Heated Tobacco Units</b>	<b>20,510</b>	<b>3,698</b>	<b>9,725</b>	<b>2,089</b>
<b>Cigarettes and Heated Tobacco Units</b>				
European Union	142,452	148,496	49,578	52,057
Eastern Europe, Middle East & Africa	190,586	203,667	69,264	72,199
Asia	191,716	199,772	68,888	63,699
Latin America & Canada	61,313	64,144	20,460	21,185
<b>Total Cigarettes and Heated Tobacco Units</b>	<b>586,067</b>	<b>616,079</b>	<b>208,190</b>	<b>209,140</b>

Heated tobacco units is the term we use to refer to our heated tobacco consumables, which include HEETS, HEETS Marlboro and HEETS FROM MARLBORO, defined collectively as HEETS, as well as Marlboro HeatSticks and Parliament HeatSticks.

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Our net revenues by product category, which include excise taxes billed to customers, are shown in the table below:

## PMI Net Revenues by Product Category

(in millions)	For the Nine		For the Three	
	Months Ended		Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
<b>Combustible Products</b>				
European Union	\$19,983	\$20,630	\$7,269	\$7,374
Eastern Europe, Middle East & Africa	13,109	13,646	4,947	5,118
Asia	14,232	14,660	4,974	4,917
Latin America & Canada	7,126	6,435	2,454	2,312
<b>Total Combustible Products</b>	<b>\$54,451</b>	<b>\$55,371</b>	<b>\$19,644</b>	<b>\$19,722</b>
<b>Reduced-Risk Products</b>				
European Union	\$173	\$35	\$79	\$14
Eastern Europe, Middle East & Africa	69	3	43	4
Asia	1,819	354	871	196
Latin America & Canada	2	2	1	—
<b>Total Reduced-Risk Products</b>	<b>\$2,063</b>	<b>\$394</b>	<b>\$994</b>	<b>\$214</b>
<b>Total PMI Net Revenues</b>	<b>\$56,513</b>	<b>\$55,764</b>	<b>\$20,638</b>	<b>\$19,935</b>

Note: Sum of product categories or Regions might not foot to total PMI due to rounding.

Net revenues related to combustible products refer to the operating revenues generated from the sale of these products, net of sales and promotion incentives. These net revenue amounts consist of the sale of our cigarettes and other tobacco products combined. Other tobacco products primarily include roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos and do not include reduced-risk products.

Net revenues related to reduced-risk products refer to the operating revenues generated from the sale of these products, net of sales and promotion incentives. These net revenue amounts consist of the sale of our heated tobacco units, IQOS devices and related accessories, and other nicotine-containing products, which primarily include our e-vapor products.

References to total international market, defined as worldwide cigarette and our heated tobacco unit volume excluding the United States, total industry, total market and market shares throughout this "Discussion and Analysis" are our tax-paid estimates based on the latest available data from a number of internal and external sources.

## Consolidated Operating Results for the Nine Months Ended September 30, 2017

The following discussion compares our consolidated operating results for the nine months ended September 30, 2017, with the nine months ended September 30, 2016.

Our total shipment volume decreased by 4.9%, principally due to:

- European Union, notably lower cigarette shipment volume in Germany, Italy and Spain, partly offset by higher heated tobacco unit shipment volume;

- EMEA, notably Saudi Arabia where our cigarette shipment volume declined by 27.6%, reflecting the impact of the new excise tax implemented in June 2017 that resulted in the doubling of retail prices, as well as Russia, Turkey and

Ukraine, partly offset by North Africa, notably Algeria, and higher heated tobacco unit shipment volume; Asia, notably lower cigarette shipment volume in Indonesia, Japan, Pakistan and the Philippines, partly offset by higher heated tobacco unit shipment volume, mainly in Japan; and Latin America & Canada, mainly due to lower cigarette shipment volume in Brazil, Canada, Colombia and Mexico.

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Excluding the impact of estimated net inventory movements, our total shipment volume decreased by 4.6%.

Our cigarette shipment volume by brand and heated tobacco unit shipment volume are shown in the table below:

## PMI Shipment Volume by Brand (Million Units)

	Nine Months Year-to-Date			
	2017	2016	Change	
Cigarettes				
Marlboro	200,115	211,426	(5.3)	)%
L&M	69,091	73,592	(6.1)	)%
Chesterfield	40,311	34,203	17.9	%
Parliament	31,723	34,247	(7.4)	)%
Bond Street	28,675	32,792	(12.6)	)%
Philip Morris	36,133	26,845	34.6	%
Lark	18,534	21,031	(11.9)	)%
Others	140,975	178,245	(20.9)	)%
Total Cigarettes	565,557	612,381	(7.6)	)%
Heated Tobacco Units	20,510	3,698	+100.0%	
Total Cigarettes and Heated Tobacco Units	586,067	616,079	(4.9)	)%

Cigarette shipment volume of Marlboro decreased in: the European Union, mainly due to Germany, Italy and Spain; EEMA, predominantly due to Saudi Arabia, reflecting the impact of the new excise tax implemented in June 2017 that resulted in the doubling of the retail price of Marlboro from SAR 12 to SAR 24 per pack, partly offset by North Africa; Asia, mainly due to Japan, principally reflecting out-switching to HeatSticks, and Korea, partly offset by Indonesia and the Philippines; and Latin America & Canada, mainly due to Argentina, Brazil and Mexico.

Cigarette shipment volume of the following brands decreased: L&M, mainly due to Russia, Saudi Arabia and Turkey, partly offset by Kazakhstan; Parliament, mainly due to Japan, Russia and Turkey, partly offset by Kazakhstan and Korea; Bond Street, mainly due to Kazakhstan, Russia and Ukraine; Lark, principally due to Japan and Turkey; and "Others," mainly due to Indonesia and local, low-price brands in Pakistan, the Philippines, Russia and Ukraine.

Cigarette shipment volume of the following brands increased: Chesterfield, notably driven by Argentina, Saudi Arabia and Turkey, partly offset by Italy and Russia; and Philip Morris, mainly driven by Russia and Ukraine, notably reflecting successful portfolio consolidation of local, low-price brands in "Others," partly offset by Argentina and Italy.

Our net revenues and excise taxes on products were as follows:

(in millions)	For the Nine Months Ended			Variance
	2017	2016	Change	
Net revenues	\$56,513	\$55,764	\$749	1.3%
Excise taxes on products	36,059	36,050	9	—%
Net revenues, excluding excise taxes on products	\$20,454	\$19,714	\$740	3.8%



Net revenues, which include excise taxes billed to customers, increased by \$749 million. Excluding excise taxes, net revenues increased by \$740 million due to:

price increases (\$1,084 million) and  
favorable volume/mix (\$107 million), partly offset by  
unfavorable currency (\$451 million).

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The unfavorable currency was due primarily to the Argentine peso, Egyptian pound, Euro, Philippine peso and Turkish lira, partially offset by the Russian ruble.

Net revenues include \$2,063 million in 2017 and \$394 million in 2016 related to sales of RRPs, mainly driven by Japan. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for RRPs were \$1,997 million in 2017 and \$390 million in 2016. In some jurisdictions, including Japan, we are not responsible for collecting excise taxes.

Excise taxes on products increased by \$9 million due to:

• higher excise taxes resulting from changes in retail prices and tax rates (\$3.6 billion), partially offset by  
 • favorable currency (\$1.8 billion) and  
 • lower excise taxes resulting from volume/mix (\$1.8 billion).

Our cost of sales; marketing, administration and research costs; and operating income were as follows:

(in millions)	For the Nine Months Ended September 30,			Variance %
	2017	2016		
Cost of sales	\$7,431	\$6,892	\$539	7.8 %
Marketing, administration and research costs	4,773	4,563	210	4.6 %
Operating income	8,185	8,203	(18 )	(0.2)%

Cost of sales increased \$539 million due primarily to:

• higher cost of sales resulting from volume/mix (\$591 million), partly offset by  
 • favorable currency (\$44 million).

Marketing, administration and research costs increased by \$210 million due to:

• higher expenses (\$263 million, largely reflecting increased support behind reduced-risk products), partly offset by  
 • favorable currency (\$53 million).

Operating income decreased by \$18 million due primarily to:

• unfavorable volume/mix (\$484 million),  
 • unfavorable currency (\$353 million) and  
 • higher marketing, administration and research costs (\$263 million), partly offset by  
 • price increases (\$1,084 million).

Our effective tax rate decreased by 1.0 percentage point to 27.1%. We estimate that our full-year 2017 effective tax rate will be approximately 28%. The effective tax rate for the nine months ended September 30, 2017, was favorably impacted by a legal entity restructuring (\$61 million). The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in currency exchange rates, earnings mix by taxing jurisdiction, or cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

We are regularly examined by tax authorities around the world, and we are currently under examination in a number of jurisdictions. It is reasonably possible that within the next 12 months certain tax examinations will close, which could result in a change in unrecognized tax benefits along with related interest and penalties. An estimate of any possible change cannot be made at this time.

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Interest expense, net, of \$655 million decreased by \$35 million (5.1%), due primarily to lower effective interest rates on debt and higher interest income.

Net earnings attributable to PMI of \$5.3 billion increased by \$85 million (1.6%). This increase was due primarily to a lower effective tax rate and lower interest expense, net, partially offset by a lower operating income as discussed above. Diluted and basic EPS of \$3.43 increased by 1.5%. Excluding an unfavorable currency impact of \$0.23, diluted EPS increased by 8.3%.

#### Consolidated Operating Results for the Three Months Ended September 30, 2017

The following discussion compares our consolidated operating results for the three months ended September 30, 2017, with the three months ended September 30, 2016.

Our total shipment volume decreased by 0.5%, principally due to:

• European Union, notably lower cigarette shipment volume in Germany, Italy and Spain, partly offset by higher heated tobacco unit shipment volume;

• EEMA, notably Saudi Arabia where our cigarette shipment volume declined by 48.3%, reflecting the impact of the new excise tax implemented in June 2017 that resulted in the doubling of retail prices, as well as Russia and Ukraine, partly offset by North Africa and higher heated tobacco unit shipment volume; and

• Latin America & Canada, mainly due to lower cigarette shipment volume in Mexico, partly offset by Argentina and Brazil.

The decline of our total shipment volume was largely offset by growth in Asia, mainly driven by: Japan, reflecting higher heated tobacco unit shipment volume, Indonesia, and Pakistan, notably reflecting a lower price gap with illicit product following a modification to the excise tax structure, partly offset by the Philippines.

Our total shipment volume benefited from the favorable impact of estimated net combustible and heated tobacco unit inventory movements, driven by approximately 2.1 billion units in Japan. The favorable estimated net inventory movements in Japan, anticipated to continue in the fourth quarter of 2017, primarily reflected the growing demand for HeatSticks and a manufacturing capability sufficient to begin establishing normal levels of distributor inventory of heated tobacco units for risk management purposes, partly offset by a reduction of distributor inventory of combustible products. Excluding the impact of total estimated net inventory movements, our total shipment volume decreased by 1.3%.

Our cigarette shipment volume by brand and heated tobacco unit shipment volume are shown in the table below:

#### PMI Shipment Volume by Brand (Million Units)

	Third-Quarter			
	2017	2016	Change	
Cigarettes				
Marlboro	68,886	73,338	(6.1	)%
L&M	23,809	25,349	(6.1	)%
Chesterfield	15,116	12,425	21.7	%
Parliament	11,354	12,200	(6.9	)%
Bond Street	9,912	11,709	(15.3	)%
Philip Morris	12,838	8,726	47.1	%
Lark	6,321	6,994	(9.6	)%
Others	50,229	56,310	(10.8	)%
Total Cigarettes	198,465	207,051	(4.1	)%
Heated Tobacco Units	9,725	2,089	+100.0%	

Total Cigarettes and Heated Tobacco Units 208,190,209,140(0.5 )%

Cigarette shipment volume of Marlboro decreased in: the European Union, mainly due to Germany, Italy and Spain; EEMA, predominantly due to Saudi Arabia, reflecting the impact of the new excise tax implemented in June 2017 that resulted in the doubling of the retail price of Marlboro from SAR 12 to SAR 24 per pack; Asia, mainly due to Japan, principally reflecting out-switching to HeatSticks, partly offset by Indonesia and the Philippines; and Latin America & Canada, mainly due to Mexico.

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Cigarette shipment volume of the following brands decreased: L&M, mainly due to Russia, Saudi Arabia and Turkey, partly offset by North Africa; Parliament, mainly due to Japan and Russia, partly offset by Kazakhstan and Turkey; Bond Street, mainly due to Russia and Ukraine; Lark, principally due to Japan, partly offset by Turkey; and "Others," mainly due to local, low-price brands in the Philippines, Russia and Ukraine, partly offset by Indonesia and low-price brands in Pakistan.

Cigarette shipment volume of the following brands increased: Chesterfield, mainly driven by Argentina, Brazil, reflecting successful brand portfolio consolidation, Saudi Arabia and Turkey, partly offset by Russia; and Philip Morris, mainly driven by Russia and Ukraine, notably reflecting successful portfolio consolidation of local, low-price brands in "Others," partly offset by Argentina and Italy.

Our net revenues and excise taxes on products were as follows:

(in millions)	For the Three Months Ended September 30,			
	2017	2016	Variance	
Net revenues	\$20,638	\$19,935	\$703	3.5%
Excise taxes on products	13,165	12,953	212	1.6%
Net revenues, excluding excise taxes on products	\$7,473	\$6,982	\$491	7.0%

Net revenues, which include excise taxes billed to customers, increased by \$703 million. Excluding excise taxes, net revenues increased by \$491 million due to:

• favorable volume/mix (\$318 million) and  
 • price increases (\$309 million), partly offset by  
 • unfavorable currency (\$136 million).

The unfavorable currency was due primarily to the Egyptian pound, Japanese yen and Turkish lira, partially offset by the Euro and Russian ruble.

Net revenues include \$994 million in 2017 and \$214 million in 2016 related to sale of RRPs, mainly driven by Japan. These amounts include excise taxes billed to customers. Excluding excise taxes, net revenues for RRPs were \$947 million in 2017 and \$212 million in 2016. In some jurisdictions, including Japan, we are not responsible for collecting excise taxes.

Excise taxes on products increased by \$212 million due to:

• higher excise taxes resulting from changes in retail prices and tax rates (\$1.1 billion), partially offset by  
 • favorable currency (\$480 million) and  
 • lower excise taxes resulting from volume/mix (\$405 million).

Our cost of sales; marketing, administration and research costs; and operating income were as follows:

(in millions)	For the Three Months Ended September 30,			
	2017	2016	Variance	
Cost of sales	\$2,735	\$2,432	\$303	12.5%

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Marketing, administration and research costs	1,649	1,554	95	6.1	%
Operating income	3,068	2,977	91	3.1	%

Cost of sales increased by \$303 million due primarily to:

higher cost of sales resulting from volume/mix (\$338 million), partly offset by lower manufacturing costs (\$44 million).

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Marketing, administration and research costs increased by \$95 million due primarily to:

higher expenses (\$98 million, largely reflecting increased support behind reduced-risk products, predominantly in the European Union); partly offset by favorable currency.

Operating income increased by \$91 million due primarily to:

price increases (\$309 million) and lower manufacturing costs (\$44 million), partly offset by unfavorable currency (\$141 million), higher marketing, administration and research costs (\$98 million) and unfavorable volume/mix (\$20 million).

Our effective tax rate increased by 0.8 percentage points to 28.5%. The effective tax rate is based on our full-year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in currency exchange rates, earnings mix by taxing jurisdiction, or cash repatriation plans could have an impact on the effective tax rate, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

Net earnings attributable to PMI of \$2.0 billion increased by \$32 million (1.7%). This increase was primarily due to a higher operating income as discussed above, partially offset by a higher effective tax rate. Diluted and basic EPS of \$1.27 increased by 1.6%. Excluding an unfavorable currency impact of \$0.12, diluted EPS increased by 11.2%.

## Operating Results by Business Segment

### Business Environment

#### Taxes, Legislation, Regulation and Other Matters Regarding the Manufacture, Marketing, Sale and Use of Tobacco Products

The tobacco industry and our business face a number of challenges that may adversely affect our business, volume, results of operations, cash flows and financial position. These challenges, which are discussed below and in “Cautionary Factors That May Affect Future Results,” include:

regulatory restrictions on our products, including restrictions on the packaging, marketing, and sale of tobacco or other nicotine-containing products that could reduce our competitiveness, eliminate our ability to communicate with adult consumers, or even ban certain of our products;

fiscal challenges, such as excessive excise tax increases and discriminatory tax structures;

illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so-called “illicit whites”;

intense competition, including from non-tax paid volume by certain local manufacturers;

pending and threatened litigation as discussed in Note 8. Contingencies; and

governmental investigations.

**Regulatory Restrictions:** The tobacco industry operates in a highly regulated environment. The well-known risks of smoking have led regulators to impose significant restrictions and high excise taxes on cigarettes.

We support a comprehensive regulatory framework for tobacco products based on the principle of harm reduction, including mandated health warnings, minimum age laws, restrictions on advertising, and public place smoking restrictions. We also support regulatory measures that help reduce illicit trade.



Much of the regulation that shapes the business environment in which we operate is driven by the World Health Organization's ("WHO") Framework Convention on Tobacco Control ("FCTC"), which entered into force in 2005. The FCTC is the first international public health treaty and has as its main objective to establish a global agenda for tobacco regulation, with the purpose of reducing tobacco use. To date, 180 countries and the European Union are Parties to the FCTC. The treaty requires Parties to

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have in place various tobacco control measures and recommends others. The FCTC governing body, the Conference of the Parties (“CoP”), has also adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC that go beyond the text of the treaty.

We have opposed certain measures and continue to engage in a dialogue with regulators with respect to those measures that we do not believe would protect public health and, if implemented, could disrupt competition, severely limit our ability to market and sell our products to adult smokers, or increase illicit trade. Certain measures are discussed in more detail below. It is not possible to predict whether or to what extent measures recommended in the FCTC guidelines will be implemented.

**Fiscal Challenges:** Excessive and disruptive excise, sales and other tax increases and discriminatory tax structures are expected to continue to have an adverse impact on our profitability, due to lower consumption and consumer down-trading to non-premium, discount, other low-price or low-taxed combustible tobacco products such as fine cut tobacco, and illicit cigarettes. In addition, in certain jurisdictions, some of our combustible products are subject to tax structures that discriminate against premium-price products and manufactured cigarettes. We believe that such tax policies undermine public health by encouraging consumers to turn to the illicit trade, and ultimately undercut government revenue objectives, disrupt the competitive environment, and encourage criminal activity. Other jurisdictions have imposed, or are seeking to impose, levies or other taxes specifically on tobacco companies, such as taxes on revenues and/or profits.

**EU Tobacco Products Directive:** In April 2014, the EU adopted the text of a significantly revised EU Tobacco Products Directive (TPD), which entered into force in May 2016. All 28 Member States and Norway have adopted laws transposing the TPD. The TPD sets forth a comprehensive set of regulatory requirements for tobacco products, including:

- health warnings covering 65% of the front and back panels of cigarette packs, with an option for Member States to further standardize tobacco packaging, including the introduction of plain packaging;
- a ban on characterizing flavors in some tobacco products, with a transition period for menthol expiring in May 2020;
- security features and tracking and tracing measures some of which could increase operational expenses depending on the scope of the implementing regulation; and
- a framework for the regulation of novel tobacco products and e-cigarettes, including requirements for health warnings and information leaflets, a prohibition on product packaging text related to reduced risk, and the introduction of notification requirements or authorization procedures in advance of commercialization.

**Plain Packaging and Other Packaging Restrictions:** Plain packaging legislation bans the use of branding, logos and colors on packaging other than the brand name and variant that may be printed only in specified locations and in a uniform font. To date, Australia, France, Georgia, Hungary, Ireland, New Zealand, Norway, Slovenia and the U.K. have adopted plain packaging laws, which are in various degrees of implementation.

Several countries have initiated World Trade Organization (“WTO”) dispute settlement proceedings against Australia related to Australia's plain packaging legislation. The matter is still pending before the WTO panel.

Other countries are also considering adopting plain packaging legislation, including, but not limited to, Canada, Singapore, South Africa and Turkey.

Some countries have adopted, or are considering adopting, packaging restrictions that could have an impact similar to plain packaging. Examples of such restrictions include standardizing the shape and size of packages, prohibiting certain colors or the use of certain descriptive phrases on packaging, and requiring very large graphic health warnings

that leave little space for branding.

**Restrictions and Bans on the Use of Ingredients:** The WHO and others in the public health community have recommended restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Broad restrictions and ingredient bans would require us to reformulate our American blend tobacco products and could reduce our ability to differentiate these products in the market in the long term. Menthol bans would eliminate the entire category of mentholated tobacco products. The European Union has banned flavored tobacco products, subject to an exemption until May 2020 for menthol. Other countries may follow the EU's approach. For instance, Turkey has banned menthol as of May 2020. Broader ingredient bans have been adopted by Canada and Brazil. While the Canadian ingredient ban initially exempted menthol, amendments to the federal Tobacco Act ban menthol in cigarettes as of October 2017. In addition, the Canadian parliament is considering further amendments to the Act that would extend the menthol ban to all tobacco products. The majority of Canadian provinces have also adopted or are in the process of adopting menthol bans. The Brazil ingredients ban, which would prohibit the use of virtually all ingredients with flavoring or aromatic properties, is not in force due to a legal challenge by a tobacco industry union, of which our Brazilian

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subsidiary is a member. Other lawsuits are also pending against the Brazil ingredients ban. It is not possible to predict the outcome of these legal proceedings.

**Bans on Display of Tobacco Products at Retail:** In a number of our markets, including, but not limited to, Australia, Canada, Norway, Russia, and Singapore, governments have banned the display of tobacco products at the point of sale. Other countries are also considering similar bans.

**Bans and Restrictions on Advertising, Marketing, Promotions and Sponsorships:** For many years, the FCTC has called for, and countries have imposed, partial or total bans on tobacco advertising, marketing, promotions and sponsorships, including bans and restrictions on advertising on radio and television, in print and on the Internet. The FCTC's non-binding guidelines recommend that governments prohibit all forms of communication with adult smokers.

**Restrictions on Product Design:** Some members of the public health community are calling for the further standardization of tobacco products by requiring, for example, that cigarettes have a certain minimum diameter, which would amount to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. In addition, at its meeting in November 2016, the CoP adopted non-binding guidelines recommending that countries regulate product design features that increase the attractiveness of tobacco products, such as the diameter of cigarettes and the use of flavor capsules. Reduced cigarette ignition propensity standards previously recommended by the FCTC guidelines have been adopted in several of our markets (e.g., Australia, Canada, South Africa, South Korea, and the EU), and are being considered in others.

**Restrictions on Public Smoking:** The pace and scope of public smoking restrictions have increased significantly in most of our markets. Many countries around the world have adopted, or are likely to adopt, regulations that restrict or ban smoking in public and/or work places, restaurants, bars and nightclubs. Some public health groups have called for, and some countries, regional governments and municipalities have adopted or proposed, bans on smoking in outdoor places, as well as bans on smoking in cars (typically, when minors are present) and private homes.

**Other Regulatory Issues:** Some regulators are considering, or in some cases have adopted, regulatory measures designed to reduce the supply of tobacco products. These include regulations intended to reduce the number of retailers selling tobacco products by, for example, reducing the overall number of tobacco retail licenses available or banning the sale of tobacco products within arbitrary distances of certain public facilities.

In a limited number of markets, most notably Japan, we are dependent on governmental approvals that may limit our pricing flexibility.

**Illicit Trade:** The illicit tobacco trade creates a cheap and unregulated supply of tobacco products, undermines efforts to reduce smoking prevalence, especially among youth, damages legitimate businesses, stimulates organized crime, increases corruption and reduces government tax revenue. Illicit trade may account for as much as 10% of global cigarette consumption; this includes counterfeit, contraband and the growing problem of “illicit whites,” which are cigarettes legally produced in one jurisdiction for the sole purpose of being exported and illegally sold in another jurisdiction where they have no legitimate market. We estimate that illicit trade in the European Union accounted for slightly less than 10% of total cigarette consumption in 2016.

A number of jurisdictions are considering actions to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the “Protocol”), which includes supply chain control measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty free and Internet sales and the implementation of tracking and tracing technologies. To date, 54 Parties have signed the Protocol, and 32 Parties, including the European Union, have ratified it. The Protocol will come into force once the fortieth Party

ratifies it, after which countries must implement its measures via national legislation. We expect, and welcome, that other Parties will ratify the Protocol.

In 2009, our Colombian subsidiaries entered into an Investment and Cooperation Agreement with the national and regional governments of Colombia to promote investment in, and cooperation on, anti-contraband and anti-counterfeit efforts. The agreement provides \$200 million in funding over a 20-year period to address issues such as combating the illegal cigarette trade and increasing the quality and quantity of locally-grown tobacco.

In May 2016, PMI launched PMI IMPACT, a new global initiative that supports third-party projects dedicated to fighting illegal trade and related crimes such as corruption, organized criminal networks and money laundering. The centerpiece of PMI IMPACT is a council of external independent experts with impeccable credentials in the fields of law, anti-corruption and law enforcement. The experts are responsible for evaluating and approving funding proposals for PMI IMPACT grants. PMI has pledged \$100 million to fund projects within PMI IMPACT over three funding rounds. The first round of grants were awarded in the second quarter of 2017.

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In November 2016, PMI signed a joint Declaration of Intent to Prevent the Maritime Transportation of Counterfeit Goods together with eight other global brand owners and five of the world's largest shipping companies. This commitment was a result of a dialogue with the International Chamber of Commerce's Business Action to Stop Counterfeiting and Piracy. The signatories aim to tackle the infiltration of shipping services by criminal networks that exploit vessels to transport counterfeit goods, including "illicit whites," across the oceans.

Reduced-Risk Products (RRPs)

**Our Approach to RRPs:** We recognize that smoking cigarettes causes serious diseases and that the best way to avoid the harms of smoking is never to start, or to quit. Nevertheless, it is predicted that over the next decade the number of smokers will remain largely unchanged from the current estimate of 1.1 billion, despite the considerable efforts to discourage smoking.

Cigarettes burn tobacco, which produces smoke. As a result of the combustion process, the smoker inhales various toxic substances. In contrast, RRPs do not burn tobacco and produce significantly lower levels of harmful and potentially harmful constituents ("HPHCs") than found in cigarette smoke.

For smokers who would otherwise continue to smoke, we believe that RRPs offer a much better choice. Accordingly, our key strategic priorities are: to develop and commercialize products that present less risk of harm to adult smokers who switch to those products versus continued smoking; and to convince current adult smokers who would otherwise continue to smoke to switch to those products.

We recognize that this transformation from cigarettes to RRPs will take time and that the speed of transformation will depend in part upon factors beyond our control, such as the willingness of governments, regulators and other policy groups to embrace RRPs as a desired alternative to continued cigarette smoking. We also recognize that our part in this transformation must be funded from our existing cigarette business. For as long as a significant number of adult smokers continues to smoke, it is critical that the industry be led by responsible and ethical manufacturers. Therefore, during the transformation, we intend to remain a leading international cigarette manufacturer.

We have a range of RRPs in various stages of development, scientific assessment and commercialization. We conduct rigorous scientific assessments of our RRP platforms to substantiate that they reduce exposure to HPHCs and, ultimately, that these products present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to them versus continued smoking. We draw upon a team of expert scientists and engineers from a broad spectrum of scientific disciplines and our extensive learnings of adult consumer preferences to develop and assess our RRPs. Our efforts are guided by the following key objectives:

- to develop RRPs that adult smokers who would otherwise continue to smoke find to be satisfying alternatives to smoking;
- for those adult smokers, our goal is to offer RRPs with a scientifically substantiated risk-reduction profile that approaches as closely as possible that associated with smoking cessation;
- to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on scientific evidence of the highest standard that is made available for scrutiny and review by external independent scientists and relevant regulatory bodies; and
- to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs, including the communication of scientifically substantiated information to enable adult smokers to make better choices.

Our RRP Platforms: Our product development is based on the elimination of combustion via tobacco heating and other innovative systems for aerosol generation, which we believe is the most promising path to providing a better choice for those who would otherwise continue to smoke. We recognize that no single product will appeal to all adult smokers. Therefore, we are developing a portfolio of products intended to appeal to a variety of distinct adult consumer preferences.

Four RRP platforms are in various stages of development and commercialization readiness:

Platform 1 uses a precisely controlled heating device that we are commercializing under the IQOS brand name, into which a specially designed and proprietary tobacco unit is inserted and heated to generate an aerosol. We have conducted a series of clinical studies for this platform, the results of which formed the basis for our submission to the U.S. Food and Drug Administration (“FDA”) described below. We are also progressing with our 6+6 month exposure response study initiated in December 2014 and expect results regarding the first six-month term by the end of 2017.

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Platform 2 uses a pressed carbon heat source which, when ignited, generates an aerosol by heating tobacco. The results of our pharmacokinetic study (that measured the nicotine pharmacokinetic profile and subjective effects) and of our five-day reduced exposure study with Platform 2 indicate that this platform could be an acceptable substitute for adult smokers who seek an alternative to cigarettes. Furthermore, the reduced exposure study showed a substantial reduction in relevant biomarkers of exposure to HPHCs in those who switched to Platform 2 compared to those who continued to smoke cigarettes over a five-day period. The sustainability of this reduction as well as changes in clinical risk markers are being determined in our ongoing 3-month reduced exposure study. We expect the results of this study by the end of 2017.

Platform 3 provides an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. We have explored two routes for this platform, one with electronics and one without, and have initiated a new nicotine pharmacokinetic study. The results are expected in the first quarter of 2018.

Platform 4 covers e-vapor products, which are battery-powered devices that produce an aerosol by vaporizing a nicotine-containing liquid solution. Our e-vapor products comprise devices using current generation technology, and we are well advanced in the development and commercialization of our new e-vapor mesh technology that addresses certain challenges presented by some e-vapor products currently on the market. Our MESH products are designed to ensure the consistency and quality of the generated aerosol. We have initiated a nicotine pharmacokinetic study for which results are expected early in 2018; the results of this study are expected to contribute to further developments of Platform 4 products.

Commercialization of RRP: In 2014, we introduced the IQOS system in pilot city launches in Nagoya, Japan, and in Milan, Italy. Since then, we have expanded our commercialization activities to include all of Japan, as well as multiple cities in Italy. To date, IQOS is available for sale in key cities in 30 markets and nationwide in Japan, and we estimate that more than 3.7 million adult consumers worldwide have stopped smoking and converted to IQOS. By the end of 2017, we expect IQOS to be available in key cities in up to 35 markets, as capacity permits. To further improve the consumer experience, we introduced a new version of the IQOS device in the first quarter of 2017.

On the basis of our experience in Japan and Italy, we estimate that only a very small percentage of adult smokers who convert to IQOS switch back to cigarettes.

In the first quarter of 2016, we started the large scale commercial production of heated tobacco units. We experienced supply shortages resulting from stronger-than-anticipated demand, primarily in Japan. Currently, capacity limitations are beginning to ease. We are integrating the production of our heated tobacco units into our existing manufacturing facilities in Europe and progressing with our plans to build manufacturing capacity for our other RRP platforms. Our 2016 year-end installed capacity was approximately 15 billion heated tobacco units, and we expect that our 2017 year-end installed capacity will reach over 60 billion units. This installed capacity is expected to allow us to produce approximately 35 billion units in 2017, up from 7 billion in 2016. We will update our 2018 annual installed capacity plans in early 2018.

We are expanding our supplier base for IQOS devices. Currently, we experience constraints on the IQOS devices in Japan; however, we expect to be able to fully supply this market with devices in early 2018, based on our current demand forecasts.

Our IQOS devices are generally subject to product warranties for a period of 12 months from the date of purchase or such other periods as required by law. Warranty claims for these devices have not had a material impact on our consolidated financial position, results of operations or cash flows in any of the periods presented, although they may



become more significant as the number of devices sold increases.

We currently market our e-vapor products in several markets, including Ireland, Israel, Spain and the U.K. A city test of MESH, one of our Platform 4 products, is ongoing in Birmingham, U.K. We also expect to initiate city tests of our Platform 2 product before the end of 2017.

**RRP Regulation and Taxation:** RRP's contain nicotine and are not risk-free. We therefore support science-based regulation and taxation of RRP's. Regulation and taxation should differentiate between cigarettes and products that present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to these products versus continued smoking. Regulation should provide minimum standards for RRP's and specific rules for product assessment methodologies, ingredients, labelling and consumer communication, and should ensure that the public is informed about the health risks of all combustible and non-combustible tobacco and nicotine-containing products. Regulation, as well as tobacco industry activities, should reflect the fact that youth should not consume nicotine in any form.

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Some governments have banned or are seeking to ban or severely restrict emerging tobacco and nicotine-containing products such as our RRPs. These regulations might foreclose or unreasonably restrict adult consumer access even to products that might be shown to be a better choice than continuing to smoke. We oppose such blanket bans and unreasonable restrictions of products that have the potential to present less risk of harm compared to continued smoking. By contrast, we support regulation that sets clear standards and propels innovation to benefit adult smokers who would otherwise continue to smoke.

In the United States, an established regulatory framework for assessing “Modified Risk Tobacco Products” and “New Tobacco Products” exists under the jurisdiction of the FDA. Future FDA actions may influence the regulatory approach of other governments. We submitted to the FDA a Modified Risk Tobacco Product Application (“MRTPA”) for Platform 1 in December 2016, and a Premarket Tobacco Product Application (“PMTA”) for Platform 1 in March 2017. In May 2017, the FDA formally accepted and filed our MRTPA for substantive scientific review and, in June 2017, the FDA opened the period for the public to provide comments on our application. In August 2017, the FDA completed a preliminary review of our PMTA for Platform 1 and accepted our application for substantive review.

In the EU, all EU Member States and Norway have transposed the EU Tobacco Products Directive, including the provisions on Novel Tobacco Products, such as heated tobacco units and e-cigarettes. Most of the EU Member States require a notification submitted six months before the intended placing on the market of a Novel Tobacco Product, while some require pre-market authorizations for the introduction of such products. To date, we have filed a comprehensive dossier summarizing our scientific assessment of Platform 1 in 20 Member States.

We make our scientific findings publicly available for scrutiny and peer review through several channels, including our websites. From time to time, adult consumers, competitors, members of the scientific community, and others inquire into our scientific methodologies, challenge our scientific conclusions or request further study of certain aspects of our RRPs and their health effects. We are committed to a robust and open scientific debate but believe that such debate should be based on accurate and reliable scientific information. We seek to provide accurate and reliable scientific information about our RRPs; nonetheless, we may not be able to prevent third-party dissemination of false, misleading or unsubstantiated information about these products.

To date, we have been largely successful in demonstrating to regulators that our RRPs are not cigarettes, and as such they are generally taxed either as a separate category or as other tobacco products, which yields more favorable tax rates than cigarettes. Although we believe that this is sensible from the public health perspective, we cannot guarantee that regulators will maintain this approach.

There can be no assurance that we will succeed in our efforts to replace cigarettes with RRPs or that regulation will allow us to commercialize RRPs in all markets, to communicate scientifically substantiated risk-reduction claims, or to treat RRPs differently from cigarettes.

**Our RRP Business Development Initiatives:** In December 2013, we established a strategic framework with Altria Group, Inc. (“Altria”) under which Altria will make available its e-vapor products exclusively to us for commercialization outside the United States, and we will make available two of our RRPs exclusively to Altria for commercialization in the United States. In March 2015, we launched Solaris, a Platform 4 e-vapor product licensed from Altria, in Spain. In December 2015, we introduced Solaris in Israel.

In July 2015, we extended the strategic framework with Altria to include a Joint Research, Development and Technology Sharing Agreement. The additional agreement provides the framework under which PMI and Altria will collaborate to develop the next generation of e-vapor products for commercialization in the United States by Altria and in markets outside the United States by PMI. The collaboration between PMI and Altria in this endeavor is

enabled by exclusive technology cross licenses and technical information sharing. The agreements also provide for cooperation on the scientific assessment of, and for the sharing of improvements to, the existing generation of licensed products.

Other Developments: On September 12, 2017, we announced our support of the Foundation for a Smoke-Free World. The Foundation is an independent body, governed by its independent Board of Directors. The Foundation will fund research and encourage innovative measures to reduce the harm caused by smoking. It will evaluate the impact that smoke-free alternatives can have on smokers and public health, assess the effect of reduced cigarette consumption on the industry value chain, and measure overall progress towards a smoke-free world. We currently expect to support the Foundation by contributing approximately USD 80 million per year, depending on the Foundation's requirements and operations, over the next 12 years, beginning in 2018.

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### Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters. We describe certain matters pending in Thailand and South Korea in Note 8. Contingencies.

In November 2010, a WTO panel issued its decision in a dispute relating to facts that arose from August 2006 between the Philippines and Thailand concerning a series of Thai customs and tax measures affecting cigarettes imported by PM Thailand into Thailand (see Note 8. Contingencies for additional information). The WTO panel decision, which was upheld by the WTO Appellate Body, concluded that Thailand had no basis to find that PM Thailand's declared customs values and taxes paid were too low, as alleged by the DSI in 2009. The decision also created obligations for Thailand to revise its laws, regulations, or practices affecting the customs valuation and tax treatment of future cigarette imports. Thailand agreed in September 2011 to fully comply with the decision by October 2012. The Philippines asserts that to date Thailand has not fully complied with the WTO panel decision. The Philippines has repeatedly expressed concerns with ongoing investigations by Thailand of PM Thailand, including those that led to the criminal charges described in Note 8. Contingencies, and has commenced two formal proceedings at the WTO to challenge criminal charges against PM Thailand arguing that the criminal charges appear to be based on grounds not supported by WTO customs valuation rules and inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies.

### Investments in Unconsolidated Subsidiaries

We discuss our investments in unconsolidated subsidiaries in Note 14. Investments in Unconsolidated Subsidiaries to our condensed consolidated financial statements.

### Trade Policy

We are subject to various trade restrictions imposed by the United States of America and countries in which we do business ("Trade Sanctions"), including the trade and economic sanctions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control and the U.S. Department of State. It is our policy to comply fully with these Trade Sanctions.

Tobacco products are agricultural products under U.S. law and are not technological or strategic in nature. From time to time we make sales in countries subject to Trade Sanctions, either where such sanctions do not apply to our business or pursuant to exemptions or licenses.

To our knowledge, none of our commercial arrangements results in the governments of any country identified by the U.S. government as a state sponsor of terrorism, nor entities controlled by those governments, receiving cash or acting as intermediaries in violation of U.S. laws.

We do not sell products in Iran, Sudan, North Korea, and Syria. From time to time, we explore opportunities to sell our products in one or more of these countries, as permitted by law.

We expect to commence sales of cigarettes in Cuba within the next six months, as permitted by law.

Certain states within the U.S. have enacted legislation permitting state pension funds to divest or abstain from future investment in stocks of companies that do business with certain countries that are sanctioned by the U.S. We do not believe such legislation has had a material effect on the price of our shares.



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## Operating Results – Nine Months and Three Months Ended September 30, 2017

The following discussion compares operating results within each of our reportable segments for the nine months and three months ended September 30, 2017, with the nine months and three months ended September 30, 2016.

Unless otherwise stated, references to total industry, total market, our shipment volume and our market share performance reflect cigarettes and our heated tobacco units for those markets that have commercial sales of IQOS.

## European Union:

European Union (in millions)	For the Nine Months Ended September 30,		
	2017	2016	Variance%
Net revenues	\$20,156	\$20,664	\$(508) (2.5)%
Excise taxes on products	14,102	14,446	(344) (2.4)%
Net revenues, excluding excise taxes on products	6,054	6,218	(164) (2.6)%
Operating companies income	2,783	3,096	(313) (10.1)%

For the nine months ended September 30, 2017, net revenues decreased by \$508 million. Excluding excise taxes, net revenues decreased by \$164 million due to:

- unfavorable volume/mix (\$192 million) and
- unfavorable currency (\$94 million), partially offset by
- price increases (\$122 million).

The net revenues of the European Union segment include \$173 million in 2017 and \$35 million in 2016 related to the sale of RRP. Excluding excise taxes, net revenues for RRP were \$145 million in 2017 and \$32 million in 2016. Operating companies income decreased by \$313 million during the nine months ended September 30, 2017. This decrease was due primarily to:

- unfavorable volume/mix (\$220 million),
- higher marketing, administration and research costs (\$162 million) and
- unfavorable currency (\$82 million), partly offset by
- price increases (\$122 million) and
- lower manufacturing costs (\$30 million).

European Union (in millions)	For the Three Months Ended September 30,		
	2017	2016	Variance%
Net revenues	\$7,346	\$7,387	\$(41) (0.6)%
Excise taxes on products	5,142	5,187	(45) (0.9)%
Net revenues, excluding excise taxes on products	2,204	2,200	4 0.2%
Operating companies income	1,042	1,120	(78) (7.0)%

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For the three months ended September 30, 2017, net revenues decreased by \$41 million. Excluding excise taxes, net revenues increased by \$4 million due to:

• favorable currency (\$53 million) and  
 • price increases (\$37 million), partly offset by  
 • unfavorable volume/mix (\$86 million).

The net revenues of the European Union segment include \$79 million in 2017 and \$14 million in 2016 related to the sale of RRPs. Excluding excise taxes, net revenues for RRPs were \$65 million in 2017 and \$13 million in 2016.

Operating companies income decreased by \$78 million during the three months ended September 30, 2017. This decrease was due primarily to:

• unfavorable volume/mix (\$88 million) and  
 • higher marketing, administration and research costs (\$47 million, primarily reflecting increased investment behind reduced-risk products), partially offset by  
 • price increases (\$37 million) and  
 • lower manufacturing costs (\$14 million).

## European Union - Total Market

In the third quarter, the estimated total market in the European Union decreased by 4.5% to 131.9 billion units. Excluding the net impact of estimated trade inventory movements, largely associated with the third quarter of 2016 reflecting the anticipated implementation of the Tobacco Products Directive in 2017, notably in France, Italy and the United Kingdom, the estimated total market declined by 3.9%.

For the nine months year-to-date, the estimated total market in the European Union decreased by 2.7% to 372.8 billion units. The net impact of estimated trade inventory movements year-to-date was immaterial.

## European Union - PMI Shipment Volume and Market Share Commentaries

Shipment volume and market share performance by brand for cigarettes and heated tobacco units are shown in the tables below:

## European Union Shipment Volume by Brand (Million Units)

	Third-Quarter			Nine Months Year-to-Date		
	2017	2016	Change	2017	2016	Change
Cigarettes						
Marlboro	24,246	25,943	(6.5)	69,770	73,582	(5.2)
L&M	8,990	9,454	(4.9)	25,992	26,628	(2.4)
Chesterfield	8,002	8,055	(0.7)	22,270	23,111	(3.6)
Philip Morris	3,779	4,330	(12.7)	11,635	12,621	(7.8)
Others	4,097	4,219	(2.9)	11,745	12,451	(5.7)
Total Cigarettes	49,114	52,001	(5.6)	141,412	148,393	(4.7)
Heated Tobacco Units	464	56	+100.0%	1,040	103	+100.0%
Total European Union	49,578	52,057	(4.8)	142,452	148,496	(4.1)





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## European Union Market Shares by Brand

	Third-Quarter			Nine Months Year-to-Date		
	2017	2016	Change p.p.	2017	2016	Change p.p.
Marlboro	18.6	% 19.0	%(0.4)	)18.7	% 19.0	%(0.3)
L&M	6.8	% 6.9	%(0.1)	)6.9	% 6.9	%—
Chesterfield	6.0	% 5.9	%0.1	6.0	% 5.9	%0.1
Philip Morris	3.0	% 3.2	%(0.2)	)3.1	% 3.3	%(0.2)
Others*	3.6	% 3.1	%0.5	3.4	% 3.2	%0.2
Total European Union	38.0	% 38.1	%(0.1)	)38.1	% 38.3	%(0.2)

\*Includes heated tobacco units.

In the third quarter, our total shipment volume decreased by 4.8% to 49.6 billion units, mainly due to cigarette volume declines in Germany, Italy and Spain. Estimated net inventory movements were immaterial. The decrease in cigarette shipment volume of Marlboro was mainly due to Germany, Italy and Spain. The decrease in cigarette shipment volume of L&M was mainly due to Germany, Poland and Spain. The decrease in cigarette shipment volume of Chesterfield was mainly due to Portugal and the United Kingdom, largely offset by Poland. The decrease in cigarette shipment volume of Philip Morris was mainly due to France and Italy. The decrease in cigarette shipment volume of "Others" was mainly due to RGD in Poland.

In the quarter, our total market share decreased by 0.1 point to 38.0%, with gains in France, Italy and Poland largely offset by declines in Germany and Spain.

For the nine months year-to-date, our total shipment volume decreased by 4.1% to 142.5 billion units, mainly due to cigarette volume declines in Germany, Italy and Spain. Excluding estimated net inventory movements, principally associated with distributor cigarette inventory movements in France, Italy and Spain, our total shipment volume decreased by 3.2%. The decrease in cigarette shipment volume of Marlboro was mainly due to Germany, Italy and Spain. The decrease in cigarette shipment volume of L&M was mainly due to Germany and Spain. The decrease in cigarette shipment volume of Chesterfield was mainly due to Italy, Portugal and Spain, partly offset by Poland. The decrease in cigarette shipment volume of Philip Morris was mainly due to Italy. The decrease in cigarette shipment volume of "Others" was mainly due to Muratti in Italy.

For the nine months year-to-date, our total market share decreased by 0.2 points to 38.1%, with declines in Germany, Italy and Spain partly offset by gains in France and Poland.

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## European Union - Key Market Commentaries

In France, estimated industry size, our shipment volume and market share performance, shown in the table below, include cigarettes and our heated tobacco units.

	France Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	11.4	12.1	(5.4 )	% 34.0	34.5	(1.3 )	%
PMI Shipments (million units)	4,804	5,037	(4.6 )	% 14,679	14,872	(1.3 )	%
PMI Market Share							
Marlboro	27.3	% 26.3	% 1.0		26.9	% 26.2	% 0.7
Philip Morris	10.0	% 10.1	% (0.1 )		10.2	% 10.1	% 0.1
Chesterfield	3.0	% 3.1	% (0.1 )		3.1	% 3.1	% —
Others*	2.7	% 2.7	% —		2.7	% 2.8	% (0.1 )
Total	43.0	% 42.2	% 0.8		42.9	% 42.2	% 0.7

\*Includes heated tobacco units.

In the third quarter, the estimated total market decreased by 5.4%. Excluding the aforementioned net impact of estimated trade inventory movements, the estimated total market declined by 3.6%. The decrease in our shipment volume was mainly due to the lower total market, partly offset by higher market share, principally Marlboro, notably reflecting the growth of both Marlboro Red and Gold in 30s packs launched in March 2017.

For the nine months year-to-date, the estimated total market decreased by 1.3%. The decrease in our shipment volume mainly reflected the lower total market, partly offset by higher market share.

In Germany, estimated industry size, our shipment volume and market share performance, shown in the table below, include cigarettes and our heated tobacco units.

	Germany Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	20.4	21.7	(6.1 )	% 57.6	59.7	(3.4 )	%
PMI Shipments (million units)	7,082	7,693	(7.9 )	% 21,014	22,068	(4.8 )	%
PMI Market Share							
Marlboro	21.0	% 21.5	% (0.5 )		22.1	% 22.3	% (0.2 )
L&M	10.8	% 11.1	% (0.3 )		11.3	% 11.6	% (0.3 )
Chesterfield	1.5	% 1.5	% —		1.5	% 1.6	% (0.1 )
Others*	1.4	% 1.3	% 0.1		1.6	% 1.5	% 0.1
Total	34.7	% 35.4	% (0.7 )		36.5	% 37.0	% (0.5 )

\*Includes heated tobacco units.

In the third quarter, the estimated total market decreased by 6.1%, partly reflecting the impact of price increases in March 2017 as well as a challenging comparison with the third quarter of 2016, which declined by 0.5%. The decrease

in our shipment volume was mainly due to the lower total market and market share, mainly Marlboro, reflecting the impact of its price increase from the round €6.00 per pack price point to €6.30 in March 2017, combined with the later timing of competitors' price increases.

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For the nine months year-to-date, the estimated total market decreased by 3.4%, partly reflecting the impact of price increases in March 2017 as well as a challenging comparison with the nine months year-to-date of 2016, which declined by 0.3%, benefiting from a lower prevalence of illicit trade and the estimated favorable impact of immigration. The decrease in our shipment volume was mainly due to the lower total market and lower market share, largely reflecting the same dynamics as in the quarter.

In Italy, estimated industry size, our shipment volume and market share performance, shown in the table below, include cigarettes and our heated tobacco units.

	Italy Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	18.7	19.7	(5.1 )	%53.1	55.6	(4.3 )	%
PMI Shipments (million units)	9,694	9,967	(2.7 )	%27,738	29,914	(7.3 )	%
PMI Market Share							
Marlboro	24.1	%24.3	%(0.2 )	23.9	%24.5	%(0.6 )	
Chesterfield	11.3	%11.6	%(0.3 )	11.3	%11.6	%(0.3 )	
Philip Morris	7.7	%8.3	%(0.6 )	7.8	%8.6	%(0.8 )	
HEETS	0.7	%0.1	%0.6	0.6	%0.1	%0.5	
Others	8.6	%8.0	%0.6	8.5	%7.9	%0.6	
Total	52.4	%52.3	%0.1	52.1	%52.7	%(0.6 )	

In the third quarter, the estimated total market decreased by 5.1%. Excluding the aforementioned net impact of estimated trade inventory movements, the estimated total market declined by 3.6%, partly reflecting the Tobacco Product Directive's ban on pack sizes of ten cigarettes that fueled growth in cheaper alternatives, including fine cut and cigarillos. The decline of our shipments, down by 5.0% excluding the net impact of distributor inventory movements, mainly reflected the lower total market. Our slightly higher market share was mainly driven by HEETS and Merit in "Others," largely offset by low-price Philip Morris, impacted by the growth of the super-low price segment.

For the nine months year-to-date, the estimated total market decreased by 4.3%, mainly reflecting the same dynamics as in the quarter. The decline of the total market also reflected a challenging comparison with the first nine months of 2016, which were flat. The decline of our shipments, down by 5.4% excluding the net impact of distributor inventory movements, mainly reflected the lower total market, as well as lower cigarette market share, principally due to Marlboro, partly reflecting the ban on pack sizes of ten cigarettes, and low-price Philip Morris, impacted by the growth of the super-low price segment, partly offset by HEETS, as well as Merit in "Others."

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In Poland, estimated industry size, our shipment volume and market share performance, shown in the table below, include cigarettes and our heated tobacco units.

	Poland Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	11.2	11.5	(2.9 )	% 32.3	32.3	(0.1 )	%
PMI Shipments (million units)	4,819	4,864	(0.9 )	% 13,695	13,515	1.3	%
PMI Market Share							
Marlboro	10.6	% 11.3	% (0.7 )	10.6	% 11.3	% (0.7 )	
L&M	17.9	% 18.2	% (0.3 )	18.3	% 18.3	% —	
Chesterfield	11.6	% 9.4	% 2.2	10.5	% 9.1	% 1.4	
Others*	2.9	% 3.2	% (0.3 )	3.0	% 3.1	% (0.1 )	
Total	43.0	% 42.1	% 0.9	42.4	% 41.8	% 0.6	

\*Includes heated tobacco units.

In the third quarter, the estimated total market decreased by 2.9%. The decrease in our shipment volume primarily reflected the lower total market, partly offset by an increase in our market share, driven by Chesterfield, benefiting from brand support.

For the nine months year-to-date, the estimated total market decreased by 0.1%, reflecting a lower prevalence of illicit trade. The increase in our shipment volume was primarily driven by higher market share, mainly reflecting the same dynamics as in the quarter.

In Spain, estimated industry size, our shipment volume and market share performance, shown in the table below, include cigarettes and our heated tobacco units.

	Spain Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	12.4	13.0	(5.0 )	% 34.1	35.3	(3.4 )	%
PMI Shipments (million units)	3,847	4,274	(10.0 )	% 11,131	12,640	(11.9 )	%
PMI Market Share							
Marlboro	17.1	% 18.6	% (1.5 )	16.6	% 18.1	% (1.5 )	
L&M	5.3	% 5.3	% —	5.4	% 5.4	% —	
Chesterfield	8.5	% 8.4	% 0.1	8.5	% 8.6	% (0.1 )	
Others*	2.2	% 2.1	% 0.1	1.9	% 2.0	% (0.1 )	
Total	33.1	% 34.4	% (1.3 )	32.4	% 34.1	% (1.7 )	

\*Includes heated tobacco units.

In the third quarter, the estimated total market decreased by 5.0%, mainly reflecting the impact of price increases in December 2016. The decline of our shipment volume was mainly due to the lower total market and lower market share, principally due to Marlboro, reflecting the impact of price increases, particularly above the round €5.00 per pack price point in the vending channel, as well as a challenging comparison with the third quarter of 2016 in which the

market share of Marlboro grew by 0.9 points.

For the nine months year-to-date, the estimated total market decreased by 3.4%. The decline of our shipment volume, down by 7.8% excluding the net impact of distributor inventory movements, was mainly due to the lower total market and lower market

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share, principally due to Marlboro, reflecting the same dynamics as in the quarter, as well as a challenging comparison with the first nine months of 2016 in which the market share of Marlboro grew by 1.2 points.

Eastern Europe, Middle East & Africa:

Eastern Europe, Middle East & Africa (in millions)	For the Nine Months Ended September 30,		
	2017	2016	Variance%
Net revenues	\$13,177	\$13,650	\$(473) (3.5)%
Excise taxes on products	8,242	8,448	(206 ) (2.4)%
Net revenues, excluding excise taxes on products	4,935	5,202	(267 ) (5.1)%
Operating companies income	2,188	2,389	(201 ) (8.4)%

For the nine months ended September 30, 2017, net revenues decreased by \$473 million. Excluding excise taxes, net revenues decreased by \$267 million due to:

- unfavorable volume/mix (\$344 million) and
- unfavorable currency (\$268 million), partly offset by
- price increases (\$345 million).

The net revenues of the Eastern Europe, Middle East & Africa segment include \$69 million in 2017 related to the sale of RRP. Excluding excise taxes, net revenues for RRP were \$64 million in 2017.

Operating companies income decreased by \$201 million during the nine months ended September 30, 2017. This decrease was due primarily to:

- unfavorable volume/mix (\$299 million),
- unfavorable currency (\$183 million) and
- higher marketing, administration and research costs (\$52 million), partly offset by
- price increases (\$345 million).

Eastern Europe, Middle East & Africa (in millions)	For the Three Months Ended September 30,		
	2017	2016	Variance%
Net revenues	\$4,990	\$5,122	\$(132) (2.6 )%
Excise taxes on products	3,207	3,186	21 0.7 %
Net revenues, excluding excise taxes on products	1,783	1,936	(153 ) (7.9 )%
Operating companies income	765	962	(197 ) (20.5)%

For the three months ended September 30, 2017, net revenues decreased by \$132 million. Excluding excise taxes, net revenues decreased by \$153 million due to:

- unfavorable volume/mix (\$111 million) and
- unfavorable currency (\$107 million), partly offset by
- price increases (\$65 million).

The net revenues of the Eastern Europe, Middle East & Africa segment include \$43 million in 2017 related to the sale of RRPs. Excluding excise taxes, net revenues for RRPs were \$41 million in 2017.

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Operating companies income decreased by \$197 million during the three months ended September 30, 2017. This decrease was due primarily to:

- unfavorable volume/mix (\$121 million),
- unfavorable currency (\$84 million) and
- higher marketing, administration and research costs (\$48 million), partly offset by price increases (\$65 million).

## Eastern Europe, Middle East &amp; Africa - PMI Shipment Volume Commentaries

## EEMA PMI Shipment Volume by Brand (Million Units)

	Third-Quarter			Nine Months Year-to-Date		
	2017	2016	Change	2017	2016	Change
Cigarettes						
Marlboro	18,655	20,082	(7.1)	51,808	55,005	(5.8)
L&M	12,639	13,486	(6.3)	35,919	39,511	(9.1)
Bond Street	9,473	11,159	(15.1)	27,449	31,310	(12.3)
Parliament	8,710	9,262	(6.0)	23,525	25,501	(7.8)
Philip Morris	5,501	344	+100.0%	13,813	824	+100.0%
Others	13,859	17,839	(22.3)	37,311	51,479	(27.5)
Total Cigarettes	68,837	72,172	(4.6)	189,825	203,630	(6.8)
Heated Tobacco Units	427	27	+100.0%	761	37	+100.0%
Total EEMA	69,264	72,199	(4.1)	190,586	203,667	(6.4)

In the third quarter, our total shipment volume decreased by 4.1% to 69.3 billion units, mainly due to cigarette volume declines in: Russia, Saudi Arabia, where our cigarette shipment volume declined by 48.3% reflecting the impact of the new excise tax implemented in June 2017, and Ukraine, partly offset by North Africa, notably Egypt, and higher heated tobacco unit shipment volume. The decrease in cigarette shipment volume of Marlboro was mainly due to Saudi Arabia. The decrease in cigarette shipment volume of L&M was mainly due to Russia, Saudi Arabia and Turkey, partly offset by Kazakhstan and North Africa, notably Egypt. The decrease in cigarette shipment volume of Bond Street was mainly due to Russia and Ukraine. The decrease in cigarette shipment volume of Parliament was mainly due to Russia, partly offset by Kazakhstan and Turkey. The increase in cigarette shipment volume of Philip Morris was driven by Russia and Ukraine, reflecting successful portfolio consolidation of local, low-price brands. The decrease in cigarette shipment volume of "Others" was mainly due to low-price Next/Dubliss in Russia.

For the nine months year-to-date, our total shipment volume decreased by 6.4% to 190.6 billion units, mainly reflecting cigarette volume declines in Russia, Saudi Arabia, Turkey and Ukraine, partly offset by North Africa, notably Algeria, and higher heated tobacco unit shipment volume. The decrease in cigarette shipment volume of Marlboro was mainly due to Saudi Arabia, partly offset by North Africa. The decrease in cigarette shipment volume of L&M was mainly due to Russia, Saudi Arabia and Turkey, partly offset by Kazakhstan. The decrease in cigarette shipment volume of Bond Street was mainly due to Kazakhstan, Russia and Ukraine. The decrease in cigarette shipment volume of Parliament was mainly due to Russia, Saudi Arabia and Turkey, partly offset by Kazakhstan. The increase in cigarette shipment volume of Philip Morris was driven by Russia and Ukraine, reflecting the same dynamics as in the quarter. The decrease in cigarette shipment volume of "Others" was mainly due to the same dynamics as in the quarter.



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## Eastern Europe, Middle East &amp; Africa - Key Market Commentaries

In North Africa (defined as Algeria, Egypt, Libya, Morocco and Tunisia), estimated cigarette industry size, our cigarette shipment volume and cigarette market share performance are shown in the table below.

	North Africa Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Cigarette Market (billion units)	37.6	36.9	1.7	% 104.7	105.4	(0.7 )%	
PMI Cigarette Shipments (million units)	9,558	8,480	12.7	% 25,953	25,893	0.2 %	
PMI Cigarette Market Share							
Marlboro	10.4	% 10.2	% 0.2	9.3	% 8.2	% 1.1	
L&M	13.1	% 11.6	% 1.5	12.1	% 12.5	% (0.4 )	
Others	3.3	% 2.5	% 0.8	2.9	% 2.9	% —	
Total	26.8	% 24.3	% 2.5	24.3	% 23.6	% 0.7	

In the third quarter, the estimated total cigarette market increased by 1.7%. The increase in our cigarette shipment volume mainly reflected higher cigarette market share, notably of Marlboro and L&M in Algeria and Egypt.

For the nine months year-to-date, the estimated total cigarette market decreased by 0.7%, mainly due to Algeria, partially offset by Egypt. The increase in our cigarette shipment volume, up by 2.2% excluding estimated distributor inventory movements, was mainly driven by higher cigarette market share, notably of Marlboro in Algeria, partly offset by L&M in Egypt.

In Russia, estimated industry size and our shipment volume, shown in the table below, include cigarettes and our heated tobacco units. Our August quarter-to-date and year-to-date market share performance, as measured by Nielsen and shown in the table below, reflects that of cigarettes.

	Russia Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	70.4	76.5	(7.9 )	% 193.9	209.0	(7.2 )%	
PMI Shipments (million units)	18,942	20,778	(8.8 )	% 53,365	59,132	(9.8 )%	
PMI Cigarette Market Share							
Marlboro	1.6	% 1.3	% 0.3	1.4	% 1.4	% —	
Parliament	3.6	% 3.8	% (0.2 )	3.6	% 3.9	% (0.3 )	
Bond Street	8.5	% 8.2	% 0.3	8.9	% 8.1	% 0.8	
Philip Morris	5.1	% 0.1	% 5.0	3.6	% 0.1	% 3.5	
Others	8.5	% 13.5	% (5.0 )	9.7	% 13.7	% (4.0 )	
Total	27.3	% 26.9	% 0.4	27.2	% 27.2	% —	

In the third quarter, the estimated total market decreased by 7.9%, reflecting the impact of excise tax-driven price increases and an increase in the prevalence of illicit trade. The decline of our shipment volume was mainly due to the lower total market. The increase in our market share was mainly driven by Philip Morris, reflecting successful

portfolio consolidation of local, low-price brands in "Others."

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For the nine months year-to-date, the estimated total market decreased by 7.2%, reflecting the same dynamics as in the quarter. Our market share was flat, largely reflecting the same dynamics as in the quarter.

In Turkey, estimated cigarette industry size, our cigarette shipment volume and August quarter-to-date and year-to-date cigarette market share performance, as measured by Nielsen, are shown in the table below.

	Turkey Key Market Data							
	Third-Quarter			Nine Months Year-to-Date				
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.		
Total Cigarette Market (billion units)	29.9	29.3	2.1	% 77.6	79.5	(2.3	)%	
PMI Cigarette Shipments (million units)	14,130	14,041	0.6	% 36,094	37,550	(3.9	)%	
PMI Cigarette Market Share								
Marlboro	10.3	% 10.4	% (0.1	)	10.1	% 10.2	% (0.1	)
Parliament	11.6	% 11.7	% (0.1	)	11.5	% 11.6	% (0.1	)
Lark	6.8	% 7.3	% (0.5	)	6.9	% 7.5	% (0.6	)
Others	14.7	% 15.1	% (0.4	)	14.7	% 14.9	% (0.2	)
Total	43.4	% 44.5	% (1.1	)	43.2	% 44.2	% (1.0	)

In the third quarter, the estimated total cigarette market increased by 2.1%. Excluding the net impact of estimated trade inventory movements, the estimated total cigarette market increased by 1.1%. The increase in our cigarette shipments was mainly due to the higher total market. The decline in our cigarette market share, as measured by Nielsen, was mainly due to low-price Lark, reflecting competitive pressure from super-low price alternatives, and L&M and Muratti in "Others."

For the nine months year-to-date, the estimated total cigarette market decreased by 2.3%, partly reflecting a challenging comparison with the nine months year-to-date of 2016, which increased by 6.0%, benefiting from a lower prevalence of illicit trade. Excluding the net impact of estimated trade inventory movements associated with the timing of anticipated price increases, the estimated total cigarette market declined by 4.1%, mainly reflecting a higher prevalence of illicit trade resulting from the impact of price increases. The decrease in our cigarette shipments was principally due to the lower total cigarette market and lower cigarette market share, mainly due to the same dynamics as in the quarter.

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In Ukraine, estimated industry size and our shipment volume, shown in the table below, include cigarettes and our heated tobacco units. Our August quarter-to-date and year-to-date market share performance, as measured by Nielsen and shown in the table below, reflects that of cigarettes.

	Ukraine Key Market Data						
	Third-Quarter			Nine Months Year-to-Date			
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.	
Total Market (billion units)	17.9	19.1	(6.2 )	% 50.7	56.0	(9.5 )%	
PMI Shipments (million units)	5,116	5,626	(9.1 )	% 14,521	17,226	(15.7 )%	
PMI Cigarette Market Share							
Marlboro	3.0	% 3.2	% (0.2 )	3.1	% 3.2	% (0.1 )	
Parliament	3.3	% 3.0	% 0.3	3.3	% 2.8	% 0.5	
Bond Street	8.4	% 10.3	% (1.9 )	8.9	% 10.4	% (1.5 )	
Philip Morris	3.6	% —	% 3.6	2.7	% —	% 2.7	
Others	9.4	% 13.1	% (3.7 )	9.7	% 13.8	% (4.1 )	
Total	27.7	% 29.6	% (1.9 )	27.7	% 30.2	% (2.5 )	

In the third quarter, the estimated total market decreased by 6.2%, mainly due to the impact of price increases and a challenging comparison with the third quarter of 2016, which grew by 1.7%. The decrease in our shipment volume was primarily due to the lower total market, as well as lower cigarette market share, notably of low-price Bond Street, partly offset by Parliament and Philip Morris, following successful portfolio consolidation of a local, low-price brand in "Others."

For the nine months year-to-date, the estimated total market decreased by 9.5%, mainly due to the impact of price increases and a challenging comparison with the first nine months of 2016, which grew by 6.9%. The decrease in our shipment volume was primarily due to the lower total market, as well as lower cigarette market share, reflecting the same dynamics as in the quarter.

Asia:

Asia (in millions)	For the Nine Months Ended September 30,			
	2017	2016	Variance %	
Net revenues	\$16,051	\$15,014	\$1,037	6.9 %
Excise taxes on products	8,696	8,777	(81 )	(0.9 )%
Net revenues, excluding excise taxes on products	7,355	6,237	1,118	17.9 %
Operating companies income	2,753	2,288	465	20.3 %

For the nine months ended September 30, 2017, net revenues increased by \$1.0 billion. Excluding excise taxes, net revenues increased by \$1.1 billion due to:

• favorable volume/mix (\$758 million) and  
 • price increases (\$393 million), partly offset by  
 • unfavorable currency (\$33 million).

The net revenues of the Asia segment include \$1,819 million in 2017 and \$354 million in 2016 related to the sale of RRPs, mainly driven by Japan. Excluding excise taxes, net revenues for RRPs were \$1,786 million in 2017 and \$354 million in 2016. In some jurisdictions, including Japan, we are not responsible for collecting excise taxes.

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Operating companies income increased by \$465 million during the nine months ended September 30, 2017. This increase was due primarily to:

price increases (\$393 million) and favorable volume/mix (\$151 million), partly offset by higher marketing, administration and research costs (\$50 million) and unfavorable currency (\$26 million).

Asia (in millions)	For the Three Months Ended September 30,			
	2017	2016	Variance	%
Net revenues	\$5,846	\$5,113	\$733	14.3 %
Excise taxes on products	3,116	2,977	139	4.7 %
Net revenues, excluding excise taxes on products	2,730	2,136	594	27.8 %
Operating companies income	1,065	761	304	39.9 %

For the three months ended September 30, 2017, net revenues increased by \$733 million. Excluding excise taxes, net revenues increased by \$594 million due to:

favorable volume/mix (\$540 million) and price increases (\$122 million), partly offset by unfavorable currency (\$68 million).

The net revenues of the Asia segment include \$871 million in 2017 and \$196 million in 2016 related to the sale of RRP's, mainly driven by Japan. Excluding excise taxes, net revenues for RRP's were \$841 million in 2017 and \$196 million in 2016.

Operating companies income increased by \$304 million during the three months ended September 30, 2017. This increase was due primarily to:

favorable volume/mix (\$226 million), price increases (\$122 million) and lower manufacturing costs (\$18 million), partly offset by unfavorable currency (\$55 million).

## Asia - PMI Shipment Volume Commentaries

## Asia PMI Shipment Volume by Brand (Million Units)

	Third-Quarter			Nine Months Year-to-Date		
	2017	2016	Change	2017	2016	Change
Cigarettes						
Marlboro	18,227	18,967	(3.9)	54,255	57,277	(5.3)
Lark	3,539	4,274	(17.2)	11,396	13,421	(15.1)
Parliament	2,269	2,545	(10.8)	7,128	7,534	(5.4)
Others	36,027	35,907	0.3	100,240	117,982	(15.0)



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Total Cigarettes	60,062	61,693	(2.6 )%	173,019	196,214	(11.8 )%
Heated Tobacco Units	8,826	2,006	+100.0%	18,697	3,558	+100.0%
Total Asia	68,888	63,699	8.1 %	191,716	199,772	(4.0 )%

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In the third quarter, our total shipment volume increased by 8.1% to 68.9 billion units, mainly driven by Indonesia, Pakistan, notably reflecting a lower price gap with illicit product following a modification to the excise tax structure, and higher heated tobacco unit volume, mainly in Japan and Korea. The increase was partly offset by cigarette volume declines in Japan, primarily reflecting out-switching to HeatSticks, and the Philippines. The decrease in cigarette shipment volume of Marlboro was notably due to Japan and Korea, primarily reflecting out-switching to our heated tobacco units, partly offset by Indonesia. The decrease in cigarette shipment volume of Lark was primarily due to Japan. The decrease in cigarette shipment volume of Parliament was mainly due to Japan, partly offset by Korea. The increase in cigarette shipment volume of "Others" was mainly driven by Indonesia and low-price brands in Pakistan.

In the third quarter, our total shipment volume benefited from the favorable impact of estimated net combustible and heated tobacco unit inventory movements, driven by approximately 2.1 billion units in Japan. The favorable estimated net inventory movements in Japan, anticipated to continue in the fourth quarter of 2017, primarily reflected the growing demand for HeatSticks and a manufacturing capability sufficient to begin establishing normal levels of distributor inventory of heated tobacco units for risk management purposes, partly offset by a reduction of distributor inventory of combustible products. Excluding the impact of total estimated net inventory movements, our total shipment volume increased by 4.7%.

For the nine months year-to-date, our total shipment volume decreased by 4.0% to 191.7 billion units, mainly due to lower cigarette shipment volume in Indonesia, Japan, Pakistan and the Philippines, partly offset by higher heated tobacco unit volume, mainly in Japan and Korea. The decrease in cigarette shipment volume of Marlboro was mainly due to Japan, primarily reflecting out-switching to HeatSticks, and Korea, partly offset by Indonesia and the Philippines. The decrease in cigarette shipment volume of Lark was primarily due to Japan. The decrease in cigarette shipment volume of Parliament was mainly due to Japan, partly offset by Korea. The decrease in cigarette shipment volume of "Others" was mainly due to Indonesia and local, low-price brands in Pakistan and the Philippines.

For the nine months year-to-date, our total shipment volume benefited from the favorable impact of estimated net combustible and heated tobacco unit inventory movements, driven by approximately 3.5 billion units in Japan. Excluding the impact of these estimated net inventory movements, our total shipment volume decreased by 5.6%.

## Asia - Key Market Commentaries

In Indonesia, estimated cigarette industry size, our cigarette shipment volume, cigarette market share and segmentation performance are shown in the tables below.

	Indonesia Key Market Data							
	Third-Quarter			Nine Months Year-to-Date				
	2017	2016	Change % / p.p.	2017	2016	Change % / p.p.		
Total Cigarette Market (billion units)	79.2	74.4	6.5	% 225.9	235.1	(3.9	)%	
PMI Cigarette Shipments (million units)	26,211	25,084	4.5	% 74,421	78,792	(5.5	)%	
PMI Cigarette Market Share								
Sampoerna A	13.2	% 14.0	% (0.8	)	13.7	% 14.0	% (0.3	)
Dji Sam Soe	8.1	% 6.4	% 1.7		6.9	% 6.5		