

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 March 31, 2015

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 incorporation or organization) (I.R.S. Employer 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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

At April 29, 2015, there were 1,549,145,097 shares outstanding of the registrant's common stock, no par value per share.

PHILIP MORRIS INTERNATIONAL INC.

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

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

Philip Morris International Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in millions of dollars)
(Unaudited)

	March 31, 2015	December 31, 2014
ASSETS		
Cash and cash equivalents	\$ 1,524	\$ 1,682
Receivables (less allowances of \$48 in 2015 and \$50 in 2014)	3,741	4,004
Inventories:		
Leaf tobacco	3,098	3,135
Other raw materials	1,636	1,696
Finished product	2,818	3,761
	7,552	8,592
Deferred income taxes	457	533
Other current assets	1,001	673
Total current assets	14,275	15,484
Property, plant and equipment, at cost	12,085	12,759
Less: accumulated depreciation	6,388	6,688
	5,697	6,071
Goodwill (Note 5)	7,920	8,388
Other intangible assets, net (Note 5)	2,855	2,985
Investments in unconsolidated subsidiaries (Note 15)	1,064	1,083
Other assets	1,444	1,176
TOTAL ASSETS	\$ 33,255	\$ 35,187

See notes to condensed consolidated financial statements.

Continued

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

	March 31, 2015	December 31, 2014
LIABILITIES		
Short-term borrowings (Note 11)	\$ 3,384	\$ 1,208
Current portion of long-term debt (Note 11)	1,629	1,318
Accounts payable	1,038	1,242
Accrued liabilities:		
Marketing and selling	437	549
Taxes, except income taxes	3,945	5,490
Employment costs	848	1,135
Dividends payable	1,559	1,559
Other	1,482	1,375
Income taxes	493	1,078
Deferred income taxes	165	158
Total current liabilities	<u>14,980</u>	<u>15,112</u>
Long-term debt (Note 11)	25,572	26,929
Deferred income taxes	1,975	1,549
Employment costs	2,097	2,202
Other liabilities	877	598
Total liabilities	<u>45,501</u>	<u>46,390</u>
Contingencies (Note 9)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Common stock, no par value (2,109,316,331 shares issued in 2015 and 2014)	—	—
Additional paid-in capital	613	710
Earnings reinvested in the business	29,489	29,249
Accumulated other comprehensive losses	(8,090)	(6,826)
	<u>22,012</u>	<u>23,133</u>
Less: cost of repurchased stock (560,220,461 and 562,416,635 shares in 2015 and 2014, respectively)	35,628	35,762
Total PMI stockholders' deficit	<u>(13,616)</u>	<u>(12,629)</u>
Noncontrolling interests	1,370	1,426
Total stockholders' deficit	<u>(12,246)</u>	<u>(11,203)</u>
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	<u>\$ 33,255</u>	<u>\$ 35,187</u>

See notes to condensed consolidated financial statements.

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 March 31,	
	2015	2014
Net revenues	\$ 17,352	\$ 17,779
Cost of sales	2,229	2,374
Excise taxes on products	10,736	10,862
Gross profit	4,387	4,543
Marketing, administration and research costs	1,494	1,547
Asset impairment and exit costs (Note 2)	—	23
Amortization of intangibles	22	22
Operating income	2,871	2,951
Interest expense, net	275	268
Earnings before income taxes	2,596	2,683
Provision for income taxes	785	776
Equity (income)/loss in unconsolidated subsidiaries, net	(23)	(9)
Net earnings	1,834	1,916
Net earnings attributable to noncontrolling interests	39	41
Net earnings attributable to PMI	<u>\$ 1,795</u>	<u>\$ 1,875</u>
Per share data (Note 7):		
Basic earnings per share	<u>\$ 1.16</u>	<u>\$ 1.18</u>
Diluted earnings per share	<u>\$ 1.16</u>	<u>\$ 1.18</u>
Dividends declared	<u>\$ 1.00</u>	<u>\$ 0.94</u>

See notes to condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2015	2014
Net earnings	\$ 1,834	\$ 1,916
Other comprehensive earnings (losses), net of income taxes:		
Change in currency translation adjustments:		
Unrealized losses, net of income taxes of (\$434) in 2015 and (\$4) in 2014	(1,343)	(37)
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 2015 and (\$12) in 2014	56	38
Change in fair value of derivatives accounted for as hedges:		
Gains (losses) recognized, net of income taxes of (\$2) in 2015 and \$3 in 2014	25	(24)
Gains transferred to earnings, net of income taxes of \$3 in 2015 and \$1 in 2014	(27)	(7)
Total other comprehensive losses	(1,289)	(30)
Total comprehensive earnings	545	1,886
Less comprehensive earnings attributable to:		
Noncontrolling interests	14	34
Comprehensive earnings attributable to PMI	\$ 531	\$ 1,852

See notes to condensed consolidated financial statements

Philip Morris International Inc. and Subsidiaries
 Condensed Consolidated Statements of Stockholders' (Deficit) Equity
 For the Three Months Ended March 31, 2015 and 2014
 (in millions of dollars, except per share amounts)
 (Unaudited)

	PMI Stockholders' (Deficit) Equity						
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Losses	Cost of Repurchased Stock	Noncontrolling Interests	Total
Balances, January 1, 2014	\$ —	\$ 723	\$ 27,843	\$ (4,190)	\$ (32,142)	\$ 1,492	\$ (6,274)
Net earnings			1,875			41	1,916
Other comprehensive earnings (losses), net of income taxes				(23)		(7)	(30)
Issuance of stock awards and exercise of stock options		(115)			156		41
Dividends declared (\$0.94 per share)			(1,490)				(1,490)
Payments to noncontrolling interests						(70)	(70)
Common stock repurchased					(1,250)		(1,250)
Balances, March 31, 2014	<u>\$ —</u>	<u>\$ 608</u>	<u>\$ 28,228</u>	<u>\$ (4,213)</u>	<u>\$ (33,236)</u>	<u>\$ 1,456</u>	<u>\$ (7,157)</u>
Balances, January 1, 2015	\$ —	\$ 710	\$ 29,249	\$ (6,826)	\$ (35,762)	\$ 1,426	\$ (11,203)
Net earnings			1,795			39	1,834
Other comprehensive earnings (losses), net of income taxes				(1,264)		(25)	(1,289)
Issuance of stock awards		(97)			134		37
Dividends declared (\$1.00 per share)			(1,555)				(1,555)
Payments to noncontrolling interests						(70)	(70)
Common stock repurchased					—		—
Balances, March 31, 2015	<u>\$ —</u>	<u>\$ 613</u>	<u>\$ 29,489</u>	<u>\$ (8,090)</u>	<u>\$ (35,628)</u>	<u>\$ 1,370</u>	<u>\$ (12,246)</u>

See notes to condensed consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2015	2014
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings	\$ 1,834	\$ 1,916
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	192	211
Deferred income tax provision	132	86
Asset impairment and exit costs, net of cash paid	(160)	(177)
Cash effects of changes, net of the effects from acquired companies:		
Receivables, net	54	395
Inventories	393	1,086
Accounts payable	44	35
Income taxes	(535)	(762)
Accrued liabilities and other current assets	(2,327)	(2,131)
Pension plan contributions	(9)	(29)
Other	7	85
Net cash provided by (used in) operating activities	(375)	715
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Capital expenditures	(203)	(256)
Investments in unconsolidated subsidiaries	(8)	—
Other	279	48
Net cash provided by (used in) investing activities	68	(208)

See notes to condensed consolidated financial statements.

Continued

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

	For the Three Months Ended March 31,	
	2015	2014
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Short-term borrowing activity by original maturity:		
Net issuances - maturities of 90 days or less	\$ 2,237	\$ 655
Issuances - maturities longer than 90 days	13	744
Repayments - maturities longer than 90 days	—	(465)
Long-term debt proceeds	302	2,359
Long-term debt repaid	(399)	(1,240)
Repurchases of common stock	(48)	(1,241)
Dividends paid	(1,555)	(1,503)
Other	(25)	(114)
Net cash provided by (used in) financing activities	525	(805)
Effect of exchange rate changes on cash and cash equivalents	(376)	(33)
Cash and cash equivalents:		
Decrease	(158)	(331)
Balance at beginning of period	1,682	2,154
Balance at end of period	\$ 1,524	\$ 1,823

See notes to condensed consolidated financial statements.

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 U.S. generally accepted accounting principles 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, 2014.

Note 2. Asset Impairment and Exit Costs:

Pre-tax asset impairment and exit costs consisted of the following:

(in millions)	For the Three Months Ended March 31,	
	2015	2014
Separation programs:		
Asia	\$ —	\$ 23
Total separation programs	—	23
Asset impairment and exit costs	\$ —	\$ 23

Exit Costs

Separation Programs

PMI recorded pre-tax separation program charges of \$23 million for the three months ended March 31, 2014. These charges related to severance costs for a factory closure in Australia.

Movement in Exit Cost Liabilities

The movement in exit cost liabilities for the three months ended March 31, 2015 was as follows:

(in millions)	
Liability balance, January 1, 2015	\$ 270
Charges, net	—
Cash spent	(160)
Currency/other	(15)
Liability balance, March 31, 2015	\$ 95

Cash payments related to exit costs at PMI were \$160 million and \$200 million for the three months ended March 31, 2015 and 2014, respectively. Future cash payments for exit costs incurred to date are expected to be approximately \$95 million, and will be substantially paid by the end of 2015.

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

Note 3. Stock Plans:

In May 2012, PMI’s shareholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the “2012 Plan”). The 2012 Plan replaced the 2008 Performance Incentive Plan (the “2008 Plan”) and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of PMI’s common stock may be issued under the 2012 Plan. At March 31, 2015, shares available for grant under the 2012 Plan were 23,252,170.

In 2008, PMI adopted the Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (the “Non-Employee Directors 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 Non-Employee Directors Plan. At March 31, 2015, shares available for grant under the plan were 715,185.

During the three months ended March 31, 2015, PMI granted 1.5 million shares of deferred stock awards to eligible employees at a grant date fair value of \$82.28 per share. During the three months ended March 31, 2014, PMI granted 2.4 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of \$77.74 per share. PMI recorded compensation expense related to stock awards of \$58 million and \$66 million during the three months ended March 31, 2015 and 2014, respectively. As of March 31, 2015, PMI had \$251 million of total unrecognized compensation cost related to non-vested deferred stock awards. The cost is recognized over the original restriction period of the awards, which is typically three or more years after the date of the award, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

During the three months ended March 31, 2015, 2.5 million shares of PMI deferred stock awards vested. The grant date fair value of all the vested shares was approximately \$196 million. The total fair value of deferred stock awards that vested during the three months ended March 31, 2015 was approximately \$203 million.

Note 4. 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 Three Months Ended March 31,		For the Three Months Ended March 31,	
	2015	2014	2015	2014
Service cost	\$ 1	\$ 1	\$ 51	\$ 52
Interest cost	5	4	36	51
Expected return on plan assets	(4)	(4)	(83)	(88)
Amortization:				
Net loss	3	2	46	28
Prior service cost	—	—	1	2
Net periodic pension cost	\$ 5	\$ 3	\$ 51	\$ 45

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 \$9 million were made to the pension plans during the three months ended March 31, 2015. Currently, PMI anticipates making additional contributions during the remainder of 2015 of approximately \$131 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 rates.

Note 5. Goodwill and Other Intangible Assets, net:

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

(in millions)	Goodwill		Other Intangible Assets, net	
	March 31, 2015	December 31, 2014	March 31, 2015	December 31, 2014
European Union	\$ 1,277	\$ 1,398	\$ 556	\$ 582
Eastern Europe, Middle East & Africa	481	517	211	215
Asia	3,764	3,904	1,156	1,207
Latin America & Canada	2,398	2,569	932	981
Total	\$ 7,920	\$ 8,388	\$ 2,855	\$ 2,985

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, 2014, were as follows:

(in millions)	European Union	Eastern Europe, Middle East & Africa	Asia	Latin America & Canada	Total
Balances, December 31, 2014	\$ 1,398	\$ 517	\$ 3,904	\$ 2,569	\$ 8,388
Changes due to:					
Currency	(121)	(36)	(140)	(171)	(468)
Balances, March 31, 2015	\$ 1,277	\$ 481	\$ 3,764	\$ 2,398	\$ 7,920

Additional details of other intangible assets were as follows:

(in millions)	March 31, 2015		December 31, 2014	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	\$ 1,641		\$ 1,704	
Amortizable intangible assets	1,799	\$ 585	1,877	\$ 596
Total other intangible assets	\$ 3,440	\$ 585	\$ 3,581	\$ 596

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, distribution networks and non-compete agreements associated with business combinations. The gross carrying amount, the range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at March 31, 2015, were as follows:

(dollars in millions)	Gross Carrying Amount	Initial Estimated Useful Lives	Weighted-Average Remaining Useful Life
Trademarks	\$ 1,444	2 - 40 years	23 years
Distribution networks	161	5 - 30 years	12 years
Non-compete agreements	108	4 - 10 years	0.2 years
Other (including farmer contracts and intellectual property rights)	86	10 - 17 years	12 years
	\$ 1,799		

Pre-tax amortization expense for intangible assets was \$22 million for each of the three months ended March 31, 2015 and 2014. Amortization expense for each of the next five years is estimated to be \$81 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The decrease in the gross carrying amount of other intangible assets from December 31, 2014, was due to currency movements.

During the first quarter of 2015, 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.

Note 6. 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, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At March 31, 2015, PMI had contracts with aggregate notional amounts of \$18.7 billion of which \$2.1 billion related to cash flow hedges, \$3.8 billion related to hedges of net investments in foreign operations and \$12.8 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

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

The fair value of PMI's foreign exchange contracts included in the condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014, were as follows:

(in millions)	Asset Derivatives				Liability Derivatives			
	Balance Sheet Classification	Fair Value		Balance Sheet Classification	Fair Value			
		At March 31, 2015	At December 31, 2014		At March 31, 2015	At December 31, 2014		
Foreign exchange contracts designated as hedging instruments	Other current assets	\$ 132	\$ 248	Other liabilities	\$ 42	\$ 25		
	Other assets	416	122					
Foreign exchange contracts not designated as hedging instruments	Other current assets	65	34	Other accrued liabilities	347	126		
	Other assets	59	2					
Total derivatives		\$ 672	\$ 406		\$ 389	\$ 151		

For the three months ended March 31, 2015 and 2014, PMI's cash flow and net investment hedging instruments impacted the consolidated statements of earnings and comprehensive earnings as follows:

(pre-tax, millions)	For the Three Months Ended March 31,					
	Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives		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	
	2015	2014			2015	2014
Derivatives in Cash Flow Hedging Relationship						
Foreign exchange contracts	\$ 27	\$ (27)			\$ 30	\$ 15
			Net revenues		\$ 30	\$ 15
			Marketing, administration and research costs		7	—
			Interest expense, net		(7)	(7)
Derivatives in Net Investment Hedging Relationship						
Foreign exchange contracts	286	25				
Total	\$ 313	\$ (2)			\$ 30	\$ 8

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

Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk 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 three months ended March 31, 2015 and 2014, ineffectiveness related to cash flow hedges was not material. As of March 31, 2015, PMI has hedged forecasted transactions for periods not exceeding the next twenty-one 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 statement 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 three months ended March 31, 2015 and 2014, these hedges of net investments resulted in gains net of income taxes, of \$835 million and \$17 million, respectively. These gains were reported as a component of accumulated other comprehensive losses within currency translation adjustments. For the three months ended March 31, 2015 and 2014, ineffectiveness related to net investment hedges was not material. Other investing cash flows on PMI's condensed consolidated statements of cash flows include the premiums paid for, and settlements of, net investment hedges.

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 statement of earnings. For the three months ended March 31, 2015 and 2014, the losses from contracts for which PMI did not apply hedge accounting were \$751 million and \$48 million, respectively. The losses from these contracts substantially offset the gains generated by the underlying intercompany and third-party loans being hedged.

For the three months ended March 31, 2015 and 2014, the net impact of these contracts on the condensed consolidated statements of earnings was immaterial.

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 Three Months Ended March 31,	
	2015	2014
Gain as of January 1,	\$ 123	\$ 63
Derivative gains transferred to earnings	(27)	(7)
Change in fair value	25	(24)
Gain as of March 31,	\$ 121	\$ 32

At March 31, 2015, PMI expects \$85 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 twelve 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

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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 12. *Fair Value Measurements* and Note 14. *Balance Sheet Offsetting* for additional discussion of derivative financial instruments.

Note 7. Earnings Per Share:

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

(in millions)	For the Three Months Ended March 31,	
	2015	2014
Net earnings attributable to PMI	\$ 1,795	\$ 1,875
Less distributed and undistributed earnings attributable to share-based payment awards	7	9
Net earnings for basic and diluted EPS	\$ 1,788	\$ 1,866
Weighted-average shares for basic and diluted EPS	1,548	1,583

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 2015 and 2014 computations, there were no antidilutive stock options.

Note 8. 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 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.

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Segment data were as follows:

(in millions)	For the Three Months Ended March 31,	
	2015	2014
Net revenues:		
European Union	\$ 5,940	\$ 6,619
Eastern Europe, Middle East & Africa	4,429	4,562
Asia	4,764	4,475
Latin America & Canada	2,219	2,123
Net revenues	\$ 17,352	\$ 17,779
Earnings before income taxes:		
Operating companies income:		
European Union	\$ 913	\$ 978
Eastern Europe, Middle East & Africa	880	927
Asia	934	915
Latin America & Canada	230	202
Amortization of intangibles	(22)	(22)
General corporate expenses	(41)	(40)
Less:		
Equity (income)/loss in unconsolidated subsidiaries, net	(23)	(9)
Operating income	2,871	2,951
Interest expense, net	(275)	(268)
Earnings before income taxes	\$ 2,596	\$ 2,683

Items affecting the comparability of results from operations are asset impairment and exit costs. See Note 2. *Asset Impairment and Exit Costs* for a breakdown of these costs by segment.

Note 9. 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 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

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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, if any. 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, we have paid one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately \$1,500), and that payment was made in order to appeal an Italian small claims case, which was subsequently reversed on appeal. 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 April 30, 2015, May 1, 2014 and May 1, 2013:

Type of Case	Number of Cases Pending as of April 30, 2015	Number of Cases Pending as of May 1, 2014	Number of Cases Pending as of May 1, 2013
Individual Smoking and Health Cases	61	65	71
Smoking and Health Class Actions	11	11	11
Health Care Cost Recovery Actions	16	15	15
Lights Class Actions	—	1	2
Individual Lights Cases	2	2	1
Public Civil Actions	2	2	4

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 434 Smoking and Health, Lights, 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. Ten cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and one remains on appeal.

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The table below lists the verdict and post-trial developments in the remaining case where a verdict was returned in favor of the plaintiff:

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. 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.	In April 2004, the court clarified its ruling, awarding “moral damages” of R\$1,000 (approximately \$340) 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. Plaintiff appealed the decision. In February 2015, the court unanimously dismissed plaintiff’s appeal. Plaintiff may further appeal. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that the plaintiff did not have standing to bring the lawsuit. This appeal is still pending.

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 April 30, 2015, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

- 61 cases brought by individual plaintiffs in Argentina (23), Brazil (22), Canada (2), Chile (7), Costa Rica (2), Greece (1), Italy (2), the Philippines (1) and Scotland (1), compared with 65 such cases on May 1, 2014, and 71 cases on May 1, 2013; and
- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on May 1, 2014 and 11 such cases on May 1, 2013.

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

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for smokers and former smokers and injunctive relief. The verdict and post-trial developments in this case are described in the above table.

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, 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 Letourneau 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 are defendants. The plaintiff, an individual smoker, is seeking compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began in March 2012 and concluded in December 2014. The parties now await the judgment. There is no fixed time period by which the trial court must issue its decision.

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 are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, are seeking compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began in March 2012 and concluded in December 2014. The parties now await the judgment. There is no fixed time period by which the trial court must issue its decision.

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 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).

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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, the 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 April 30, 2015, 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 15 such cases on May 1, 2014 and 15 such cases on May 1, 2013.

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 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

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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 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.” Preliminary motions are pending.

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.” Preliminary motions are pending.

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.” In December 2014, defendants began filing their statements of defense.

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.” Preliminary motions are pending.

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.” In September 2014, defendants filed their statements of defense. Discovery is scheduled to begin in 2017.

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 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.

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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.” In January 2015, we, our subsidiaries, and our indemnitees were served with the statement of claim. Preliminary motions are pending. Defenses are scheduled to be filed during 2015, and 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.

Lights Cases: These cases, brought by individual plaintiffs, or on behalf of a class of individual plaintiffs, allege that the use of the term “lights” constitutes fraudulent and misleading conduct. Plaintiffs' allegations of liability in these cases are based on various theories of recovery 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.

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As of April 30, 2015, there were 2 lights cases brought by individual plaintiffs pending against our subsidiaries or indemnitees in Chile (1) and Italy (1), compared with 2 such cases on May 1, 2014, and 1 such case on May 1, 2013.

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 April 30, 2015, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 2 such cases on May 1, 2014, and 4 such cases on May 1, 2013.

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 the 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

We are also involved in other 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 10. 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 three months ended March 31, 2015 and 2014 were 30.2% and 28.9%, respectively. PMI estimates that its full-year 2015 effective tax rate will be approximately 29%. The effective tax rate for the three months ended March 31, 2015 was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). Excluding the effect of the 2015 repatriation assertion changes, the change in the effective tax rate for the three months ended March 31, 2015, as compared to the three months ended March 31, 2014, 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 earnings mix by taxing jurisdiction or in 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 2007 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 11. Indebtedness:

Short-term Borrowings:

At March 31, 2015 and December 31, 2014, PMI's short-term borrowings, consisting of commercial paper and bank loans to certain PMI subsidiaries, had a carrying value of \$3,384 million and \$1,208 million, respectively. The fair value of PMI's short-term borrowings, based on current market interest rates, approximates carrying value.

Long-term Debt:

At March 31, 2015 and December 31, 2014, PMI's long-term debt consisted of the following:

(in millions)	March 31, 2015	December 31, 2014
U.S. dollar notes, 1.125% to 6.375% (average interest rate 3.874%), due through 2044	\$ 16,831	\$ 17,229
Foreign currency obligations:		
Euro notes, 1.750% to 5.875% (average interest rate 3.104%), due through 2033	8,165	9,161
Swiss franc notes, 0.750% to 2.000% (average interest rate 1.217%), due through 2024	1,736	1,690
Other (average interest rate 3.125%), due through 2024	469	167
	27,201	28,247
Less current portion of long-term debt	1,629	1,318
	\$ 25,572	\$ 26,929

Other foreign currency debt above includes mortgage debt in Switzerland and capital lease obligations at March 31, 2015 and December 31, 2014.

Credit Facilities:

On January 23, 2015, PMI entered into an agreement to extend the term of its existing \$2.0 billion 364-day revolving credit facility, effective February 10, 2015, from February 10, 2015 to February 9, 2016. On January 23, 2015, PMI also entered into an agreement to extend the term of its existing \$2.5 billion multi-year revolving credit facility, effective February 28, 2015, from February 28, 2019 to February 28, 2020.

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At March 31, 2015, PMI's total committed credit facilities were as follows:

(in billions)

Type	Committed Credit Facilities
364-day revolving credit, expiring February 9, 2016	\$ 2.0
Multi-year revolving credit, expiring February 28, 2020	2.5
Multi-year revolving credit, expiring October 25, 2016	3.5
Total facilities	\$ 8.0

At March 31, 2015, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

Note 12. 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:

- 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 6. *Financial Instruments* for an 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 \$12 million of capital lease obligations, was \$27,189 million at March 31, 2015. The fair value of PMI's outstanding debt, excluding the aforementioned short-term borrowings and capital lease obligations, has been classified within Level 1 and Level 2 in the table shown below.

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Contingent Consideration

The fair value of PMI's contingent consideration relating to acquisitions is determined utilizing a discounted cash flow approach using various probability weighted scenarios. The significant unobservable inputs used in calculating the fair value of the contingent consideration includes financial performance scenarios, the probability of achieving those scenarios, and the discount rate. PMI's contingent consideration has been classified within Level 3 in the table shown below. For additional information, see Note 16. *Acquisitions and Other Business Arrangements*.

The aggregate fair values of PMI's derivative financial instruments, debt and contingent consideration as of March 31, 2015, were as follows:

(in millions)	Fair Value at March 31, 2015	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Foreign exchange contracts	\$ 672	\$ —	\$ 672	\$ —
Total assets	\$ 672	\$ —	\$ 672	\$ —
Liabilities:				
Debt	\$ 29,881	\$ 29,396	\$ 485	\$ —
Foreign exchange contracts	389	—	389	—
Contingent consideration	21	—	—	21
Total liabilities	\$ 30,291	\$ 29,396	\$ 874	\$ 21

Note 13. Accumulated Other Comprehensive Losses:

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

(in millions)	At March 31, 2015	At December 31, 2014	At March 31, 2014
Currency translation adjustments	\$ (5,247)	\$ (3,929)	\$ (2,237)
Pension and other benefits	(2,964)	(3,020)	(2,008)
Derivatives accounted for as hedges	121	123	32
Total accumulated other comprehensive losses	\$ (8,090)	\$ (6,826)	\$ (4,213)

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 three months ended March 31, 2015 and 2014. For additional information, see Note 4. *Benefit Plans* and Note 6. *Financial Instruments* for disclosures related to PMI's pension and other benefits, and derivative financial instruments, respectively.

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Note 14. 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 6. *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 Amounts Recognized	Gross Amount Offset in the Condensed Consolidated Balance Sheet	Net Amounts Presented in the Condensed Consolidated Balance Sheet	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received/ Pledged	
At March 31, 2015						
Assets						
Foreign exchange contracts	\$ 672	\$ —	\$ 672	\$ (157)	\$ (447)	68
Liabilities						
Foreign exchange contracts	\$ 389	\$ —	\$ 389	\$ (157)	\$ (215)	17
At December 31, 2014						
Assets						
Foreign exchange contracts	\$ 406	\$ —	\$ 406	\$ (77)	\$ (306)	23
Liabilities						
Foreign exchange contracts	\$ 151	\$ —	\$ 151	\$ (77)	\$ (63)	11

Note 15. Investments in Unconsolidated Subsidiaries:

At March 31, 2015 and December 31, 2014, PMI had total investments in unconsolidated subsidiaries of \$1,064 million and \$1,083 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 the acquisition date exceeded our share of the unconsolidated subsidiaries' book value by \$1,417 million, including \$1,264 million attributable to goodwill. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding the \$1,264 million attributable to goodwill, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 3 to 20 years. As of March 31, 2015, PMI received no dividends from unconsolidated subsidiaries. At December 31, 2014, PMI received year-to-date dividends from unconsolidated subsidiaries of \$107 million.

On September 30, 2013, PMI acquired a 49% equity interest in United Arab Emirates-based Emirati Investors-TA (FZC) ("EITA"), formerly Arab Investors-TA (FZC), for approximately \$625 million. As a result of this transaction, 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. The initial investment in EITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

On December 12, 2013, PMI acquired from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), PMI's distributor in Russia, for a purchase price of \$760 million. An

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additional payment of up to \$100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by PMI if the performance criteria are satisfied. PMI has also agreed to provide Megapolis Investment BV with a \$100 million interest-bearing loan. PMI and Megapolis Investment BV have agreed to set off any future contingent payments owed by PMI against the future repayments due under the loan agreement. Any loan repayments in excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to PMI on March 31, 2017. At December 31, 2013, PMI had recorded a \$100 million asset related to the loan receivable and a discounted liability of \$86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

At March 31, 2015 and December 31, 2014, PMI's investments in other unconsolidated subsidiaries were \$41 million and \$38 million, respectively, with ownership percentages ranging from 40% to 50%.

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

(in millions)	For the Three Months Ended March 31,	
	2015	2014
Net revenues	\$ 896	\$ 1,186

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

(in millions)	At March 31, 2015	At December 31, 2014
Receivables	\$ 457	\$ 407
Notes receivable	\$ 102	\$ 100
Other liabilities	\$ 95	\$ 93

The activity primarily related to agreements with PMI's unconsolidated subsidiaries within the Eastern Europe, Middle East & Africa Region. 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 16. Acquisitions and Other Business Arrangements:

In June 2014, PMI acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. As of March 31, 2015, the additional contingent payments were up to \$59 million over the remaining two-year period. For additional information regarding this contingent consideration, see Note 12. *Fair Value Measurements*.

In May 2013, PMI announced that Grupo Carso, S.A.B. de C.V. ("Grupo Carso") would sell to PMI its remaining 20% interest in PMI's Mexican tobacco business. The sale was completed on September 30, 2013, for \$703 million. As a result, PMI now owns 100% of its Mexican tobacco business. A director of PMI has an affiliation with Grupo Carso. The final purchase price is subject to a potential adjustment based on the actual performance of the Mexican tobacco business over the three-year period ending two fiscal years after the closing of the purchase. In addition, upon declaration, PMI agreed to pay a dividend of approximately \$38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a decrease to PMI's additional paid-in capital of \$672 million.

The effects of these and other smaller acquisitions were not material to PMI's condensed consolidated financial position, results of operations or operating cash flows in any of the periods presented.

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Note 17. New Accounting Standards:

On May 28, 2014, the Financial Accounting Standards Board ("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 to in exchange for those goods or services.

Entities can apply the final standard using one of the following two methods:

1. retrospectively to each prior period presented; or
2. retrospectively, with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application, with additional disclosures in reporting periods that include the date of initial application.

ASU 2014-09 is effective for interim and annual reporting periods beginning on or after January 1, 2017. In April 2015, the FASB proposed to defer implementation until January 1, 2018. If the FASB adopts the proposal to defer implementation, early application would be permitted, but not before the original effective date of January 1, 2017. PMI is currently assessing the impact that the adoption of ASU 2014-09 will have on its financial position or results of operations.

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. We manage our business in four segments:

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

Our products are sold in more than 180 markets and, in many of these markets, we 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.

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 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.

Executive Summary

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

Consolidated Operating Results for the Three Months Ended March 31, 2015 – The changes in our reported diluted earnings per share ("diluted EPS") for the three months ended March 31, 2015, from the comparable 2014 amounts, were as follows:

	Diluted EPS	% Growth
For the three months ended March 31, 2014	\$ 1.18	
2014 Asset impairment and exit costs	0.01	
2014 Tax items	—	
Subtotal of 2014 items	0.01	
2015 Asset impairment and exit costs	—	
2015 Tax items	—	
Subtotal of 2015 items	—	
Currency	(0.31)	
Interest	(0.01)	
Change in tax rate	(0.03)	
Impact of lower shares outstanding and share-based payments	0.04	
Operations	0.28	
For the three months ended March 31, 2015	\$ 1.16	(1.7)%

Asset Impairment and Exit Costs – During the first quarter of 2014, we decided to cease cigarette production in Australia by the end of 2014 and transition all Australian cigarette production to our affiliate in South Korea. As a result, we recorded pre-tax asset impairment and exit costs of \$23 million (\$16 million after tax or \$0.01 per share) related to severance costs for the factory closure in Australia.

Income Taxes – Our effective income tax rate for the three months ended March 31, 2015 increased by 1.3 percentage points to 30.2%. The change in the tax rate decreased our diluted EPS by \$0.03 per share in 2015. The effective tax rate during the first quarter of 2015 was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). Excluding the effect of the 2015 repatriation assertion changes, the change in the effective tax rate for the three months ended March 31, 2015, as compared to the three months ended March 31, 2014, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences. We estimate that our full-year 2015 effective tax rate will be approximately 29%.

Currency – The unfavorable currency impact during the reporting period results from the strengthening of the U.S. dollar, especially against the Euro, Indonesian rupiah, Japanese yen, Russian ruble and the Ukraine hryvnia. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The unfavorable impact of interest was due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Lower Shares Outstanding and Share-Based Payments – The favorable diluted EPS impact was due to the repurchase of our common stock in 2014 pursuant to our share repurchase program.

Operations – The increase in diluted EPS of \$0.28 from our operations in the table above was due primarily to the following segments:

- EEMA: Higher pricing, favorable volume/mix and higher equity income in unconsolidated subsidiaries derived from our investments in North Africa and Russia, partially offset by higher manufacturing costs and higher marketing, administration and research costs;

- European Union: Higher pricing, favorable volume/mix and lower manufacturing costs, partially offset by higher marketing, administration and research costs;
- Asia: Higher pricing, partially offset by unfavorable volume/mix and higher manufacturing costs; and
- Latin America & Canada: Higher pricing, partially offset by unfavorable volume/mix, higher manufacturing costs and higher marketing, administration and research costs.

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

2015 Forecasted Results - On April 16, 2015, we increased our 2015 full-year reported diluted EPS forecast to be in a range of \$4.32 to \$4.42, at prevailing exchange rates at that time, versus \$4.76 in 2014. Excluding an unfavorable currency impact, at then-prevailing exchange rates, of approximately \$1.15 per share for the full-year 2015, the reported diluted earnings per share range represents a projected increase of 9% to 11% versus adjusted diluted earnings per share of \$5.02 in 2014, compared to 8% to 10% as communicated in our previous forecast of February 2015. This forecast includes incremental spending versus 2014 for the deployment of our Reduced-Risk Product, *iQOS*. The spending, which is skewed towards the second half of the year, will support our plans for national expansion in Japan and Italy, as well as pilot or national launches in additional markets, later in 2015. This forecast does not include any share repurchases in 2015.

We calculated 2014 adjusted diluted EPS as reported diluted EPS of \$4.76, plus the \$0.26 per share charge related to asset impairment and exit costs.

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, discrete tax items and 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 2015 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 55-59 for a discussion of our "Cautionary Factors That May Affect Future Results." Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

(in millions)	For the Three Months Ended March 31,	
	2015	2014
Cigarette volume:		
European Union	42,721	41,705
Eastern Europe, Middle East & Africa	64,721	62,006
Asia	70,125	70,801
Latin America & Canada	21,190	21,449
Total cigarette volume	198,757	195,961
Net revenues:		
European Union	\$ 5,940	\$ 6,619
Eastern Europe, Middle East & Africa	4,429	4,562
Asia	4,764	4,475
Latin America & Canada	2,219	2,123
Net revenues	\$ 17,352	\$ 17,779
Excise taxes on products:		
European Union	\$ 4,048	\$ 4,606
Eastern Europe, Middle East & Africa	2,586	2,553
Asia	2,609	2,293
Latin America & Canada	1,493	1,410
Excise taxes on products	\$ 10,736	\$ 10,862
Operating income:		
Operating companies income:		
European Union	\$ 913	\$ 978
Eastern Europe, Middle East & Africa	880	927
Asia	934	915
Latin America & Canada	230	202
Amortization of intangibles	(22)	(22)
General corporate expenses	(41)	(40)
Less:		
Equity (income)/loss in unconsolidated subsidiaries, net	(23)	(9)
Operating income	\$ 2,871	\$ 2,951

As discussed in Note 8. *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.

References to total international cigarette market, total cigarette market, total market and market shares throughout this "Discussion and Analysis" reflect our best estimates based on a number of internal and external sources.

Consolidated Operating Results for the Three Months Ended March 31, 2015

The following discussion compares our consolidated operating results for the three months ended March 31, 2015, with the three months ended March 31, 2014.

Our cigarette shipment volume of 198.8 billion units increased by 1.4% excluding acquisitions, or by 2.7 billion units. Excluding acquisitions and inventory movements, notably in Italy, Spain and other markets, principally in EEMA, our cigarette shipment volume decreased by 0.5%, due to:

- Asia, mainly Japan, principally reflecting an unfavorable comparison with the first quarter of 2014, and Korea, resulting from the excise tax increase in January 2015, partially offset by Indonesia; and
- Latin America & Canada, mainly Argentina and Canada, partially offset by Brazil and Mexico.

Our cigarette market share increased in a number of key markets, including Algeria, Argentina, Australia, Austria, Belgium, the Czech Republic, Egypt, France, Germany, Hong Kong, Indonesia, Italy, Japan, Korea, the Netherlands, Poland, Russia, Saudi Arabia, Spain and Switzerland.

Total cigarette shipments of *Marlboro* of 67.2 billion units increased by 2.1%, driven by: the European Union, notably France, Italy and Spain; and EEMA, notably Algeria, Saudi Arabia and Turkey, partly offset by Egypt and Ukraine. Total shipments of *Marlboro* decreased in Asia, predominantly due to Japan and Korea, partially offset by the Philippines, and declined slightly in Latin America & Canada, mainly due to Argentina, partially offset by Brazil and Mexico.

Total cigarette shipments of *L&M* of 22.7 billion units increased by 8.2%, driven by growth in EEMA, notably Egypt, Turkey and Ukraine, and in Asia, mainly Thailand. Total cigarette shipments of *L&M* in the European Union were essentially flat, with growth in the Czech Republic, Germany and Spain offset by declines in other markets, mainly France. Total cigarette shipments of *Parliament* of 9.6 billion units decreased by 3.5%, primarily due to Korea and Ukraine, partially offset by growth in Russia and Turkey. Total cigarette shipments of *Chesterfield* of 9.5 billion units increased by 8.6%, driven primarily by Italy, partly offset by Russia and Ukraine. Total cigarette shipments of *Bond Street* of 9.2 billion units decreased by 1.1%, predominantly due to Kazakhstan and Ukraine, partly offset by Australia and Russia. Total cigarette shipments of *Philip Morris* of 7.8 billion units decreased by 3.3%, principally reflecting the morphing to *Lark* in Japan. Total cigarette shipments of *Lark* of 6.4 billion units decreased by 5.6%, predominantly due to Korea and Turkey.

Our other tobacco products ("OTP") primarily include tobacco for roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos. Total shipment volume of OTP, in cigarette equivalent units, increased by 2.1%, mainly reflecting growth in the fine cut category, notably in the Czech Republic and Italy, partly offset by Germany and Portugal.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, increased by 1.4%, excluding acquisitions.

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

(in millions)	For the Three Months Ended March 31,		Variance	%
	2015	2014		
Net revenues	\$ 17,352	\$ 17,779	\$ (427)	(2.4)%
Excise taxes on products	10,736	10,862	(126)	(1.2)%
Net revenues, excluding excise taxes on products	\$ 6,616	\$ 6,917	\$ (301)	(4.4)%

Currency movements decreased net revenues by \$2.4 billion and net revenues, excluding excise taxes on products, by \$939 million. The \$939 million decrease was due primarily to the Argentine peso, Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Polish zloty, Russian ruble, Turkish lira and the Ukraine hryvnia.

Net revenues include \$443 million in 2015 and \$470 million in 2014 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excise taxes, net revenues for OTP were \$164 million in 2015 and \$177 million in 2014.

Net revenues, which include excise taxes billed to customers, decreased by \$427 million (2.4)%. Excluding excise taxes, net revenues decreased by \$301 million (4.4)% to \$6.6 billion. This decrease was due to:

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- unfavorable currency (\$939 million), partly offset by
- price increases (\$552 million),
- favorable volume/mix (\$78 million), and
- the impact of acquisitions (\$8 million).

Excise taxes on products decreased by \$126 million (1.2)%, due to:

- favorable currency (\$1.5 billion), partly offset by
- higher excise taxes resulting from changes in retail prices and tax rates (\$1.2 billion),
- higher excise taxes resulting from favorable volume/mix (\$143 million), and
- the impact of acquisitions (\$3 million).

Governments have consistently increased excise taxes in most of the markets in which we operate. As discussed under the caption *Business Environment*, we expect excise taxes to continue to increase.

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

(in millions)	For the Three Months Ended March 31,		Variance	%
	2015	2014		
Cost of sales	\$ 2,229	\$ 2,374	\$ (145)	(6.1)%
Marketing, administration and research costs	1,494	1,547	(53)	(3.4)%
Operating income	2,871	2,951	(80)	(2.7)%

Cost of sales decreased by \$145 million (6.1%), due to:

- favorable currency (\$257 million), partly offset by
- higher manufacturing costs (\$63 million, principally in Egypt, due to the impact of the change to our new business structure, and in Indonesia),
- higher cost of sales resulting from favorable volume/mix (\$45 million), and
- the impact of acquisitions (\$4 million).

Marketing, administration and research costs decreased by \$53 million (3.4%), due to:

- favorable currency (\$111 million), partly offset by
- higher expenses (\$55 million, primarily higher marketing and selling expenses), and
- the impact of acquisitions (\$3 million).

Operating income decreased by \$80 million (2.7%), due to:

- unfavorable currency (\$570 million),
- higher manufacturing costs (\$63 million), and
- higher marketing, administration and research costs (\$55 million), partly offset by
- price increases (\$552 million),
- favorable volume/mix (\$33 million), and
- pre-tax charges for asset impairment and exit costs in 2014 (\$23 million).

Interest expense, net, of \$275 million increased \$7 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate increased by 1.3 percentage points to 30.2%. We estimate that our full-year 2015 effective tax rate will be approximately 29%. The effective tax rate for the three months ended March 31, 2015 was unfavorably impacted by changes to repatriation assertions on certain foreign subsidiary historical earnings (\$58 million). The effective tax rate is based on our full-

year earnings mix by taxing jurisdiction and cash repatriation plans. Changes in our 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 twelve 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 charge cannot be made at this time.

Equity (income)/loss in unconsolidated subsidiaries, net, of \$(23) million increased by \$14 million, due primarily to higher earnings from our investments in North Africa and Russia, which are reflected in the Eastern Europe, Middle East & Africa segment.

Net earnings attributable to PMI of \$1.8 billion decreased by \$80 million (4.3%). This decrease was due primarily to lower operating income as discussed above. Diluted and basic EPS of \$1.16 decreased by 1.7%. Excluding an unfavorable currency impact of \$0.31, diluted EPS increased by 24.6%.

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:

- fiscal challenges, such as excise tax increases and discriminatory tax structures;
- actual and proposed extreme regulatory requirements, including regulation of the packaging, marketing and sale of tobacco products, as well as the products themselves, that may reduce our competitiveness, eliminate our ability to communicate with adult smokers, ban certain of our products, limit our ability to differentiate our products from those of our competitors, and interfere with our intellectual property rights;
- 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 9. *Contingencies*; and
- governmental investigations.

FCTC: The World Health Organization's (“WHO”) Framework Convention on Tobacco Control (“FCTC”), an international public health treaty with the objective of reducing tobacco use, drives much of the regulation that shapes the business environment in which we operate. The treaty, to which 179 countries and the European Union are Parties, requires Parties to have in place various tobacco control measures and recommends others.

We support many of the regulatory policies required by the FCTC, including measures that strictly prohibit the sale of tobacco products to minors, limit public smoking, require health warnings on tobacco packaging, and regulate product content to prevent increased adverse health effects of smoking. We advocate measures that establish a regulatory framework for Reduced-Risk Products. We also support the use of tax and price policies to achieve public health objectives, as long as such policies are not discriminatory or excessive, and do not result in increased illicit trade.

However, the FCTC governing body, the Conference of the Parties (“CoP”), has adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC, some of which we strongly oppose, including extreme measures such as point-of-sale display bans, plain packaging, bans on all forms of communications with adult smokers, ingredient restrictions or bans based on the concepts of palatability or attractiveness, and excessive taxation. Among other things, these measures would limit our ability to differentiate our products and disrupt competition, are not based on sound evidence of a public health benefit, are likely to lead to adverse consequences such as increased illicit trade and, in some cases, result in the expropriation of our trademarks and violate international treaties.

It is not possible to predict whether or to what extent measures recommended in the FTC guidelines will be implemented. In some instances where these extreme measures have been adopted by national governments, we have commenced legal proceedings challenging them.

Excise, Sales and Other Taxes: Excessive and disruptive 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 from premium to non-premium, discount, other low-price or low-taxed tobacco products, such as fine cut tobacco and illicit products. In addition, in certain jurisdictions, our products are subject to tax structures that discriminate against premium-price products and manufactured cigarettes. We believe that such tax structures undermine public health by encouraging consumers to turn to the illicit trade for cheaper tobacco products 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 on tobacco companies. We oppose such extreme and discriminatory tax measures.

EU Tobacco Products Directive: In April 2014, the EU adopted the text of a significantly revised EU Tobacco Products Directive that, among other things, provides for:

- health warnings covering 65% of the front and back panels of packs with specific health warning dimensions that will in effect prohibit various pack formats, such as certain packs for slim cigarettes, even though the agreed text does not ban slim cigarettes. Member States would also have the option to further standardize tobacco packaging, including, under certain conditions, by introducing plain packaging;
- a ban on packs of fewer than 20 cigarettes;
- a ban on characterizing flavors in some tobacco products, with a transition period for menthol expiring in May 2020;
- tracking and tracing measures requiring tracking at pack level down to retail, which we believe will provide no incremental benefit in the fight against illicit trade; and
- a framework for the regulation of novel tobacco products and e-cigarettes (except for those found to be medicines or medical devices), including requirements for health warnings and information leaflets, prohibiting product packaging text related to reduced risk, and introducing notification requirements in advance of commercialization.

The revised Directive entered into force in May 2014. Member States are required to implement the Directive by May 2016.

In June 2014, two of our subsidiaries filed papers in the English High Court seeking judicial review of whether the Directive complies with existing EU Treaties. In November 2014, the English High Court referred the case to the Court of Justice of the European Union ("CJEU") and requested that the CJEU issue a judgment in advance of May 2016. In July 2014, the government of Poland filed a complaint with the CJEU challenging the validity of various provisions in the Directive that ban menthol cigarettes. It is not possible to predict the outcome of these legal proceedings.

Plain Packaging: To date, only Australia has implemented plain packaging. Its regulation, which came into force in December 2012, bans the use of branding, logos and colors on packaging of all tobacco products other than the brand name and variant, which may be printed only in specified locations and in a uniform font. The remainder of the pack is reserved for health warnings and government messages about cessation. The branding of individual cigarettes is also prohibited under this regulation.

Ireland and the U.K. have adopted plain packaging legislation, with implementation scheduled to begin no later than May 2016 and full compliance at retail required as of May 2017. In Ireland, implementation is subject to a Ministerial Commencement Order, which has yet to be issued.

In other countries, including France and New Zealand, proposals to implement plain packaging are in various stages of the legislative process. Additionally, several countries, including Turkey and Norway, are considering plain packaging, but no legislative proposals have been published. It is not possible to predict whether any of these countries will implement plain packaging.

Australia's plain packaging legislation triggered three legal challenges. First, major tobacco manufacturers, including our Australian subsidiary, challenged the legislation's constitutionality in the High Court of Australia. Although the High Court found the legislation constitutional, a majority of the Justices concluded that plain packaging deprives tobacco manufacturers of their property, raising serious questions about the legality of similar proposals in other jurisdictions. Second, our Hong Kong subsidiary has initiated arbitration proceedings against the Australian government pursuant to the Hong Kong-Australia Bilateral Investment Treaty and is seeking substantial compensation for the deprivation of its investments in Australia. Third, several countries have

initiated World Trade Organization ("WTO") dispute settlement proceedings against Australia. The ongoing legal challenges may take several years to complete, and it is not possible to predict their outcomes.

We oppose plain packaging because it expropriates our valuable intellectual property by taking away our trademarks and moves the industry much closer to a commodity business where there is no distinction among brands and, therefore, the ability to compete for adult smoker market share is greatly reduced. Several studies, including industry-commissioned studies as well as data released by Australian state governments, show that there is no sound basis to conclude that the implementation of plain packaging in Australia has had any impact on smoking prevalence among adults or youth. Data from Australia also appear to confirm that, since the implementation of plain packaging, down-trading to lower price and lower margin brands has accelerated and the illicit trade has increased.

In the event any particular jurisdiction adopts plain packaging regulation, we will consider all available options, including litigation, to ensure the protection of our intellectual property.

Restrictions and Bans on the Use of Ingredients: Currently, the WHO and others in the public health community recommend restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Some regulators have considered and rejected such proposals, while others have proposed and, in a few cases, adopted restrictions or bans. In particular, as mentioned above, the European Union has adopted a ban of characterizing flavors in tobacco products, subject to an exemption until May 2020 for menthol. Furthermore, Turkey has adopted a ban of menthol as of May 2020. Sweeping ingredient bans have been adopted only by Canada (with an exemption for menthol) and Brazil.

However, the Brazil ingredients ban, which, as originally drafted, 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 subsidiary is a member. It is not possible to predict the outcome of this legal proceeding.

Broad restrictions and bans on the use of ingredients 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. We oppose broad bans or sweeping restrictions on the use of ingredients, as they are often based on the subjective and scientifically unsupported notion that ingredients make tobacco products more "attractive" or "palatable" and therefore could encourage tobacco consumption, and also because prohibiting entire categories of cigarettes, such as menthol, will lead to a massive increase in illicit trade.

Many countries have enacted or proposed legislation or regulations that require cigarette manufacturers to disclose to governments and to the public the ingredients used in the manufacture of tobacco products and, in certain cases, to provide toxicological information about those ingredients. We have made, and will continue to make, full disclosures where adequate assurances of trade secret protection are provided.

Bans on Display of Tobacco Products at Retail: In a few of our markets, governments have banned or propose to ban the display of tobacco products at the point of retail sale. Other countries have rejected display ban proposals. We oppose display bans because they restrict competition by favoring established brands and encourage illicit trade, while not reducing smoking or otherwise benefiting public health. In some markets, our subsidiaries and, in some cases, individual retailers have commenced legal proceedings to overturn display bans.

Health Warning Requirements: In most countries, governments require large and often graphic health warnings covering at least 30% of the front and back of cigarette packs (the size mandated by the FCTC). A growing number of countries require warnings covering 50% of the front and back of the pack, and a small number of countries require larger warnings, such as Australia (75% front and 90% back), Mexico (30% front and 100% back), Uruguay (80% front and back) and Canada (75% front and back).

In March 2013, the Ministry of Public Health in Thailand issued a regulation mandating health warnings covering 85% of the front and back of cigarette packs. While a lower court suspended this requirement pending the outcome of legal challenges by two of our affiliates, Thailand's Supreme Administrative Court recently overturned this order and allowed the regulation to be implemented during the pendency of our affiliates' claims. The legal challenges by our affiliates are still pending. It is not possible to predict the outcome of these proceedings.

We support health warning requirements designed to inform consumers of the risks of smoking. In fact, where health warnings are not required, we place them on packaging voluntarily in the official language or languages of the country. We defer to governments on the content of warnings except for content that vilifies tobacco companies or does not fairly represent the actual effects of smoking. However, we oppose excessively large health warnings, i.e., larger than 50%. The data show that

disproportionately increasing the size of health warnings does not effectively reduce tobacco consumption. Yet, such health warnings impede our ability to compete in the market by leaving insufficient space for our distinctive trademarks and pack designs.

Other Packaging Restrictions: Some governments have passed, or are seeking to pass, restrictions on packaging and labeling, including standardizing the shape, format and lay-out of packaging, as well as imposing broad restrictions on how the space left for branding and product descriptions can be used. Examples include prohibitions on (1) the use of colors that are alleged to suggest that one brand is less harmful than others, (2) specific descriptive phrases deemed to be misleading, including, for example, “premium,” “full flavor,” “international,” “gold,” “silver,” and “menthol,” and (3) in one country, all but one variant per brand. We oppose broad packaging restrictions because they unnecessarily limit brand and product differentiation, are anticompetitive, prevent us from providing consumers with information about our products, unduly restrict our intellectual property rights, and violate international trade agreements. In some instances, we have commenced litigation challenging such regulations. It is not possible to predict the outcome of these proceedings.

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 also requires disclosure of expenditures on advertising, promotion and sponsorship where such activities are not prohibited. The FCTC guidelines recommend that governments adopt extreme and sweeping prohibitions, including all forms of communication to adult smokers. Where restrictions on advertising prevent us from communicating directly and effectively with adult smokers, they impede our ability to compete in the market. For this reason, and because we believe that the available evidence does not show that marketing restrictions effectively reduce smoking, we oppose complete bans on advertising and communication that do not allow manufacturers to communicate directly and effectively with adult smokers.

Restrictions on Product Design: Anti-tobacco organizations and some regulators are calling for the further standardization of tobacco products by requiring, for example, that cigarettes have a certain minimum diameter, which amounts to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. We oppose such restrictions because they limit our ability to differentiate our products and because we believe that there is no correlation, let alone a causal link, between product design variations and smoking rates, nor is there any scientific evidence that these restrictions would improve public health.

Reduced cigarette ignition propensity standards are 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 several 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 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. The FCTC requires Parties to adopt restrictions on public smoking, and the guidelines call for broad bans in all indoor public places but limit their recommendations on private place smoking, such as in cars and private homes, to increased education on the risk of exposure to environmental tobacco smoke.

While we believe outright bans are appropriate in many public places, such as schools, playgrounds, youth facilities, and many indoor public places, governments can and should seek a balance between the desire to protect non-smokers from environmental tobacco smoke and allowing adults who choose to smoke to do so. Owners of restaurants, bars, cafes, and other entertainment establishments should have the flexibility to permit, restrict, or prohibit smoking, and workplaces should be permitted to provide designated smoking rooms for adult smokers. Finally, we oppose bans on smoking outdoors (beyond places and facilities for children) and in private places.

Other Regulatory Issues: Some regulators are considering, or in some cases have adopted, regulatory measures designed to reduce the supply of tobacco. These include regulations intended to reduce the number of retailers selling tobacco by, for example, reducing the overall number of tobacco retail licenses available or banning the sale of tobacco within arbitrary distances of certain public facilities. We oppose such measures because they stimulate illicit trade and could arbitrarily deprive business owners and their employees of their livelihood with no indication that such restrictions would improve public health.

Regulators in some countries have also called for the exclusion of tobacco from certain basic provisions of trade and investment agreements, such as the Trans-Pacific Partnership Agreement, which is under negotiation. This could limit our ability to protect investments and intellectual property, would constitute unfair discrimination against a legal industry, and would be at odds with fundamental principles of international trade.

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, 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 unique cigarette brands manufactured predominantly for smuggling. We estimate that illicit trade in the European Union accounted for more than 10% of total cigarette consumption in 2013.

A number of jurisdictions are considering regulatory measures and government action 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. The Protocol, which we support, will come into force once the fortieth country ratifies it, after which countries must implement its measures via national legislation. To date, five countries have ratified the Protocol. It is not possible to predict whether other countries will do so.

Additionally, we and our subsidiaries have entered into cooperation agreements with governments and authorities to support their anti-illicit trade efforts. For example, in 2004, we entered into a 12-year cooperation agreement with the EU and its member states that provides for cooperation with European law enforcement agencies on anti-contraband and on anti-counterfeit efforts. Under the terms of this agreement we make financial contributions of approximately \$75 million per year (recorded as an expense in cost of sales when product is shipped) to support these efforts. We are also required to pay the excise taxes, VAT and customs duties on qualifying seizures of up to 450 million genuine PMI products in the EU in a given year, and five times the applicable taxes and duties if seizures exceed this threshold in a given year. To date, our payments for product seizures have been immaterial.

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 June 2012, we committed €15 million to INTERPOL over a three-year period to support the agency's global initiative to combat trans-border crime involving illicit goods, including tobacco products. This initiative funds the coordination of information gathering, training programs for law enforcement officials, development of product authentication standards and public information campaigns.

Reduced-Risk Products: We use the term Reduced-Risk Products ("RRPs") to refer to products with the potential to reduce individual risk and population harm in comparison to smoking combustible cigarettes. One of our strategic priorities is to develop, assess and commercialize a portfolio of innovative RRPs. Our RRPs are in various stages of development and commercialization, and we are conducting extensive and rigorous scientific studies to determine whether we can support claims for such products of reduced exposure to harmful and potentially harmful constituents in smoke, and ultimately claims of reduced disease risk, when compared to smoking combustible cigarettes. Before making any such claims, we will need to rigorously evaluate the full set of data from the relevant scientific studies to determine whether they substantiate reduced exposure or risk. Any such claims may also be subject to government review and approval, as is the case in the U.S. today. We draw upon a team of world-class scientists from a broad spectrum of scientific disciplines, and our efforts are guided by the following three key objectives:

- to develop RRPs that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by combustible cigarettes;
- to substantiate the reduction of risk for the individual adult smoker and the reduction of harm to the population as a whole, based on robust scientific evidence derived from well-established assessment processes; and
- to advocate for the development of science-based regulatory frameworks for the development and commercialization of RRPs, including the communication to adult smokers of substantiated reduced exposure or reduced risk claims.

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 reduce risk.

Our approach to individual risk assessment is to use cessation as the benchmark, because the short-term and long-term effects of smoking cessation are well known, and the closer the clinical data derived from adult smokers who switch to an RRP resemble the data from those who quit, the more confident one can be that the product reduces risk.

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

- *Platform 1*, as discussed below, uses a precisely controlled heating device that we are commercializing under the *iQOS* brand name, into which a specially designed tobacco product under the *Marlboro* and *HeatSticks* brands is inserted to generate an aerosol. Six short-term clinical studies for Platform 1 have been completed. Two three-month clinical studies will be completed at the end of the second quarter 2015. We also initiated a longer term clinical study in December 2014, with the final results anticipated in the fourth quarter of 2016.
- *Platform 2* uses a pressed carbon heat source to generate an aerosol by heating tobacco. The product is currently in the pre-clinical testing phase, and we plan to begin clinical trials as of the second half of 2015.
- *Platform 3* is based on technology we acquired from Professor Jed Rose of Duke University and his co-inventors in May 2011. This product creates an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. We are exploring two routes for this platform, one with electronics and one without. The product replicates the feel and ritual of smoking without tobacco and without burning. We have begun pre-clinical testing of this product.
- *Platform 4* covers e-vapor products, which are battery powered devices that produce an aerosol by vaporizing a liquid nicotine solution. Our e-vapor products comprise devices using current generation technology, and we are working on developing the next generation of e-vapor technologies to address the challenges presented by the e-vapor products currently on the market, ranging from consumer satisfaction to manufacturing processes and product consistency.

We are also developing other potential product platforms.

We are proceeding with the commercialization of RRPs. In January 2014, we announced an investment of up to €500 million over three years in our first manufacturing facility in the European Union and an associated pilot plant near Bologna, Italy, to produce our RRPs. We plan for the factory to initially manufacture Platform 1 tobacco products (*HeatSticks*). When fully operational by 2016, and together with the pilot plant that was opened for production in October 2014, we expect to reach an annual production capacity of up to 30 billion units.

In the United States of America, an established regulatory framework for assessing “Modified Risk Tobacco Products” (“MRTPs”) exists under the jurisdiction of the Food and Drug Administration (“FDA”). We expect that future FDA actions are likely to influence the regulatory approach of other interested governments. Our assessment approach and the studies conducted to date reflect the rigorous evidentiary package contemplated in the FDA’s Draft Guidance for Modified Risk Tobacco Product Applications (2012). We have shared our approach and studies with the FDA’s Center for Tobacco Products. In parallel, we are engaging with regulators in several EU member states, as well as in a number of other countries. We expect to submit a Modified Risk Tobacco Product application for Platform 1 when we believe we have met the evidentiary package contemplated in the Draft Guidance.

As we work to develop evidence to substantiate the risk reduction potential of our products, we will review our ability to make claims of reduced exposure or risk based on applicable laws and regulations and, as we are already doing, engage with regulators and share the evidence with them. We are also engaging with the scientific community, sharing our assessment approach and the results we have generated. There can be no assurance that we will succeed in our efforts or that regulators will permit the marketing of our RRPs with substantiated claims of reduced formation, exposure, individual risk or population harm.

We have commercialized the Platform 1 electronic system under the *iQOS* brand name, for use with specially designed tobacco products, under the *Marlboro* and *HeatSticks* brands. In November 2014, we introduced the *iQOS* system in pilot city launches in Nagoya, Japan, and in Milan, Italy, and plan to expand nationally in those two countries in 2015. We plan to launch the product in several other markets thereafter. To date, the product has not been marketed with claims of reduced exposure or risk.

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. The agreements also provide for cooperation on the scientific assessment of and for the sharing of improvements to the existing generation of licensed products.

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company whose principal brand is *Nicolites*. This acquisition provided PMI with immediate access to, and a significant presence in, the U.K. e-vapor market.

Other Legislation, Regulation or Governmental Action: In Argentina, the National Commission for the Defense of Competition issued a resolution in May 2010 in which it found that our affiliate's establishment in 1997 of a system of exclusive zonified distributors ("EZDs") in Buenos Aires city and region was anticompetitive, despite having issued two prior decisions (in 1997 and 2000) in which it had found the establishment of the EZD system was not anticompetitive. The resolution is not a final decision, and our Argentinean affiliate has opposed the resolution and submitted additional evidence.

In Germany, in October 2013, the Administrative District Office Munich, acting under the policy supervision of the Bavarian Ministry of Health and Environment, sent our German affiliate an order alleging that certain components of its *Marlboro* advertising campaign do not comply with the applicable tobacco advertising law, and requiring our affiliate to stop this particular campaign throughout Germany and to remove all outdoor advertisements within one month from the effective date of the order and point-of-sale materials within three months. Our affiliate did not believe the allegations properly reflected the facts and the law and filed a challenge in the Munich Administrative Court, which was granted in part and denied in part. At an appeals hearing in April 2014, before the Bavarian Higher Administrative Court, the parties agreed that our affiliate could continue the campaign with certain limitations on image visuals and text slogans for the duration of the court proceedings. In April 2015, the Administrative District Office Munich issued a revised order, which again requires our affiliate to stop using core elements of this particular campaign within one to three months from the effective date of the order. Our affiliate does not agree with the revised order and will challenge it in the Munich Administrative Court.

It is not possible to predict what, if any, additional legislation, regulation or other governmental action will be enacted or implemented relating to the manufacturing, advertising, sale or use of tobacco products, or the tobacco industry generally. It is possible, however, that legislation, regulation or other governmental action could be enacted or implemented that might materially affect our business, volume, results of operations, cash flows and financial position.

Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters. As part of an investigation by the Department of Special Investigations ("DSI") of the government of Thailand into alleged under declaration of import prices by Thai cigarette importers, the DSI proposed to bring charges against our subsidiary, Philip Morris (Thailand) Limited, Thailand Branch ("PM Thailand") for alleged underpayment of customs duties and excise taxes of approximately \$2 billion covering the period from July 28, 2003, to February 20, 2007 ("2003-2007 Investigation"). In September 2009, the DSI submitted the case file to the Public Prosecutor for review. The DSI also commenced an informal inquiry alleging underpayment by PM Thailand of customs duties and excise taxes of approximately \$1.8 billion, covering the period 2000-2003. In early 2011, the Public Prosecutor's office issued a non-prosecution order in the 2003-2007 Investigation. In August 2011, the Director-General of DSI publicly announced that he disagreed with the non-prosecution order. Thus, the matter was referred for resolution to the Attorney General, whose deputy subsequently stated that the Attorney General has made a ruling to proceed with a prosecution order. Based on available information, it is probable that criminal charges will be filed. PM Thailand has been cooperating with the Thai authorities and believes that its declared import prices are in compliance with the Customs Valuation Agreement of the WTO and Thai law.

Additionally, 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 from the Philippines. 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 comply with the decision by October 2012. The Philippines contends that to date Thailand has not fully complied and is pursuing bilateral discussions with Thailand to address the outstanding issues. At WTO meetings, the Philippines has repeatedly expressed concerns with ongoing investigations by Thailand of PM Thailand, noting that these investigations 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.

Acquisitions and Other Business Arrangements

In June 2014, we acquired 100% of Nicocigs Limited, a leading U.K.-based e-vapor company, for the final purchase price of \$103 million, net of cash acquired, with additional contingent payments of up to \$77 million, primarily relating to performance targets over a three-year period. As of March 31, 2015, the additional contingent payments were up to \$59 million over the remaining two-year period. For additional information, see Note 12. *Fair Value Measurements* to our condensed consolidated financial

statements. The effect of this acquisition was not material to our consolidated financial position, results of operations or cash flows in any of the periods presented.

In September 2013, Grupo Carso, S.A.B. de C.V. ("Grupo Carso") sold to us its remaining 20% interest in our Mexican tobacco business for \$703 million. As a result, we own 100% of the Mexican tobacco business. A director of PMI has an affiliation with Grupo Carso. The final purchase price is subject to a potential adjustment based on the actual performance of the Mexican tobacco business over the three-year period ending two fiscal years after the closing of the purchase. In addition, upon declaration, we agreed to pay a dividend of approximately \$38 million to Grupo Carso related to the earnings of the Mexican tobacco business for the nine months ended September 30, 2013. In March 2014, the dividend was declared and paid. The purchase of the remaining 20% interest resulted in a decrease to our additional paid-in capital of \$672 million.

Investments in Unconsolidated Subsidiaries

On September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Emirati Investors-TA (FZC) ("EITA"), formerly Arab Investors-TA (FZC), for approximately \$625 million. As a result of this transaction, we hold an approximate 25% economic interest in Société des Tabacs Algéro-Emiratie ("STAEM"), an Algerian joint venture which 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 our brands. The initial investment in EITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

On December 12, 2013, we acquired from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), our distributor in Russia, for a purchase price of \$760 million. An additional payment of up to \$100 million, which is contingent on Megapolis's operational performance over the four fiscal years following the closing of the transaction, will also be made by us if the performance criteria are satisfied. We have also agreed to provide Megapolis Investment BV with a \$100 million interest-bearing loan. We and Megapolis Investment BV have agreed to set off any future contingent payments owed by us against the future repayments due under the loan agreement. Any loan repayments in excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to us on March 31, 2017. At December 31, 2013, we recorded a \$100 million asset related to the loan receivable and a discounted liability of \$86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the condensed consolidated balance sheets.

Asset Impairment and Exit Costs

On April 4, 2014, we announced the initiation by our affiliate, Philip Morris Holland B.V. ("PMH"), of consultations with employee representatives on a proposal to discontinue cigarette production at its factory located in Bergen op Zoom, the Netherlands. PMH reached an agreement with the trade unions and their members on a social plan, and ceased cigarette production on September 1, 2014. In total, we expect to incur a total pre-tax charge of approximately \$547 million for the program. During 2014, we recorded pre-tax asset impairment and exit costs of \$489 million. This amount includes employee separation costs of \$343 million, asset impairment costs of \$139 million and other separation costs of \$7 million. In addition, as part of the total program, up to \$58 million of pre-tax implementation costs, primarily related to notice period payments, will be reflected in cost of sales and marketing, administration and research costs in our consolidated statement of earnings. During 2014, \$50 million of these pre-tax implementations costs were reflected in our consolidated statements of earnings. Excluding asset impairment costs, substantially all of these charges will result in cash expenditures expected to be paid by the end of 2015.

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, pursuant to either exemptions or licenses granted under the applicable Trade Sanctions.

A subsidiary sells products to distributors that in turn sell those products to duty free customers that supply U.N. peacekeeping forces around the world, including those in the Republic of the Sudan. We do not believe that these exempt sales of our products for ultimate resale in the Republic of the Sudan, which are de minimis in volume and value, present a material risk to our shareholders, our reputation or the value of our shares. We have no employees, operations or assets in the Republic of the Sudan.

We do not sell products in Cuba, Iran and Syria.

To our knowledge, none of our commercial arrangements result 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.

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.

Operating Results – Three Months Ended March 31, 2015

The following discussion compares operating results within each of our reportable segments for the three months ended March 31, 2015, with the three months ended March 31, 2014.

European Union. Net revenues, which include excise taxes billed to customers, decreased by \$679 million (10.3%). Excluding excise taxes, net revenues decreased by \$121 million (6.0%) to \$1.9 billion. This decrease was due to:

- unfavorable currency (\$278 million), partly offset by
- price increases (\$108 million),
- favorable volume/mix (\$42 million), and
- the impact of acquisitions (\$7 million).

The net revenues of the European Union segment include \$350 million in 2015 and \$387 million in 2014 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were \$124 million in 2015 and \$134 million in 2014.

Operating companies income of \$913 million decreased by \$65 million (6.6%). This decrease was due primarily to:

- unfavorable currency (\$191 million) and
- higher marketing, administration and research costs (\$20 million), partly offset by
- price increases (\$108 million),
- favorable volume/mix (\$29 million), and
- lower manufacturing costs (\$8 million).

The total cigarette market in the European Union of 104.6 billion units decreased by 1.6%. Excluding the impact of estimated trade inventory movements, the total cigarette market declined by 2.7%, reflecting a favorable comparison with the first quarter of 2014 in which the total cigarette market declined by 5.7% and, in certain key geographies, improving economies, a moderation in the level of illicit trade, lower out-switching to the fine cut category and a lower prevalence of e-vapor products. In 2015, the total cigarette market in the European Union is forecast to decrease by approximately 4%, reflecting the anticipated impact of recently implemented price increases on adult smoker demand over the balance of the year. The total OTP market in the European Union in the quarter of 37.7 billion cigarette equivalent units decreased by 1.8%, reflecting a lower total fine cut market, down by 2.0% to 32.9 billion cigarette equivalent units.

Our cigarette shipment volume of 42.7 billion units increased by 2.4%, or by 0.2% excluding inventory movements, notably in Italy and Spain. Market share increased by 0.4 share points to 39.6%. Shipment volume of *Marlboro* increased by 2.8% to 20.8 billion units, driven by France, Italy and Spain, and market share increased by 0.1 share point to 19.2%. While cigarette shipment volume of *L&M* decreased slightly by 0.1% to 7.4 billion units, market share increased by 0.1 share point to 7.0%. Cigarette shipment volume of *Chesterfield* of 6.3 billion units increased by 16.6%, driven by Italy, and market share increased by 0.9 share points to 5.8%. Cigarette shipment volume of *Philip Morris* of 2.4 billion units increased by 1.3%, driven by Spain, partly offset by France, and market share increased by 0.1 share point to 2.2%.

Our shipments of OTP of 5.5 billion cigarette equivalent units increased by 3.7%, driven principally by higher market share. Our total OTP market share increased by 0.1 share point to 14.3%, reflecting gains in the fine cut category.

In France, the total cigarette market increased by 0.5% to 10.6 billion units. Excluding the impact of estimated trade inventory movements, the total cigarette market declined by 0.5%, mainly reflecting a favorable comparison with the first quarter of 2014

in which the total cigarette market declined by 8.9%, and a lower prevalence of e-vapor products. Our shipments of 4.6 billion units increased by 0.4%. Market share performance is shown in the table below.

France Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	25.4%	25.0%	0.4
<i>Philip Morris</i>	9.6%	9.4%	0.2
<i>L&M</i>	2.5%	2.6%	(0.1)
Others	3.7%	4.0%	(0.3)
TOTAL	41.2%	41.0%	0.2

The total industry fine cut category of 3.3 billion cigarette equivalent units increased by 5.0%. Our market share of the category decreased by 0.9 share points to 25.1%.

In Germany, the total cigarette market was flat at 18.2 billion units. Excluding the impact of estimated trade inventory movements, the total cigarette market declined by 1.6%, mainly reflecting the impact of price increases in August and September of 2014, partially offset by a lower prevalence of illicit trade. Our shipments of 6.7 billion units increased by 0.5%. Market share performance is shown in the table below.

Germany Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	21.8%	22.0%	(0.2)
<i>L&M</i>	12.1%	11.7%	0.4
<i>Chesterfield</i>	1.7%	1.7%	—
Others	1.5%	1.5%	—
TOTAL	37.1%	36.9%	0.2

The total industry fine cut category of 9.5 billion cigarette equivalent units decreased by 3.6%. Our market share of the category decreased by 0.6 share points to 12.5%.

In Italy, the total cigarette market decreased by 1.8% to 16.5 billion units, mainly reflecting the impact of price increases in January 2015, partly offset by a lower prevalence of e-vapor products. Our shipments of 9.6 billion units increased by 6.4%, or by 0.2% excluding inventory movements. Market share performance is shown in the table below.

Italy Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	24.4%	25.6%	(1.2)
<i>Diana</i>	7.7%	9.9%	(2.2)
<i>Chesterfield</i>	10.5%	5.1%	5.4
Others	11.5%	12.4%	(0.9)
TOTAL	54.1%	53.0%	1.1

The share decline of *Marlboro* was largely driven by its price increase in the first quarter of 2015 to €5.20 per pack from its round retail price point of €5.00 per pack. The share of low-price *Diana* was impacted by the growth of the super-low price segment.

The share decline of "Others" was mainly due to *Merit*, down by 0.5 share points to 6.1%. The total industry fine cut category of 1.4 billion cigarette equivalent units increased by 3.9%. Our market share of the category increased by 0.4 share points to 41.5%.

In Poland, the total cigarette market decreased by 6.8% to 9.8 billion units, reflecting the prevalence of e-cigarettes, illicit trade and non-duty paid OTP products. Our shipments of 3.8 billion units increased by 2.4%. Market share performance is shown in the table below.

Poland Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Marlboro</i>	10.6%	10.2%	0.4
<i>L&M</i>	17.6%	16.4%	1.2
<i>Chesterfield</i>	8.0%	6.9%	1.1
Others	2.3%	3.7%	(1.4)
TOTAL	38.5%	37.2%	1.3

The share growth of *L&M* was driven by its king-size and super-slimes variants, including the capsule product *L&M Link Forward*. The share growth of *Chesterfield* was driven by its round corner box super-slimes variants introduced in the first quarter of 2014. The share decline of "Others" was due to super low-price brands, notably *RGD* and *Red & White*. The total industry fine cut category of 1.0 billion cigarette equivalent units decreased by 1.2%. Our market share of the category decreased by 1.4 share points to 33.6%.

In Spain, the total cigarette market decreased by 0.7% to 10.5 billion units. Excluding the impact of estimated trade inventory movements, the total cigarette market declined by 1.7%, reflecting the impact of price increases in the second quarter of 2014 and the first quarter of 2015, partially offset by an improving economic environment. Our shipments of 3.6 billion units increased by 11.9%, or by 4.2% excluding inventory movements. Market share performance is shown in the table below.

Spain Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Marlboro</i>	16.1%	15.1%	1.0
<i>L&M</i>	6.0%	6.2%	(0.2)
<i>Chesterfield</i>	9.4%	9.3%	0.1
Others	1.2%	0.6%	0.6
TOTAL	32.7%	31.2%	1.5

The share growth of *Marlboro* benefited notably from a round price point in the vending channel, the roll-out of the 2.0 Architecture and an improving economy. The share growth of "Others" was mainly driven by *Philip Morris*, up by 0.6 points to 1.1%. The total industry fine cut category of 2.2 billion cigarette equivalent units decreased by 0.7%. Our market share of the fine cut category decreased by 1.3 share points to 14.4%.

Eastern Europe, Middle East & Africa. Net revenues, which include excise taxes billed to customers, decreased by \$133 million (2.9%). Excluding excise taxes, net revenues decreased by \$166 million (8.3%) to \$1.8 billion. This decrease was due to:

- unfavorable currency (\$445 million), partly offset by
- price increases (\$169 million), and
- favorable volume/mix (\$110 million).

Operating companies income of \$880 million decreased by \$47 million (5.1%). This decrease was due to:

- unfavorable currency (\$271 million),
- higher manufacturing costs (\$24 million, principally related to the implementation of our new business model in Egypt), and
- higher marketing, administration and research costs (\$20 million), partly offset by
- price increases (\$169 million),
- favorable volume/mix (\$74 million), and
- higher equity income in unconsolidated subsidiaries (\$25 million).

Our cigarette shipment volume of 64.7 billion units increased by 4.4%, or by 0.1% excluding inventory movements. Our cigarette shipment volume of premium brands increased by 6.9%, driven principally by: *Marlboro*, up by 9.8% to 20.3 billion units, driven notably by Algeria, Saudi Arabia and Turkey, partially offset by Egypt and Ukraine; and *Parliament*, up by 3.1% to 7.4 billion units, driven by Russia and Turkey, partly offset by Ukraine.

In North Africa, the estimated total cigarette market decreased by 4.5% to 32.6 billion units, due to Algeria, Egypt, Libya and Morocco, partly offset by Tunisia. Our shipment volume of 9.2 billion units increased by 7.6%, mainly driven by *Marlboro* in Algeria and *L&M* in Egypt. Market share performance is shown in the table below.

North Africa Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	14.7%	15.3%	(0.6)
<i>L&M</i>	10.7%	8.1%	2.6
Others	2.0%	1.9%	0.1
TOTAL	27.4%	25.3%	2.1

In Russia, the estimated total cigarette market decreased by 9.3% to 61.5 billion units, mainly due to the unfavorable impact of tax-driven price increases and a weak economy. In 2015, the total market is forecast to decrease by an estimated 8% to 10%. Our shipment volume in the quarter of 19.0 billion units increased by 2.3%. Market share performance, as measured by Nielsen, is shown in the table below.

Russia Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Parliament</i>	3.9%	3.5%	0.4
<i>Marlboro</i>	1.4%	1.7%	(0.3)
<i>Bond Street</i>	7.9%	7.0%	0.9
Others	14.4%	14.6%	(0.2)
TOTAL	27.6%	26.8%	0.8

The share growth of *Bond Street* was driven by its *Compact* variant, partly offset by its mainline variants.

In Turkey, the estimated total cigarette market increased by 7.0% to 19.4 billion units. Excluding the impact of estimated trade inventory movements, the total cigarette market increased by 3.9%, mainly reflecting an increase in the adult population and a lower prevalence of illicit trade. Our shipment volume of 9.3 billion units increased by 3.5%. Market share performance, as measured by Nielsen, is shown in the table below.

Turkey Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Parliament</i>	11.5 %	10.5 %	1.0
<i>Marlboro</i>	8.9 %	8.6 %	0.3
<i>Lark</i>	7.3 %	10.3 %	(3.0)
Others	15.5 %	15.0 %	0.5
TOTAL	43.2%	44.4%	(1.2)

The share growth of *Parliament* was driven by strong brand equity, especially its king-size variant, *Night Blue*, up by 0.8 share points to 6.2%, and by up-trading from the mid-price segment. The share decline of *Lark* reflects the impact of price repositioning by our principal competitor in May 2014. The share increase of "Others" was driven by *L&M*, up by 0.5 share points to 7.1%, and *Chesterfield*, up by 1.0 share point to 3.2%.

In Ukraine, the estimated total cigarette market increased by 3.2% to 14.8 billion units, mainly reflecting a favorable comparison with the first quarter of 2014 in which the estimated total cigarette market declined by 6.6%, and a lower prevalence of illicit trade, partly offset by continued business disruption due to the political instability in the east of the country. Our shipment volume of 4.6 billion units decreased by 9.8%. Market share performance, as measured by Nielsen, is shown in the table below.

Ukraine Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Parliament</i>	2.9 %	3.0 %	(0.1)
<i>Marlboro</i>	4.5 %	5.1 %	(0.6)
<i>Chesterfield</i>	4.3 %	5.3 %	(1.0)
Others	20.2 %	19.7 %	0.5
TOTAL	31.9%	33.1%	(1.2)

Asia. Net revenues, which include excise taxes billed to customers, increased by \$289 million (6.5%). Excluding excise taxes, net revenues decreased by \$27 million (1.2%) to \$2.2 billion. This decrease was due to:

- unfavorable currency (\$128 million) and
- unfavorable volume/mix (\$50 million), partly offset by
- price increases (\$151 million).

Operating companies income of \$934 million increased by \$19 million (2.1%). This increase was due primarily to:

- price increases (\$151 million) and
- the 2014 pre-tax charges for asset impairment and exit costs related to the factory closure in Australia (\$23 million), partly offset by
- unfavorable currency (\$79 million),
- unfavorable volume/mix (\$44 million), and
- higher manufacturing costs (\$33 million, mainly due to higher costs in Indonesia).

Our cigarette shipment volume of 70.1 billion units decreased by 1.0%, primarily due to Japan, mainly reflecting an unfavorable comparison with the first quarter of 2014, and Korea, resulting from the disruptive excise tax increase in January 2015, partially offset by industry and market share growth in Indonesia. Shipment volume of *Marlboro* of 18.0 billion units decreased by 5.2%,

predominantly due to Japan and Korea, partly offset by the Philippines. Shipment volume of *Parliament* of 1.9 billion units decreased by 23.5%, due to Korea. Shipment volume of *Lark* of 4.6 billion units decreased by 1.0%, due to Korea, partly offset by Japan.

In Indonesia, the estimated total cigarette market increased by 5.9% to 78.2 billion units, reflecting a favorable comparison with the first quarter of 2014 in which the estimated total cigarette market declined by 0.5%, and an increase in the adult population. In 2015, the total market is forecast to increase by approximately 2%. Our shipment volume in the quarter of 27.7 billion units increased by 8.4%, driven by industry growth and market share gains, notably of our machine-made brands. Market share performance is shown in the table below.

	Indonesia Market Share		
	First-Quarter		Change
	2015	2014	
<i>Sampoerna A</i>	14.9%	14.4%	0.5
<i>Dji Sam Soe</i>	7.0%	5.6%	1.4
<i>U Mild</i>	5.0%	5.2%	(0.2)
Others	8.5%	9.4%	(0.9)
TOTAL	35.4%	34.6%	0.8

The share decline of "Others" was mainly due to *Sampoerna Hijau*, down by 0.6 share points to 3.1%, largely reflecting the decline of the total hand-rolled kretek segment. While *Marlboro's* market share decreased by 0.2 share points to 5.1%, its share of the "white" cigarettes segment, which represented 6.2% of the total cigarette market, increased by 0.9 share points to 81.3%. The machine-made kretek segment, representing 74.6% of the total cigarette market, increased by 2.1 share points and our share of the segment increased by 2.0 share points to 30.9%. The hand-rolled kretek segment, representing 19.2% of the total cigarette market, decreased by 1.7 share points. Our share of the segment decreased by 1.8 share points to 37.8%.

In Japan, the total cigarette market decreased by 13.9% to 42.5 billion units, primarily reflecting an unfavorable comparison with the first quarter of 2014 in which the total market increased by 9.6%, mainly driven by retail trade and consumer purchasing ahead of the consumption tax-driven retail price increases of April 2014. Excluding the impact of these estimated inventory movements, the total cigarette market declined by 3.5%, mainly reflecting the unfavorable impact of the price increases. In 2015, the total market is forecast to decrease by an estimated 2.5% to 3.0%. Our shipment volume in the quarter of 11.8 billion units decreased by 12.2%, principally due to the lower total market. Market share performance is shown in the table below.

	Japan Market Share		
	First-Quarter		Change
	2015	2014	
<i>Marlboro</i>	11.5%	11.9%	(0.4)
<i>Lark</i>	9.9%	9.4%	0.5
<i>Virginia S.</i>	1.9%	1.9%	—
Others	2.3%	2.3%	—
TOTAL	25.6%	25.5%	0.1

In Korea, the total cigarette market decreased by 35.1% to 12.6 billion units, reflecting the reversal of estimated trade inventories built ahead of the announced excise tax increase effective January 2015, and the impact of the related price increases that saw the retail price of our premium brands increase by 67%. Excluding the impact of these estimated inventory movements, the total cigarette market declined by 22.8%, in line with the underlying forecast decline of 20%-25% for the full year 2015. Our shipment

volume in the quarter of 2.5 billion units decreased by 35.8%, reflecting the lower total market. Market share performance is shown in the table below.

Korea Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Parliament</i>	6.6%	7.1%	(0.5)
<i>Marlboro</i>	9.1%	7.9%	1.2
<i>Virginia S.</i>	3.8%	4.1%	(0.3)
Others	0.6%	0.8%	(0.2)
TOTAL	20.1%	19.9%	0.2

In the Philippines, the estimated total tax-paid industry cigarette volume increased by 1.0% to 18.9 billion units, primarily reflecting higher estimated tax-paid volume by our principal domestic competitor. Our shipment volume of 15.9 billion units decreased by 1.6%, primarily due to declines of our low and super-low price brands, partially offset by growth of *Marlboro*, reflecting the positive impact of retail price increases at the bottom end of the market that narrowed price gaps. Market share performance is shown in the table below.

Philippines Market Share

	First-Quarter		Change p.p.
	2015	2014	
<i>Marlboro</i>	21.8%	19.4%	2.4
<i>Fortune</i>	32.3%	33.3%	(1.0)
<i>Jackpot</i>	16.5%	17.9%	(1.4)
Others	13.3%	15.6%	(2.3)
TOTAL	83.9%	86.2%	(2.3)

The share decline of "Others" was principally due to super-low price *Champion*, down by 2.3 share points to 2.3%.

Latin America & Canada. Net revenues, which include excise taxes billed to customers, increased by \$96 million (4.5%). Excluding excise taxes, net revenues increased by \$13 million (1.8%) to \$726 million. This increase was due primarily to:

- price increases (\$124 million), partly offset by
- unfavorable currency (\$88 million) and
- unfavorable volume/mix (\$24 million).

Operating companies income of \$230 million increased by \$28 million (13.9%). This increase was due primarily to:

- price increases (\$124 million), partly offset by
- unfavorable currency (\$44 million),
- unfavorable volume/mix (\$26 million),
- higher manufacturing costs (\$14 million), and
- higher marketing, administration and research costs (\$13 million).

Our cigarette shipment volume of 21.2 billion units decreased by 1.2%, largely due to Argentina and Canada, partly offset by Brazil and Mexico. Although shipment volume of *Marlboro* of 8.2 billion units decreased slightly by 0.3%, its Regional market

share increased by 0.5 share points to an estimated 14.6%. Market share of *Marlboro* increased notably in Argentina, Brazil and Colombia, by 0.3, 1.1 and 1.3 share points to 24.4%, 9.6% and 8.8%, respectively.

In Argentina, the total cigarette market decreased by 3.5% to 10.3 billion units. Our cigarette shipment volume in the quarter of 8.1 billion units decreased by 1.9%. Market share performance is shown in the table below.

Argentina Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	24.4 %	24.1 %	0.3
<i>Philip Morris</i>	44.6 %	43.3 %	1.3
<i>Next</i>	1.7 %	2.2 %	(0.5)
Others	7.8 %	7.5 %	0.3
TOTAL	78.5%	77.1%	1.4

The share growth of *Philip Morris* reflects the positive impact of its capsule variants.

In Canada, the total cigarette market decreased by 6.6% to 5.4 billion units, mainly due to the impact of tax-driven price increases during the first half of 2014. Our cigarette shipment volume of 2.1 billion units decreased by 7.7%. Market share performance is shown in the table below.

Canada Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Belmont</i>	3.1 %	2.8 %	0.3
<i>Canadian Classics</i>	10.9 %	11.2 %	(0.3)
<i>Next</i>	10.6 %	10.9 %	(0.3)
Others	13.1 %	13.7 %	(0.6)
TOTAL	37.7%	38.6%	(0.9)

In Mexico, the total cigarette market increased by 4.7% to 7.5 billion units. Excluding the impact of favorable trade inventory movements, the total cigarette market was estimated to have declined by 0.7%. Our cigarette shipment volume in the quarter of 5.0 billion units increased by 2.6%. Market share performance is shown in the table below.

Mexico Market Share

	First-Quarter		Change
	2015	2014	p.p.
<i>Marlboro</i>	45.4 %	47.0 %	(1.6)
<i>Benson & Hedges</i>	4.6 %	5.2 %	(0.6)
<i>Delicados</i>	10.9 %	10.7 %	0.2
Others	5.4 %	4.8 %	0.6
TOTAL	66.3%	67.7%	(1.4)

The share decline of *Marlboro* was primarily due to adult smoker down-trading and the timing of price increases by our principal competitor.

Financial Review

Net Cash Provided by (Used in) Operating Activities

During the first quarter of 2015, net cash used in operating activities was \$375 million, compared with net cash provided of \$715 million during the first quarter of 2014. The change was due primarily to unfavorable currency movements and an increase in our working capital requirements.

The unfavorable movements in working capital were due primarily to the following:

- less cash provided by inventories (\$693 million), primarily related to higher leaf tobacco purchases; and
- less cash provided by accounts receivable (\$341 million), primarily due to the timing of sales and cash collections.

Net Cash Provided by (Used in) Investing Activities

During the first quarter of 2015, net cash provided by investing activities was \$68 million, compared with net cash used of \$208 million during the first quarter of 2014. The change was due primarily to higher cash collateral received from derivatives designated as net investment hedges.

Our capital expenditures were \$203 million and \$256 million during the three months ended March 31, 2015 and 2014, respectively. The 2015 expenditures were primarily related to investments in Reduced-Risk Products, productivity-enhancing programs, and equipment for new products.

Net Cash Provided by (Used in) Financing Activities

During the first quarter of 2015, net cash provided by financing activities was \$525 million, compared with net cash used of \$805 million during the first quarter of 2014. The change was due primarily to the cash used in 2014 to repurchase our common stock pursuant to our share repurchase program. On February 5, 2015 we announced that we do not plan any share repurchases in 2015.

Dividends paid in the first quarter of 2015 and 2014 were \$1.6 billion and \$1.5 billion, respectively. The increase reflects a higher dividend rate in 2015, partially offset by lower shares outstanding as a result of our share repurchases in 2014 pursuant to our share repurchase program.

Debt and Liquidity

We define cash and cash equivalents as short-term, highly liquid investments, readily convertible to known amounts of cash that mature within a maximum of three months and have an insignificant risk of change in value due to interest rate or credit risk changes. As a policy, we do not hold any investments in structured or equity-linked products. Our cash and cash equivalents are predominantly held in short-term bank deposits with institutions having a long-term rating of A- or better.

Credit Ratings – The cost and terms of our financing arrangements as well as our access to commercial paper markets may be affected by applicable credit ratings. At March 31, 2015, our credit ratings and outlook by major credit rating agencies were as follows:

	<u>Short-term</u>	<u>Long-term</u>	<u>Outlook</u>
Moody's	P-1	A2	Stable
Standard & Poor's	A-1	A	Stable
Fitch	F1	A	Stable

Credit Facilities – On January 23, 2015, we entered into an agreement to extend the term of our existing \$2.0 billion 364-day revolving credit facility effective February 10, 2015, from February 10, 2015 to February 9, 2016. On January 23, 2015, we also entered into an agreement to extend the term of our existing \$2.5 billion multi-year revolving credit facility, effective February 28, 2015, from February 28, 2019 to February 28, 2020.

At March 31, 2015, our committed credit facilities and commercial paper outstanding were as follows:

(in billions)

Type	Committed Credit Facilities	Commercial Paper
364-day revolving credit, expiring February 9, 2016	\$ 2.0	
Multi-year revolving credit, expiring February 28, 2020	2.5	
Multi-year revolving credit, expiring October 25, 2016	3.5	
Total facilities	\$ 8.0	
Commercial paper outstanding		\$ 2.6

At March 31, 2015, there were no borrowings under the committed credit facilities, and the entire committed amounts were available for borrowing.

All banks participating in our committed credit facilities have an investment-grade long-term credit rating from the credit rating agencies. We continuously monitor the credit quality of our banking group, and at this time we are not aware of any potential non-performing credit provider.

Each of these facilities requires us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization (“consolidated EBITDA”) to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis. At March 31, 2015, our ratio calculated in accordance with the agreements was 12.0 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require us to post collateral. We expect to continue to meet our covenants. The terms “consolidated EBITDA” and “consolidated interest expense,” both of which include certain adjustments, are defined in the facility agreements previously filed with the U.S. Securities and Exchange Commission.

In addition to the committed credit facilities discussed above, certain of our subsidiaries maintain short-term credit arrangements to meet their respective working capital needs. These credit arrangements, which amounted to approximately \$2.4 billion at March 31, 2015 and \$3.2 billion at December 31, 2014, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to \$763 million at March 31, 2015, and \$1.2 billion at December 31, 2014.

Commercial Paper Program – We have commercial paper programs in place in the U.S. and in Europe. Our commercial paper programs in place in the U.S. and in Europe currently have an aggregate issuance capacity of \$8.0 billion.

At March 31, 2015 we had \$2.6 billion in commercial paper outstanding. At December 31, 2014, we had no commercial paper outstanding.

We expect that the existence of the commercial paper program and the committed credit facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

Debt – Our total debt was \$30.6 billion at March 31, 2015 and \$29.5 billion at December 31, 2014.

On February 21, 2014, we filed a shelf registration statement with the U.S. Securities and Exchange Commission, under which we may from time to time sell debt securities and/or warrants to purchase debt securities over a three-year period.

Guarantees – At March 31, 2015, we were contingently liable for \$0.9 billion of guarantees of our own performance, which were primarily related to excise taxes on the shipment of our products. There is no liability in the condensed consolidated financial statements associated with these guarantees. At March 31, 2015, our third-party guarantees were insignificant.

Equity and Dividends

As discussed in Note 3. *Stock Plans* to our condensed consolidated financial statements, during the three months ended March 31, 2015, we granted 1.5 million shares of deferred stock awards to eligible employees at a grant date fair value of \$82.28 per share. Equity awards generally vest three or more years after the date of the award, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

In May 2012, our stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). The 2012 Plan replaced the 2008 Performance Incentive Plan (the "2008 Plan") and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, we may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. Up to 30 million shares of our common stock may be issued under the 2012 Plan. At March 31, 2015, shares available for grant under the 2012 Plan were 23,252,170.

On August 1, 2012, we began repurchasing shares under a three-year \$18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012 through March 31, 2015, we repurchased 144.6 million shares of our common stock at a cost of \$12.7 billion under this repurchase program. During the first three months of 2015, we did not repurchase our common stock. On February 5, 2015, we announced that we do not plan any share repurchases in 2015. During the first three months of 2014, we repurchased 15.4 million shares at a cost of \$1.2 billion.

Dividends paid in the first three months of 2015 were \$1.6 billion. During the third quarter of 2014, our Board of Directors approved a 6.4% increase in the quarterly dividend to \$1.00 per common share. As a result, the present annualized dividend rate is \$4.00 per common share.

Market Risk

Counterparty Risk - We predominantly work with financial institutions with strong short- and long-term credit ratings as assigned by Standard & Poor's and Moody's. These banks are also part of a defined group of relationship banks. Non-investment grade institutions are only used in certain emerging markets to the extent required by local business needs. We have a conservative approach when it comes to choosing financial counterparties and financial instruments. As such we do not invest or hold investments in any structured or equity-linked products. The majority of our cash and cash equivalents is currently invested in bank deposits maturing within less than 30 days.

We continuously monitor and assess the credit worthiness of all our counterparties.

Derivative Financial Instruments - We operate in markets outside of the United States of America, with manufacturing and sales facilities in various locations throughout the world. Consequently, we use certain financial instruments to manage our foreign currency and interest rate exposure. We use derivative financial instruments principally to reduce our exposure to market risks resulting from fluctuations in foreign exchange rates by creating offsetting exposures. We are not a party to leveraged derivatives and, by policy, do not use derivative financial instruments for speculative purposes.

See Note 6. *Financial Instruments*, Note 12. *Fair Value Measurements*, and Note 14. *Balance Sheet Offsetting* to our condensed consolidated financial statements for further details on our derivative financial instruments and the related collateral arrangements.

Contingencies

See Note 9. *Contingencies* to our condensed consolidated financial statements for a discussion of contingencies.

Cautionary Factors That May Affect Future Results

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in filings with the SEC, in reports to stockholders and in press releases and investor webcasts. You can identify these forward-looking statements by use of words such as "strategy," "expects," "continues," "plans," "anticipates," "believes," "will," "estimates," "intends," "projects," "goals," "targets" and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or

unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements and whether to invest in or remain invested in our securities. In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by us; any such statement is qualified by reference to the following cautionary statements. We elaborate on these and other risks we face throughout this document, particularly in the “Business Environment” section. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties. We do not undertake to update any forward-looking statement that we may make from time to time, except in the normal course of our public disclosure obligations.

Risks Related to Our Business and Industry

Consumption of duty paid cigarettes continues to decline in many of our markets.

This decline is due to multiple factors, including increased taxes and pricing, governmental actions, the diminishing social acceptance of smoking, continuing economic and geopolitical uncertainty, and the continuing prevalence of illicit products. These factors and their potential consequences are discussed more fully below and in the "Business Environment" section.

Cigarettes are subject to substantial taxes. Significant increases in cigarette-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions. These tax increases may disproportionately affect our profitability and make us less competitive versus certain of our competitors.

Tax regimes, including excise taxes, sales taxes and import duties, can disproportionately affect the retail price of manufactured cigarettes versus other tobacco products, or disproportionately affect the relative retail price of our manufactured cigarette brands versus cigarette brands manufactured by certain of our competitors. Because our portfolio is weighted toward the premium-price manufactured cigarette category, tax regimes based on sales price can place us at a competitive disadvantage in certain markets. As a result, our volume and profitability may be adversely affected in these markets.

Increases in cigarette taxes are expected to continue to have an adverse impact on our sales of cigarettes, due to resulting lower consumption levels, a shift in sales from manufactured cigarettes to other tobacco products and from the premium-price to the mid-price or low-price cigarette categories, where we may be under-represented, from local sales to legal cross-border purchases of lower price products, or to illicit products such as contraband, counterfeit and "illicit whites."

Our business faces significant governmental action aimed at increasing regulatory requirements with the goal of reducing or preventing the use of tobacco products.

Governmental actions, combined with the diminishing social acceptance of smoking and private actions to restrict smoking, have resulted in reduced industry volume in many of our markets, and we expect that such factors will continue to reduce consumption levels and will increase down-trading and the risk of counterfeiting, contraband, "illicit whites" and legal cross-border purchases. Significant regulatory developments will take place over the next few years in most of our markets, driven principally by the FCTC. The FCTC is the first international public health treaty on tobacco, and its objective is to establish a global agenda for tobacco regulation. The FCTC has led to increased efforts by tobacco control advocates and public health organizations to reduce the palatability and attractiveness of tobacco products to adult smokers. Regulatory initiatives that have been proposed, introduced or enacted include:

- restrictions on or licensing of outlets permitted to sell cigarettes;
- the levying of substantial and increasing tax and duty charges;
- restrictions or bans on advertising, marketing and sponsorship;
- the display of larger health warnings, graphic health warnings and other labeling requirements;
- restrictions on packaging design, including the use of colors, and plain packaging;
- restrictions on packaging and cigarette formats and dimensions;
- restrictions or bans on the display of tobacco product packaging at the point of sale and restrictions or bans on cigarette vending machines;
- requirements regarding testing, disclosure and performance standards for tar, nicotine, carbon monoxide and other smoke constituents;

- disclosure, restrictions or bans of tobacco product ingredients;
- increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors;
- elimination of duty free sales and duty free allowances for travelers; and
- encouraging litigation against tobacco companies.

Our operating income could be significantly affected by regulatory initiatives resulting in a significant decrease in demand for our brands, in particular requirements that lead to a commoditization of tobacco products, as well as any significant increase in the cost of complying with new regulatory requirements.

Litigation related to tobacco use and exposure to environmental tobacco smoke could substantially reduce our profitability and could severely impair our liquidity.

There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The FCTC encourages litigation against tobacco product manufacturers. 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. Please see Note 9. *Contingencies* to our condensed consolidated financial statements for a discussion of pending litigation.

We face intense competition, and our failure to compete effectively could have a material adverse effect on our profitability and results of operations.

We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, innovation, packaging, service, marketing, advertising and price. We are subject to highly competitive conditions in all aspects of our business. The competitive environment and our competitive position can be significantly influenced by weak economic conditions, erosion of consumer confidence, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices and larger gaps between retail price categories, and product regulation that diminishes the ability to differentiate tobacco products. Competitors include three large international tobacco companies and several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, China, Egypt, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives and some international competitors are susceptible to changes in different currency exchange rates.

Because we have operations in numerous countries, our results may be influenced by economic, regulatory and political developments, natural disasters or conflicts.

Some of the countries in which we operate face the threat of civil unrest and can be subject to regime changes. In others, nationalization, terrorism, conflict and the threat of war may have a significant impact on the business environment. Economic, political, regulatory or other developments or natural disasters could disrupt our supply chain, manufacturing capabilities or our distribution capabilities. In addition, such developments could lead to loss of property or equipment that are critical to our business in certain markets and difficulty in staffing and managing our operations, which could reduce our volumes, revenues and net earnings.

There is an increasing number of conflicts, including in the Middle East and Ukraine. Political uncertainty, including potential effects from economic sanctions by the U.S. or other governments, could lead to significant disruptions to our business.

In certain markets, we are dependent on governmental approvals of various actions such as price changes, and failure to obtain such approvals could impair growth in our profitability.

In addition, despite our high ethical standards and rigorous control and compliance procedures aimed at preventing and detecting unlawful conduct, given the breadth and scope of our international operations, we may not be able to detect all potential improper or unlawful conduct by our employees and international partners.

We may be unable to anticipate changes in consumer preferences or to respond to consumer behavior influenced by economic downturns.

Our tobacco business is subject to changes in consumer preferences, which may be influenced by local economic conditions. To be successful, we must:

- promote brand equity successfully;
- anticipate and respond to new consumer trends;
- develop new products and markets and broaden brand portfolios;
- improve productivity; and
- be able to protect or enhance margins through price increases.

In periods of economic uncertainty, consumers may tend to purchase lower-price brands, and the volume of our premium-price and mid-price brands and our profitability could suffer accordingly. Such down-trading trends may be reinforced by regulation that limits branding, communication and product differentiation.

We lose revenues as a result of counterfeiting, contraband, cross-border purchases and non-tax-paid volume produced by local manufacturers.

Large quantities of counterfeit cigarettes are sold in the international market. We believe that *Marlboro* is the most heavily counterfeited international cigarette brand, although we cannot quantify the revenues we lose as a result of this activity. In addition, our revenues are reduced by contraband, legal cross-border purchases and non-tax-paid volume produced by local manufacturers.

From time to time, we are subject to governmental investigations on a range of matters.

Investigations include allegations of contraband shipments of cigarettes, allegations of unlawful pricing activities within certain markets, allegations of underpayment of customs duties and/or excise taxes, allegations of false and misleading usage of descriptors and allegations of unlawful advertising. We cannot predict the outcome of those investigations or whether additional investigations may be commenced, and it is possible that our business could be materially affected by an unfavorable outcome of pending or future investigations. See “Management's Discussion and Analysis of Financial Condition and Results of Operations-Operating Results by Business Segment-Business Environment-Governmental Investigations” for a description of certain governmental investigations to which we are subject.

We may be unsuccessful in our attempts to produce Reduced-Risk Products, and regulators may not permit reduced exposure or risk claims.

We continue to seek ways to develop commercially viable new product technologies with the potential to reduce exposure to harmful constituents in smoke and individual risk and population harm, all in comparison to smoking combustible cigarettes. Our goal is to develop products whose potential to reduce exposure, individual risk and population harm can be substantiated by rigorous scientific studies and that provide adult smokers the taste, sensory experience, nicotine delivery profile and ritual characteristics that are similar to those currently provided by combustible cigarettes. We may not succeed in these efforts. If we do not succeed, but others do, we may be at a competitive disadvantage. Furthermore, we cannot predict whether regulators will permit the marketing of tobacco products or other nicotine-containing products with claims of reduced exposure or risk as compared with combustible cigarettes. A prohibition on any such claims could significantly undermine the commercial viability of these products.

Our reported results could be adversely affected by unfavorable currency exchange rates, and currency devaluations could impair our competitiveness.

We conduct our business primarily in local currency and, for purposes of financial reporting, the local currency results are translated into U.S. dollars based on average exchange rates prevailing during a reporting period. During times of a strengthening U.S. dollar, our reported net revenues and operating income will be reduced because the local currency translates into fewer U.S. dollars. During periods of local economic crises, foreign currencies may be devalued significantly against the U.S. dollar, reducing our margins. Actions to recover margins may result in lower volume and a weaker competitive position.

The repatriation of our foreign earnings, changes in the earnings mix, and changes in U.S. tax laws may increase our effective tax rate. Our ability to receive payments from foreign subsidiaries or to repatriate royalties and dividends could be restricted by local country currency exchange controls.

Because we are a U.S. holding company, our most significant source of funds is distributions from our non-U.S. subsidiaries. Under current U.S. tax law, in general we do not pay U.S. taxes on our foreign earnings until they are repatriated to the U.S. as distributions from our non-U.S. subsidiaries. These distributions may result in a residual U.S. tax cost. It may be advantageous to us in certain circumstances to significantly increase the amount of such distributions, which could result in a material increase in our overall effective tax rate. Additionally, the Obama Administration has indicated that it favors changes in U.S. tax law that would fundamentally change how our earnings are taxed in the U.S. If enacted and depending upon its precise terms, such legislation could increase our overall effective tax rate. Certain countries in which we operate have adopted or could institute currency exchange controls that limit or prohibit our local subsidiaries' ability to make payments outside the country.

Our ability to grow profitability may be limited by our inability to introduce new products, enter new markets or to improve our margins through higher pricing and improvements in our brand and geographic mix.

Our profit growth may suffer if we are unable to introduce new products or enter new markets successfully, to raise prices or to improve the proportion of our sales of higher margin products and in higher margin geographies.

We may be unable to expand our brand portfolio through successful acquisitions or the development of strategic business relationships.

One element of our growth strategy is to strengthen our brand portfolio and market positions through selective acquisitions and the development of strategic business relationships. Acquisition and strategic business development opportunities are limited and present risks of failing to achieve efficient and effective integration, strategic objectives and anticipated revenue improvements and cost savings. There is no assurance that we will be able to acquire attractive businesses on favorable terms, or that future acquisitions or strategic business developments will be accretive to earnings.

Government mandated prices, production control programs, shifts in crops driven by economic conditions and the impact of climate change may increase the cost or reduce the quality of the tobacco and other agricultural products used to manufacture our products.

As with other agricultural commodities, the price of tobacco leaf and cloves can be influenced by imbalances in supply and demand, and crop quality can be influenced by variations in weather patterns, including those caused by climate change. Tobacco production in certain countries is subject to a variety of controls, including government mandated prices and production control programs. Changes in the patterns of demand for agricultural products could cause farmers to plant less tobacco. Any significant change in tobacco leaf and clove prices, quality and quantity could affect our profitability and our business.

Our ability to implement our strategy of attracting and retaining the best global talent may be impaired by the decreasing social acceptance of cigarette smoking.

The tobacco industry competes for talent with consumer products and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best global talent.

The failure of our information systems to function as intended or their penetration by outside parties with the intent to corrupt them could result in business disruption, litigation and regulatory action, and loss of revenue, assets or personal or other sensitive data.

We use information systems to help manage business processes, collect and interpret business data and communicate internally and externally with employees, suppliers, customers and others. Some of these information systems are managed by third-party service providers. We have backup systems and business continuity plans in place, and we take care to protect our systems and data from unauthorized access. Nevertheless, failure of our systems to function as intended, or penetration of our systems by outside parties intent on extracting or corrupting information or otherwise disrupting business processes, could result in loss of revenue, assets or personal or other sensitive data, litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs to us.

We may be required to replace third-party contract manufacturers or service providers with our own resources.

In certain instances, we contract with third parties to manufacture some of our products or product parts or to provide other services. We may be unable to renew these agreements on satisfactory terms for numerous reasons, including government regulations. Accordingly, our costs may increase significantly if we must replace such third parties with our own resources.

Item 4. Controls and Procedures.

PMI carried out an evaluation, with the participation of PMI's management, including PMI's Chief Executive Officer and Chief Financial Officer, of the effectiveness of PMI's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, PMI's Chief Executive Officer and Chief Financial Officer concluded that PMI's disclosure controls and procedures are effective. There have been no changes in PMI's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, PMI's internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 9. *Contingencies* of the Notes to the Condensed Consolidated Financial Statements included in Part I – Item 1 of this report for a discussion of legal proceedings pending against Philip Morris International Inc. and its subsidiaries.

Item 1A. Risk Factors.

Information regarding Risk Factors appears in “MD&A – Cautionary Factors That May Affect Future Results,” in Part I – Item 2 of this Form 10-Q and in Part I – Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Our share repurchase activity for each of the three months in the quarter ended March 31, 2015 was as follows:

Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
January 1, 2015 – January 31, 2015 (1)	—	\$ —	144,643,396	\$ 5,347,045,761
February 1, 2015 – February 28, 2015 (1)	—	\$ —	144,643,396	\$ 5,347,045,761
March 1, 2015 – March 31, 2015 (1)	—	\$ —	144,643,396	\$ 5,347,045,761
Pursuant to Publicly Announced Plans or Programs	—	\$ —		
January 1, 2015 – January 31, 2015 (3)	1,819	\$ 80.92		
February 1, 2015 – February 28, 2015 (3)	256,442	\$ 82.61		
March 1, 2015 – March 31, 2015 (3)	6,448	\$ 82.20		
For the Quarter Ended March 31, 2015	<u>264,709</u>	\$ 82.59		

- (1) On June 13, 2012, our Board of Directors authorized a share repurchase program of \$18 billion over three years. The program commenced on August 1, 2012 after the completion of the three-year \$12 billion program in July 2012. These share repurchases have been made pursuant to the \$18 billion program. On February 5, 2015, we announced that we do not plan any share repurchases in 2015.
- (2) Aggregate number of shares repurchased under the above-mentioned share repurchase program as of the end of the period presented.
- (3) Shares repurchased represent shares tendered to us by employees who vested in deferred stock awards and used shares to pay all, or a portion of, the related taxes.

Item 6. Exhibits.

- 3.1 Amended and Restated By-Laws of Philip Morris International Inc., effective January 1, 2015 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed December 15, 2014).
- 3.2 Amended and Restated By-Laws of Philip Morris International Inc., effective immediately prior to the 2015 Annual Meeting of Shareholders (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed March 13, 2015).
- 10.1 Employment Agreement with Martin King.
- 10.2 Pension Fund of Philip Morris in Switzerland (IC).
- 10.3 Summary of Supplemental Pension Plan of Philip Morris in Switzerland (incorporated by reference to Exhibit 10.19 to the Annual Report on Form 10-K for the year ended December 31, 2014).
- 10.4 Form of Deferred Stock Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 10, 2015).
- 10.5 Extension Agreement, effective February 10, 2015, among Philip Morris International Inc., the lenders named therein and the Royal Bank of Scotland plc, as administrative agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed January 29, 2015).
- 10.6 Extension Agreement, effective February 28, 2015, among Philip Morris International Inc., the lenders named therein, J.P. Morgan Europe Limited, as facility agent, and JPMorgan Chase Bank, N.A., as swingline agent (incorporated by reference to Exhibit 10.2 to Form 8-K filed January 29, 2015).
- 12 Statement regarding computation of ratios of earnings to fixed charges.
- 31.1 Certification of the Registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Registrant's Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Registrant's Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase.
- 101.LAB XBRL Taxonomy Extension Label Linkbase.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHILIP MORRIS INTERNATIONAL INC.

/s/ JACEK OLCZAK

Jacek Olczak

Chief Financial Officer

May 1, 2015

Exhibit 12

PHILIP MORRIS INTERNATIONAL INC. AND SUBSIDIARIES
 Computation of Ratios of Earnings to Fixed Charges
 (in millions of dollars)

	Three Months Ended March 31, 2015
Earnings before income taxes	\$ 2,596
Add (deduct):	
Dividends from less than 50% owned affiliates	—
Fixed charges	334
Interest capitalized, net of amortization	—
Earnings available for fixed charges	<u>\$ 2,930</u>
Fixed charges:	
Interest incurred	\$ 306
Portion of rent expense deemed to represent interest factor	28
Fixed charges	<u>\$ 334</u>
Ratio of earnings to fixed charges	<u>8.8</u>

Exhibit 12

PHILIP MORRIS INTERNATIONAL INC. AND SUBSIDIARIES
 Computation of Ratios of Earnings to Fixed Charges
 (in millions of dollars)

	For the Years Ended December 31,				
	2014	2013	2012	2011	2010
Earnings before income taxes	\$ 10,650	\$ 12,542	\$ 13,004	\$ 12,542	\$ 10,332
Add (deduct):					
Dividends from less than 50% owned affiliates	107	1	—	—	—
Fixed charges	1,284	1,216	1,115	1,042	1,069
Interest capitalized, net of amortization	1	4	2	(2)	1
Earnings available for fixed charges	<u>\$ 12,042</u>	<u>\$ 13,763</u>	<u>\$ 14,121</u>	<u>\$ 13,582</u>	<u>\$ 11,402</u>
Fixed charges:					
Interest incurred	\$ 1,172	\$ 1,105	\$ 1,009	\$ 940	\$ 976
Portion of rent expense deemed to represent interest factor	112	111	106	102	93
Fixed charges	<u>\$ 1,284</u>	<u>\$ 1,216</u>	<u>\$ 1,115</u>	<u>\$ 1,042</u>	<u>\$ 1,069</u>
Ratio of earnings to fixed charges	<u>9.4</u>	<u>11.3</u>	<u>12.7</u>	<u>13.0</u>	<u>10.7</u>

Certifications

I, André Calantzopoulos, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Philip Morris International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 1, 2015

/s/ ANDRÉ CALANTZOPOULOS

André Calantzopoulos

Chief Executive Officer

Certifications

I, Jacek Olczak, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Philip Morris International Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 1, 2015

/s/ JACEK OLCZAK

 Jacek Olczak
 Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Philip Morris International Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, André Calantzopoulos, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ANDRÉ CALANTZOPOULOS

André Calantzopoulos
Chief Executive Officer

May 1, 2015

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Philip Morris International Inc. and will be retained by Philip Morris International Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Philip Morris International Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jacek Olczak, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JACEK OLCZAK

Jacek Olczak

Chief Financial Officer

May 1, 2015

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Philip Morris International Inc. and will be retained by Philip Morris International Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**Pension Fund of
Philip Morris in Switzerland**

**Regulations
IC Pension Plan**

January 2015

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Introduction

The objective of the Pension Fund of Philip Morris in Switzerland (hereafter "the Pension Fund") is to protect the employees of the Philip Morris Group in Switzerland and companies which, in accordance with the Statutes, can be affiliated with the Fund (hereafter: "the Employer" or, collectively, "the Employers") against the economic consequences of retirement, disability and death.

In compliance with Article 5 of the Statutes governing the Pension Fund of Philip Morris in Switzerland, the Pension Board issues the regulations for this Plan (hereafter: "the IC Pension Plan").

The IC Pension Plan is a "defined contributions plan" within the meaning of Article 15 of the Federal Law on Vesting in Pension Plans of 17 December 1993 (hereafter: "LFLP/FZG").

The benefits contemplated in these Regulations supplement the benefits under the Plan Rules of the Pension Plan of Philip Morris in Switzerland (hereafter, "the Main Plan"), which is a "defined benefits plan" within the meaning of Article 16 LFLP/FZG. These benefits are paid out together with those of the Main Plan.

In these Regulations, words importing the masculine gender refer equally to men and women.

Persons bound by a registered civil partnership, within the meaning of the Federal Law on Registered Civil Partnerships Between Persons of the Same Sex, are treated in the same way as married persons (spouses) as defined in these Regulations. The registration of a civil partnership at a registry office is treated in the same way as a marriage and the dissolution of a civil partnership by a court is treated in the same way as a divorce.

Articles 15 to 20 (General provisions), 60 to 73 (Encouragement of Home Ownership), 77 (Assets), 78 to 85 (Administration of the Fund), of the Main Plan regulations remain applicable by analogy.

1. Membership in the IC Plan

Article 1 - Principle

1. Membership in the IC Plan is compulsory for all grade 14 employees or higher who are members of the Pension Fund's Main Plan.

Art. 2 - Start of Membership

1. Membership in the IC Plan commences on the first day of the month in which a bonus is paid. As a result, the employee acquires the status of insured member.

Art. 3 - Termination of Membership

1. Membership in the IC Pension Plan ceases at the date of termination of employment
 2. Termination of membership in the IC Plan entails the loss member status, subject, however, to Article 24 (end of insurance) and Article 25 (maintenance of insurance as an external member) and to the Pension Fund's obligation to provide the individual concerned with all necessary information.
-

2. Definitions

Art. 4 - Normal retirement

1. Normal retirement begins on the first day of the month following a member's 65th birthday, irrespective of gender.

Art. 5 - Contributory salary

1. The contributory salary of members in salary grades 19 to 28 is equal to the contributory salary of the Main Plan. This salary is hereafter referred to as "contributory salary I".

The contributory salary I is limited to ten times the maximum amount defined in Article 8(1) LPP/BVG.

2. The contributory salary of members in salary grade 14 to 17 is equal to the bonus (IC). This salary is hereafter referred to as "contributory salary II".

The contributory salary II is limited to ten times the upper amount defined in Article 8(1) LPP less the sum of compensation elements defined in Article 6(1) of the Main Plan regulations.

3. The contributory salary of members in salary grade 18 is equal to the contributory salary I when the sum of compensation elements defined in Article 6(1) of the Main Plan regulations plus the bonus (IC) exceeds ten times the upper amount defined in Article 8(1) LPP/BVG.

In all other cases, the contributory salary is equal to the contributory salary II.

4. If any bonus (IC) is paid during the current year, the contributory salary is equal to zero.
5. The contributory salary never includes any compensation earned from employment with a third party.

Art. 6 - Retirement savings capital

1. A retirement savings capital is created for each member, consisting of:
 - retirement credits in accordance with Article 7 below
 - the member's voluntary contributions;
 - possible repayments of amounts lost in implementation of Article 9 (loss of benefits); and
 - interest accrued on the above amounts.
-

Art. 7 - Retirement credits

1. The retirement credits calculated on a yearly basis and expressed as a percentage of the contributory salary are equal to:
 - a. contributory salary I:
 - grades 28 to 24 : 3 %
 - grade 23 : 11.4 %
 - grade 22 : 10.8 %
 - grade 21 : 9.6 %
 - grade 20 : 9.0 %
 - grade 19 : 8.4 %
 - grade 18 : 7.8 % ;
 - b. contributory salary II: 12 %

Art. 8 - Voluntary contributions

1. An active member who has accrued the maximum duration specified in Article 10(1) of the Main Plan regulations may purchase pension benefits at any time by means of a voluntary contribution.
 2. Vested termination benefits that are not entirely absorbed by the Main Plan in accordance with Article 10(5) of its regulations may be applied to the purchase of benefits in the IC Pension Plan.
 3. Voluntary contributions are limited to the difference between:
 - a. contributory salary I:
 - 3 % of the contributory salary I, multiplied by the difference in years between the year of the member's 30th birthday and the current calendar year, and
 - the retirement savings capital accrued at the date of the voluntary contribution, increased by an annual interest of 4%;
 - b. contributory salary II:
 - 12 % of the contributory salary, multiplied by the difference in years between the year of the member's 30th birthday and the current calendar year, and
 - the retirement savings capital accrued at the date of the voluntary contribution, increased by an annual interest of 4%.

The reference salary for calculating the maximum voluntary contribution is equal to the average of the last three contributory salaries II earned since the start of membership in the IC Pension Plan.
 4. Members can only make a voluntary contribution if they have fully repaid any previous withdrawals obtained for the financing of home ownership. However, voluntary contributions made after the 62th birthday are allowed, to the extent that when added to the withdrawals, they do not exceed the maximum benefits under the present regulations.
 5. The maximum amount that may be allocated to the voluntary purchase is reduced by any vested termination benefit that has not been transferred to the Fund plus that portion of the member's 3a pillar assets which exceeds the sum of the maximum annual tax deductible contributions from age 24, plus interest, in accordance with Article 7(1)(a) OPP 3.
-

6. In the case of members arriving from abroad who have never belonged to a pension plan in Switzerland, the maximum annual voluntary contribution is limited, during the first 5 years of membership in a Swiss pension scheme, to 20 % of the contributory salary.
7. Benefits deriving from a member's voluntary contributions may not be paid out in the form of capital for at least three years.
8. If one of the Employers finances all or part of a purchase of benefits in the context of a member's international transfer within the Philip Morris Group, an agreement will be concluded between the Fund, the Employer and the member.

Art. 9 - Loss of benefits

1. If Article 18 (transfer of termination benefits in case of divorce) is applied following a divorce, the member's retirement savings capital will be reduced and his voluntary and regulatory contributions accounts will be adjusted accordingly.
2. If a member makes a withdrawal for the financing of home ownership and an amount is transferred from the IC Pension Plan, the member's retirement savings capital will be reduced by an equal amount. The voluntary and regulatory contributions of the member will be reduced proportionately with the reduction in retirement savings capital.

Art. 10 - Interest

1. The interest rate payable on the retirement savings capital is set by the Pension Board.
2. Interest is credited at the end of each calendar year or on the date the member leaves the IC Pension Plan if an insured event occurs during the year.
3. Retirement credits bear interest from the 1st day of the month following their payment; voluntary contributions bear interest from the date they are paid in.
4. The default interest rate is the minimum interest rate set in the LPP plus one percentage point.

3. IC Pension Plan benefits

General principles

Art. 11 - Insured benefits

1. Subject to the conditions set out below, the IC Pension Plan insures benefits in the form of:
 - a) lump-sum retirement capital ;
 - b) lump-sum disability benefit;
 - c) lump-sum death benefit
 - d) benefits in case of divorce;
 - e) vested termination benefit.
-

Lump-sum Retirement Capital

Art. 12 - Entitlement

1. Entitlement to retirement benefits begins on the normal retirement date.
2. If a member leaves the Main Plan after the last day of the month preceding his 58th birthday for any reason other than death or disability, he is entitled to the retirement benefits of the IC Pension Plan from that date. Article 19(1bis) (entitlement to a vested termination benefit) remains applicable.
3. A member who has applied to the Main Plan for a partial or full retirement pension may use all or part of his IC Pension Plan retirement savings capital to purchase retirement pension benefits from the Main Plan. Pension benefits thus purchased are governed by the regulations of the Main Plan.
4. The member must inform the Pension Fund's management of his choice 3 months before retirement date, otherwise he shall be deemed to have opted for payment of a lump-sum retirement capital. Article 8(7) remains applicable.
5. If the member is married, payment of a lump-sum capital is subject to the written consent of his spouse. If such agreement cannot be obtained or if it is refused, the member may appeal to the courts.

Art. 13 - Amount

1. The lump-sum retirement capital is equal to the retirement savings capital accrued at the retirement date.
2. The annual retirement pension purchased in the Main Plan results from the conversion of all or part of the accrued retirement savings capital using the conversion factor for the member's age at retirement indicated in Annexe 1 of the Main Plan regulations, plus a percentage of the reserve for changes in mortality tables indicated in the balance sheet of the Main Plan on 1 January of the year of retirement.

Lump-sum disability benefit

Art. 14 - Recognition of Disability

1. A member who is recognised as disabled under the Main Plan regulations qualifies as disabled at the same date and to the same degree under the IC Pension Plan.

Art. 15 - Entitlement and amount

1. The member is entitled to a lump-sum disability benefit when he is recognised as disabled under the Main Plan regulations.
 2. The lump-sum disability benefit is equal to the accrued retirement savings capital at the date of recognition of disability by the Main Plan.
-

3. Entitlement to the full Main Plan pension entails entitlement to full payment of the capital.

If the member is entitled to a partial rent under the Main Plan regulations, the lump-sum disability benefit is paid in the same proportion.

Lump-sum death benefit

Art. 16 - Entitlement and amount

1. If an active member dies, a lump-sum death benefit is payable to the beneficiaries in accordance with Article 17 below.
2. The lump-sum death benefit is equal to:
 - a) the retirement savings capital accrued at the date of the member's death, if the beneficiaries are beneficiaries within the meaning of Article 17(1) of these Regulations, or of Article 46(1) of the Main Plan regulations.
 - b) 50 % of the retirement savings capital, but no less than the aggregate of the member's contributions, without interest, if the beneficiaries are "other legal heirs" within the meaning of the LPP.

Art. 17 - Beneficiaries

1. The lump-sum death benefit is payable:
 - first: to the surviving spouse or to the surviving partner who can claim payment of a pension in accordance with Article 40^{bis} of the Main Plan regulations;
 - failing them: to the other beneficiaries in accordance with Article 46 of the Main Plan regulations.
2. If there are no beneficiaries in accordance with paragraph 1 above, the lump-sum death benefit vests in the IC Pension Plan.

Benefits in Case of Divorce

Art. 18 - Transfer of Termination Benefit in Case of Divorce

1. If an active member divorces, the termination benefits that accrued to the member and his ex-spouse during their marriage are divided between them in accordance with Sections 122, 123, 141 and 142 of the Swiss Civil Code. The Court automatically notifies the Fund of the amount to be transferred and all information necessary for the transfer.
 2. If the court notifies the Fund in accordance with paragraph 1, the retirement savings capital in the IC Pension Plan at the time of the divorce is reduced by the amount attributed by the court to the ex-spouse. The member may partially or fully repay the amount thus transferred; the repayment will be applied to rebuilding his retirement savings capital. Article 8(6) remains applicable.
 3. The sum of voluntary and regulatory contributions made by the member up to the divorce will be reduced proportionately to the reduction in retirement savings capital.
-

Vested Termination Benefit

Art. 19 - Termination of employment

1. A member who leaves the Main Plan for any reason other than death or disability before he is entitled to draw retirement benefits is entitled to vested termination benefits in the amount determined in accordance with Article 20 (amount of vested termination benefits) and Article 21 (minimum amount of vested termination benefits) below.
- 1^{bis} A member wishing to avail himself of his right to a termination benefit in accordance with Article 51(1bis) of the Main Plan regulations, obtains also a vested termination benefit from the IC Pension Plan.
2. Vested termination benefits are payable when a member leaves the IC Pension Plan. After that date, they earn interest at the minimum LPP/BVG rate. If the Fund does not transfer the benefits due within 30 days of receipt of all requisite information, default interest shall accrue as of that time.

Art. 20 - Amount of the Vested Termination Benefit

1. Subject to Article 21 below, the vested termination benefits are equal to the member's retirement savings capital at the date he leaves.
2. If, on the last day of employment, the member was employed with the Philip Morris Group for less than 5 years starting from the date of the member's 18th birthday, the vested termination benefit will be reduced by any amounts financed by the Employer pursuant to Articles 8(8). That reduction is decreased by one tenth of the amount financed by the Employer for every year of employment with the Philip Morris Group starting from the date of the member's 18th birthday. The reduction for a fraction of a year is calculated pro rata temporis. The amount not attributed to the member is treated as a contribution reserve of the Employer. If, on the last day of employment, the member has been employed with the Philip Morris Group for 5 years or more since the date of his 18th birthday, no reduction shall be made.

Art. 21 - Minimum Amount of Vested Termination Benefit

1. When a member leaves the Pension Fund, he is entitled at least to any voluntary contributions made pursuant to Articles 8 and to any repayments of amounts lost pursuant to Article 9, with interest at the rate set in the LPP; in addition, the member is entitled to any personal contributions to the IC Pension Plan paid in after 1 January following his 24th birthday, without interest but increased by 4 % per year over age 20, up to a maximum of 100 %.
 2. The vested termination benefits are reduced by any amount financed by the Employer in accordance with Article 8(8). That deduction is reduced by one tenth of the amount financed by the Employer for every year of contribution to the IC Pension Plan. The reduction for a fraction of a year is calculated pro rata temporis. The amount not attributed to the member is treated as a contribution reserve of the Employer.
-

Art. 22 - Transfer of the Vested Termination Benefit

1. When a member leaves the Pension Fund, the Fund informs him of the amount of his vested termination benefits, inviting him to provide the necessary instructions for their transfer within 30 days in accordance with paragraphs 2 and 3 below.
2. If the member starts working for a new employer, the Fund shall transfer the vested termination benefits together with the vested termination benefits of the Main Plan to the new employer's pension plan in accordance with the member's instructions.
3. If the member does not go to work for a new employer, he may choose between:
 - a) purchasing a vested benefits policy with an insurance company subject to ordinary insurance regulation; or
 - b) opening a vested benefits account with a pension fund whose assets are invested by, or with, a bank governed by the Federal Law on Banks and Savings Institutions.
4. If the member fails to provide the requisite information within the specified time, the IC Pension Plan shall transfer the vested termination benefit, including interest, to a vested benefits account or to the Substitute Pension Plan no later than two years after termination of employment.
5. Article 23 remains applicable.

Art. 23 - Cash Payment

1. Subject to Article 8(7), a member may apply to receive his vested termination benefit in cash:
 - a) if he leaves Switzerland permanently for a country other than the Principality of Liechtenstein;
 - b) if he becomes self-employed and is no longer subject to the LPP/BVG;
 - c) if the vested termination benefit is less than the member's annual contribution at the time of termination of employment.
2. If the member is married, payment in cash may only be made with the written consent of the spouse. If such consent cannot be obtained, or is unduly withheld, the member may appeal to the courts.
3. The Pension Board may require the member to submit any proof it deems necessary and may delay payment until such proof is submitted.

Art. 24 - End of insurance

1. IC Pension Plan insurance coverage ends on the day the member leaves the Pension Fund, namely on the last day of the month when employment ends.
 2. If, in the month following the end of employment, the member does not enter into an employment contract with a new employer, and if he has an earning incapacity which subsequently causes him to be qualified as disabled under the Main Plan, the benefits paid by the IC Pension Plan are those that were insured on the day the member left the IC Pension Plan.
-

3. If the IC Pension Plan intervenes in accordance with paragraph 2 of this Article, and if the vested termination benefit was already transferred, the Pension Fund shall claim restitution. If restitution is not forthcoming, the IC Plan benefits shall be reduced accordingly.
4. Article 25 (maintenance of insurance as an external member) remains applicable.

Maintenance of Insurance Coverage

Art. 25 - Maintenance of Insurance as an External Member

1. A member who applies to maintain his insurance cover as an external member under the Main Plan in accordance with Articles 57 and 58 of that Plan's regulations also maintains his insurance coverage under the IC Pension Plan. The same applies to a member who applies to maintain his insurance cover as a contributing external member under the Main Plan in accordance with Article 59 of that Plan's regulations.
2. The member stops paying contributions; the retirement savings capital accrued at the last day of employment will be increased by interest at the rate set by the Pension Board.
3. Benefit entitlements remain subject to the provisions of these Regulations. However, the application of Article 8 (voluntary contributions) of present regulations, and Articles 60 to 73 (accession to the property) of Main Plan regulations, is excluded.
4. A member who is downgraded below grade 14 maintains his insurance coverage under the IC Pension Plan as an external member from the 1st day of the month coinciding with the downgrading. The member stops paying contributions; the accrued retirement savings capital will be increased by interest at the rate set by the Pension Board. Benefit entitlements remain subject to the provisions of these Regulations. Notwithstanding, Article 8 is excluded from application from the date of downgrading.

4. IC Pension Plan Resources

Art. 26 - General Resources

1. The resources of the IC Plan consist of:
 - a) regulatory contributions of the members;
 - b) voluntary contributions within the meaning of Article 8 (voluntary contributions) and any repayments of amounts lost in accordance with Article 9 (loss of benefits);
 - c) the regulatory contributions of the Employer;
 - d) any temporary remedial contributions from members and the Employer;
 - e) any grants, donations and bequests;
 - f) insurance benefits and residual balances which, for whatever reason, are not allocated to the beneficiaries;
 - g) income on Fund's assets.

Art. 27 - Member's Contributions

1. Each member must pay contributions from the time he joins the IC Pension Plan and for as long as he is a member of that plan, but no later than the date on which he is recognised as disabled, or until the date he reaches normal retirement age. Article 25 (maintenance of insurance as an external member) remains applicable.
2. The member's annual contribution is equal to:
 - a. contributory salary I:
 - grades 28 to 24 : 1,5 %
 - grade 23 : 5.7 %
 - grade 22 : 5.4 %
 - grade 21 : 4.8 %
 - grade 20 : 4.5 %
 - grade 19 : 4.2 %
 - grade 18 : 3.9 % ;
 - b. contributory salary II: 6 %
3. The member's contribution to the IC Pension Plan is deducted from the member's salary each year.

Art. 28 - Employer's contribution

1. As long as the member is required to pay contributions, the Employer shall do so as well.
2. For each active member, the Employer pays a contribution equal to the contribution amount paid by the member.

5. Transitional Provisions

Art. 29 – Member's contribution and retirement credits

1. The members who, on April 1st 2014, are in grade 22 or 23 pay an annual contribution of 1.5% of contributory salary I as long as they remain in one of these grades. The retirement credits equal to 3 % of contributory salary I.
-

6. Final Provisions

Art. 30 - Amendment of the Regulations

1. The Pension Board may amend these Regulations at any time provided it does not reduce members' vested benefits calculated at the date of the amendment.

Art. 31 - Interpretation

1. The Main Plan regulations apply to all matters not explicitly mentioned for in these Regulations.
2. Any cases not explicitly mentioned for in these Regulations or in the Main Plan regulations shall be decided by the Pension Board taking into account the meaning and spirit of the Statutes of the Pension Fund, the Regulations of the IC Pension Plan, applicable legislation and the corresponding implementation ordinances.

Art. 32 - Disputes

1. Any dispute arising out of the interpretation, the application or non-application of these Regulations shall be submitted to the competent courts at the registered office or Swiss domicile of the defendant, or of the place of business in Switzerland where the member was employed.

Art. 33 - Translations

1. These Regulations were drawn up in French; they may be translated into English.
2. In case of discrepancy between the French version and the English translation, the French version shall take precedence.

Art. 34 - Effective Date

1. These Regulations enter into effect on **1 January 2015**; they supersede the Regulations effective on 1 January 2011.
2. They shall be submitted to the competent regulatory authority.
3. They shall be published on the Employer's intranet site and a hard copy shall be sent to members upon request.



PHILIP MORRIS SERVICES S.A.

CONFIDENTIAL

Mr. Martin King

Lausanne, January 7, 2014

Dear Martin,

We are pleased to confirm your assignment to the PMI Global Services Inc. in New York, United States of America.

Overview of Assignment

You will be seconded from your employer Philip Morris Services S.A. ("Home Company") to PMI Global Services Inc. ("Host Company"). During this assignment you will be based in New York, United States of America and will work as President Latin America & Canada under the supervision of Andre Calantzopoulos, Chief Executive Officer PMI ("Host Manager").

Employment with Home Company

During the assignment you will continue to be an employee of the Home Company and your employment contract with the Home Company will remain in effect. The existing terms and conditions of employment with the Home Company will continue, but as amended and supplemented by this letter. The provisions of the PMI Global Long Term Assignment Guidelines (as they may be amended or re-issued from time to time) ("Global Guidelines") will also apply to your assignment.

Commencement and Duration of Assignment

The assignment will be effective as of February 1st, 2014 or, if later, the date of issue of your work permit, and is expected to continue for a period of 5 years, although no commitment can be given as to its exact duration.

Home Country/Point of Origin

Your Home Country, for the purpose of your remuneration package, shall be deemed to be Switzerland. Your point of origin for the purposes of Home Leave will be deemed as Geneva, Switzerland.

Direction and Control

During your assignment, the Home Company will remain your employer, however, you will be subject to the direction and control of the Host Company and you must comply with the rules, policies, procedures and working practices of the Host Company, as well as all applicable laws of the Host Country. Your Host Manager will define your day to day activities and participate in your performance appraisal for the period of this assignment.

Throughout the assignment, you must not represent yourself as conducting business on behalf of the Home Company and you are expressly not authorized to bind the Home Company in any way. Throughout your assignment you must comply with the "Guidelines on Business Practice for Assignees" attached to this letter at Annex "A".

Salary, Bonuses and other Allowances

Your annual base salary of CHF 825'006.-- ("Base Salary") corresponding to your grade, which is 24 will continue to be administered by the Home Company.

You will continue to be entitled to participate in the PMI Variable Compensation schemes.

Your assignment package will be calculated in accordance with the Global Guidelines and is notified to you separately. The assignment package is reviewed on an ongoing basis in accordance with the provisions of the Global Guidelines.

Medical Cover

You and any Accompanying Family Members (as defined in the Global Guidelines) will be provided with medical insurance during the whole period of your assignment.

Vacation & Holidays

During your assignment you will be entitled to the greater of the number of days determined by the Home Company's or the Host Company's vacation policy.

You will be entitled to the public holidays as determined by United States of America law and the Host Company's policy and practice.

Working schedule, working hours, etc.

During the assignment, you will be required to follow the working schedule and working hours of the Host Company.

Travel Security

PMI's goal is to help our employees travel and work safely and securely wherever our business takes us. Please refer to the Travel Security page on PMI's intranet site for travel security information, including specific information about your Host Country. Before leaving for your assignment or any pre-assignment trip, please ensure that you have completed an appropriate travel security training program. If you have any questions or concerns regarding health, safety or security in connection with your assignment, please contact Host Country Human Resources.

Privacy Policy and Data Protection

The Home Company and Host Company will, in the course of their business, process personal data relating to you, You give your consent to the Home and Host Company to: (a) process your personal information for their, and their Affiliates', business purposes; (b) process your sensitive personal data where this is necessary for the administration of the employment relationship; (c) make your personal information available to their Affiliates or to third parties, where necessary for the purposes of the administration of your employment, or where required by law; (d) transfer your personal information within or outside your Home or Host Country, including where the country in question may not maintain data protection standards that are equivalent to those of your Home or Host Country.

Termination of Assignment

Your assignment may be terminated by Home Company or Host Company at any time. Except in the case of localization, at the end of your assignment, you will revert to the terms and conditions of employment under your employment agreement with your Home Company, except that your compensation, benefits and other terms of

employment may be adjusted to conform to the corresponding terms and conditions, benefit schemes and other practices applicable to your return position with the Home Company or to any further assignment with another PMI affiliate.

The Company may decide at any time that continuation in an assignment role will require localization. Any decision on localization is taken in the light of periodic reviews by the Company of its Long Term Assignees. Localization will be in accordance with the provisions of the Global Guidelines.

Your assignment will terminate automatically if your employment with the Home Company is terminated (whether by you or by the Home Company).

Governing Law

Your employment by the Home Company, and the terms of your assignment to the Host Company, shall be governed by the substantive and procedural law of Switzerland, without giving effect to any principles relating to conflicts of laws.

I wish you every success in your assignment. Please return one copy of this letter duly signed for agreement to Maddalena Beucler, HR Services Administrator, Lausanne, Switzerland.

Yours sincerely,

PHILIP MORRIS SERVICES S.A.

/s/ RALF ZYSK

Ralf Zysk

*Vice President Compensation & Benefits and
International Assignments PMI*

/s/ KRISTIN HOLTER

Kristin Holter

Director Human Resources Switzerland

Acknowledgment

I acknowledge receipt of this letter and I agree with its terms. I have retained a copy of the letter for reference. I confirm that I have read the PMI Global Long Term Assignment Guidelines, provided during the assignment briefing. I also acknowledge receipt of the Guidelines on Business Practice for Assignees, attached at Annex "A", which I have read and understood.

Signed...../s/ MARTIN KING.....

Full Name of Assignee: Martin King

Date of Signature8 January 2014.....

Annex “A” to Assignment Letter

Guidelines on Business Practice for Assignees

1. Your assignment is a secondment to the Host affiliate. This means that you will continue to be an employee of your Home Company, but you will be temporarily seconded to the Host Company. The purpose of the assignment is so that you can undertake work on behalf of the Host Company for a temporary period.
2. Although you remain employed by your Home Company, for the period of your assignment you will be under the supervision and direction of the Host Company and you must comply with the guidelines, practices, rules and regulations of the Host Company from time to time in effect, as well as all applicable laws in the Host Country.
3. You also remain subject to many of your Home Company policies, to the extent that they do not conflict with those of the Host Country whilst you are on assignment. Further details can be found in the Global Guidelines.
4. During your assignment it is important that you do not do anything that may appear to be, or may be construed as, the conduct of business by or on behalf of the Home Company.

For example:

- You must not distribute business cards naming the Home Company;
- Your e-mail signature and contact details must reference the Host Company only;
- You must not use your Home Company title, but should use a title that is legally acceptable to, and approved by, the Host Company;
- You may send e-mails only from an e-mail address associated with the Host Company;
- You should not transact any business whatsoever on behalf of the Home Company.

5. During your assignment it is also important that you do not do anything that may bind the Home Company to any agreement, arrangement or business transaction.

For example:

- You may not sign any agreements, reports to third parties or regulatory filings on behalf of the Home Company, or on behalf of any other Company affiliates except the Host Company;
- You may not sign any document on behalf of the Home Company;
- You are expressly forbidden to bind the Home Company in any way, whether verbally or in writing.



CONFIDENTIAL

Mr. Martin King

Lausanne, January 7, 2014

Dear Martin,

This letter confirms the terms and conditions of your employment effective as of the date of issue of your work permit or February 1st, 2014, whichever is the later (the "Effective Date") with Philip Morris Services S.A. ("the Company").

Compensation

Your gross annual base salary will be Swiss Francs (CHF) 825'006.-- corresponding to your grade, which is 24. Your base salary will be paid in twelve (12) equal monthly installments and reviewed annually, for the first time on April 1st, 2014.

As explained in the PMI Global Long Term Assignment Guidelines ("Global Guidelines"), when working for the Company on an assignment outside Switzerland, your compensation is adjusted in several ways to enable you to maintain a standard of living in the host location which is reasonably comparable to that in your Home Country, allowing for the costs (personal income taxes, social security contributions, participation in other mandatory state schemes, Home Country contributory benefit schemes and housing and utilities) for which you would normally be responsible while working in your Home Country. Your Home Country, for the purpose of your remuneration package, shall be deemed to be Switzerland. Your point of origin for the purposes of home leave will be deemed as Geneva, Switzerland.

Incentive Compensation Award Program

As a grade 24 employee, you will be eligible to participate in the Incentive Compensation ("IC") Award Program, which is administered at the sole discretion of the Compensation and Leadership Development Committee of the Board of Directors pursuant and subject to the terms of the 2012 Performance Incentive Plan (or any similar plan in the future). Each eligible employee has an annual IC award target that assumes a PMI company performance rating of 100 and an "Optimal" individual performance.

As a grade 24 employee, for 2014 your target is 100% of your annual base salary. Targets are reviewed annually by the Company and are made available to employees under the PMI 23-G4 Guidelines Global Variable Compensation Programs Annex 1.

Equity Award Program

As a grade 24 employee, you will be eligible to participate in the Equity Award Program, which is administered at the sole discretion of the Compensation and Leadership Development Committee of the Board of Directors pursuant and subject to the terms of the 2012 Performance Incentive Plan (or any similar plan in the future). Each eligible employee has an annual equity award target that assumes a PMI company performance rating of 100 and an "Optimal" individual performance.

As a grade 24 employee, for 2014 your target is 160% of your annual base salary. Targets are reviewed annually by the Company and are made available to employees under the PMI 23-G4 Guidelines Global Variable Compensation Programs Annex 2.

The Incentive Compensation and Equity Award Programs are discretionary and do not obligate the Company to make an award nor entitle employees to receive an award. Eligibility to participate in the Programs does not guarantee receipt of an award and receiving an annual award does not guarantee receipt of an award in the future. Any awards that are made may be higher or lower than the targets mentioned above. Targets may be amended at the discretion of the Company at any time without prior notice.

Fidelity premium

For each completed year of service, the Company pays a cumulative bonus of CHF 150.-- on each anniversary of the Effective Date, up to a maximum of CHF 3'000.-- for 20 years of service.

Pension

In accordance with the Federal pension law ("LPP"), you will continue to be a member of the "Caisse de pensions Philip Morris en Suisse", providing old age, disability, and survivor's benefits.

According to the current Pension Fund regulations, you will pay a contribution equivalent to 6% of your pensionable salary. Your contribution will be deducted each month from your salary. For further details, please refer to the Pension Fund regulations.

Other benefits

For the purpose of benefits which are linked to seniority in the Company, but with the exception of Pension Fund affiliation, your initial entry date into Philip Morris International Inc. or its subsidiaries will be taken into account, i.e. June 3rd, 1991.

Accident Insurance

In accordance with Swiss law (LAA) employees are automatically covered for accident in the event of occupational or non-occupational accidents. This cover is paid for by the Company.

Health Insurance

You will join the Company group health insurance contract. Employees and their eligible dependents (spouse and dependent children up to age 18 or up to age 25 if full-time student or apprentices) are enrolled into this group health insurance scheme. Human Resources International Assignments will provide you full details of the coverage.

Salary continuation in the event of sickness

Subject to the regulations of the Company's insurer, 100% of the annual base salary is paid for up to 2 years from the first day you are unable to work. This cover is paid for by the Company.

Life Insurance

In accordance with the regulations of the Company's insurer and in coordination with the Pension Fund, you are provided with an insurance cover in case of death and permanent disability paid for by the Company.

Vacation

Your annual entitlement to vacation will be 20 days per calendar year and will be increased to 25 days per calendar year from your 5th year of service with the Altria group of companies or age 50 (whichever comes first).

Your entitlement will be further increased to 30 days per calendar year after the age of 55 and 10 years of service.

You will be entitled to the greater of the number of days determined by applicable Home or Host Country Affiliate vacation practice.

Your entitlement to public holidays will be in accordance with local office practice.

Privacy policy and data protection

The Company and Host Country Affiliate will, in the course of their business, process personal data relating to you. You give your consent to the Company and Host Country Affiliate to: (a) process your personal information for their, and their Affiliates', business purposes; (b) process your sensitive personal data where this is necessary for the administration of the employment relationship; (c) make your personal information available to their Affiliates or to third parties, where necessary for the purposes of the administration of your employment, or where required by law; (d) transfer your personal information within or outside your Home or Host Country, including where the country in question may not maintain data protection standards that are equivalent to those of your Home or Host Country.

Confidential Information

Consistent with your obligations under Swiss law, you undertake not to disclose any Confidential Information, whether during or after your employment by the Company, and upon termination of your employment to return any Confidential Information in tangible or electronic form in your possession. For these purposes "Confidential Information" means any trade secrets and other proprietary information pertaining to the Company or its affiliates, which has not been made available to the general public by an authorized representative of the Company or its affiliates, whether patentable or not, including for example any idea, formula, technique, invention, process, program, business, marketing and sales plans, financial, organizational and sales data, and similar information.

Expatriate Status

In accepting the terms and conditions of employment contained herein, you acknowledge that you have accepted an assignment to work outside Switzerland for an affiliate of the Company or an entity that does business with the Company. The terms of the assignment are set out in a separate letter. You acknowledge that your benefits and entitlements as an expatriate are determined in accordance with the Global Guidelines. Even if you still have a contract of employment with a Philip Morris International affiliate in your Home Country, you will not be eligible for any duplication of benefits and entitlements. You acknowledge that you may also be requested in the future to accept other such assignments outside Switzerland.

You also acknowledge that repatriation will, or any future assignment may entail the termination of this contract.

Company Property

Upon termination of your employment, you should return to the Company and/or its affiliates all paper and electronic files and documents, tapes, CD's, and copies thereof and other items belonging to the Company and its affiliates, irrespective of their source and origin, including, if any, Company corporate cards, telephone, telephone cards, keys, access and identification cards, computers, blackberry, car, and, if requested, will certify that this has been done to the best of your belief and that you also comply with all Company Records & Information Management (RIM) policies, procedures, and guidelines before your departure.

The settlement of any outstanding expenses due to the Company, including, but not limited to any outstanding balance on the account of the corporate card issued in your name will be set-off with any payable sums.

Termination of employment

This contract shall be terminable in accordance with Swiss law.

Miscellaneous

This letter, when countersigned by you, will represent the complete agreement between you and the Company concerning its subject matter and will supersede and replace any previous agreements or understandings between you and the Company or any of its affiliates. This agreement may not be modified or waived in any respect except in a written document duly signed by you and the Company.

This agreement will be governed by and construed in accordance with Swiss law.

Please indicate your acceptance of the foregoing by countersigning and returning the enclosed copy of this letter to the attention of Maddalena Beucler, HR Services Administrator, Lausanne, Switzerland, **before January 21, 2014**.

Yours sincerely,

PHILIP MORRIS SERVICES S.A.

/s/ RALF ZYSK

Ralf Zysk

*Vice President Compensation & Benefits and
International Assignments PMI*

/s/ KRISTIN HOLTER

Kristin Holter

Director Human Resources Switzerland

Acknowledged and agreed:

/s/ MARTIN KING

Martin King

Date: 8 January 2014