



André Calantzopoulos
Chief Executive Officer

Louis C. Camilleri
Chairman of the Board

Dear Shareholder,

Our robust performance in 2017, a landmark year in our transformation to a smoke-free future, underscored the enormous promise of reduced-risk products (RRPs), the strength of our combustible product portfolio and the commitment of our employees to lead the transformation of our industry.

Our strong currency-neutral financial results were underpinned by the excellent performance of our flagship smoke-free product, IQOS, which exceeded our expectations and helped offset the adverse impact of essentially no net pricing in Russia and a severe cigarette volume contraction in Saudi Arabia.

2017 vs. 2016 Results

Our total cigarette and heated tobacco unit shipment volume of 798.2 billion units declined by 2.7%, primarily reflecting lower cigarette industry volume in the Asia and Eastern Europe, Middle East & Africa (EEMA) Regions, partly offset by higher heated tobacco unit volume, driven principally by Japan.

Our total international market share, excluding China and the U.S., declined by 0.1 percentage point to 28.0%, mainly due to mid- and low price segments cigarette brands in the Asia and EEMA Regions. Market share of our premium brands increased, driven by the strong performance of our heated tobacco portfolio. We recorded growing or stable total market share in 16 of our top 30 operating companies income (OCI)⁽¹⁾ markets.

Marlboro's international cigarette share increased slightly to 9.7%,⁽²⁾ a notable achievement given the impact of out-switching to our heated tobacco products in IQOS launch markets and the volume contraction in Saudi Arabia. The brand's cigarette share increased in the Asia and EEMA Regions, reflecting robust growth in the Philippines and across markets in North Africa.

Our other key international cigarette brands also

performed well. *Chesterfield* and *Philip Morris* grew their cigarette share. While share of *L&M*, the third-largest international cigarette brand, declined slightly, *Parliament*, our above-premium brand, recorded stable share – noteworthy given the challenging economic conditions and related consumer down-trading in some of its key Eastern European markets.

Net revenues, excluding excise taxes, of \$28.7 billion increased by 7.7%, driven by strong RRP growth (principally heated tobacco units and IQOS devices) coupled with favorable pricing for our cigarette portfolio. This reflected a favorable volume/mix variance of \$1.1 billion, our best-ever full-year performance on this measure. On a currency-neutral basis, net revenues, excluding excise taxes, grew by 9.4%.

Adjusted OCI of \$11.8 billion increased by 6.0%, or by 7.4% excluding currency, driven by the strong growth in net revenues, partly offset by investment behind the commercialization of IQOS, as well as the unfavorable profitability impact of higher IQOS device sales, which yielded a negative margin due to introductory discounts offered in the initial commercialization phase to accelerate adult smoker switching. Adjusted OCI margin declined by 0.7 points to 41.1%, or by 0.8 points, excluding currency.

Our reported diluted EPS were unfavorably impacted by tax items totaling \$0.84 primarily related to the enactment of the Tax Cuts and Jobs Act in the United States, reflecting the requirement to pay a one-time transition tax on accumulated foreign earnings. Excluding these tax items, our adjusted diluted EPS of \$4.72 increased by 5.4%, despite a currency headwind of \$0.21 per share. Excluding currency and the aforementioned tax items, adjusted diluted EPS increased by 10.0%.

⁽¹⁾ Operating companies income, or OCI, is defined as operating income, excluding general corporate expenses and the amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net.

⁽²⁾ *Marlboro* international cigarette share is defined as PMI total sales volume for *Marlboro* cigarettes as a percentage of the total industry estimated sales volume for cigarettes, excluding China and the U.S.

Note: Reduced-risk products (RRPs) is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRP in various stages of development, scientific assessment and commercialization. Because our RRP do not burn tobacco, they produce an aerosol that contains far lower quantities of harmful and potentially harmful constituents than found in cigarette smoke.

Robust EPS Growth
+10.0%
 in 2017 vs. 2016,
 Adjusted Diluted,
 Excluding Currency



Since its Spin-Off in
 March 2008,⁽⁴⁾ PMI has
 Increased its Regular
 Quarterly Dividend by
132.6%



Representing a
 Compound Annual
 Growth Rate of
9.8%

Operating cash flow⁽¹⁾ of \$8.9 billion increased by \$0.8 billion or 10.3%. Excluding currency, operating cash flow increased by \$0.4 billion, or 5.5%. Capital expenditures of \$1.5 billion increased by \$0.4 billion, primarily reflecting investment behind heated tobacco production capacity expansion.

In September, the Board of Directors approved an increase in our quarterly dividend to an annualized rate of \$4.28 per share. This was the tenth consecutive year in which we increased our dividend, representing a total increase of 132.6%, or a compound annual growth rate of 9.8%, since we became a public company.

We continued to access the capital markets at favorable rates in 2017, raising \$6.9 billion and reducing the weighted-average all-in financing cost of our total debt by 20 basis points to 2.6%. The weighted-average time to maturity of our total long-term debt stood at 9.4 years at the end of 2017 compared to 10.6 years at the end of 2016.

U.S. Tax Reform

As a U.S. company that operates exclusively in markets outside of the U.S., the impact of the Tax Cuts and Jobs Act on our business is unique. Based on our current interpretation of the law, we expect an effective tax rate of approximately 28% for 2018. The difference between this rate and the 21% statutory tax rate under the new law reflects three main factors: foreign tax rate differences, the non-deductibility of interest expense, and the partial disallowance of foreign tax credits related to the application of the rules for global intangible low-taxed income. A more detailed discussion on the impact of U.S. tax reform on our business is included in our Form 10-K.

Fiscal, Regulatory and Illicit Trade Environment

Our favorable pricing in 2017 was supported by a fiscal environment for combustible tobacco products that remained largely rational with either no, or moderate, excise tax increases in most of our major markets. The clear exception was Saudi Arabia, where the introduction of the country's first-ever excise tax system resulted in a doubling of cigarette retail prices.

Depending on national legislation, heated tobacco units generally continue to be taxed under a dedicated excise category or as OTP (Other Tobacco Products). Last year, the governments of Japan and Korea reviewed their fiscal structures for heated tobacco and maintained the excise tax differentiation to cigarettes, albeit at reduced levels.

In implementing traditional restrictive regulatory measures, including plain packaging, governments aim to foster smoking prevention and cessation. We believe these objectives can be met more rapidly and sustainably by fully incorporating the opportunities represented by reduced-risk products into existing tobacco control policies. The establishment of regula-

tory frameworks that differentiate between cigarettes and smoke-free products is a critical component in the switching of smokers to better alternatives compared to continued smoking.

The regulatory environment for RRP's continued to evolve in 2017, though the underlying process remains undeniably complex, as RRP's are uncharted territory for the vast majority of regulators. This complexity is exacerbated by the divide in the public health community on the topic of tobacco harm reduction. We hope that the interests of the men and women who smoke will ultimately prevail over ideology in this debate.

We were encouraged by a number of policy announcements and findings related to RRP's by governmental agencies and advisory committees, such as the U.S. Food & Drug Administration (FDA), the U.K. Committee on Toxicity, Public Health England and others. We hope that they will soon act as a catalyst for other governments to adopt similar sensible policies.

Despite continued progress on combatting illicit trade, notably in the EU Region, it remains a sizable challenge, particularly in markets such as Brazil and Pakistan. To help confront tobacco smuggling and related crimes, we launched PMI IMPACT in 2016, and last year the program's council of independent experts, in the fields of law, anti-corruption and law enforcement, allocated approximately \$28 million in grants across 32 projects as part of its first funding round. The projects come from public, private and academic organizations in 18 countries.

Reduced-Risk Product Commercialization

In 2017, PMI's journey to replace cigarettes with RRP's took a meaningful step forward, led by significant momentum in the product development, commercialization and scientific substantiation of our product platforms.

The most notable achievement was our ongoing progress in commercializing IQOS. As of year-end, IQOS was available in key cities in 38 markets. We estimate that nearly 5 million adult consumers around the world have already stopped smoking and made the change to IQOS. The impressive performance of IQOS was led by Japan and Korea, where national market shares in the fourth quarter reached 13.9% and 5.5%, respectively, despite capacity-driven constraints, first on the heated tobacco consumables and then on device sales.

Outside Asia, we recorded sequential quarterly volume growth for our heated tobacco products in essentially all launch markets. Favorable performances in the Czech Republic, Greece, Portugal and Romania stood out in particular.

For the time being, the momentum of IQOS outside Asia remains below the very high bar set by Japan and Korea. We are actively enhancing sustainable adult consumer adoption against a backdrop of lower

⁽¹⁾ Net cash provided by operating activities.

⁽²⁾ Reported diluted EPS. ⁽³⁾ Reported diluted EPS of \$3.88, excluding the unfavorable impact of tax items and currency of \$0.84 and \$0.21 per share, respectively.

⁽⁴⁾ Dividends for 2008 and 2017 are annualized rates. The 2008 annualized rate is based on a quarterly dividend of \$0.46 per common share, declared June 18, 2008. The 2017 annualized rate is based on a quarterly dividend of \$1.07 per common share, declared September 13, 2017.

initial awareness and greater limitations on consumer engagement. To address this, we are working to build adult consumer understanding of the heated tobacco category, raise adult consumers' commitment to the exclusive use of IQOS and enhance consumer conversion support. This approach entails a greater deployment of specialized field forces to conduct IQOS guided trials.

We remain focused on our aspiration to see IQOS launched in the United States. Following the submission of our Modified Risk Tobacco Product (MRTP) application to the FDA in December 2016, we submitted our Premarket Tobacco Application in March 2017. Both applications have been accepted by the FDA for substantive review. As part of this process, the FDA concluded a series of pre-approval inspections of our manufacturing facilities and quality control systems, as well as research and select suppliers' facilities. In addition, in January 2018 the FDA's Tobacco Product Scientific Advisory Committee (TPSAC) held a two-day meeting on our MRTP application for IQOS. We appreciate the open, positive dialogue and the serious consideration that TPSAC showed in discussing the complex science presented in our MRTP application and are encouraged by the recognition of the risk-reduction potential of IQOS compared to continued smoking – including a significant decrease in exposure to harmful chemicals – that clearly emerged from the statements of the Committee members.

With respect to our other RRP platforms, we made further progress in terms of product development and commercialization. We began a small-scale city test of our Platform 2 product, marketed under the brand name TEEPS, in the Dominican Republic in December 2017, and while still early, we are very excited by the potential for this platform. The city test in the U.K. of our Platform 4 product with MESH technology has been well received by adult consumers and has provided important insights and uncovered opportunities for product improvement. We plan to commercialize a next-generation version of the product this year. Finally, we also advanced the development of our Platform 3 product, for which we plan a consumer test in 2018.

Scientific Assessment, Engagement and Research & Development

Our scientific assessment program, outlined in our dedicated website at www.pmscience.com, continued to make substantial progress last year. The program is built on best practices and guidelines. We adhere to the internationally recognized Good Clinical Practices and Good Laboratory Practices. We actively share our methods and data, making them available to the public for verification of our approaches and results. We post our clinical study protocols and subsequent results on www.ClinicalTrials.gov. We invite scientists from around the world to verify our systems biology methods through a crowd-sourcing platform called



Reduced-Risk Products – Our Four Product Platforms

Heated Tobacco Products

Platform 1

IQOS, using the consumables *HeatSticks* or *HEETS*, features an electronic holder that heats tobacco rather than burning it, thereby creating a nicotine-containing vapor with significantly fewer harmful toxicants compared to cigarette smoke.



Platform 2

TEEPS uses a pressed carbon heat source that, once ignited, heats the tobacco without burning it, to generate a nicotine-containing vapor with a reduction in harmful toxicants similar to *IQOS*. A small-scale city test of the product was initiated in 2017.



Products Without Tobacco

Platform 3

Platform 3 is based on acquired technology that uses a chemical process to create a nicotine-containing vapor. We are exploring two routes for this platform: one with electronics and one without.



Platform 4

Products under this platform are e-vapor products: battery-powered devices that produce an aerosol by vaporizing a nicotine solution. One of these – *MESH* – uses new proprietary vaporization technology.



www.sbvIMPROVER.com. We are going a step further by gradually making the data and results from our non-clinical and clinical programs around IQOS available to the public this year, in part through a database and associated web portal called INTERVALS (see <http://intervals.science>).

In 2017, we published 46 peer-reviewed papers in leading scientific journals and shared our science and smoke-free vision in over 150 presentations at 76 scientific conferences.

With regard to our research and development program, we continued to build our RRP-related intellectual property portfolio in 2017, with over 170 new patent applications filed, and we expect, once again, to have been among the top 100 filers at the European Patent Office. We currently have more than 2,900 RRP-related patents granted worldwide and over 4,600 such patent applications pending.

Manufacturing & Supply Chain

The accelerated expansion of our heated tobacco unit and IQOS device capacity was the major undertaking of 2017. The increase of our annualized production capacity of heated tobacco units was mainly driven by the installation of additional machines at our Greenfield facility in Bologna, Italy, and also greater production efficiency.

To support the growth of our heated tobacco unit production capacity over the near to mid-term, we began the second phase of our facility expansion in Bologna and the partial or full conversion of our cigarette factories in Greece, Korea, Romania and Russia. Additionally, we announced plans for a new Greenfield facility in Dresden, Germany.

Last year, we qualified additional manufacturers for the IQOS device and its critical components such as the heating blade, allowing us to diversify our supply base and increase capacity. Indeed, since February of this year, we have been able to fully supply devices to our markets. Importantly, we also reduced the unit cost of devices, a key – and ongoing – component of improving their economics.

The Organization

To deliver on the substantial promise of RRP, we initiated fundamental changes to our operating model, organizational structure and culture in 2017 to accelerate our evolution into a consumer-centric, technology and science-driven company.

We grouped the smoke-free products and related ecosystem development, as well as scientific substantiation, under a new Science & Innovation function. We focused the commercial deployment of both our smoke-free and combustible products, as well as global strategy execution, under a newly created Chief Operating Officer position. And we realigned our operating segments from four to six geographic Regions to provide greater speed and efficiency and recognize their differing levels of maturity with respect to our smoke-free vision.

Further to enhancing organizational effectiveness, employee engagement remains a top priority – even more so as we transform into an RRP-focused company. In 2017, the Top Employer Institute recognized PMI for its excellence in professional development programs, workplace environment and opportunities for career advancement in a total of 34 countries, compared to 24 and 15 in 2016 and 2015, respectively.

We are committed to leveraging the full potential of women in the workplace, and we recognize we have more work to do. Nevertheless, by year-end 2017, women made up over 34% of our employees at managerial levels, reflecting continued steady progress towards our goal of reaching 40% by 2022. To support this goal, we aim for a 50:50 gender ratio in our recruitment pipeline. In 2017, 43% of new hires at managerial levels and 47% of new hires at more junior levels were women. Women's career support and advancement are also critical for achieving this goal. In 2017, women accounted for 38% of promotions at managerial levels.

Overall, our organization is fully energized by our smoke-free vision that will benefit the hundreds of millions of men and women who smoke, our company and ultimately society at large. Finally, we continue to benefit from the tremendous experience of our Board of Directors, whose relationship with management continues to be based on transparency and candor.

The Year Ahead

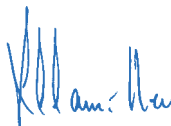
Against the backdrop of a broadly rational regulatory and excise tax environment, the fundamentals of our business remain robust, supported by our leading brand portfolio in the combustible product category. For the first time since 2011, we entered the year with annual EPS guidance that, at exchange rates prevailing at the time it was announced, reflects favorable currency.

Our RRP portfolio continues to provide us with the single-largest opportunity to accelerate our business growth and generously reward our shareholders, and we will make further significant investments in 2018 to drive this growth potential over the coming years.

Momentum behind the harm-reduction principle is accelerating, helped by our vision for a smoke-free future. While the task is enormous, our resolve is steadfast, and we are confident that the outstanding people of PMI will rise to the challenge.



André Calantzopoulos, Chief Executive Officer



Louis C. Camilleri, Chairman of the Board
March 2, 2018