Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations.*

The following discussion should be read in conjunction with the other sections of this Annual Report on Form 10-K, including the consolidated financial statements and related notes contained in Item 8, and the discussion of risks and cautionary factors that may affect future results in Item 1A. *Risk Factors*.

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, they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands.

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

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

Philip Morris International Inc. is a legal entity separate and distinct from our 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 –** The changes in our reported diluted earnings per share ("diluted EPS") for the year ended December 31, 2014, from the comparable 2013 amounts, were as follows:

		Diluted EPS	% Growth
For the year ended December 31, 2013	$	**5.26**	
2013 Asset impairment and exit costs		**0.12**	
2013 Tax items		**0.02**	
Subtotal of 2013 items		**0.14**	
2014 Asset impairment and exit costs		**(0.26)**	
2014 Tax items		—	
Subtotal of 2014 items		**(0.26)**	
Currency		**(0.80)**	
Interest		**(0.04)**	
Change in tax rate		**0.02**	
Impact of lower shares outstanding and share-based payments		**0.18**	
Operations		**0.26**	
For the year ended December 31, 2014	$	**4.76**	**(9.5)%**

See the discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis.

- **Asset Impairment and Exit Costs –** During 2014, we recorded pre-tax asset impairment and exit costs of $535 million ($409 million after tax or $0.26 per share) primarily related to the factory closures in the Netherlands, Australia and Canada and the restructuring of the U.S. leaf purchasing model. During 2013, we recorded pre-tax asset impairment and exit costs of $309 million ($202 million after tax and noncontrolling interests, or $0.12 per share) related to the termination of distribution agreements in the Eastern Europe, Middle East & Africa and Asia segments, as well as the restructuring of our global and regional functions based in Switzerland and Australia.

  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. PMI expects to incur a total pre-tax charge of approximately $547 million for the total program. During 2014, we recorded pre-tax asset impairment and exist costs of $489 million. For further details, see the *Asset Impairment and Exit Costs* section of the following *Discussion and Analysis*.

- **Income Taxes -** Our effective income tax rate for 2014 decreased by 0.2 percentage points to 29.1%. The effective tax rate for 2014 was unfavorably impacted by the above asset impairment and exit costs related to the factory closures. The 2013 effective tax rate was unfavorably impacted by the additional expense associated with the enactment of the American Taxpayer Relief Act of 2012 ($17 million) and the enactment of tax law changes in Mexico ($14 million), which decreased our diluted EPS by $0.02 per share in 2013. Excluding the impact of these items, the change in tax rate that increased our diluted EPS by $0.02 per share in 2014 was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

- **Currency –** The unfavorable currency impact during 2014 was due primarily to the Argentine peso, Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Kazakhstan tenge, Russian ruble, Turkish lira and the Ukraine hryvnia.

- **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 pursuant to our share repurchase program.

- **Operations –** The increase in diluted EPS of $0.26 from our operations in the table above was due to the following segments:

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

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

  - European Union: Higher marketing, administration and research costs, higher manufacturing costs and unfavorable volume/mix, partially offset by higher pricing; and

  - Asia: Unfavorable volume/mix and higher manufacturing costs, partially offset by higher pricing.

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 February 5, 2015, we announced our forecast for 2015 full-year reported diluted EPS to be in a range of $4.27 to $4.37, at prevailing exchange rates at that time, versus $4.76 in 2014. Excluding an unfavorable currency impact, at then-prevailing rates, of approximately $1.15 per share for the full-year 2015, the reported diluted earnings per share range represents an increase of 8% to 10% versus adjusted diluted earnings per share of $5.02 in 2014. This forecast includes incremental spending versus 2014 for 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. The company will revisit the potential for repurchases as the year unfolds, depending on the currency environment.

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 future acquisitions, unanticipated asset impairment and exit cost charges, future changes in currency exchange rates and any unusual events. The factors described in Item 1A. *Risk Factors* represent continuing risks to this forecast.

Discussion and Analysis

Critical Accounting Policies and Estimates

Item 8, Note 2. *Summary of Significant Accounting Policies* to our consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. In most instances, we must use a particular accounting policy or method because it is the only one that is permitted under U.S. GAAP.

The preparation of financial statements requires that we use estimates and assumptions that affect the reported amounts of our assets, liabilities, net revenues and expenses, as well as our disclosure of contingencies. If actual amounts differ from previous estimates, we include the revisions in our consolidated results of operations in the period during which we know the actual amounts. Historically, aggregate differences, if any, between our estimates and actual amounts in any year have not had a significant impact on our consolidated financial statements.

The selection and disclosure of our critical accounting policies and estimates have been discussed with our Audit Committee. The following is a discussion of the more significant assumptions, estimates, accounting policies and methods used in the preparation of our consolidated financial statements:

• **Revenue Recognition –** As required by U.S. GAAP, we recognize revenues, net of sales and promotion incentives. Our net revenues include excise taxes and shipping and handling charges billed to our customers. Our net revenues are recognized upon shipment or delivery of goods when title and risk of loss pass to our customers. We record shipping and handling costs paid to third parties as part of cost of sales.

• **Goodwill and Non-Amortizable Intangible Assets Valuation –** We test goodwill and non-amortizable intangible assets annually for impairment or more frequently if events occur that would warrant such review. We perform our annual impairment analysis in the first quarter of each year. The impairment analysis involves comparing the fair value of each reporting unit or non-amortizable intangible asset to the carrying value. If the carrying value exceeds the fair value, goodwill or a non-amortizable intangible asset is considered impaired. To determine the fair value of goodwill, we primarily use a discounted cash flow model, supported by the market approach using earnings multiples of comparable companies. To determine the fair value of non-amortizable intangible assets, we primarily use a discounted cash flow model applying the relief-from-royalty method. These discounted cash flow models include management assumptions relevant for forecasting operating cash flows, which are subject to changes in business conditions, such as volumes and prices, costs to produce, discount rates and estimated capital needs. Management considers historical experience and all available information at the time the fair values are estimated, and we believe these assumptions are consistent with the assumptions a hypothetical marketplace participant would use. We concluded that the fair value of our reporting units and non-amortizable intangible assets exceeded the carrying value, and any reasonable movement in the assumptions would not result in an impairment. Since the March 28, 2008, spin-off from Altria Group, Inc. ("Altria"), we have not recorded a charge to earnings for an impairment of goodwill or non-amortizable intangible assets.

• **Marketing and Advertising Costs –** As required by U.S. GAAP, we record marketing costs as an expense in the year to which costs relate. We do not defer amounts on our balance sheet. We expense advertising costs during the year in which the costs are incurred. We record trade promotion costs as a reduction of revenues during the year in which these programs are offered, relying on estimates of utilization and redemption rates that have been developed from historical information. Such programs include, but are not limited to, discounts, rebates, in-store display incentives and volume-based incentives. For interim reporting purposes, advertising and certain consumer incentives are charged to earnings based on estimated sales and related expenses for the full year.

• **Employee Benefit Plans –** As discussed in Item 8, Note 13. *Benefit Plans* to our consolidated financial statements, we provide a range of benefits to our employees and retired employees, including pensions, postretirement health care and postemployment benefits (primarily severance). We record annual amounts relating to these plans based on calculations specified by U.S. GAAP. These calculations include various actuarial assumptions, such as discount rates, assumed rates of return on plan assets, compensation increases and turnover rates. We review actuarial assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. As permitted by U.S. GAAP, any effect of the modifications is generally amortized over future periods. We believe that the assumptions utilized in calculating our obligations under these plans are reasonable based upon advice from our actuaries.

At December 31, 2014, our discount rate was 3.95% for our U.S. pension plans and 4.10% for our U.S. postretirement plans. These rates were 85 basis points lower than our 2013 discount rate of 4.80% for U.S. pension plans, and 4.95% for U.S. postretirement plans. Our weighted-average discount rate assumption for our non-U.S. pension plans decreased to 1.92%, from 3.09% at December 31, 2013. Our weighted-average discount rate assumption for our non-U.S. postretirement plans was 4.28% at December 31, 2014, and 5.07% at December 31, 2013. We anticipate that assumption changes, coupled with increased amortization of deferred losses, will increase 2015 pre-tax U.S. and non-U.S. pension and postretirement expense to approximately $246 million as compared with approximately $207 million in 2014, excluding amounts related to early retirement programs. A fifty-basis-point decrease in our discount rate would increase our 2015 pension and postretirement expense by approximately $55 million, and a fifty-basis-point increase in our discount rate would decrease our 2015 pension and postretirement expense by approximately $45 million. Similarly, a fifty-basis-point decrease (increase) in the expected return on plan assets would increase (decrease) our 2015 pension expense by approximately $30 million.

See Item 8, Note 13. *Benefit Plans* to our consolidated financial statements for a sensitivity discussion of the assumed health care cost trend rates.

• **Income Taxes –** Income tax provisions for jurisdictions outside the United States, as well as state and local income tax provisions, are determined on a separate company basis, and the related assets and liabilities are recorded in our consolidated balance sheets.

The extent of our operations involves dealing with uncertainties and judgments in the application of complex tax regulations in a multitude of jurisdictions. The final taxes paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions and resolution of disputes arising from federal, state, and international tax audits. In accordance with the authoritative guidance for income taxes, we evaluate potential tax exposures and record tax liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. We adjust these reserves in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. If our estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge to expense would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary.

The effective tax rates used for interim reporting are based on our full-year geographic earnings mix projections and cash repatriation plans. Changes in currency exchange rates, earnings mix by taxing jurisdiction or in cash repatriation plans could have an impact on the effective tax rates, which we monitor each quarter. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

At December 31, 2014, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately $23 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested. These earnings have been or will be invested to support the growth of our international business. Further, we do not foresee a need to repatriate these earnings to the U.S. since our U.S. cash requirements are supported by: distributions from foreign entities of earnings that have not been designated as permanently reinvested; and existing credit facilities. Repatriation of earnings from foreign subsidiaries for which we have asserted that the earnings are permanently reinvested would result in additional U.S. income and foreign withholding taxes. The determination of the amount of deferred tax related to these earnings is not practicable due to the complexity of the U.S. foreign tax credit regime, as well as differences between earnings determined for book and tax purposes mainly resulting from intercompany transactions, purchase accounting and currency fluctuations.

Prior to the spin-off of PMI by Altria, we were a wholly owned subsidiary of Altria. We participated in a tax-sharing agreement with Altria for U.S. tax liabilities, and our accounts were included with those of Altria for purposes of its U.S. federal income tax return. Under the terms of the agreement, taxes were computed on a separate company basis. To the extent that we generated foreign tax credits, capital losses and other credits that could not be utilized on a separate company basis, but were utilized in Altria's consolidated U.S. federal income tax return, we would recognize the resulting benefit in the calculation of our provision for income taxes. We made payments to, or were reimbursed by, Altria for the tax effects resulting from our inclusion in Altria's consolidated United States federal income tax return. On the date of the spin-off of PMI by Altria, we entered into a Tax Sharing Agreement with Altria. The Tax Sharing Agreement generally governs Altria's and our respective rights, responsibilities and obligations for pre-distribution periods and for potential taxes on the spin-off of PMI by Altria. With respect to any potential tax resulting from the spin-off of PMI by Altria, responsibility for the tax will be allocated to the party that acted (or failed to act) in a manner that resulted in the tax. Beginning March 31, 2008, we were no longer a member of the Altria consolidated tax return group, and we filed our own U.S. federal consolidated income tax return.

For further details, see Item 8, Note 11. *Income Taxes* to our consolidated financial statements.

• **Hedging –** As discussed below in "Market Risk," we use derivative financial instruments principally to reduce exposures to market risks resulting from fluctuations in foreign currency exchange and interest rates by creating offsetting exposures. For derivatives to which we have elected to apply hedge accounting, gains and losses on these derivatives are initially deferred in accumulated other comprehensive losses on the consolidated balance sheet and recognized in the consolidated statement of earnings in the periods when the related hedged transactions are also recognized in operating results. If we had elected not to use the hedge accounting provisions gains (losses) deferred in stockholders' (deficit) equity would have been recorded in our net earnings for these derivatives.

• **Contingencies –** As discussed in Item 8, Note 21. *Contingencies* to our consolidated financial statements, 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. 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. 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. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, after assessing the information available to it (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss for any of the pending tobacco-related cases; and (iii) accordingly, no estimated loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred.

Consolidated Operating Results

Our cigarette volume, net revenues, excise taxes on products and operating companies income by segment were as follows:

(in millions)	2014	2013	2012
Cigarette Volume			
European Union	**185,197**	185,096	197,966
Eastern Europe, Middle East & Africa	**287,923**	296,462	303,828
Asia	**288,128**	301,324	326,582
Latin America & Canada	**94,706**	97,287	98,660
Total cigarette volume	**855,954**	880,169	927,036

(in millions)	2014	2013	2012
Net Revenues			
European Union	**$ 29,058**	$ 28,303	$ 27,338
Eastern Europe, Middle East & Africa	**21,928**	20,695	19,272
Asia	**19,255**	20,987	21,071
Latin America & Canada	**9,865**	10,044	9,712
Net revenues	**$ 80,106**	$ 80,029	$ 77,393

(in millions)	2014	2013	2012
Excise Taxes on Products			
European Union	**$ 20,219**	$ 19,707	$ 18,812
Eastern Europe, Middle East & Africa	**13,006**	11,929	10,940
Asia	**10,527**	10,486	9,873
Latin America & Canada	**6,587**	6,690	6,391
Excise taxes on products	**$ 50,339**	$ 48,812	$ 46,016

(in millions)	2014	2013	2012
Operating Income			
Operating companies income:			
European Union	**$ 3,727**	$ 4,238	$ 4,187
Eastern Europe, Middle East & Africa	**4,121**	3,779	3,726
Asia	**3,187**	4,622	5,197
Latin America & Canada	**1,030**	1,134	1,043
Amortization of intangibles	**(93)**	(93)	(97)
General corporate expenses	**(165)**	(187)	(210)
Less:			
Equity (income)/loss in unconsolidated subsidiaries, net	**(105)**	22	17
Operating income	**$ 11,702**	$ 13,515	$ 13,863

As discussed in Item 8, Note 12. *Segment Reporting* to our 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.

The following events that occurred during 2014, 2013 and 2012 affected the comparability of our statement of earnings amounts:

• **Asset Impairment and Exit Costs –** For the years ended December 31, 2014, 2013 and 2012, pre-tax asset impairment and exit costs by segment were as follows:

(in millions)	2014	2013	2012
Separation programs:			
European Union	**$ 351**	$ 13	—
Eastern Europe, Middle East & Africa	**2**	14	—
Asia	**35**	19	13
Latin America & Canada	**3**	5	29
Total separation programs	**391**	51	42
Contract termination charges:			
Eastern Europe, Middle East & Africa	**—**	250	—
Asia	**—**	8	13
Total contract termination charges	**—**	258	13
Asset impairment charges:			
European Union	**139**	—	5
Eastern Europe, Middle East & Africa	**—**	—	5
Asia	**—**	—	13
Latin America & Canada	**5**	—	5
Total asset impairment charges	**144**	—	28
Asset impairment and exit costs	**$ 535**	$ 309	$ 83

For further details, see Item 8, Note 5. *Asset Impairment and Exit Costs* to our consolidated financial statements.

• **Acquisitions and Other Business Arrangements –** For further details, see Item 8, Note 6. *Acquisitions and Other Business Arrangements* to our consolidated financial statements.

2014 compared with 2013

The following discussion compares our consolidated operating results for the year ended December 31, 2014, with the year ended December 31, 2013.

Our cigarette shipment volume of 856.0 billion units decreased by 2.8%, excluding acquisitions, or 24.3 billion units. The decline in our cigarette shipment volume was due primarily to:

- EEMA, principally Kazakhstan, Russia and Ukraine, partially offset by Algeria and Turkey;
- Asia, predominantly Japan, reflecting a lower total market, lower market share and the unfavorable impact of an adjustment in distributor inventories, as well as Australia, Indonesia and Pakistan; and
- Latin America & Canada, principally Canada and Mexico.

The overall declines were partially offset by:

- the positive impact of market share growth in the European Union, EEMA and Latin America & Canada Regions; and
- cigarette shipment volume in the European Union, which was slightly positive.

Our market share increased, or was flat in a number of key markets, including Algeria, Argentina, Austria, Canada, France, Germany, Italy, Korea, the Netherlands, the Philippines, Poland, Russia, Saudi Arabia, Spain, Switzerland and the United Kingdom.

Total cigarette shipments of *Marlboro* of 283.0 billion units decreased by 2.8%, due primarily to declines in: the European Union, notably France, Italy and Poland, partly offset by the Czech Republic and Spain; EEMA, notably in Egypt, Russia and Ukraine, partly offset by Algeria and Saudi Arabia; Asia, due almost entirely to Japan, partly offset by the Philippines; and Latin America & Canada, due predominantly to Mexico. The overall decline was partially offset by the positive impact of market share growth in the European Union and EEMA Regions. Market share of *Marlboro* in Asia and Latin America & Canada was flat.

Total cigarette shipments of *Parliament* of 47.2 billion units increased by 5.6%, driven by growth in all Regions and notably in Turkey. Total cigarette shipments of *L&M* of 94.2 billion units were down by 0.9%, due primarily to EEMA, notably Saudi Arabia and Turkey, partially offset by slightly increased or essentially flat shipments in the three other Regions. Total cigarette shipments of *Bond Street* of 43.6 billion units decreased by 2.9%, due predominantly to Kazakhstan, Serbia and Ukraine, partially offset by Australia and Russia. Total cigarette shipments of *Philip Morris* of 31.9 billion units decreased by 8.7%, due almost entirely to Japan, principally reflecting the morphing to *Lark*, partly offset by growth in the three other Regions. Total cigarette shipments of *Chesterfield* of 42.1 billion units increased by 22.6%, driven by growth in all Regions and notably in Italy, Poland and Turkey, partly offset by Russia and Ukraine. Total cigarette shipments of *Lark* of 28.5 billion units decreased by 1.3%, due predominantly to Turkey, partly offset by Japan (including the impact of the morphing of *Philip Morris*).

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 3.4% to 33.8 billion cigarette equivalent units, mainly due to growth in the fine cut category, notably in Belgium, the Czech Republic, Hungary and Poland, partially offset by France and Germany.

Total shipment volume for cigarettes and OTP, in cigarette equivalent units, was down by 2.5%.

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

(in millions)	**2014**	**2013**	**Variance**	**%**
Net revenues	**$ 80,106**	$ 80,029	$ 77	0.1 %
Excise taxes on products	**50,339**	48,812	1,527	3.1 %
Net revenues, excluding excise taxes on products	**$ 29,767**	$ 31,217	$ (1,450)	(4.6)%

Currency movements decreased net revenues by $5.3 billion and net revenues, excluding excise taxes on products, by $2.1 billion, due primarily to the Argentine peso, Indonesian rupiah, Japanese yen, Russian ruble, Turkish lira and the Ukraine hryvnia, partially offset by the Euro.

Net revenues include $2,017 million in 2014 and $1,876 million in 2013 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $753 million in 2014 and $739 million in 2013.

Net revenues, which include excise taxes billed to customers, increased by $77 million (0.1%). Excluding excise taxes, net revenues decreased by $1,450 million (4.6%) to $29.8 billion. This decrease was due to:

- unfavorable currency ($2.1 billion) and
- unfavorable volume/mix ($1.3 billion), partly offset by
- price increases ($1.9 billion) and
- the impact of acquisitions ($13 million).

Excise taxes on products increased by $1.5 billion (3.1%), due primarily to:

- higher excise taxes resulting from changes in retail prices and tax rates ($5.5 billion), partly offset by
- favorable currency ($3.3 billion) and
- volume/mix ($755 million).

Governments have consistently increased excise taxes in most of the markets in which we operate. As discussed in *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)		2014		2013		Variance	%
Cost of sales	$	**10,436**	$	10,410	$	26	0.2 %
Marketing, administration and research costs		**7,001**		6,890		111	1.6 %
Operating income		**11,702**		13,515		(1,813)	(13.4)%

Cost of sales increased $26 million (0.2%), due to:

- higher manufacturing costs ($545 million, principally in Egypt, due to the impact of the change to our new business structure; in Indonesia, due to higher distribution and manufacturing costs; investments related to the launch and commercialization of the company's Reduced-Risk Product, *iQOS;* and ongoing costs related to the factory closure in Australia and the decision to discontinue cigarette production in the Netherlands). For further details on our change in business structure in Egypt, see the *Acquisitions and Other Business Arrangements* section of this *Discussion and Analysis* and
- the impact of acquisitions ($8 million), partially offset by
- favorable currency ($380 million) and
- volume/mix ($147 million).

Marketing, administration and research costs increased by $111 million (1.6%), due to:

- higher expenses ($340 million, primarily higher marketing and selling expenses) and
- the impact of acquisitions ($15 million), partly offset by
- favorable currency ($244 million).

Operating income decreased by $1.8 billion (13.4%). This decrease was due primarily to:

- unfavorable currency ($1.5 billion),
- unfavorable volume/mix ($1.1 billion),
- higher manufacturing costs ($545 million),
- higher marketing, administration and research costs ($340 million) and
- higher pre-tax charges for asset impairment and exit costs ($226 million, primarily related to the decision to discontinue cigarette production in the Netherlands), partly offset by
- price increases ($1.9 billion).

Interest expense, net, of $1.1 billion increased $79 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 0.2 percentage points to 29.1%. The 2014 effective tax rate was unfavorably impacted by the asset impairment and exit costs related to the factory closures. The 2013 effective tax rate was unfavorably impacted by the additional expense associated with the American Taxpayer Relief Act of 2012 ($17 million) and the enactment of tax law changes in Mexico ($14 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. Based upon tax regulations in existence at December 31, 2014, and our cash repatriation plans, we estimate that our 2015 effective tax rate will be approximately 29%.

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 $(105) million increased by $127 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 $7.5 billion decreased by $1.1 billion (12.6%). This decrease was due primarily to an unfavorable currency impact on operating income and higher interest expense, net. Diluted and basic EPS of $4.76 decreased by 9.5%. Excluding an unfavorable currency impact of $0.80, diluted EPS increased by 5.7%.

2013 compared with 2012

The following discussion compares our consolidated operating results for the year ended December 31, 2013, with the year ended December 31, 2012.

Our cigarette shipment volume of 880.2 billion units decreased by 5.1% or 46.9 billion units, driven by a total industry tax-paid volume decline. The decline in our cigarette shipment volume mainly reflected:

- in the European Union, the unfavorable impact of excise tax-driven price increases, the weak economic and employment environment, the growth of the OTP category, and the prevalence of e-cigarettes and non-duty paid products;
- in EEMA, the impact of price increases in Russia and Ukraine, an increase in illicit trade in Russia, Turkey and Ukraine, and a weaker economy in Russia;
- in Asia, the unfavorable impact of the disruptive January 2013 excise tax increase and a surge in the prevalence of domestic non-duty-paid products in the Philippines, and lower share in Japan and Pakistan, partly offset by Indonesia; and
- in Latin America & Canada, primarily due to a lower total cigarette market, primarily in Brazil.

Excluding the Philippines, our cigarette shipment volume was down by 2.7%, and our total tobacco volume (including OTP in cigarette equivalent units) was down by 2.4%.

Our market share grew in a number of key markets, including Algeria, Argentina, Belgium, Brazil, Canada, Colombia, Egypt, France, Germany, Greece, Indonesia, Italy, Korea, the Netherlands, Poland, Portugal, Saudi Arabia, Spain, Thailand, Ukraine and the United Kingdom.

Total cigarette shipments of *Marlboro* of 291.1 billion units decreased by 3.5%, due primarily to declines in: the European Union, notably France, Poland and Spain, partly offset by Italy; EEMA, primarily Romania, Russia, Turkey and Ukraine, largely offset by North Africa; Asia, predominantly Japan and the Philippines, partly offset by Indonesia; and Latin America & Canada, mainly Argentina and Brazil, partly offset by Colombia and Mexico. Excluding the Philippines, total cigarette shipments of *Marlboro* declined by 1.3%.

Total cigarette shipments of *L&M* of 95.0 billion units were up by 1.4%, driven notably by Egypt, Russia and Saudi Arabia, partly offset by Turkey. Total cigarette shipments of *Bond Street* of 44.9 billion units decreased by 4.2%, due primarily to Russia and Ukraine. Total cigarette shipments of *Parliament* of 44.7 billion units were up by 2.9%, due primarily to Turkey, partly offset by Japan. Total cigarette shipments of *Philip Morris* of 35.0 billion units decreased by 7.9%, due primarily to Italy and the Philippines, partly offset by Argentina. Total cigarette shipments of *Chesterfield* of 34.4 billion units were down by 3.2%, due primarily to Russia and Ukraine, partly offset by Germany and Turkey. Total cigarette shipments of *Lark* of 28.8 billion units decreased by 10.2%, due predominantly to Japan and Turkey.

Total shipment volume of OTP, in cigarette equivalent units, grew by 4.9% to 32.7 billion cigarette equivalent units, primarily reflecting growth in the European Union, notably in Belgium, France, Hungary and Italy.

Total shipment volume for cigarettes and OTP combined was down by 4.7%.

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

(in millions)		2013		2012		Variance	%
Net revenues	$	80,029	$	77,393	$	2,636	3.4 %
Excise taxes on products		48,812		46,016		2,796	6.1 %
Net revenues, excluding excise taxes on products	$	31,217	$	31,377	$	(160)	(0.5)%

Currency movements decreased net revenues by $1.4 billion and net revenues, excluding excise taxes on products, by $765 million. The $765 million decrease was due primarily to the Argentine peso, Australian dollar, Brazilian real, Indonesian rupiah, Japanese yen, Russian ruble and Turkish lira, partially offset by the Euro and Mexican peso.

Net revenues include $1,876 million in 2013 and $1,709 million in 2012 related to sales of OTP. These net revenue amounts include excise taxes billed to customers. Excluding excises taxes, net revenues for OTP were $739 million in 2013 and $676 million in 2012.

Net revenues, which include excise taxes billed to customers, increased by $2.6 billion (3.4%). Excluding excise taxes, net revenues decreased by $160 million (0.5%) to $31.2 billion. This decrease was due to:

- unfavorable volume/mix ($1.5 billion) and
- unfavorable currency ($765 million), partly offset by
- price increases ($2.1 billion, including gains related to inventory movements, notably in the Philippines).

Excise taxes on products increased by $2.8 billion (6.1%), due to:

- higher excise taxes resulting from changes in retail prices and tax rates ($5.1 billion), partly offset by
- volume/mix ($1.6 billion) and
- favorable currency ($637 million).

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

(in millions)		2013		2012		Variance	%
Cost of sales	$	10,410	$	10,373	$	37	0.4 %
Marketing, administration and research costs		6,890		6,961		(71)	(1.0)%
Operating income		13,515		13,863		(348)	(2.5)%

Cost of sales increased $37 million (0.4%), due to:

- higher manufacturing costs ($398 million, principally in Indonesia), partly offset by
- volume/mix ($266 million) and
- favorable currency ($95 million).

Marketing, administration and research costs decreased by $71 million (1.0%), due to:

- lower expenses ($42 million, primarily lower marketing expenses) and
- favorable currency ($29 million).

Operating income decreased by $348 million (2.5%). This decrease was due primarily to:

- unfavorable volume/mix ($1.2 billion),
- unfavorable currency ($640 million),
- higher manufacturing costs ($398 million) and
- higher pre-tax charges for asset impairment and exit costs ($226 million), partly offset by
- price increases ($2.1 billion) and

- lower marketing, administration and research costs ($42 million).

Interest expense, net, of $973 million increased $114 million, due primarily to higher average debt levels, partially offset by lower average interest rates on debt.

Our effective tax rate decreased by 0.2 percentage points to 29.3%. The 2013 effective tax rate was unfavorably impacted by the additional expense associated with the American Taxpayer Relief Act of 2012 ($17 million) and the enactment of tax law changes in Mexico ($14 million). The 2012 effective tax rate was unfavorably impacted by an additional income tax provision of $79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004-2006, partially offset by a $40 million benefit from a tax accounting method change in Germany.

Net earnings attributable to PMI of $8.6 billion decreased $224 million (2.5%). This decrease was due primarily to an unfavorable currency impact on operating income and higher interest expense, net, partially offset by a lower effective tax rate. Diluted and basic EPS of $5.26 increased by 1.7%. Excluding an unfavorable currency impact of $0.34, diluted EPS increased by 8.3%.

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 Item 1A. *Risk Factors*, 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 local manufacturers;
- pending and threatened litigation as discussed in Item 3 and Item 8, Note 21. *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 178 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, regulate product content to prevent increased adverse health effects of smoking and 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 tax increases are not excessive, disruptive or discriminatory 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 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 FCTC 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. Other jurisdictions have imposed, or are seeking to impose, levies or other taxes on tobacco companies. We oppose such extreme tax measures. We believe that they 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.

- **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 some characterizing flavors in 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 is not feasible and 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.

In other countries, including Ireland, New Zealand and the U.K., 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 between brands and, therefore, the ability to compete for adult smoker market share is greatly reduced. Data from Australia appear to confirm that with plain packaging, adult smokers down-trade to lower price and lower margin brands and illicit products. According to recent industry-commissioned studies, the implementation of plain packaging in Australia has had no impact on smoking prevalence among adults or youth, while illicit trade has increased, with a significant shift towards branded illicit products (away from unbranded loose tobacco). 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 some 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, while 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 pack variation 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 communications 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 communications 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 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 free trade agreements, such as the Trans-Pacific Partnership Agreement, which is under negotiation. This could limit our ability to protect investments and intellectual property through these treaties. We oppose such measures because they unfairly discriminate against a legal industry and are at odds with fundamental principles of global 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 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 approval and commercialization of RRPs, including the communication of substantiated health benefits to adult smokers.

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. Eight clinical trials for Platform 1 were initiated in 2013 including six short-term clinical studies and two three-month studies. The results of those studies will be available in 2015. We 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 quarter 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 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, 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 standards set forth 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 standards set forth 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 disease 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 made tobacco sticks, 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. The product is not being marketed with claims of reduced formation, reduced exposure or disease risk pending the outcome of our scientific studies and, where required, governmental review and approval.

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 candidate reduced-risk tobacco products exclusively to Altria for commercialization in the United States. In March 2015, we will launch Solaris, a Platform 4 e-vapor product, 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, which required our affiliate to stop this particular campaign throughout Germany and remove all outdoor advertisements within one month from the effective date of the order and point-of-sale materials within three months. Our affiliate does not believe the allegations properly reflect the facts and the law and filed a challenge in the Munich Administrative Court against the order. At a hearing held in April 2014, at the Bavarian Higher Administrative Court, the parties agreed that our affiliate can continue the campaign with certain limitations on image visuals and text slogans for the duration of the court proceedings.

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 December 31, 2014, the additional contingent payments were projected to be up to $62 million over the remaining two-year period. For additional information, see Item 8, Note 16. *Fair Value Measurements* to our 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 the fourth quarter of 2013, as part of our initiative to enhance profitability and growth in North African and Middle Eastern markets, we decided to restructure our business in Egypt. The new business model entails a new contract manufacturing agreement with our long-standing, strategic business partner, Eastern Company S.A.E., the creation of a new PMI affiliate in Egypt and a new distribution agreement with Trans Business for Trading and Distribution LLC. To accomplish this restructuring and to ensure a smooth transition to the new model, we recorded, in the fourth quarter of 2013, a charge to our 2013 full-year reported diluted EPS of approximately $0.10 to reflect the discontinuation of existing contractual arrangements.

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.

See Item 8, Note 6. *Acquisitions and Other Business Arrangements* to our consolidated financial statements for additional information.

Investments in Unconsolidated Subsidiaries

On September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) ("AITA") 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 owned 51% by AITA 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 AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the 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 consolidated balance sheets.

See Item 8, Note 4. *Investments in Unconsolidated Subsidiaries* to our consolidated financial statements for additional information.

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 on 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 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 ("OFAC") and the U.S. Department of State. It is our policy to fully comply 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.

2014 compared with 2013

The following discussion compares operating results within each of our reportable segments for 2014 with 2013.

- **European Union.** Net revenues, which include excise taxes billed to customers, increased by $755 million (2.7%). Excluding excise taxes, net revenues increased by $243 million (2.8%) to $8.8 billion. This increase was due to:

  - price increases ($127 million),
  - favorable currency ($122 million) and
  - the impact of acquisitions ($11 million), partly offset by
  - unfavorable volume/mix ($17 million).

The net revenues of the European Union segment include $1,644 million in 2014 and $1,524 million in 2013 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $573 million in 2014 and $543 million in 2013.

Operating companies income of $3.7 billion decreased by $511 million (12.1%). This decrease was due primarily to:

- higher pre-tax charge for asset impairment and exit costs ($477 million, primarily related to the decision to discontinue cigarette production in the Netherlands in 2014),
- higher marketing, administration and research costs ($99 million),
- higher manufacturing costs ($50 million) and
- unfavorable volume/mix ($46 million), partly offset by
- price increases ($127 million) and
- favorable currency ($37 million).

The total cigarette market in the European Union of 467.7 billion units decreased by 3.1%, due primarily to the impact of tax-driven price increases and the unfavorable economic and employment environment, partly offset by: the subdued performance of the e-vapor category; less out-switching to fine cut products; a reduction in the consumption of illicit products in several markets; and lower than historical average pricing, mainly in Italy. In 2015, the total cigarette market in the European Union is forecast to decrease by approximately 4%. Our cigarette shipment volume of 185.2 billion units increased by 0.1%, predominantly reflecting improved market share that increased by 1.0 share point to 39.8% . The total OTP market in the European Union of 164.6 billion cigarette equivalent units increased by 1.1%, reflecting a larger total fine cut market, up by 0.9% to 143.1 billion cigarette equivalent units.

While shipment volume of *Marlboro* of 89.4 billion units decreased by 2.0%, mainly due to a lower total market, market share increased by 0.3 share points to 19.3%, driven notably by the Czech Republic, Germany, Italy and Spain, partly offset by France and Poland. While cigarette shipment volume of *L&M* was essentially flat at 32.9 billion units, market share increased by 0.2 share points to 7.1%, driven notably by Germany, partly offset by Poland. Cigarette shipment volume of *Chesterfield* of 26.2 billion units increased by 38.4% and market share increased by 1.1 share points to 5.5%, driven notably by Italy and Poland. Cigarette shipment volume of *Philip Morris* of 10.0 billion units increased by 5.0%, driven notably by Latvia, Lithuania, the Slovak Republic and Spain, and market share increased by 0.1 share point to 2.1%.

Our shipments of OTP of 22.8 billion cigarette equivalent units increased by 6.2%, driven principally by higher share. Our OTP total market share was 14.0%, up by 0.6 share points, reflecting gains in the fine cut category: notably in the Czech Republic, up by 7.8 share points to 26.5%; Hungary, up by 6.4 share points to 18.3%; Italy, up by 3.9 share points to 41.5%; Poland, up by 11.2 share points to 34.7%; partly offset by France, down by 0.7 share points to 26.2%; Germany down by 1.3 share points to 12.9%, and Portugal, down by 5.4 share points to 26.5%.

In France, the total cigarette market of 45.0 billion units decreased by 5.3% in 2014, mainly reflecting the impact of price increases in January 2014, the increased incidence of e-vapor products and a weak economy. Our cigarette shipment volume of 18.6 billion units decreased by 2.9%. Our market share increased by 0.8 share points to 41.0%, mainly driven by the growth of *Marlboro*, *L&M* and premium *Philip Morris*, up by 0.4 share points, 0.1 share point and 0.3 share points to 25.1%, 2.6% and 9.4%, respectively. Market share of *Chesterfield* was flat at 3.4%. The total industry fine cut category of 13.6 billion cigarette equivalent units decreased by 2.2%. Our market share of the category decreased by 0.7 share points to 26.2%.

In Germany, the total cigarette market of 80.4 billion units increased by 0.9% in 2014, mainly reflecting the net favorable impact of estimated trade purchases and a lower incidence of illicit trade. Excluding the impact of these estimated inventory movements, the total cigarette market was essentially flat. Our cigarette shipment volume of 29.4 billion units increased by 2.0%, and market share increased by 0.4 share points to 36.6%, driven by *L&M*, up by 0.9 share points to 11.8%. Market share of *Marlboro* decreased by 0.3 share points to 21.7%, while share of *Chesterfield* was flat at 1.7%. The total industry fine cut category of 41.2 billion cigarette-equivalent units decreased by 1.0%. Our market share of the category decreased by 1.3 share points to 12.9%.

In Italy, the total cigarette market of 74.4 billion units increased by 0.5% in 2014, partly reflecting a lower incidence of e-vapor products. Our cigarette shipment volume of 40.4 billion units increased by 3.9%. Our market share increased by 1.8 share points to 54.9%, driven by *Chesterfield*, up by 5.7 share points to 9.2%, partly offset by *Marlboro*, down by 0.7 share points to 25.2%, and *Diana* in the low-price segment, down by 2.8 share points to 8.5%, the latter primarily impacted by the growth of the super-low price segment. Share of *Philip Morris* was flat at 2.4%. The total industry fine cut category of 6.1 billion cigarette equivalent units increased by 1.6%. Our market share of the category increased by 3.9 share points to 41.5%.

In Poland, the total cigarette market of 42.1 billion units decreased by 9.8%, reflecting the prevalence of e-cigarettes, illicit trade and non-duty paid OTP products. Although our cigarette shipment volume of 16.6 billion units decreased by 2.6%, our market share increased by 1.9 share points to 40.1%, driven by *L&M* and *Chesterfield*, up by 0.4 and 2.0 share points to 18.2% and 7.6%, respectively. Market share of *Marlboro* was down by 0.3 share points to 11.2%. The total industry fine cut category of 3.6 billion cigarette equivalent units increased by 7.7%, and our market share of the category increased by 11.2 share points to 34.7%.

In Spain, the total cigarette market of 47.0 billion units decreased by 1.5% in 2014, mainly due to a deceleration in adult smoker down-trading to fine cut, e-vapor and illicit products. Our cigarette shipment volume of 14.9 billion units increased by 1.9%. Our market share increased by 0.9 share points to 32.1%, driven by higher share of *Marlboro*, up by 1.1 share points to 15.9% and *Philip Morris*, up by 0.3 share points to 0.9%. Market share of *Chesterfield* was down by 0.1 share point to 9.2% and share of *L&M* was down by 0.2 share points to 6.1%. The total industry fine cut category of 9.7 billion cigarette equivalent units decreased by 9.8%, partly reflecting lower consumption resulting from further tax harmonization with cigarettes following the July 2013 and July 2014 price increases. Our market share of the fine cut category increased by 1.0 share point to 14.8% in 2014.

- **Eastern Europe, Middle East & Africa**. Net revenues, which include excise taxes billed to customers, increased by $1.2 billion (6.0%). Excluding excise taxes, net revenues increased by $156 million (1.8%) to $8.9 billion. This increase was due primarily to:

  - price increases ($1.1 billion), partly offset by
  - unfavorable currency ($761 million) and
  - unfavorable volume/mix ($224 million).

Operating companies income of $4.1 billion increased by $342 million (9.1%). This increase was due primarily to:

- price increases ($1.1 billion),
- lower pre-tax charges for asset impairment and exit costs ($262 million) and
- higher equity income in unconsolidated subsidiaries ($135 million), partly offset by
- unfavorable currency ($611 million),
- higher manufacturing costs ($244 million, principally related to the impact of the change to our new business structure in Egypt),
- unfavorable volume/mix ($202 million) and
- higher marketing, administration and research costs ($130 million).

Our cigarette shipment volume in EEMA decreased by 2.9% to 287.9 billion units, mainly due to Kazakhstan, Russia, Serbia and Ukraine, partly offset by Algeria, Saudi Arabia and Turkey. Our cigarette shipment volume of premium brands increased by 1.2%, driven by *Parliament*, up by 6.9% to 35.3 billion units, partly offset by *Marlboro*, down by 0.7% to 85.2 billion units.

In North Africa, defined as Algeria, Egypt, Libya, Morocco and Tunisia, the estimated total cigarette market increased by 2.2% to 141.8 billion units in 2014, driven by Algeria, Egypt and Tunisia, partially offset by Libya and Morocco. Our cigarette shipment volume of

37.8 billion units increased by 2.5%, driven largely by *Marlboro* in Algeria and *L&M* in Egypt. Our market share decreased by 0.2 share points to 26.3%. Market share of *Marlboro* increased by 0.2 share points to 15.5%, while share of *L&M* decreased by 0.1 share point to 9.0%.

In Russia, the total cigarette market decreased by 9.2% to an estimated 310.6 billion units in 2014, 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 cigarette shipment volume of 84.9 billion units in 2014 decreased by 3.5%. Shipment volume of our premium portfolio decreased by 2.5%, mainly due to *Marlboro,* down by 13.6%, partially offset by *Parliament*, up by 1.6%. In the mid-price segment, shipment volume decreased by 9.1%, mainly due to *Chesterfield*, down by 18.6%. In the low-price segment, shipment volume decreased by 1.4%, mainly due to *Optima* and *Apollo Soyuz*, down by 16.3% and 8.5%, respectively, partly offset by *Bond Street*, up by 2.5%. Our market share of 27.1%, as measured by Nielsen, was up by 1.0 share point. Market share of *Parliament* increased by 0.3 share points to 3.7%, *L&M* increased by 0.3 share points to 3.1% and *Bond Street* increased by 1.0 share point to 7.5%*,* while *Marlboro* decreased by 0.2 share points to 1.5% and *Chesterfield* decreased by 0.2 share points to 2.8%.

In Turkey, the total cigarette market increased by 2.4% to an estimated 93.9 billion units in 2014, primarily reflecting an increase in the adult population. Our cigarette shipment volume of 46.3 billion units increased by 2.3%. Our market share, as measured by Nielsen, decreased by 1.5 share points to 44.0%, mainly due to: *Marlboro*, down by 0.3 share points to 8.6%; mid-price *Muratti,* down by 1.4 share points to 5.5%; low-price *L&M*, down by 0.9 share points to 6.4%, and low-price *Lark*, down by 2.4 share points to 9.0%, partly offset by premium *Parliament*, up by 1.2 share points to 11.2%, and low-price *Chesterfield*, up by 2.3 share points to 3.1%.

In Ukraine, the total cigarette market decreased by 2.5% to an estimated 73.3 billion units in 2014, mainly reflecting the impact of price increases in 2014 and business disruption due to the political instability in the east of the country, partially offset by a lower prevalence of illicit trade. Our 2014 cigarette shipment volume of 23.3 billion units decreased by 8.8%. Our market share, as measured by Nielsen, decreased by 1.0 share point to 32.5%, mainly due to: *Marlboro,* down by 0.7 share points to 4.8%; *Parliament,*down by 0.3 share points to 3.0%; *Chesterfield*, down by 0.9 share points to 5.0%, and *Optima*, down by 0.8 share points to 1.0%, partly offset by growth from low-price *President*, up by 2.3 share points to 5.1%.

- **Asia.** Net revenues, which include excise taxes billed to customers, decreased by $1.7 billion (8.3%). Excluding excise taxes, net revenues decreased by $1.8 billion (16.9%) to $8.7 billion. This decrease was due to:

  - unfavorable currency ($1.0 billion) and
  - unfavorable volume/mix ($906 million), partly offset by
  - price increases ($155 million).

Operating companies income of $3.2 billion decreased by $1.4 billion (31.0%). This decrease was due primarily to:

- unfavorable volume/mix ($746 million),
- unfavorable currency ($656 million),
- higher manufacturing costs ($181 million, principally in Indonesia driven mainly by higher clove prices and cost related to the transition from hand-rolled to machine-made kretek cigarette production) and
- higher pre-tax charges for asset impairment and exit costs ($8 million, principally due to the factory closure in Australia), partly offset by
- price increases ($155 million).

Our cigarette shipment volume of 288.1 billion units decreased by 4.4%, due primarily to: the unfavorable impact of an adjustment in distributor inventories in Japan; lower total market and share in Australia, mainly reflecting the impact of excise tax-driven price increases and competitive pricing in the deep discount segment, Japan and Pakistan, and lower share in Indonesia. Shipment volume of *Marlboro* of 71.4 billion units decreased by 5.3%, due almost entirely to Japan, partly offset by the Philippines. Shipment volume of *Parliament* of 10.7 billion units increased by 1.8%, driven by Korea. Shipment volume of *Lark* of 17.7 billion units increased by 7.4%, driven mainly by Japan (including the morphed *Philip Morris*).

In Indonesia, the total cigarette market increased by 1.9% to 314.0 billion units in 2014. In 2015, the total market is forecast to increase by up to 2%. Our cigarette shipment volume of 109.7 billion units in 2014 decreased by 1.5%. Our market share decreased by 1.3 share points to 34.9%, predominantly due to the share decline of: *Sampoerna Hijau*, down by 0.9 share points to 3.4%, mainly reflecting the decline of the total hand-rolled kretek segment, and the hand-rolled, full-flavor variants of *Dji Sam Soe* in the premium segment, which decreased by 1.5 share points to 4.2%, mainly due to a retail price change ahead of competition. The decline in our market share was partly offset by machine-made mid-price *U Mild*, up by 1.0 share point to 5.4% and machine-made *Dji Sam Soe Magnum* and *Dji Sam Soe Magnum Blue*, up by a combined 1.0 share point to 2.1%. Market share of *Sampoerna A* in the premium machine-made lighter-tasting kretek segment was flat at 14.4%. While market share of *Marlboro* decreased by 0.1 share point to 5.1%, its share of the "white" cigarettes segment, representing 6.4% of the total cigarette market, increased by 2.0 share points to 79.7%. The machine-made kretek segment, representing 73.5% of the total cigarette market, increased by 3.8 share points, and our share of the segment increased by 0.4 share points to 29.9%.

In Japan, the total cigarette market decreased by 3.4% to 186.2 billion units in 2014, partly reflecting the unfavorable impact of the consumption tax-driven retail price increases of April 1, 2014. In 2015, the total market is forecast to decrease by an estimated 2.5% to 3.0%. Our cigarette shipment volume of 45.6 billion units in 2014 decreased by 14.0%, principally due to the unfavorable impact of an adjustment in distributor inventories and a lower total market and share. Excluding the impact of these inventory movements, our cigarette shipment volume decreased by 5.8%. Our market share decreased by 0.8 share points to 25.9%. Share of *Marlboro* and *Virginia S.* decreased by 0.5 share points and 0.1 share point to 11.6% and 1.9%, respectively. Share of *Lark* (including the morphed *Philip Morris*) declined by 0.1 share point to 10.0%.

In Korea, the total cigarette market increased by 1.2% to 89.4 billion units in 2014, reflecting favorable estimated trade inventory movements. Excluding the impact of these inventory movements, the total cigarette market decreased by approximately 2%. In 2015, the underlying total market is forecast to decrease by approximately 20% - 25%, as a result of higher pricing following the January 2015 excise tax increase. Our shipment volume of 17.3 billion units in 2014 increased by 1.1%, and market share was flat at 19.4%, with share of *Parliament* up by 0.1 share point to 7.0%, partly offset by *Marlboro*, down by 0.1 share point to 7.6%.

In the Philippines, the estimated total tax-paid industry cigarette volume decreased by 4.6% to an estimated 82.3 billion units in 2014, reflecting the prevalence of domestic non-duty-paid products. While our cigarette shipment volume of 68.4 billion units decreased by 0.2%, our market share of the estimated total tax-paid cigarette industry increased by 3.7 share points to 83.0%. *Marlboro*'s market share increased by 1.7 share points to 18.4% and share of *Fortune* increased by 1.8 share points to 33.4%.

- **Latin America & Canada.** Net revenues, which include excise taxes billed to customers, decreased by $179 million (1.8%). Excluding excise taxes, net revenues decreased by $76 million (2.3%) to $3.3 billion. This decrease was due primarily to:

  - unfavorable currency ($431 million) and
  - unfavorable volume/mix ($127 million), partly offset by
  - price increases ($481 million).

Operating companies income of $1.0 billion decreased by $104 million (9.2%). This decrease was due primarily to:

- unfavorable currency ($243 million),
- unfavorable volume/mix ($133 million),
- higher marketing, administration and research costs ($135 million) and
- higher manufacturing costs ($70 million), partly offset by
- price increases ($481 million).

Our cigarette shipment volume of 94.7 billion units decreased by 2.7%, principally due to a lower total market, predominantly in Canada and Mexico. While shipment volume of *Marlboro* of 37.0 billion units decreased by 4.3%, due predominantly to Mexico, its market share was up in Argentina, Brazil and Colombia by 0.3, 0.5 and 1.0 share points to 24.1%, 9.2% and 7.9%, respectively. Shipment volume of *Philip Morris* of 19.1 billion units increased by 2.1%, driven mainly by Argentina.

In Argentina, the total cigarette market decreased by 2.2% to 41.7 billion units in 2014. While our cigarette shipment volume of 32.3 billion units decreased by 0.2%, market share increased by 1.5 share points to 77.1%, driven by *Marlboro,* up by 0.3 share points to 24.1%, and mid-price *Philip Morris*, up by 1.9 share points to 43.4%, reflecting the positive impact of its capsule variants, partly offset by low-price *Next*, down by 0.5 share points to 2.0%.

In Canada, the total cigarette market decreased by 5.5% to 27.3 billion units in 2014, mainly due to the impact of both federal and provincial tax-driven price increases during the first half of the year. While our cigarette shipment volume of 10.3 billion units decreased by 4.6%, market share increased by 0.4 share points to 37.6%, with premium *Belmont* up by 0.4 share points to 3.0% and premium *Benson*

& Hedges flat at 2.4%. Market share of low-price *Next* was up by 0.7 share points to 10.6%, partly offset by mid-price *Number 7* and low-price *Accord*, down by 0.2 and 0.5 share points to 4.0% and 2.4%, respectively. Market share of mid-price *Canadian Classics* was up by 0.3 share points to 10.4%.

In Mexico, the total cigarette market decreased by 3.2% to 33.5 billion units in 2014, primarily reflecting unfavorable estimated trade inventory movements compared to 2013. Excluding the impact of these inventory movements, the total cigarette market is estimated to have declined by approximately 0.5%. Our cigarette shipment volume of 23.9 billion units decreased by 6.1%. Our market share decreased by 2.2 share points to 71.3%. While market share of *Marlboro* and *Benson & Hedges* was down by 2.6 and 0.3 share points to 49.7% and 5.2%, respectively, reflecting consumer down-trading, our share of the premium price segment was up by 0.8 share points to 91.5%. Market share of *Delicados*, the second best-selling brand in the market, decreased by 0.1 share point to 11.1%.

2013 compared with 2012

The following discussion compares operating results within each of our reportable segments for 2013 with 2012.

- **European Union**. Net revenues, which include excise taxes billed to customers, increased $965 million (3.5%). Excluding excise taxes, net revenues increased $70 million (0.8%) to $8.6 billion. This increase was due to:

  - price increases ($348 million) and
  - favorable currency ($205 million), partly offset by
  - unfavorable volume/mix ($483 million).

The net revenues of the European Union segment include $1,524 million in 2013 and $1,372 million in 2012 related to sales of OTP. Excluding excise taxes, OTP net revenues for the European Union segment were $543 million in 2013 and $475 million in 2012.

Operating companies income of $4.2 billion increased by $51 million (1.2%). This increase was due primarily to:

- price increases ($348 million),
- favorable currency ($92 million) and
- lower marketing, administration and research costs ($44 million), partly offset by
- unfavorable volume/mix ($403 million),
- higher manufacturing costs ($21 million) and
- higher pre-tax charges for asset impairment and exit costs ($8 million).

The total cigarette market of 482.7 billion units decreased by 7.4%, due primarily to the impact of tax-driven price increases, the unfavorable economic and employment environment and the prevalence of non-duty-paid products. Although our cigarette shipment volume of 185.1 billion units decreased by 6.5%, predominantly reflecting a lower total market across the Region, our market share increased by 0.6 share points to 38.8%. The total OTP market in the European Union of 162.8 billion cigarette equivalent units increased by 0.4%, reflecting a larger total fine cut market, up by 0.3% to 141.8 billion cigarette equivalent units.

While shipment volume of *Marlboro* of 91.3 billion units decreased by 3.7%, mainly due to a lower total market, market share increased by 0.4 share points to 19.0%, driven notably by Germany, Greece, the Netherlands, Italy and Spain. While shipment volume of *L&M* decreased by 4.0% to 32.9 billion units, market share increased by 0.2 share points to 6.9%, driven notably by Germany and Poland. Shipment volume of *Chesterfield* of 19.0 billion units increased by 5.1%, and market share increased by 0.1 share point to 4.4%, driven notably by the Czech Republic, Portugal and the United Kingdom. Although shipment volume of *Philip Morris* of 9.6 billion units decreased by 10.4%, due predominantly to Italy, reflecting the morphing of certain brand variants into *Marlboro,* market share increased by 0.2 share points to 2.0%.

Our shipment volume of OTP of 21.5 billion cigarette equivalent units increased by 6.7%, driven principally by higher share. Our OTP total market share was 13.4%, up by 0.9 share points, reflecting gains in the fine cut category, notably in France, up by 1.7 share points to 26.9%; Italy, up by 9.7 share points to 37.6%; Poland, up by 0.7 share points to 23.5%; Portugal, up by 11.5 share points to 31.9%, and Spain, up by 2.0 share points to 13.8%.

In France, the total cigarette market of 47.5 billion units decreased by 7.6%, mainly reflecting the unfavorable impact of price increases in the fourth quarter of 2012 and July 2013, an increase in the prevalence of non-duty-paid products, growth of the fine cut category, and a weak economy. Our shipments of 19.1 billion units decreased by 5.3%, including a favorable trade inventory comparison driven by the timing of shipments in the second half of 2012 in anticipation of price increases in the fourth quarter of 2012. Our market share was up by 0.6 share points to 40.2%, mainly driven by the resilience of premium *Philip Morris*, up by 0.8 share points to 9.1%, and the growth of *Chesterfield*, up by 0.1 share point to 3.4%. Market share of *Marlboro* and *L&M* decreased by 0.1 and 0.2 share points to 24.7% and 2.5%, respectively. The total industry fine cut category of 13.9 billion cigarette equivalent units increased by 3.7% in 2013. Our market share of the category increased by 1.7 share points to 26.9%.

In Germany, the total cigarette market of 79.6 billion units decreased by 4.6% in 2013, mainly reflecting the impact of price increases in the second quarter of 2013. While our shipments of 28.8 billion units decreased by 3.4%, market share increased by 0.4 share points to 36.2%, driven by *Marlboro* and *L&M,* up by 0.7 and 0.4 share points to 22.0% and 10.9%, respectively, partly offset by *Chesterfield*, down by 0.6 share points to 1.7%. The total industry fine cut category of 41.6 billion cigarette equivalent units increased by 0.7% in 2013. Our market share of the category decreased by 0.5 share points to 14.2%.

In Italy, the total cigarette market of 74.0 billion units decreased by 6.0% in 2013, reflecting an unfavorable economic and employment environment and the prevalence of illicit trade and substitute products. Our shipments of 38.9 billion units decreased by 7.0%, including an unfavorable comparison with 2012, which benefited from trade inventory movements ahead of the morphing of certain variants of *Philip Morris* into *Marlboro* as of the first quarter of 2013. Our market share increased by 0.1 share point to 53.1%, driven by *Marlboro,* up by 0.5 share points to 25.9%, and *Philip Morris,* up by 1.1 share points to 2.4%, partially offset by *Chesterfield*, down by 0.1 share point to 3.5%, and *Diana* in the low-price segment, down by 1.1 share points to 11.3%, the latter impacted by the growth of the super-low price segment and the availability of non-duty-paid products. The total industry fine cut category of 6.0 billion cigarette equivalent units decreased by 3.5%, reflecting the 2012 excise tax-driven reduction of the price gap differential with cigarettes. Our market share of the category increased by 9.7 share points to 37.6%.

In Poland, the total cigarette market of 46.6 billion units decreased by 10.6% in 2013, mainly reflecting the unfavorable impact of price increases in the first quarter of 2013 and the availability of non-duty-paid OTP. Although our shipments of 17.1 billion units decreased by 10.1%, our market share increased by 0.6 share points to 38.2%, driven by *Marlboro,* up by 0.2 share points to 11.5%, and by *L&M,* up by 1.2 share points to 17.8%. While the total industry fine cut category of 3.3 billion cigarette equivalent units decreased by 11.4%, reflecting the prevalence of non-duty-paid OTP, our market share of the category increased by 0.7 share points to 23.5%.

In Spain, the total cigarette market of 47.7 billion units decreased by 11.1% in 2013, mainly due to the impact of price increases in the first and third quarters of 2013, the unfavorable economic and employment environment and the growth of the fine cut category. Our shipments of 14.6 billion units decreased by 11.5%, including an unfavorable comparison with 2012, which benefited from trade inventory movements in the fourth quarter ahead of price increases in January 2013. Market share increased by 0.7 share points to 31.2%, driven by a higher share of *Marlboro,* up by 0.5 share points to 14.8%. Our market share of *Chesterfield* was up by 0.3 share points to 9.3%, share of *L&M* was flat at 6.3% and share of *Philip Morris* was down by 0.1 share point to 0.6%. The total industry fine cut category of 10.8 billion cigarette equivalent units increased by 6.9%, partly reflecting switching from pipe tobacco as a result of an excise tax increase on the category in 2012 . Our market share of the fine cut category increased by 2.0 share points to 13.8% in 2013.

- **Eastern Europe, Middle East & Africa**. Net revenues, which include excise taxes billed to customers, increased $1.4 billion (7.4%). Excluding excise taxes, net revenues increased $434 million (5.2%) to $8.8 billion. This increase was due to:

  - price increases ($767 million), partly offset by
  - unfavorable volume/mix ($235 million) and
  - unfavorable currency ($98 million).

Operating companies income of $3.8 billion increased by $53 million (1.4%). This increase was due primarily to:

- price increases ($767 million), partly offset by
- higher pre-tax charges for asset impairment and exit costs ($259 million, including charges associated with the termination of distribution agreements resulting from a new business model in Egypt),
- unfavorable volume/mix ($168 million),
- unfavorable currency ($122 million),
- higher marketing, administration and research costs ($86 million, notably related to the annualization of expenditures to expand our business infrastructure in Russia) and
- higher manufacturing costs ($76 million).

Our cigarette shipment volume in EEMA of 296.5 billion units decreased by 2.4%, mainly due to Russia, Serbia and Turkey, partly offset by the Middle East and North Africa. Cigarette shipment volume of our premium brands increased by 0.3%, driven by *Parliament*, up by 5.0% to 33.0 billion units, partly offset by *Marlboro*, down by 0.9% to 85.8 billion units.

In North Africa, the total cigarette market increased by 0.7% to an estimated 138.7 billion units in 2013, driven notably by Algeria and Egypt, partially offset by Morocco and Tunisia. Our shipment volume of 36.8 billion units increased by 17.0%, principally reflecting a higher total market and share. Our market share increased by 3.9 share points to 26.5%, driven by gains in all five markets, notably Algeria, up by 0.8 share points to 41.1%, and Egypt, up by 4.7 share points to 22.9%. Share of *Marlboro* and *L&M* in North Africa increased by 2.1 and 1.5 share points to 15.3% and 9.1%, respectively.

In Russia, the total cigarette market declined by 7.6% to an estimated 342.0 billion units in 2013, mainly due to the unfavorable impact of tax-driven price increases, illicit trade and a weak economy. Our shipment volume of 88.0 billion units decreased by 6.7%. Shipment volume of our premium portfolio was down by 6.0%, mainly due to *Marlboro*, down by 20.4%, partially offset by *Parliament*, up by 1.0%. In the mid-price segment, shipment volume decreased by 9.5%, mainly due to *Chesterfield*, down by 17.5%. In the low-price segment, shipment volume decreased by 5.7%, mainly due to *Bond Street*, *Optima* and *Apollo Soyuz,* down by 4.1%, 12.7% and 18.0%, respectively. Our market share of 26.1% in 2013, as measured by Nielsen, was down 0.3 share points. Market share of *Parliament* increased by 0.2 share points to 3.4%, *L&M* increased by 0.2 share points to 2.8%, *Marlboro* decreased by 0.2 share points to 1.7%, *Chesterfield* decreased by 0.4 share points to 3.0% and *Bond Street* was flat at 6.5%.

In Turkey, the total cigarette market declined by 7.6% to an estimated 91.7 billion units in 2013, primarily reflecting the renewed growth of illicit trade and an unfavorable comparison with trade inventory movements in 2012. Excluding the impact of these inventory movements, the total cigarette market was estimated to have declined by 3.5% in 2013. Our shipment volume of 45.2 billion units decreased by 7.1%. Our market share, as measured by Nielsen, decreased by 0.2 share points to 45.5% in 2013, mainly due to *Marlboro*, down by 0.3 share points to 8.9%, and low-price *L&M,* down by 1.1 share points to 7.3%, partly offset by premium *Parliament* and mid-price *Muratti*, up by 1.0 share point and 0.3 share points to 10.0% and 6.9%, respectively.

In Ukraine, the total cigarette market declined by 9.9% to an estimated 75.1 billion units in 2013, mainly reflecting the impact of price increases in 2013 and an increase in illicit trade. Although our 2013 shipment volume of 25.5 billion units decreased by 5.5%, our market share, as measured by Nielsen, increased by 1.0 share point to 33.5%, mainly reflecting growth from our low-price segment brands of *Bond Street*, *Optima* and *President*. Share for premium *Parliament* was up by 0.1 share point to 3.3%. Market share of *Marlboro* decreased by 0.3 share points to 5.5%.

- **Asia.** Net revenues, which include excise taxes billed to customers, decreased by $84 million (0.4%). Excluding excise taxes, net revenues decreased $697 million (6.2%) to $10.5 billion. This decrease was due to:

  - unfavorable currency ($726 million) and
  - unfavorable volume/mix ($670 million, primarily due to the Philippines and Japan), partly offset by
  - price increases ($699 million).

Operating companies income of $4.6 billion decreased by $575 million (11.1%). This decrease was due primarily to:

- unfavorable currency ($548 million),
- unfavorable volume/mix ($536 million) and
- higher manufacturing costs ($240 million, principally in Indonesia, driven mainly by higher clove prices), partly offset by
- price increases ($699 million),
- lower marketing, administration and research costs ($39 million) and
- lower pre-tax charges for asset impairment and exit costs ($12 million).

Our cigarette shipment volume of 301.3 billion units decreased by 7.7%, due primarily to the lower total market and share in the Philippines, and lower share in Japan and Pakistan, partly offset by share growth in Indonesia. Excluding the Philippines, our cigarette shipment volume decreased by 0.4%. Shipment volume of *Marlboro* of 75.3 billion units was down by 7.1%. Excluding the Philippines, shipment volume of *Marlboro* increased by 2.0%, primarily reflecting market share growth in Indonesia and Vietnam.

In Indonesia, the total cigarette market increased by 1.9% to 308.0 billion units in 2013. Our shipment volume of 111.3 billion units increased by 3.4%. Our market share increased by 0.6 share points to 36.2%, driven notably by *Sampoerna A* in the premium segment, up by 0.5 share points to 14.4%, and mid-price *U Mild*, up by 1.1 share points to 4.4%. Market share of the hand-rolled, full-flavor *Dji Sam Soe* in the premium segment decreased by 1.0 share point to 6.8%, mainly due to a retail price change ahead of competition. *Marlboro*'s market share was up by 0.4 share points to 5.2%, and its share of the “white” cigarettes segment, representing 6.7% of the total cigarette market, increased by 6.0 share points to 77.7%.

In Japan, the total cigarette market decreased by 2.0% to 192.6 billion units. Our shipment volume of 53.0 billion units was down by 5.3%, principally due to a lower total market and share. Our market share decreased by 1.0 share point to 26.7%, reflecting the impact of our principal competitor's brand launches and significant promotional activities in 2013. Market share of *Marlboro* and *Lark* decreased by 0.3 and 0.5 share points to 12.1% and 10.0%, respectively, and share of *Virginia S.* was down by 0.1 share point to 2.0%.

In Korea, the total cigarette market decreased by 1.0% to 88.4 billion units in 2013. Although our shipment volume of 17.2 billion units was essentially flat, market share increased by 0.2 share points to 19.4%, with share of *Parliament* up by 0.3 share points to 6.9%, partly offset by *Marlboro*, down 0.1 share point to 7.7%. Share of *Virginia S.* was flat at 4.1%.

In the Philippines, the total industry cigarette volume decreased by 15.6% to an estimated 86.3 billion units in 2013, primarily reflecting the unfavorable impact of the disruptive excise tax increase in January 2013 and a surge in the prevalence of domestic non-duty-paid products. Our shipment volume of 68.5 billion units decreased by 26.2%, primarily reflecting the unfavorable impact of the aforementioned tax increase and the underdeclaration of tax-paid volume by our main local competitor. Our market share decreased by 11.4 share points to 79.3%, primarily due to down-trading to competitors' brands. *Marlboro*'s market share decreased by 4.2 share points to 16.7%. Share of *Fortune* decreased by 17.8 share points to 31.6%, partly offset by gains from our other local brands.

- **Latin America & Canada.** Net revenues, which include excise taxes billed to customers, increased $332 million (3.4%). Excluding excise taxes, net revenues increased $33 million (1.0%) to $3.4 billion. This increase was due to:

  - price increases ($252 million), partly offset by
  - unfavorable currency ($146 million) and
  - unfavorable volume/mix ($73 million).

Operating companies income of $1.1 billion increased by $91 million (8.7%). This increase was due to:

- price increases ($252 million),
- lower pre-tax charges for asset impairment and exit costs ($29 million) and
- lower marketing, administration and research costs ($23 million), partly offset by
- unfavorable volume/mix ($88 million),
- unfavorable currency ($64 million) and
- higher manufacturing costs ($61 million, including higher leaf costs).

Our cigarette shipment volume in Latin America & Canada of 97.3 billion units decreased by 1.4%, principally due to a lower total market, predominantly in Brazil, partly offset by higher share, notably in Argentina and Brazil, and trade inventory movements in Mexico. While shipment volume of *Marlboro* of 38.7 billion units decreased by 1.4%, market share was up, notably in Brazil and Colombia by 0.7 and 0.9 share points, respectively.

In Argentina, the total cigarette market decreased by 1.8% to 42.6 billion units in 2013. While our cigarette shipment volume of 32.4 billion units decreased by 0.8%, market share increased by 0.7 share points to a record 75.6%, driven by mid-price *Philip Morris*, up by 2.1 share points to 41.5%, reflecting the positive impact of its capsule variants, partly offset by low-price *Next*, down by 0.6 share points to 2.5%. Share of *Marlboro* decreased by 0.3 share points to 23.8%.

In Canada, the total cigarette market decreased by 1.2% to 28.9 billion units in 2013. While our cigarette shipment volume of 10.8 billion units was flat, market share increased by 0.3 share points to 37.2%, with premium brands *Benson & Hedges* and *Belmont* up by 0.1 share point each to 2.4% and 2.6%, respectively. Market share of low-price brand *Next* was up by 1.7 share points to 9.9%, partly offset by mid-price *Number 7* and low-price *Accord*, down by 0.3 and 0.4 share points, to 4.2% and 2.9%, respectively. Market share of mid-price *Canadian Classics* was flat at 10.1%.

In Mexico, the total cigarette market increased by 3.0% to 34.6 billion units in 2013, primarily reflecting a favorable comparison of price-driven trade inventory movements compared to 2012. Our cigarette shipment volume in 2013 of 25.4 billion units increased by 3.0%. Our market share was flat at 73.5%. While market share of *Marlboro* and *Benson & Hedges* was down by 1.3 and 0.7 share points to 52.3% and 5.5%, respectively, reflecting consumer down-trading, our share of the premium price segment was up by 1.0 share point to 90.7%. Market share of *Delicados*, the second-best-selling brand in the market, increased by 0.8 share points to 11.2%.

Financial Review

- **Net Cash Provided by Operating Activities**

Net cash provided by operating activities of $7.7 billion for the year ended December 31, 2014, decreased by $2.4 billion from the comparable 2013 period. The decrease was due primarily to lower net earnings ($1.2 billion, primarily related to unfavorable currency movements), an increase in our working capital requirements ($708 million), and higher cash payments related to exit costs.

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

- more cash used for accrued liabilities and other current assets ($2.4 billion), largely due to the timing of payments for excise taxes, partially offset by
- more cash provided by inventories ($1.5 billion), primarily related to lower leaf tobacco and finished goods inventory levels.

On February 6, 2014, we announced a one-year gross productivity and cost savings target for 2014 of approximately $300 million. During 2014, we exceeded this target.

On February 5, 2015, we announced that our productivity and cost savings initiatives will include, but are not limited to, the continued enhancement of production processes, the harmonization of tobacco blends, the streamlining of product specifications and number of brand variants, supply chain improvements and overall spending efficiency across the company. We anticipate that these initiatives, combined with savings associated with the manufacturing footprint restructuring implemented in 2014, notably in Australia and the Netherlands, should result in a total company cost-base increase, excluding RRPs and currency, of approximately 1%.

Net cash provided by operating activities of $10.1 billion for the year ended December 31, 2013, increased by $714 million from the comparable 2012 period. The increase was due primarily to a decrease in our working capital requirements ($451 million) and lower pension contributions ($57 million).

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

- more cash provided by accrued liabilities and other current assets ($2.1 billion), largely due to the timing of payments for excise taxes, partly offset by
- more cash used for income taxes ($969 million), primarily related to the timing of payments, and
- more cash used for inventories ($685 million), primarily related to the timing of inventory purchases.

On February 7, 2013, we announced a one-year, gross productivity and cost savings target for 2013 of approximately $300 million. During 2013, we exceeded this target primarily through the rationalization of tobacco blends and product specifications and other manufacturing and procurement initiatives.

- **Net Cash Used in Investing Activities**

Net cash used in investing activities of $996 million for the year ended December 31, 2014, decreased by $1.7 billion from the comparable 2013 period, due primarily to less cash spent on investments in unconsolidated subsidiaries and higher cash collateral received from derivatives designated as net investment hedges, partially offset primarily by the purchase of Nicocigs Limited.

Net cash used in investing activities of $2.7 billion for the year ended December 31, 2013, increased by $1.7 billion from the comparable 2012 period, due primarily to higher cash spent on investments in unconsolidated subsidiaries ($1.4 billion) and higher capital expenditures ($144 million).

As previously discussed, on September 30, 2013, we acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) for approximately $625 million. 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, our distributor in Russia, for a purchase price of $760 million. For further details, see Item 8, Note 4. *Investments in Unconsolidated Subsidiaries* to our consolidated financial statements.

Our capital expenditures were $1.2 billion in 2014, $1.2 billion in 2013 and $1.1 billion in 2012. The 2014 expenditures were primarily related to investments in reduced-risk products, productivity-enhancing programs, equipment for new products and the expansion of our capacity in Indonesia for machine-made kretek cigarettes. We expect total capital expenditures in 2015 of approximately $1.2 billion (including additional capital expenditures related to our ongoing investment in reduced-risk products), to be funded by operating cash flows.

- **Net Cash Used in Financing Activities**

During 2014, net cash used in financing activities was $6.8 billion, compared with net cash used in financing activities of $8.2 billion during 2013 and $8.1 billion in 2012. During 2014, we used a total of $13.2 billion to repurchase our common stock, pay dividends and repay debt. These uses were partially offset by proceeds from our debt offerings and short-term borrowings in 2014 of $6.6 billion. During 2013, we used a total of $17.1 billion to repurchase our common stock, pay dividends, repay debt and purchase subsidiary shares from noncontrolling interests. These uses were partially offset by proceeds from our debt offerings and short-term borrowings in 2013 of $9.2 billion. During 2012, we used a total of $15.4 billion to repurchase our common stock, pay dividends, and repay debt. These uses were partially offset by proceeds from our debt offerings and short-term borrowings in 2012 of $7.6 billion.

In September 2013, Grupo Carso sold us its remaining 20% interest in our Mexican tobacco business for $703 million. As a result, we own 100% of our Mexican tobacco business. For further details, see Item 8, Note 6. *Acquisitions and Other Business Arrangements* to our consolidated financial statements.

Dividends paid in 2014, 2013 and 2012 were $6.0 billion, $5.7 billion and $5.4 billion, respectively.

- **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 February 19, 2015, our credit ratings and outlook by major credit rating agencies were as follows:

	Short-term	Long-term	Outlook
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 $2.5 billion multi-year revolving credit facility, effective February 28, 2015, from February 28, 2019 to February 28, 2020. On January 23, 2015, we also 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.

At February 19, 2015, our committed credit facilities were as follows:

(in billions)

Type		Committed Credit Facilities
364-day revolving credit, expiring February 9, 2016	**$**	**2.0**
Multi-year revolving credit, expiring February 28, 2019 (1)		**2.5**
Multi-year revolving credit, expiring October 25, 2016		**3.5**
Total facilities	**$**	**8.0**

(1) Effective February 28, 2015, our $2.5 billion multi-year revolving credit facility will be extended from February 28, 2019 to February 28, 2020.

At February 19, 2015, there were no borrowings under the committed credit facilities, and the entire $8.0 billion of 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 December 31, 2014, our ratio calculated in accordance with the agreements was 12.2 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 $3.2 billion at December 31, 2014, and $2.4 billion at December 31, 2013, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to $1.2 billion at December 31, 2014, and $1.0 billion at December 31, 2013.

Commercial Paper Program – We have commercial paper programs in place in the U.S. and in Europe. At December 31, 2014, we had no commercial paper outstanding. At December 31, 2013, we had $1.4 billion of commercial paper outstanding.

Effective April 19, 2013, our commercial paper program in the U.S. was increased by $2.0 billion. As a result, our commercial paper programs in place in the U.S. and in Europe currently have an aggregate issuance capacity of $8.0 billion.

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 $29.5 billion at December 31, 2014, and $27.7 billion at December 31, 2013. Fixed-rate debt constituted approximately 95% of our total debt at December 31, 2014, and 90% of our total debt at December 31, 2013. The weighted-average all-in financing cost of our total debt was 3.2% in 2014, compared to 3.5% in 2013. See Item 8, Note 16. *Fair Value Measurements* to our consolidated financial statements for a discussion of our disclosures related to the fair value of debt. The amount of debt that we can issue is subject to approval by our Board of Directors.

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.

Our debt issuances in 2014 were as follows:

(in millions)					
Type		Face Value [e]	Interest Rate	Issuance	Maturity
EURO notes	[a]	€750 (approximately $1,029)	1.875%	March 2014	March 2021
EURO notes	[a]	€1,000 (approximately $1,372)	2.875%	March 2014	March 2026
EURO notes	[b]	€500 (approximately $697)	2.875%	May 2014	May 2029
Swiss franc notes	[c]	CHF275 (approximately $311)	0.750%	May 2014	December 2019
Swiss franc notes	[b]	CHF250 (approximately $283)	1.625%	May 2014	May 2024
U.S. dollar notes	[d]	$500	1.250%	November 2014	November 2017
U.S. dollar notes	[d]	$750	3.250%	November 2014	November 2024
U.S. dollar notes	[d]	$750	4.250%	November 2014	November 2044

[a] Interest on these notes is payable annually in arrears beginning in March 2015.
[b] Interest on these notes is payable annually in arrears beginning in May 2015.
[c] Interest on these notes is payable annually in arrears beginning in December 2014.
[d] Interest on these notes is payable semiannually in arrears beginning in May 2015.
[e] U.S. dollar equivalents for foreign currency notes were calculated based on exchange rates on the date of issuance.

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

The weighted-average time to maturity of our long-term debt was 10.8 years at the end of 2013 and 2014.

- **Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

We have no off-balance sheet arrangements, including special purpose entities, other than guarantees and contractual obligations discussed below.

Guarantees – At December 31, 2014, we were contingently liable for $1.0 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 consolidated financial statements associated with these guarantees. At December 31, 2014, our third-party guarantees were insignificant.

***Aggregate Contractual Obligations* –** The following table summarizes our contractual obligations at December 31, 2014:

		Payments Due			
	Total	**2015**	**2016-2017**	**2018-2019**	**2020 and Thereafter**
(in millions)					
Long-term debt [1]	$28,542	$1,318	$4,299	$4,646	$18,279
RBH Legal Settlement [2]	128	34	75	19	—
Colombian Investment and Cooperation Agreement [3]	109	8	15	13	73
Interest on borrowings [4]	11,679	959	1,685	1,368	7,667
Operating leases [5]	740	197	241	109	193
Purchase obligations [6]:					
Inventory and production costs	3,980	1,902	742	512	824
Other	1,645	924	578	137	6
	5,625	2,826	1,320	649	830
Other long-term liabilities [7]	423	27	142	23	231
	$47,246	$5,369	$7,777	$6,827	$27,273

(1) Amounts represent the expected cash payments of our long-term debt and capital lease obligations.

(2) Amounts represent the estimated future payments due under the terms of the settlement agreement. See Item 8, Note 19. *RBH Legal Settlement*, to our consolidated financial statements for more details regarding this settlement.

(3) Amounts represent the expected cash payments under the terms of the Colombian Investment and Cooperation Agreement. See Item 8, Note 18. *Colombian Investment and Cooperation Agreement* to our consolidated financial statements for more details regarding this agreement.

(4) Amounts represent the expected cash payments of our interest expense on our long-term debt, including the current portion of long-term debt. Interest on our fixed-rate debt is presented using the stated interest rate. Interest on our variable rate debt is estimated using the rate in effect at December 31, 2014. Amounts exclude the amortization of debt discounts, the amortization of loan fees and fees for lines of credit that would be included in interest expense in the consolidated statements of earnings.

(5) Amounts represent the minimum rental commitments under non-cancelable operating leases.

(6) Purchase obligations for inventory and production costs (such as raw materials, indirect materials and supplies, packaging, co-manufacturing arrangements, storage and distribution) are commitments for projected needs to be utilized in the normal course of business. Other purchase obligations include commitments for marketing, advertising, capital expenditures, information technology and professional services. Arrangements are considered purchase obligations if a contract specifies all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Amounts represent the minimum commitments under non-cancelable contracts. Any amounts reflected on the consolidated balance sheet as accounts payable and accrued liabilities are excluded from the table above.

(7) Other long-term liabilities consist primarily of postretirement health care costs and accruals established for employment costs. The following long-term liabilities included on the consolidated balance sheet are excluded from the table above: accrued pension and postemployment costs, tax contingencies, insurance accruals and other accruals. We are unable to estimate the timing of payments (or contributions in the case of accrued pension costs) for these items. Currently, we anticipate making pension contributions of approximately $144 million in 2015, based on current tax and benefit laws (as discussed in Item 8, Note 13. *Benefit Plans* to our consolidated financial statements).

The E.C. agreement payments discussed below are excluded from the table above, as the payments are subject to adjustment based on certain variables including our market share in the EU.

***E.C. Agreement* –** As discussed in Item 8, Note 20. *E.C. Agreement*, in 2004, we entered into an agreement with the European Commission (acting on behalf of the European Community) that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. This agreement has been signed by all 27 Member States. This agreement calls for payments that are to be adjusted based on certain variables, including our market share in the European Union in the year preceding payment. Because future additional payments are subject to these variables, we record these payments as an expense in cost of sales when product is shipped. In addition, we are also responsible to pay the excise taxes, VAT and customs duties on qualifying product seizures of up to 90 million cigarettes and are subject to payments of five times the applicable taxes and duties if qualifying product seizures exceed 90 million cigarettes in a given year. In October 2014, this agreement was amended and the threshold was increased to 450 million cigarettes in a given year. This modification was effective as of July 2012. To date, our annual payments related to product seizures have been immaterial. Total charges related to the E.C. Agreement of $71 million, $81 million and $78 million were recorded in cost of sales in 2014, 2013 and 2012, respectively.

- **Equity and Dividends**

As discussed in Item 8, Note 9. *Stock Plans* to our consolidated financial statements, during 2014, we granted 2.4 million shares of deferred stock awards to eligible employees at a weighted-average grant date fair value of $77.79 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. While the 2008 Plan authorized incentive stock options, non-qualified stock options and stock appreciation rights, the 2012 Plan does not authorize any grants of stock options or stock appreciation rights. Up to 30 million shares of our common stock may be issued under the 2012 Plan. At December 31, 2014, shares available for grant under the 2012 plan were 24,785,260.

On May 1, 2010, we began repurchasing shares under a three-year $12.0 billion share repurchase program that was authorized by our Board of Directors in February 2010. On July 31, 2012, we completed this share repurchase program ahead of schedule. In total, we purchased 179.1 million shares for $12.0 billion under this program.

On August 1, 2012, we began repurchasing shares under a new three-year $18.0 billion share repurchase program that was authorized by our Board of Directors in June 2012. From August 1, 2012, through December 31, 2014, we repurchased 144.6 million shares of our common stock at a cost of $12.7 billion under this repurchase program. During 2014, we repurchased 45.2 million shares at a cost of $3.8 billion.

On February 5, 2015, we announced that we do not plan any share repurchases in 2015. We will revisit the potential for such repurchases as the year unfolds, depending on the currency environment.

Dividends paid in 2014 were $6.0 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 U.S., 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 Item 8, Note 15. *Financial Instruments,* Item 8, Note 16. *Fair Value Measurements* and Item 8, Note 22. *Balance Sheet Offsetting* to our consolidated financial statements for further details on our derivative financial instruments and the related collateral arrangements.

- ***Value at Risk -*** We use a value at risk computation to estimate the potential one-day loss in the fair value of our interest-rate-sensitive financial instruments and to estimate the potential one-day loss in pre-tax earnings of our foreign currency price-sensitive derivative financial instruments. This computation includes our debt, short-term investments, and foreign currency forwards, swaps and options. Anticipated transactions, foreign currency trade payables and receivables, and net investments in foreign subsidiaries, which the foregoing instruments are intended to hedge, were excluded from the computation.

The computation estimates were made assuming normal market conditions, using a 95% confidence interval. We use a "variance/co-variance" model to determine the observed interrelationships between movements in interest rates and various currencies. These interrelationships were determined by observing interest rate and forward currency rate movements over the preceding quarter for determining value at risk at December 31, 2014 and 2013, and over each of the four preceding quarters for the calculation of average value at risk amounts during each year. The values of foreign currency options do not change on a one-to-one basis with the underlying currency and were valued accordingly in the computation.

The estimated potential one-day loss in fair value of our interest-rate-sensitive instruments, primarily debt, under normal market conditions and the estimated potential one-day loss in pre-tax earnings from foreign currency instruments under normal market conditions, as calculated in the value at risk model, were as follows:

	Pre-Tax Earnings Impact			
(in millions)	**At 12/31/14**	**Average**	**High**	**Low**
Instruments sensitive to:				
Foreign currency rates	**$39**	**$25**	**$39**	**$13**

	Fair Value Impact			
(in millions)	**At 12/31/14**	**Average**	**High**	**Low**
Instruments sensitive to:				
Interest rates	**$95**	**$69**	**$95**	**$55**

	Pre-Tax Earnings Impact			
(in millions)	**At 12/31/13**	**Average**	**High**	**Low**
Instruments sensitive to:				
Foreign currency rates	$16	$27	$43	$16

	Fair Value Impact			
(in millions)	**At 12/31/13**	**Average**	**High**	**Low**
Instruments sensitive to:				
Interest rates	$60	$75	$111	$56

The value at risk computation is a risk analysis tool designed to statistically estimate the maximum probable daily loss from adverse movements in interest and foreign currency rates under normal market conditions. The computation does not purport to represent actual losses in fair value or earnings to be incurred by us, nor does it consider the effect of favorable changes in market rates. We cannot predict actual future movements in such market rates and do not present these results to be indicative of future movements in market rates or to be representative of any actual impact that future changes in market rates may have on our future results of operations or financial position.

Contingencies

See Item 3 and Item 8, Note 21. *Contingencies* to our 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 Item 1A. *Risk Factors,* and *Business Environment* of this 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.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk.*

The information called for by this Item is included in Item 7, *Market Risk*.