

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 001-33708

PHILIP MORRIS INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of
incorporation or organization)

13-3435103

(I.R.S. Employer
Identification No.)

120 Park Avenue, New York, New York

(Address of principal executive offices)

10017

(Zip Code)

917-663-2000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|----------------------------|---|
| Common Stock, no par value | New York Stock Exchange |
| 1.625% Notes due 2019 | New York Stock Exchange |
| 1.375% Notes due 2019 | New York Stock Exchange |
| 2.125% Notes due 2019 | New York Stock Exchange |
| 1.875% Notes due 2019 | New York Stock Exchange |
| 2.000% Notes due 2020 | New York Stock Exchange |
| Floating Notes due 2020 | New York Stock Exchange |
| 1.750% Notes due 2020 | New York Stock Exchange |
| 4.500% Notes due 2020 | New York Stock Exchange |
| 1.875% Notes due 2021 | New York Stock Exchange |
| 1.875% Notes due 2021 | New York Stock Exchange |
| 4.125% Notes due 2021 | New York Stock Exchange |
| 2.900% Notes due 2021 | New York Stock Exchange |
| 2.625% Notes due 2022 | New York Stock Exchange |
| 2.375% Notes due 2022 | New York Stock Exchange |
| 2.500% Notes due 2022 | New York Stock Exchange |
| 2.500% Notes due 2022 | New York Stock Exchange |
| 2.625% Notes due 2023 | New York Stock Exchange |
| 2.125% Notes due 2023 | New York Stock Exchange |
| 3.600% Notes due 2023 | New York Stock Exchange |

| Title of each class | Name of each exchange on which registered |
|-----------------------|---|
| 2.875% Notes due 2024 | New York Stock Exchange |
| 0.625% Notes due 2024 | New York Stock Exchange |
| 3.250% Notes due 2024 | New York Stock Exchange |
| 2.750% Notes due 2025 | New York Stock Exchange |
| 3.375% Notes due 2025 | New York Stock Exchange |
| 2.750% Notes due 2026 | New York Stock Exchange |
| 2.875% Notes due 2026 | New York Stock Exchange |
| 3.125% Notes due 2027 | New York Stock Exchange |
| 3.125% Notes due 2028 | New York Stock Exchange |
| 2.875% Notes due 2029 | New York Stock Exchange |
| 3.125% Notes due 2033 | New York Stock Exchange |
| 2.000% Notes due 2036 | New York Stock Exchange |
| 1.875% Notes due 2037 | New York Stock Exchange |
| 6.375% Notes due 2038 | New York Stock Exchange |
| 4.375% Notes due 2041 | New York Stock Exchange |
| 4.500% Notes due 2042 | New York Stock Exchange |
| 3.875% Notes due 2042 | New York Stock Exchange |
| 4.125% Notes due 2043 | New York Stock Exchange |
| 4.875% Notes due 2043 | New York Stock Exchange |
| 4.250% Notes due 2044 | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

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

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

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$126 billion based on the closing sale price of the common stock as reported on the New York Stock Exchange.

| Class | Outstanding at January 31, 2019 |
|-------------------------------|---------------------------------|
| Common Stock, no par value | 1,554,584,344 shares |

DOCUMENTS INCORPORATED BY REFERENCE

| <u>Document</u> | <u>Parts Into Which Incorporated</u> |
|--|--------------------------------------|
| Portions of the registrant's definitive proxy statement for use in connection with its annual meeting of shareholders to be held on May 1, 2019, to be filed with the Securities and Exchange Commission ("SEC") on or about March 21, 2019. | Part III |

TABLE OF CONTENTS

| | Page |
|---|--------------------------------|
| <u>PART I</u> | |
| Item 1. <u>Business</u> | <u>1</u> |
| Item 1A. <u>Risk Factors</u> | <u>5</u> |
| Item 1B. <u>Unresolved Staff Comments</u> | <u>10</u> |
| Item 2. <u>Properties</u> | <u>11</u> |
| Item 3. <u>Legal Proceedings</u> | <u>11</u> |
| Item 4. <u>Mine Safety Disclosures</u> | <u>11</u> |
| <u>PART II</u> | |
| Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>11</u> |
| Item 6. <u>Selected Financial Data</u> | <u>14</u> |
| Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>15</u> |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>56</u> |
| Item 8. <u>Financial Statements and Supplementary Data</u> | <u>57</u> |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | <u>113</u> |
| Item 9A. <u>Controls and Procedures</u> | <u>113</u> |
| Item 9B. <u>Other Information</u> | <u>113</u> |
| <u>PART III</u> | |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | <u>114</u> |
| Item 11. <u>Executive Compensation</u> | <u>115</u> |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | <u>115</u> |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | <u>115</u> |
| Item 14. <u>Principal Accounting Fees and Services</u> | <u>115</u> |
| <u>PART IV</u> | |
| Item 15. <u>Exhibits and Financial Statement Schedules</u> | <u>116</u> |
| <u>Signatures</u> | <u>122</u> |

In this report, “PMI,” “we,” “us” and “our” refers to Philip Morris International Inc. and its subsidiaries.

PART I

Item 1. *Business.*

General Development of Business

General

Philip Morris International Inc. is a Virginia holding company incorporated in 1987. We are a leading international tobacco company engaged in the manufacture and sale of cigarettes, smoke-free products and associated electronic devices and accessories, and other nicotine-containing products in markets outside the United States of America.

We are leading a transformation in the tobacco industry to create a smoke-free future, based on a new category of reduced-risk products that, while not risk-free, are a much better choice than continuing to smoke. Our goal is to ultimately replace cigarettes with smoke-free products to the benefit of adults who would otherwise continue to smoke, society, the company and its shareholders.

Reduced-risk products ("RRPs") is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. We have a range of RRP in various stages of development, scientific assessment and commercialization. Because our RRP do not burn tobacco, they produce an aerosol that contains far lower quantities of harmful and potentially harmful constituents than found in cigarette smoke. Through multidisciplinary capabilities in product development, state-of-the-art facilities and scientific substantiation, we aim to ensure that our RRP meet adult consumer preferences and rigorous regulatory requirements.

Our *IQOS* smoke-free product brand portfolio includes heated tobacco and nicotine-containing vapor products. Our leading smoke-free platform is a precisely controlled device into which a specially designed heated tobacco unit is inserted and heated to generate an aerosol. We market our heated tobacco units under the brand names *HEETS*, *HEETS Marlboro* and *HEETS FROM MARLBORO*, defined collectively as *HEETS*, as well as *Marlboro HeatSticks* and *Parliament HeatSticks*. *IQOS* was first introduced in Nagoya, Japan in 2014. To date, *IQOS* is available for sale in 44 markets in key cities or nationwide.

Our cigarettes 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 and is led by *Marlboro*, the world's best-selling international cigarette, which accounted for approximately 36% of our total 2018 cigarette shipment volume. *Marlboro* is complemented in the premium-price category by *Parliament*. Our other leading international cigarette brands are *Bond Street*, *Chesterfield*, *L&M*, *Lark* and *Philip Morris*. These seven international cigarette brands contributed approximately 76% of our cigarette shipment volume in 2018. We also own a number of important local cigarette brands, such as *Dji Sam Soe*, *Sampoerna A* and *Sampoerna U* in Indonesia; *Fortune* and *Jackpot* in the Philippines; and *Belmont* and *Canadian Classics* in Canada.

Source of Funds — Dividends

We are 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 that are otherwise compliant with law.

Description of Business

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

- The European Union Region ("EU") is headquartered in Lausanne, Switzerland, and covers all the European Union countries and also Switzerland, Norway and Iceland, which are linked to the European Union through trade agreements;
- The Eastern Europe Region ("EE") is also headquartered in Lausanne and includes Southeast Europe, Central Asia, Ukraine, Israel and Russia;

- The Middle East & Africa Region (“ME&A”) is also headquartered in Lausanne and covers the African continent, the Middle East, Turkey and our international duty free business;
- The South & Southeast Asia Region (“S&SA”) is headquartered in Hong Kong and includes Indonesia, the Philippines and other markets in this region;
- The East Asia & Australia Region (“EA&A”) is also headquartered in Hong Kong and includes Australia, Japan, South Korea, the People's Republic of China and other markets in this region, as well as Malaysia and Singapore; and
- The Latin America & Canada Region (“LA&C”) is headquartered in New York and covers the South American continent, Central America, Mexico, the Caribbean and Canada.

Our total shipments, including cigarettes and heated tobacco units, decreased by 2.1% in 2018 to 781.7 billion units. We estimate that international industry volumes, including cigarettes and heated tobacco units, were approximately 5.1 trillion units in 2018, a 0.8% decrease over 2017. Excluding the People’s Republic of China (“PRC”), we estimate that the international cigarette and heated tobacco unit volume was 2.8 trillion units in 2018, a 1.6% decrease over 2017. We estimate that our reported share of the international market (which is defined as worldwide cigarette and heated tobacco unit volume, excluding the United States of America) was approximately 15.3% in 2018, 15.2% in 2017 and 15.5% in 2016. Excluding the PRC, we estimate that our reported share of the international market was approximately 28.4%, 27.9%, and 28.1% in 2018, 2017 and 2016, respectively.

Shipments of our principal cigarette brand, *Marlboro*, decreased by 2.2% in 2018 and represented approximately 9.7% of the international cigarette market, excluding the PRC, in 2018, 9.7% in 2017 and 9.6% in 2016.

We have a market share of at least 15% and, in a number of instances, substantially more than 15%, in approximately 100 markets, including Algeria, Argentina, Australia, Austria, Belgium, Brazil, Canada, Canary Islands, the Czech Republic, Egypt, France, Germany, Hong Kong, Indonesia, Israel, Italy, Japan, Korea, Kuwait, Mexico, the Netherlands, the Philippines, Poland, Portugal, Russia, Saudi Arabia, Singapore, Spain, Switzerland, Turkey and Ukraine.

Heated tobacco units is the term we use to refer to heated tobacco consumables, which for us include our *HEETS*, *HEETS Marlboro* and *HEETS FROM MARLBORO*, defined collectively as *HEETS*, as well as *Marlboro HeatSticks* and *Parliament HeatSticks*. Total shipment volume of heated tobacco units reached 41.4 billion units in 2018, up from 36.2 billion units in 2017.

References to total international market, defined as worldwide cigarette and heated tobacco unit volume excluding the United States, total industry, total market and market shares in this Form 10-K are our estimates for tax-paid products based on the latest available data from a number of internal and external sources.

Distribution & Sales

Our main types of distribution are tailored to the characteristics of each market and are often used simultaneously:

- Direct sales and distribution, where we have set up our own distribution selling directly to the retailers (including gas stations and other key accounts);
- Distribution through independent distributors that often distribute other fast-moving consumer goods and are responsible for distribution in a particular market;
- Exclusive zonified distribution, where the distributors are dedicated to us in tobacco products distribution and assigned to exclusive territories within a market;
- Distribution through national or regional wholesalers that then supply the retail trade; and
- Our own brand retail and e-commerce infrastructures for our RRP products and accessories.

Competition

We are subject to highly competitive conditions in all aspects of our business. We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, R&D, innovation, packaging, customer service, marketing, advertising and retail price and, increasingly, adult smoker willingness to convert to our RRP. Our competitors include three large international tobacco companies and several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, Egypt, the PRC, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives, and some international competitors are susceptible to changes in different currency exchange rates. In the combustible product category, we predominantly sell American blend cigarette brands, such as *Marlboro*, *L&M*, *Parliament*, *Philip Morris* and *Chesterfield*, which are the most popular across many of our markets. In the RRP product category, we predominantly sell *IQOS* devices and heated tobacco units. We seek to compete in all profitable retail price categories, although our brand portfolio is weighted towards the premium-price category.

Procurement and Raw Materials

We purchase tobacco leaf of various types, grades and styles throughout the world, mostly through independent tobacco suppliers. We also contract directly with farmers in several countries, including Argentina, Brazil, Colombia, Ecuador, Italy, Pakistan, the Philippines and Poland. In 2018, direct sourcing from farmers represented approximately 24% of PMI's global leaf requirements. The largest supplies of tobacco leaf are sourced from Argentina, Brazil, China, Italy, Indonesia (mostly for domestic use in kretek products), Malawi, Mozambique, Philippines, Turkey and the United States.

We believe that there is an adequate supply of tobacco leaf in the world markets to satisfy our current and anticipated production requirements.

In addition to tobacco leaf, we purchase a wide variety of direct materials from a total of approximately 500 suppliers. In 2018, our top ten suppliers of direct materials combined represented approximately 50% of our total direct materials purchases. The three most significant direct materials that we purchase are printed paper board used in packaging, acetate tow used in filter making and fine paper used in the manufacturing of cigarettes and heated tobacco units. In addition, the adequate supply and procurement of cloves are of particular importance to our Indonesian business.

The adequate supply chain for our RRP portfolio, including the supply of electronic devices, is important to our business. We work with two electronics manufacturing service providers for the supply of our *IQOS* devices and a small number of other providers for other products in our RRP portfolio and related accessories. Although we work closely with these service providers on monitoring their production capability and financial health, the commercialization of our RRP could be adversely affected if they are unable to meet their commitments. The production of our RRP portfolio requires various metals, and we believe that there is an adequate supply of such metals in the world markets to satisfy our current and anticipated production requirements. However, some components and materials necessary for the production of our RRP are obtained from single or limited sources, and can be subject to industry-wide shortages and price fluctuations. Our inability to secure an adequate supply of such components and materials could negatively impact the commercialization of our RRP.

Our *IQOS* devices are subject to product warranties, which are described in more detail in Item 8. *Financial Statements and Supplementary Data* of this Annual Report on Form 10-K ("Item 8") in Note 5. *Product Warranty* to our consolidated financial statements. We discuss our RRP products in more detail in Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations* of this Annual Report on Form 10-K ("Item 7") in *Business Environment—Reduced Risk Products*.

Business Environment

Information called for by this Item is hereby incorporated by reference to the paragraphs in Item 7, *Business Environment*.

Other Matters

Customers

As described in more detail in “*Distribution & Sales*” above, in many of our markets we sell our products to distributors. In 2018, sales to a distributor in the European Union Region and a distributor in the East Asia & Australia Region each amounted to 10 percent or more of our consolidated net revenues. See Item 8, Note 12. *Segment Reporting* for more information. We believe that none of our business segments is dependent upon a single customer or a few customers, the loss of which would have a material adverse effect on our consolidated results of operations. In some of our markets, particularly in the European Union and in the East Asia & Australia Regions, a loss of a distributor may result in a temporary market disruption.

Employees

At December 31, 2018, we employed approximately 77,400 people worldwide, including full-time, temporary and part-time staff. Our businesses are subject to a number of laws and regulations relating to our relationship with our employees. Generally, these laws and regulations are specific to the location of each business. In addition, in accordance with European Union requirements, we have established a European Works Council composed of management and elected members of our workforce. We believe that our relations with our employees and their representative organizations are excellent.

Executive Officers of the Registrant

The disclosure regarding executive officers is set forth under the heading “Executive Officers as of February 7, 2019” in Item 10. *Directors, Executive Officers and Corporate Governance* of this Annual Report on Form 10-K (“Item 10”).

Intellectual Property

Our trademarks are valuable assets, and their protection and reputation are essential to us. We own the trademark rights to all of our principal brands, including *Marlboro* and *IQOS*, or have the right to use them in all countries where we use them.

In addition, we have approximately 10,300 granted patents worldwide and approximately 9,300 pending patent applications. Our patent portfolio, as a whole, is material to our business. However, no one patent, or group of related patents, is material to us. We also have registered industrial designs, as well as unregistered proprietary trade secrets, technology, know-how, processes and other unregistered intellectual property rights.

Effective January 1, 2008, PMI entered into an Intellectual Property Agreement with Philip Morris USA Inc. (“PM USA”). The Intellectual Property Agreement allocates ownership of jointly funded intellectual property as follows:

- PMI owns all rights to jointly funded intellectual property outside the United States, its territories and possessions; and
- PM USA owns all rights to jointly funded intellectual property in the United States, its territories and possessions.

The parties agreed to submit disputes under the Intellectual Property Agreement first to negotiation between senior executives and then to binding arbitration.

Seasonality

Our business segments are not significantly affected by seasonality, although in certain markets cigarette consumption trends rise during the summer months due to longer daylight time and tourism.

Environmental Regulation

We are subject to international, national and local environmental laws and regulations in the countries in which we do business. We have specific programs across our business units designed to meet applicable environmental compliance requirements and reduce our carbon footprint and wastage as well as water and energy consumption. We report externally about our climate change mitigation strategy, together with associated targets and results in reducing our carbon footprint, through CDP (formerly, the Carbon Disclosure Project), the leading international non-governmental organization assessing the work of thousands of companies worldwide in the area of climate change. Our environmental and occupational health and safety management system includes policies, standard practices and procedures at all our manufacturing centers. We also conduct regular safety assessments at our offices, warehouses and car fleet organizations. Furthermore, we have engaged an external certification body to validate the effectiveness of this management system at our manufacturing centers around the world, in accordance with internationally recognized standards for safety and environmental management. The environmental performance data we report externally is also verified by a qualified third party. Our subsidiaries expect to continue to make investments in order to drive improved performance and maintain compliance with environmental laws and regulations. We assess and report the compliance status of all our legal entities on a regular basis. Based on the management and controls we have in place and our review of climate change risks (both physical and regulatory), environmental expenditures have not had, and are not expected to have, a material adverse effect on our consolidated results of operations, capital expenditures, financial position, earnings or competitive position.

Available Information

We are required to file with the SEC annual, quarterly and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The SEC maintains an Internet website at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, from which investors can electronically access our SEC filings.

We make available free of charge on, or through, our website at www.pmi.com our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Investors can access our filings with the SEC by visiting www.pmi.com.

The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filings we make with the SEC.

Item 1A. Risk Factors.

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, our operating results, our financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

Forward-Looking and Cautionary Statements

We may from time to time make written or oral forward-looking statements, including statements contained in this Annual Report on Form 10-K and other 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. Our RRP's constitute a new product category in its early stages that is less predictable than our mature cigarette business. 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 7, *Business Environment*. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion

of all potential risks or uncertainties. We do not undertake to update any forward-looking statement that we may make from time to time, except in the normal course of our public disclosure obligations.

Risks Related to Our Business and Industry

- **Consumption of tax-paid cigarettes continues to decline in many of our markets.**

This decline is due to multiple factors, including increased taxes and pricing, governmental actions, the diminishing social acceptance of smoking, continuing economic and geopolitical uncertainty, and the continuing prevalence of illicit products. These factors and their potential consequences are discussed more fully below and in Item 7, *Business Environment*.

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

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

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

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

Governmental actions, combined with the diminishing social acceptance of smoking and private actions to restrict smoking, have resulted in reduced industry volume in many of our markets, and we expect that such factors will continue to reduce consumption levels and will increase down-trading and the risk of counterfeiting, contraband, "illicit whites" and legal cross-border purchases. Significant regulatory developments will continue to take place over the next few years in most of our markets, driven principally by the World Health Organization's Framework Convention on Tobacco Control ("FCTC"). Since it came into force in 2005, the FCTC has led to increased efforts by tobacco control advocates and public health organizations to promote increasingly restrictive regulatory measures on the marketing and sale of tobacco products to adult smokers. Regulatory initiatives that have been proposed, introduced or enacted include:

- restrictions on or licensing of outlets permitted to sell cigarettes;
- the levying of substantial and increasing tax and duty charges;
- restrictions or bans on advertising, marketing and sponsorship;
- the display of larger health warnings, graphic health warnings and other labeling requirements;
- restrictions on packaging design, including the use of colors, and plain packaging;
- restrictions on packaging and cigarette formats and dimensions;
- restrictions or bans on the display of tobacco product packaging at the point of sale and restrictions or bans on cigarette vending machines;
- requirements regarding testing, disclosure and performance standards for tar, nicotine, carbon monoxide and other smoke constituents;
- disclosure, restrictions, or bans of tobacco product ingredients;
- increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors;
- regulation, restrictions or prohibitions of novel tobacco or nicotine-containing products;
- elimination of duty free sales and duty free allowances for travelers;
- encouraging litigation against tobacco companies; and
- excluding tobacco companies from transparent public dialogue regarding public health and other policy matters.

Our financial results could be significantly affected by regulatory initiatives resulting in a significant decrease in demand for our brands, in particular requirements that lead to a commoditization of tobacco products or impede adult consumers' ability to convert to our RRP, as well as any significant increase in the cost of complying with new regulatory requirements.

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

There is litigation related to tobacco products pending in certain jurisdictions. Damages claimed in some tobacco-related litigation are significant and, in certain cases in Brazil, Canada, Israel and Nigeria, range into the billions of U.S. dollars. We anticipate that new cases will continue to be filed. The FTC encourages litigation against tobacco product manufacturers. It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. See Item 8, Note 18. *Contingencies* to our condensed consolidated financial statements for a discussion of pending litigation and Item 7, *Business Environment—Reduced-Risk Products (RRPs)—Legal Challenges to RRP*.

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

We compete primarily on the basis of product quality, brand recognition, brand loyalty, taste, R&D, innovation, packaging, customer service, marketing, advertising and retail price and, increasingly, adult smoker willingness to convert to our RRP. We are subject to highly competitive conditions in all aspects of our business. The competitive environment and our competitive position can be significantly influenced by weak economic conditions, erosion of consumer confidence, competitors' introduction of lower-price products or innovative products, higher tobacco product taxes, higher absolute prices and larger gaps between retail price categories, and product regulation that diminishes the ability to differentiate tobacco products and restricts adult consumer access to truthful and non-misleading information about our RRP. Competitors include three large international tobacco companies, new market entrants, particularly with respect to innovative products, several regional and local tobacco companies and, in some instances, state-owned tobacco enterprises, principally in Algeria, Egypt, the PRC, Taiwan, Thailand and Vietnam. Industry consolidation and privatizations of state-owned enterprises have led to an overall increase in competitive pressures. Some competitors have different profit and volume objectives, and some international competitors are susceptible to changes in different currency exchange rates. Certain new market entrants may alienate consumers from innovative products through inappropriate marketing campaigns and messaging and inferior product satisfaction, while not relying on scientific substantiation based on appropriate R&D protocols and standards. The growing use of digital media could increase the speed and extent of the dissemination of inaccurate and misleading information about our RRP.

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

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

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

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

- **We may be unable to anticipate changes in adult consumer preferences.**

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

- promote brand equity successfully;
- anticipate and respond to new adult consumer trends;
- develop new products and markets and broaden brand portfolios;
- improve productivity;
- convince adult smokers to convert to our RRP;
- ensure adequate production capacity to meet demand for our products; and
- be able to protect or enhance margins through price increases.

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

- **The financial and business performance of our reduced-risk products is less predictable than our cigarette business.**

Our RRP are novel products in a new category, and the pace at which adult smokers adopt them may vary, depending on the competitive, regulatory, fiscal and cultural environment, and other factors in a specific market. There may be periods of accelerated growth and periods of slower growth for these products, the timing and drivers of which may be more difficult for us to predict versus our mature cigarette business. The impact of this lower predictability on our projected results for a specific period may be significant, particularly during the early stages of this new product category.

- **We lose revenues as a result of counterfeiting, contraband, cross-border purchases, “illicit whites,” non-tax-paid volume produced by local manufacturers, and counterfeiting of our IQOS device and heated tobacco units.**

Large quantities of counterfeit cigarettes are sold in the international market. We believe that *Marlboro* is the most heavily counterfeited international cigarette brand, although we cannot quantify the revenues we lose as a result of this activity. In addition, our revenues are reduced by contraband, legal cross-border purchases, “illicit whites” and non-tax-paid volume produced by local manufacturers. Our revenues and consumer satisfaction with our IQOS device and heated tobacco units may be adversely affected by counterfeit products that do not meet our product quality standards and scientific validation procedures.

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

Investigations include allegations of contraband shipments of cigarettes, allegations of unlawful pricing activities within certain markets, allegations of underpayment of customs duties and/or excise taxes, allegations of false and misleading usage of descriptors and allegations of unlawful advertising. We cannot predict the outcome of those investigations or whether additional investigations may be commenced, and it is possible that our business could be materially affected by an unfavorable outcome of pending or future investigations. See Item, 8, Note 18. *Contingencies—Other Litigation* and Item 7, *Business Environment—Governmental Investigations* for a description of certain governmental investigations to which we are subject.

- **We may be unsuccessful in our attempts to introduce reduced-risk products, and regulators may not permit the commercialization of these products or the communication of scientifically substantiated risk-reduction claims.**

Our key strategic priorities are: to develop and commercialize products that present less risk of harm to adult smokers who switch to those products versus continued smoking; and to convince current adult smokers who would otherwise continue to smoke to switch to those RRP. For our efforts to be successful, we must: develop RRP that such adult smokers find acceptable alternatives to smoking; conduct rigorous scientific studies to substantiate that they reduce exposure to harmful and potentially harmful constituents in smoke and, ultimately, that these products present, are likely to present, or have the potential to present less risk of harm to adult smokers who switch to them versus continued smoking; and effectively advocate for the development of science-based regulatory frameworks for the development and commercialization of RRP, including communication of scientifically substantiated information to enable adult smokers to make better consumer choices. We might not succeed in our efforts. If we do not succeed, but others do, we may be at a competitive disadvantage. Furthermore, we cannot predict whether regulators will permit the sale and/or marketing of RRP with scientifically substantiated risk-reduction claims. Such restrictions could limit the success of our RRP.

- **We may be unsuccessful in our efforts to differentiate reduced-risk products and cigarettes with respect to taxation.**

To date, we have been largely successful in demonstrating to regulators that our RRP are not cigarettes, and as such they are generally taxed either as a separate category or as other tobacco products, which typically yields more favorable tax rates than cigarettes. If we cease to be successful in these efforts, RRP unit margins may be adversely affected.

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

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

- **Changes in the earnings mix and changes in tax laws may result in significant variability in our effective tax rates. Our ability to receive payments from foreign subsidiaries or to repatriate royalties and dividends could be restricted by local country currency exchange controls.**

The Tax Cuts and Jobs Act that was signed into law in December 2017 constitutes a major change to the U.S. tax system. Our estimated impact of the Tax Cuts and Jobs Act is based on management's current interpretations, and our analysis is ongoing. Our final tax liability may be materially different from current estimates due to developments such as implementing regulations and clarifications. In future periods, our effective tax rate and our ability to recover deferred tax assets could be subject to additional uncertainty as a result of such developments. Furthermore, changes in the earnings mix or applicable foreign tax laws may result in significant variability in our effective tax rates. Because we are a U.S. holding company, our most significant source of funds is distributions from our non-U.S. subsidiaries. Certain countries in which we operate have adopted or could institute currency exchange controls that limit or prohibit our local subsidiaries' ability to convert local currency into U.S. dollars or to make payments outside the country. This could subject us to the risks of local currency devaluation and business disruption.

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

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

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

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

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

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

- **Our ability to achieve our strategic goals may be impaired if we fail to attract and retain the best global talent.**

To be successful, we must continue transforming our culture and ways of working, align our talent with our business needs, innovate and transform to a consumer-centric business. We compete for talent, including in areas that are new to us, such as digital and technical solutions, with companies in the consumer products, technology and other sectors that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best global talent with the right degree of diversity, experience and skills to achieve our strategic goals.

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

We use information systems to help manage business processes, collect and interpret data and communicate internally and externally with employees, suppliers, consumers, customers and others. Some of these information systems are managed by third-party service providers. We have backup systems and business continuity plans in place, and we take care to protect our systems and data from unauthorized access. Nevertheless, failure of our systems to function as intended, or penetration of our systems by outside parties intent on extracting or corrupting information or otherwise disrupting business processes, could place us at a competitive disadvantage, result in a loss of revenue, assets or personal or other sensitive data, litigation and regulatory action, cause damage to our reputation and that of our brands and result in significant remediation and other costs. Failure to protect personal data, respect the rights of data subjects, and adhere to strict cybersecurity protocols could subject us to substantial fines and other legal challenges under regulations such as the EU General Data Protection Regulation. As we are increasingly relying on digital platforms in our business, the magnitude of these risks is likely to increase.

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

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

Item 1B. *Unresolved Staff Comments.*

None.

Item 2. *Properties.*

At December 31, 2018, we operated and owned 44 manufacturing facilities and maintained contract manufacturing relationships with 26 third-party manufacturers across 23 markets. In addition, we work with 38 third-party operators in Indonesia who manufacture our hand-rolled cigarettes.

PMI-Owned Manufacturing Facilities

| | EU ⁽¹⁾ | EE ⁽¹⁾ | ME&A | S&SA | EA&A ⁽¹⁾ | LA&C | TOTAL |
|------------------|-------------------|-------------------|------|------|---------------------|------|-------|
| Fully integrated | 8 | 5 | 3 | 8 | 1 | 6 | 31 |
| Make-pack | 2 | — | — | 1 | — | 2 | 5 |
| Other | 3 | — | 1 | 1 | 1 | 2 | 8 |
| Total | 13 | 5 | 4 | 10 | 2 | 10 | 44 |

⁽¹⁾ Includes facilities that produced heated tobacco units in 2018.

In 2018, 23 of our facilities each manufactured over 10 billion units (cigarettes and heated tobacco units combined), of which eight facilities each produced over 30 billion units. Our largest factories are in Karawang and Sukorejo (Indonesia), Izmir (Turkey), St. Petersburg and Krasnodar (Russia), Krakow (Poland), Batangas and Marikina (Philippines), Berlin (Germany), Crespellano (Italy), and Klaipeda (Lithuania). Our smallest factories are mostly in Latin America and Asia, where due to tariff and other constraints we have established small manufacturing units in individual markets. We will continue to optimize our manufacturing base.

The plants and properties owned or leased and operated by our subsidiaries are maintained in good condition and are believed to be suitable and adequate for our present needs.

We are integrating the production of heated tobacco units into a number of our existing manufacturing facilities and progressing with our plans to build manufacturing capacity for our other RRP platforms.

Item 3. *Legal Proceedings.*

The information called for by this Item is incorporated herein by reference to Item 8, Note 18. *Contingencies.*

Item 4. *Mine Safety Disclosures.*

Not applicable.

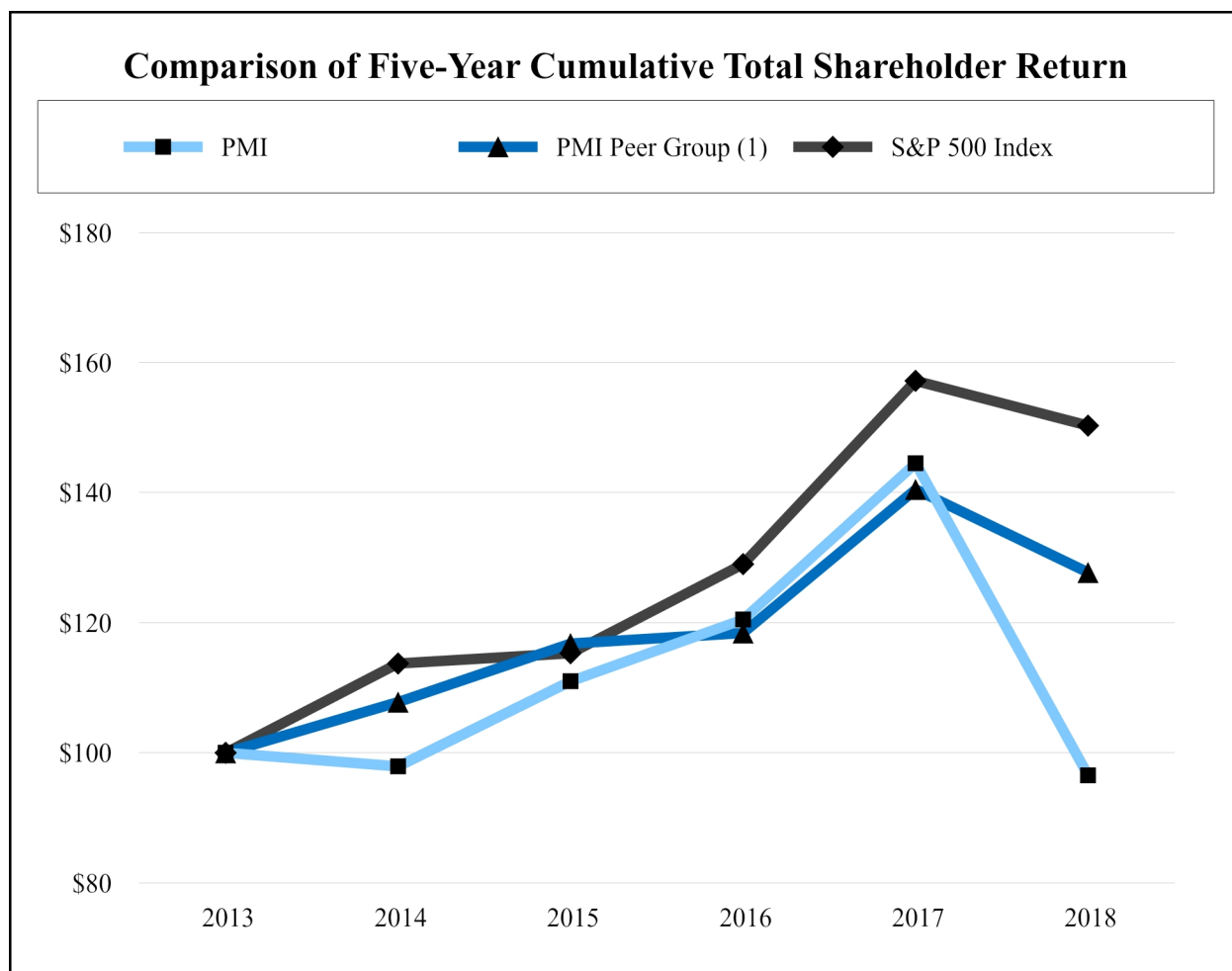
PART II

Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.*

The principal stock exchange on which our common stock (no par value) is listed is the New York Stock Exchange (ticker symbol "PM"). At January 31, 2019, there were approximately 54,100 holders of record of our common stock.

Performance Graph

The graph below compares the cumulative total shareholder return on PMI's common stock with the cumulative total return for the same period of PMI's Peer Group and the S&P 500 Index. The graph assumes the investment of \$100 as of December 31, 2013, in PMI common stock (at prices quoted on the New York Stock Exchange) and each of the indices as of the market close and reinvestment of dividends on a quarterly basis.



| Date | PMI | PMI Peer Group ⁽¹⁾ | S&P 500 Index |
|-------------------|----------|-------------------------------|---------------|
| December 31, 2013 | \$100.00 | \$100.00 | \$100.00 |
| December 31, 2014 | \$97.90 | \$107.80 | \$113.70 |
| December 31, 2015 | \$111.00 | \$116.80 | \$115.30 |
| December 31, 2016 | \$120.50 | \$118.40 | \$129.00 |
| December 31, 2017 | \$144.50 | \$140.50 | \$157.20 |
| December 31, 2018 | \$96.50 | \$127.70 | \$150.30 |

⁽¹⁾ The PMI Peer Group presented in this graph is the same as that used in the prior year. The PMI Peer Group was established based on a review of four characteristics: global presence; a focus on consumer products; and net revenues and a market capitalization of a similar size to those of PMI. The review also considered the primary international tobacco companies. As a result of this review, the following companies constitute the PMI Peer Group: Altria Group, Inc., Anheuser-Busch InBev SA/NV, British American Tobacco p.l.c., The Coca-Cola Company, Colgate-Palmolive Co., Diageo plc, Heineken N.V., Imperial Brands PLC, Japan Tobacco Inc., Johnson & Johnson, Kimberly-Clark Corporation, The Kraft-Heinz Company, McDonald's Corp., Mondelēz International, Inc., Nestlé S.A., PepsiCo, Inc., The Procter & Gamble Company, Roche Holding AG, and Unilever NV and PLC.

Note: Figures are rounded to the nearest \$0.10.

Issuer Purchases of Equity Securities During the Quarter Ended December 31, 2018

Our share repurchase activity for each of the three months in the quarter ended December 31, 2018, was as follows:

| Period | Total Number of Shares Repurchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs |
|---|---|------------------------------------|--|--|
| October 1, 2018 – October 31, 2018 (1) | — | \$ — | — | \$ — |
| November 1, 2018 – November 30, 2018 (1) | — | \$ — | — | \$ — |
| December 1, 2018 – December 31, 2018 (1) | — | \$ — | — | \$ — |
| Pursuant to Publicly Announced Plans or Programs | — | \$ — | | |
| October 1, 2018 – October 31, 2018 (2) | 439 | \$ 82.22 | | |
| November 1, 2018 – November 30, 2018 (2) | 872 | \$ 88.80 | | |
| December 1, 2018 – December 31, 2018 (2) | 1,482 | \$ 72.28 | | |
| For the Quarter Ended December 31, 2018 | 2,793 | \$ 79.00 | | |

(1) During this reporting period, we did not have an authorized share repurchase program.

(2) Shares repurchased represent shares tendered to us by employees who vested in restricted share unit awards and used shares to pay all, or a portion of, the related taxes.

Item 6. Selected Financial Data

(in millions of dollars, except per share data)

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|
| Summary of Operations: | | | | | |
| Revenues including excise taxes | \$ 79,823 | \$ 78,098 | \$ 74,953 | \$ 73,908 | \$ 80,106 |
| Excise taxes on products | 50,198 | 49,350 | 48,268 | 47,114 | 50,339 |
| Net revenues ⁽¹⁾ | 29,625 | 28,748 | 26,685 | 26,794 | 29,767 |
| Operating income ⁽¹⁾ | 11,377 | 11,581 | 10,903 | 10,745 | 11,787 |
| Net earnings attributable to PMI | 7,911 | 6,035 | 6,967 | 6,873 | 7,493 |
| Basic earnings per share | 5.08 | 3.88 | 4.48 | 4.42 | 4.76 |
| Diluted earnings per share | 5.08 | 3.88 | 4.48 | 4.42 | 4.76 |
| Dividends declared per share | 4.49 | 4.22 | 4.12 | 4.04 | 3.88 |
| Total assets | 39,801 | 42,968 | 36,851 | 33,956 | 35,187 |
| Long-term debt ⁽²⁾ | 26,975 | 31,334 | 25,851 | 25,250 | 26,929 |
| Total debt | 31,759 | 34,339 | 29,067 | 28,480 | 29,455 |

⁽¹⁾ Certain prior years' amounts in the table above have been reclassified to conform with the current year's presentation, due primarily to new accounting guidance related to revenue recognition and pension costs. For further details, see Item 8, Note 2. *Summary of Significant Accounting Policies - Revenue Recognition*, Item 8, Note 13. *Benefit Plans* and Item 8, Note 21. *New Accounting Standards*.

⁽²⁾ Excluding current portion of long-term debt.

This Selected Financial Data should be read in conjunction with Item 7 and Item 8.

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 leading a transformation in the tobacco industry to create a smoke-free future and ultimately replace cigarettes with smoke-free products to the benefit of adults who would otherwise continue to smoke, society, the company and its shareholders. We are a leading international tobacco company engaged in the manufacture and sale of cigarettes, smoke-free products and associated electronic devices and accessories, and other nicotine-containing products in markets outside the United States of America. We are building a future on a new category of smoke-free products that, while not risk-free, are a much better choice than continuing to smoke. Through multidisciplinary capabilities in product development, state-of-the-art facilities and scientific substantiation, we aim to ensure that our smoke-free products meet adult consumer preferences and rigorous regulatory requirements. Our *IQOS* smoke-free product brand portfolio includes heated tobacco and nicotine-containing vapor products.

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

- European Union ("EU");
- Eastern Europe ("EE");
- Middle East & Africa ("ME&A"), which includes our international duty free business;
- South & Southeast Asia ("S&SA");
- East Asia & Australia ("EA&A"); and
- Latin America & Canada ("LA&C").

Our cigarettes are sold in more than 180 markets, and in many of these markets they hold the number one or number two market share position. We have a wide range of premium, mid-price and low-price brands. Our portfolio comprises both international and local brands. In addition to the manufacture and sale of cigarettes, we are engaged in the development and commercialization of reduced-risk products ("RRPs"). RRP is the term we use to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking.

We use the term net revenues to refer to our operating revenues from the sale of our products, including shipping and handling charges billed to customers, net of sales and promotion incentives, and excise taxes. As discussed in Item 8, Note 21. *New Accounting Standards*, on January 1, 2018, we adopted Financial Accounting Standards Update ASU 2014-09, "Revenue from Contracts with Customers." We adopted this standard retrospectively to each prior period presented. We made an accounting policy election to exclude excise taxes collected from customers from the measurement of the transaction price, thereby presenting revenues net of excise taxes in all prior periods. 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).

Our cost of sales consists principally of: tobacco leaf, non-tobacco raw materials, labor and manufacturing costs; shipping and handling costs; and the cost of the *IQOS* devices produced by third-party electronics manufacturing service providers. Estimated costs associated with *IQOS* warranty programs are generally provided for in cost of sales in the period the related revenues are recognized.

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

Philip Morris International Inc. is a legal entity separate and distinct from its direct and indirect subsidiaries. Accordingly, our right, and thus the right of our creditors and stockholders, to participate in any distribution of the assets or earnings of any subsidiary is subject to the prior rights of creditors of such subsidiary, except to the extent that claims of our company itself as a creditor may be recognized. As a holding company, our principal sources of funds, including funds to make payment on our debt securities, are from the receipt of

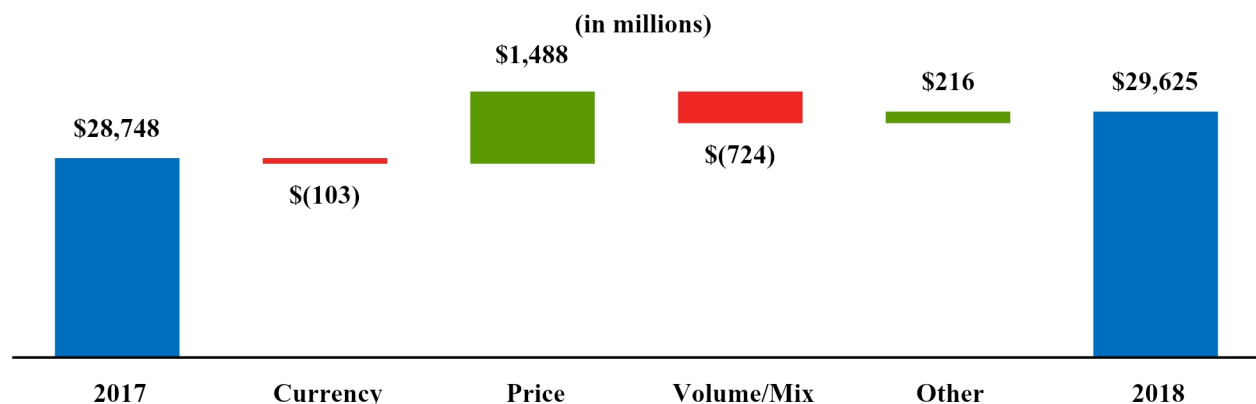
dividends and repayment of debt from our subsidiaries. Our principal wholly owned and majority-owned subsidiaries currently are not limited by long-term debt or other agreements in their ability to pay cash dividends or to make other distributions with respect to their common stock that are otherwise compliant with law.

Executive Summary

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

Consolidated Operating Results

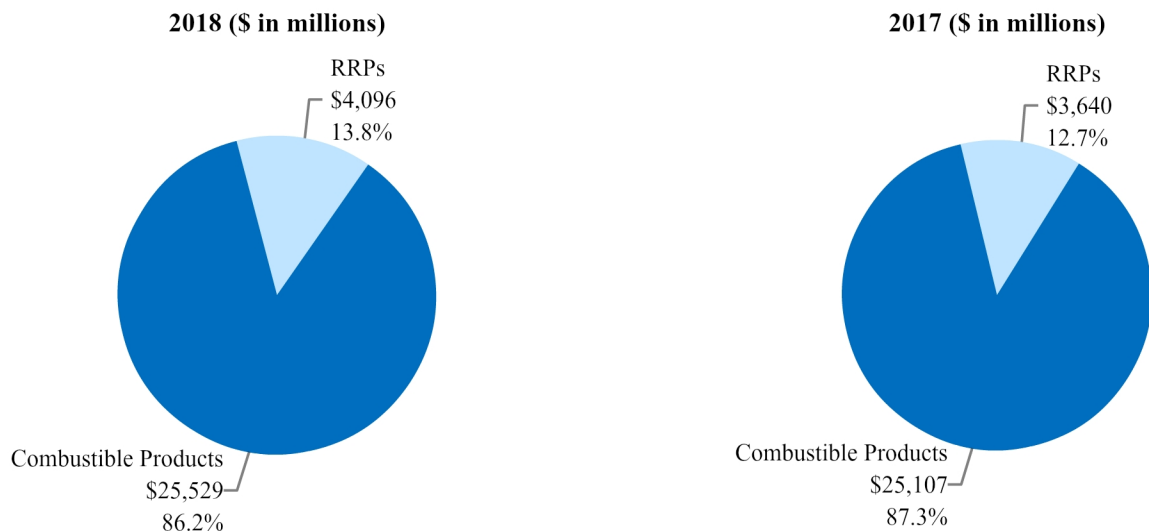
- **Net Revenues** – Net revenues of \$29.6 billion for the year ended December 31, 2018, increased by \$0.9 billion, or 3.1%, from the comparable 2017 amount. The change in our net revenues from the comparable 2017 amount was driven by the following:



Net revenues, excluding unfavorable currency, increased by 3.4%, reflecting: a favorable pricing variance, notably in Argentina, Australia, Canada, Egypt, Germany, Indonesia, Italy, Japan, Mexico, the Philippines, Russia, Turkey, and Ukraine, partly offset by France, Korea, Saudi Arabia and Thailand; as well as a favorable "Other" variance attributable to 2018 fees for certain distribution rights billed to customers in certain markets in the ME&A Region.

These favorable variances were partly offset by unfavorable volume/mix, primarily reflecting unfavorable cigarette volume/mix, notably in Australia, the Gulf Cooperation Council ("GCC"), notably Saudi Arabia and the United Arab Emirates ("UAE"), Indonesia, Italy, Japan and Russia, partly offset by Pakistan, Thailand and Turkey. The unfavorable cigarette volume/mix was partly offset by favorable heated tobacco unit volume in the EU, notably the Czech Republic, Germany and Italy, as well as Korea, PMI Duty Free and Russia, partly offset by unfavorable heated tobacco unit volume in Japan, reflecting the net impact of estimated distributor inventory movements.

Net revenues by product category for the years ended December 31, 2018 and 2017, are shown below:



- **Diluted Earnings Per Share** – The changes in our reported diluted earnings per share (“diluted EPS”) for the year ended December 31, 2018, from the comparable 2017 amounts, were as follows:

| | Diluted EPS | % Growth (Decline) |
|--------------------------------------|-------------|-----------------------|
| For the year ended December 31, 2017 | \$ 3.88 | |
| 2017 Asset impairment and exit costs | — | |
| 2017 Tax items | 0.84 | |
| Subtotal of 2017 items | 0.84 | |
| 2018 Asset impairment and exit costs | — | |
| 2018 Tax items | (0.02) | |
| Subtotal of 2018 items | (0.02) | |
| Currency | (0.11) | |
| Interest | 0.13 | |
| Change in tax rate | 0.40 | |
| Operations | (0.04) | |
| For the year ended December 31, 2018 | \$ 5.08 | 30.9% |

Income Taxes – Our effective income tax rate for 2018 decreased by 17.8 percentage points to 22.9%. The 2018 tax items that decreased our 2018 diluted EPS by \$0.02 per share in the table above represented a current income tax charge of \$185 million primarily due to an increase in our final 2017 transition tax liability, mostly offset by a deferred income tax benefit of \$154 million primarily due to the recognition of deferred tax assets for net operating losses in the state of New York. The 2017 tax items that decreased our 2017 diluted EPS by \$0.84 per share in the table above were primarily due to the impact of the Tax Cuts and Jobs Act, which was signed into law in December 2017. The change in the effective tax rate that increased our diluted EPS by \$0.40 per share in the table above was primarily due to the impact from the Tax Cuts and Jobs Act, which reduced the U.S. federal income tax rate from 35% to 21%, in addition to repatriation cost differences and earnings mix by taxing jurisdiction. For further details, see Item 8, Note 11. *Income Taxes* to our consolidated financial statements.

Currency – The unfavorable currency impact during 2018 results from the fluctuations of the U.S. dollar, especially against the Indonesian rupiah, Russian ruble and Turkish lira, partially offset by the Euro and Japanese yen. This unfavorable currency movement has impacted our profitability across our primary revenue markets and local currency cost bases.

Interest – The favorable impact of interest was due primarily to our ongoing efforts to optimize our capital structure following the passage of the Tax Cuts and Jobs Act. This included the decision to use existing cash to repay the \$2.5 billion principal for our matured May 2018 ten-year U.S. bond, which had a coupon of 5.65%.

Operations – The decrease in diluted EPS of \$0.04 from our operations in the table above was due primarily to the following segments:

- East Asia & Australia: Unfavorable volume/mix and higher marketing, administration and research costs, partially offset by lower manufacturing costs and favorable pricing;
- partially offset by
- South & Southeast Asia: Favorable pricing, partially offset by unfavorable volume/mix, higher marketing, administration and research costs, and higher manufacturing costs;
 - Latin America & Canada: Favorable pricing, partially offset by unfavorable volume/mix and higher marketing, administration and research costs;
 - Eastern Europe: Favorable pricing, partially offset by unfavorable volume/mix and higher marketing, administration and research costs;

- European Union: Favorable pricing and favorable volume/mix, partially offset by higher marketing, administration and research costs, and higher manufacturing costs; and
- Middle East & Africa: Favorable pricing, favorable volume/mix and lower marketing, administration and research costs, partially offset by higher manufacturing costs.

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

Tax Items and Impact of U.S. Tax Reform

We completed our analysis of the Tax Cuts and Jobs Act during 2018 and adjusted the 2017 provisional estimates to the final amounts based on our 2017 U.S. federal income tax return as filed. Accordingly, in the fourth quarter 2018, we recorded in our income tax provision a charge of \$31 million representing a current income tax charge of \$185 million, primarily due to an increase in our aggregate foreign cash position used to determine our final 2017 transition tax liability, mostly offset by a deferred income tax benefit of \$154 million primarily due to the recognition of deferred tax assets for net operating losses in the state of New York. Updates to the provisional estimates have been recorded in accordance with Staff Accounting Bulletin No. 118 ("SAB 118").

We estimate that our 2019 effective tax rate will be approximately 23%, reflecting the current analysis, interpretation and clarifications of the scope and impact of the Tax Cuts and Jobs Act.

The Tax Cuts and Jobs Act has significant complexity, and our final full-year effective tax rate may differ from this estimate, due to, among other things, additional guidance that may be issued by the U.S. Treasury Department and the Internal Revenue Service, related interpretations and clarifications of tax law, in addition to repatriation costs differences and earnings mix by taxing jurisdiction.

Discussion and Analysis

Critical Accounting 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 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 - We recognize revenue as performance obligations are satisfied. Our primary performance obligation is the distribution and sales of cigarettes and other nicotine-containing products, including reduced-risk products. Our performance obligations are typically satisfied upon shipment or delivery to our customers. The company estimates the cost of sales returns based on historical experience, and these estimates are immaterial. Estimated costs associated with warranty programs for IQOS devices are generally provided for in cost of sales in the period the related revenues are recognized, based on a number of factors, including historical experience, product failure rates and warranty policies. The transaction price is typically based on the amount billed to the customer and includes estimated variable consideration where applicable. Such variable consideration is typically not constrained and is estimated based on the most likely amount that PMI expects to be entitled to under the terms of the contracts with customers, historical experience of discount or rebate redemption, where relevant, and the terms of any underlying discount or rebate programs, which may change from time to time as the business and product categories evolve.

Inventories - Our inventories are valued at the lower of cost or market based upon assumptions about future demand and market conditions. The valuation of inventory also requires us to estimate obsolete and excess inventory. We perform regular reviews of our

inventory on hand, as well as our future purchase commitments with our suppliers, considering multiple factors, including demand forecasts, product life cycle, current sales levels, pricing strategy and cost trends. If our review indicates that inventories of raw materials, components or finished products have become obsolete or are in excess of anticipated demand or that inventory cost exceeds net realizable value, we may be required to make adjustments that will impact the results of operations.

Goodwill and Non-Amortizable Intangible Assets Valuation - We test goodwill and non-amortizable intangible assets for impairment annually or more frequently if events occur that would warrant such review. While the company has the option to perform a qualitative assessment for both goodwill and non-amortizable intangible assets to determine if it is more likely than not that an impairment exists, the company elects to perform the quantitative assessment for our annual impairment analysis. 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 global and local companies within the tobacco industry. At December 31, 2018, the carrying value of our goodwill was \$7.2 billion, which is related to ten reporting units, each of which consists of a group of markets with similar economic characteristics. The estimated fair value of each of our ten reporting units exceeded the carrying value as of December 31, 2018. To determine the fair value of non-amortizable intangible assets, we primarily use a discounted cash flow model applying the relief-from-royalty method. We concluded that the fair value of our non-amortizable intangible assets exceeded the carrying value. 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. Since the March 28, 2008, spin-off from Altria Group, Inc., we have not recorded a charge to earnings for an impairment of goodwill or non-amortizable intangible assets.

Marketing Costs - We incur certain costs to support our products through programs that include advertising, marketing, consumer engagement and trade promotions. The costs of our advertising and marketing programs are expensed in accordance with U.S. GAAP. Recognition of the cost related to our consumer engagement and trade promotion programs contain uncertainties due to the judgment required in estimating the potential performance and compliance for each program. For volume-based incentives provided to customers, management continually assesses and estimates, by customer, the likelihood of the customer's achieving the specified targets, and records the reduction of revenue as the sales are made. For other trade promotions, management relies on estimated utilization rates that have been developed from historical experience. Changes in the assumptions used in estimating the cost of any individual marketing program would not result in a material change in our financial position, results of operations or operating cash flows.

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, mortality, turnover rates and health care cost trend 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 our historical experience and advice from our actuaries.

Weighted-average discount rate assumptions for pension and postretirement plan obligations at December 31, 2018 and 2017 are as follows:

| | <u>2018</u> | <u>2017</u> |
|----------------------|-------------|-------------|
| Pension plans | 1.61% | 1.51% |
| Postretirement plans | 3.97% | 3.79% |

We anticipate that assumption changes will increase 2019 pre-tax pension and postretirement expense to approximately \$205 million as compared with approximately \$160 million in 2018, excluding amounts related to employee severance and early retirement programs. The anticipated increase is primarily due to higher amortization out of other comprehensive earnings for unrecognized actuarial gains/losses of \$14 million, coupled with lower return on assets of \$16 million, higher interest and service cost of \$12 million and \$4 million respectively, partially offset by other movements of \$1 million.

Weighted-average expected rate of return and discount rate assumptions have a significant effect on the amount of expense reported for the employee benefit plans. A fifty-basis-point decrease in our discount rate would increase our 2019 pension and postretirement expense by approximately \$50 million, and a fifty-basis-point increase in our discount rate would decrease our 2019 pension and postretirement

expense by approximately \$44 million. Similarly, a fifty-basis-point decrease (increase) in the expected return on plan assets would increase (decrease) our 2019 pension expense by approximately \$33 million.

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.

We are required to assess the likelihood of recovering deferred tax assets against future sources of taxable income. If we determine, using all available evidence, that we do not reach the more likely than not threshold for recovery, a valuation allowance is recorded. Significant judgment is required in determining the need for and amount of valuation allowances for deferred tax assets including estimates of future taxable income in the applicable jurisdictions and the feasibility of on-going tax planning strategies, as applicable.

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

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 into the same line item as the impact of the underlying transaction, 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 18. *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 net revenues and operating income by segment were as follows:

| (in millions) | 2018 | 2017 | 2016 |
|-------------------------|-----------|-----------|-----------|
| Net Revenues | | | |
| European Union | \$ 9,298 | \$ 8,318 | \$ 8,162 |
| Eastern Europe | 2,921 | 2,711 | 2,484 |
| Middle East & Africa | 4,114 | 3,988 | 4,516 |
| South & Southeast Asia | 4,656 | 4,417 | 4,396 |
| East Asia & Australia | 5,580 | 6,373 | 4,285 |
| Latin America & Canada | 3,056 | 2,941 | 2,842 |
| Net revenues | \$ 29,625 | \$ 28,748 | \$ 26,685 |
| Operating Income | | | |
| European Union | \$ 4,105 | \$ 3,691 | \$ 3,920 |
| Eastern Europe | 902 | 887 | 890 |
| Middle East & Africa | 1,627 | 1,884 | 1,990 |
| South & Southeast Asia | 1,747 | 1,514 | 1,474 |
| East Asia & Australia | 1,851 | 2,608 | 1,691 |
| Latin America & Canada | 1,145 | 997 | 938 |
| Operating income | \$ 11,377 | \$ 11,581 | \$ 10,903 |

As discussed in Item 8, Note 12. *Segment Reporting* to our consolidated financial statements, effective January 1, 2018, we began using operating income to evaluate segment performance and allocate resources, replacing operating companies income used previously.

Our net revenues by product category were as follows:

| PMI Net Revenues by Product Category | | | |
|---|-----------|-----------|-----------|
| (in millions) | 2018 | 2017 | 2016 |
| Combustible Products | | | |
| European Union | \$ 8,433 | \$ 8,048 | \$ 8,105 |
| Eastern Europe | 2,597 | 2,657 | 2,478 |
| Middle East & Africa | 3,732 | 3,893 | 4,513 |
| South & Southeast Asia | 4,656 | 4,417 | 4,396 |
| East Asia & Australia | 3,074 | 3,156 | 3,619 |
| Latin America & Canada | 3,037 | 2,937 | 2,841 |
| Total Combustible Products | \$ 25,529 | \$ 25,107 | \$ 25,952 |
| Reduced-Risk Products | | | |
| European Union | \$ 865 | \$ 269 | \$ 57 |
| Eastern Europe | 324 | 55 | 6 |
| Middle East & Africa | 382 | 94 | 4 |
| South & Southeast Asia | — | — | — |
| East Asia & Australia | 2,506 | 3,218 | 666 |
| Latin America & Canada | 19 | 4 | 1 |
| Total Reduced-Risk Products | \$ 4,096 | \$ 3,640 | \$ 733 |
| Total PMI Net Revenues | \$ 29,625 | \$ 28,748 | \$ 26,685 |

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

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

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

We recognize revenue when control is transferred to the customer, typically either upon shipment or delivery of goods.

Our shipment volume by segment for cigarettes and heated tobacco units was as follows:

PMI Shipment Volume (Million Units)

| | 2018 | 2017 | 2016 |
|---|----------------|----------------|----------------|
| <u>Cigarettes</u> | | | |
| European Union | 179,622 | 187,293 | 193,586 |
| Eastern Europe | 108,718 | 119,398 | 129,456 |
| Middle East & Africa | 136,605 | 136,759 | 141,937 |
| South & Southeast Asia | 178,469 | 171,600 | 185,279 |
| East Asia & Australia | 56,163 | 62,653 | 74,750 |
| Latin America & Canada | 80,738 | 84,223 | 87,938 |
| Total Cigarettes | 740,315 | 761,926 | 812,946 |
| <u>Heated Tobacco Units</u> | | | |
| European Union | 5,977 | 1,889 | 224 |
| Eastern Europe | 4,979 | 674 | 64 |
| Middle East & Africa | 3,403 | 907 | 36 |
| South & Southeast Asia | — | — | — |
| East Asia & Australia | 26,866 | 32,729 | 7,070 |
| Latin America & Canada | 147 | 27 | — |
| Total Heated Tobacco Units | 41,372 | 36,226 | 7,394 |
| <u>Cigarettes and Heated Tobacco Units</u> | | | |
| European Union | 185,599 | 189,182 | 193,810 |
| Eastern Europe | 113,697 | 120,072 | 129,520 |
| Middle East & Africa | 140,008 | 137,666 | 141,973 |
| South & Southeast Asia | 178,469 | 171,600 | 185,279 |
| East Asia & Australia | 83,029 | 95,382 | 81,820 |
| Latin America & Canada | 80,885 | 84,250 | 87,938 |
| Total Cigarettes and Heated Tobacco Units | 781,687 | 798,152 | 820,340 |

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

References to total international market, defined as worldwide cigarette and heated tobacco unit volume excluding the United States, total industry, total market and market shares throughout this "*Discussion and Analysis*" are our estimates for tax-paid products based on the latest available data from a number of internal and external sources and may, in defined instances, exclude the People's Republic of China and/or our duty free business.

In-market sales ("IMS") is defined as sales to the retail channel, depending on the market and distribution model.

North Africa is defined as Algeria, Egypt, Libya, Morocco and Tunisia.

Unless otherwise stated, references to total industry, total market, our shipment volume and our market share performance reflect cigarettes and heated tobacco units.

From time to time, PMI's shipment volumes are subject to the impact of distributor inventory movements, and estimated total industry/market volumes are subject to the impact of inventory movements in various trade channels that include estimated trade inventory movements of PMI's competitors arising from market-specific factors that significantly distort reported volume disclosures. Such factors may include changes to the manufacturing supply chain, shipment methods, consumer demand, timing of excise tax increases or other influences that may affect the timing of sales to customers. In such instances, in addition to reviewing PMI shipment volumes and certain estimated total industry/market volumes on a reported basis, management reviews these measures on an adjusted basis that excludes the impact of distributor and/or estimated trade inventory movements. Management also believes that disclosing PMI shipment volumes and estimated total industry/market volumes in such circumstances on a basis that excludes the impact of distributor and/or estimated trade inventory movements improves the comparability of performance and trends for these measures over different reporting periods.

2018 compared with 2017

The following discussion compares our consolidated operating results for the year ended December 31, 2018, with the year ended December 31, 2017.

Estimated international cigarette and heated tobacco unit volume, excluding China and the United States, of 2.8 trillion, decreased by 1.6%, mainly due to the EU, EE, EA&A and LA&C, partly offset by ME&A and S&SA, as described in the Regional sections below.

Our total shipment volume decreased by 2.1%, principally due to:

- the EU, primarily reflecting lower cigarette shipment volume in France, Germany and Italy, partly offset by higher heated tobacco unit shipment volume across the Region, notably in Italy;
- Eastern Europe, reflecting lower cigarette shipment volume, principally in Russia and Ukraine, partly offset by higher heated tobacco unit shipment volume across the Region, notably in Russia;
- East Asia & Australia, reflecting lower cigarette shipment volume, principally in Japan and Korea; lower heated tobacco unit shipment volume in Japan, reflecting the net impact of estimated distributor inventory movements described in the East Asia & Australia Region section below; partly offset by higher heated tobacco unit shipment volume in Korea; and
- Latin America & Canada, reflecting lower cigarette shipment volume, notably in Argentina and Colombia;

partly offset by

- Middle East & Africa, reflecting essentially flat cigarette shipment volume, with declines, notably in Saudi Arabia and the UAE, almost completely offset by higher cigarette shipment volume, notably in Turkey, as well as by higher heated tobacco unit shipment volume, mainly in PMI Duty Free; and
- South & Southeast Asia, reflecting higher cigarette shipment volume, principally in Pakistan, the Philippines and Thailand.

Excluding the net impact of estimated distributor inventory movements of approximately 16.6 billion units, due primarily to heated tobacco unit inventories in Japan, reflecting unfavorable cigarette and heated tobacco unit inventory movements of approximately 0.4 billion and 16.2 billion units, respectively, our total shipment volume was flat.

Our cigarette shipment volume by brand and heated tobacco unit shipment volume was as follows:

PMI Shipment Volume by Brand (Million Units)

| | <u>2018</u> | <u>Full-Year</u> <u>2017</u> | <u>Change</u> |
|--|--------------------|---|----------------------|
| <u>Cigarettes</u> | | | |
| <i>Marlboro</i> | 264,423 | 270,366 | (2.2)% |
| <i>L&M</i> | 89,789 | 90,817 | (1.1)% |
| <i>Chesterfield</i> | 59,452 | 55,075 | 7.9 % |
| <i>Philip Morris</i> | 49,864 | 48,522 | 2.8 % |
| <i>Sampoerna A</i> | 39,522 | 42,736 | (7.5)% |
| <i>Parliament</i> | 41,697 | 43,965 | (5.2)% |
| <i>Bond Street</i> | 32,173 | 37,987 | (15.3)% |
| <i>Dji Sam Soe</i> | 29,195 | 22,757 | 28.3 % |
| <i>Lark</i> | 23,021 | 24,530 | (6.2)% |
| <i>Fortune</i> | 16,596 | 13,451 | 23.4 % |
| Others | 94,583 | 111,720 | (15.3)% |
| Total Cigarettes | 740,315 | 761,926 | (2.8)% |
| Heated Tobacco Units | 41,372 | 36,226 | 14.2 % |
| Total Cigarettes and Heated Tobacco Units | 781,687 | 798,152 | (2.1)% |

Note: *Sampoerna A* includes *Sampoerna*; *Philip Morris* includes *Philip Morris/Dubliss*; and *Lark* includes *Lark Harmony*.

Our cigarette shipment volume decreased, partly reflecting the impact of out-switching to heated tobacco units largely from premium and mid-price cigarette brands. Our cigarette shipment volume of the following brands decreased:

- *Marlboro*, mainly due to France, the GCC, notably Saudi Arabia and the UAE, Italy, Japan and Korea, partly offset by Indonesia, North Africa and Turkey;
- *L&M*, mainly due to the GCC, notably Saudi Arabia, as well as North Africa, Russia and Turkey, partly offset by Kazakhstan, Serbia and Thailand;
- *Sampoerna A* in Indonesia, mainly reflecting the impact of its retail price increasing past its round pack price point in the fourth quarter of 2017;
- *Parliament*, mainly due to Korea and Russia, partly offset by Turkey;
- *Bond Street*, mainly due to Kazakhstan, Russia and Ukraine;
- *Lark*, mainly due to Japan, partly offset by Turkey; and
- "Others," mainly due to: mid-price brands, notably *Sampoerna U* in Indonesia, partly reflecting the impact of above-inflation retail price increases; the successful portfolio consolidation of local brands into international trademarks, notably in Brazil, Colombia, Mexico and Russia; low-price *Jackpot* in the Philippines, reflecting up-trading as a result of narrowed price gaps; partly offset by low-price *Hope* in the Philippines and *Morven* in Pakistan.

Our cigarette shipment volume of the following brands increased:

- *Chesterfield*, mainly driven by Argentina, Brazil, Colombia, the GCC, notably Saudi Arabia, Mexico and Turkey, partly offset by Portugal, Russia and Venezuela;
- *Philip Morris*, mainly driven by Russia, partly offset by Argentina, Italy and the Philippines;
- *Dji Sam Soe* in Indonesia, notably reflecting the continued strong performance of its *Magnum Mild 16s* variant launched in the second quarter of 2017; and
- *Fortune* in the Philippines, reflecting the favorable impact of its narrowed retail price gap to competitors' products.

Our heated tobacco unit shipment volume increased, reflecting favorable heated tobacco unit volume across the EU, notably Italy, as well as Korea, PMI Duty Free and Russia, partly offset by unfavorable heated tobacco unit volume in Japan, reflecting the net impact of estimated distributor inventory movements.

2018 International Share of Market (excluding China and the United States)

Our 2018 total international market share, defined as our cigarette and heated tobacco unit sales volume as a percentage of total industry cigarette and heated tobacco unit sales volume, increased by 0.5 points to 28.4%, reflecting:

- Total international cigarette market share of 26.8%, down by 0.3 points; and
- Total international heated tobacco unit market share of 1.6%, up by 0.8 points.

Our total international cigarette market share, defined as our cigarette sales volume as a percentage of total industry cigarette sales volume, was flat at 27.4%.

In 2018, we owned six of the world's top 15 international cigarette brands, with international cigarette market shares as follows: *Marlboro*, 9.7%; *L&M*, 3.3%; *Chesterfield*, 2.2%; *Philip Morris*, 1.8%; *Parliament*, 1.6%; and *Bond Street*, 1.2%.

Key Market Data

Key market data regarding total market size, our shipments and market share were as follows:

| Market | Total Market (billion units) | | PMI Shipments (billion units) | | | | | | PMI Market Share (%) ⁽¹⁾ | | | |
|------------------------|---------------------------------|-------|-------------------------------|-------|-----------|-------|---------------------|------|-------------------------------------|------|---------------------|------|
| | | | Total | | Cigarette | | Heated Tobacco Unit | | Total | | Heated Tobacco Unit | |
| | | | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| European Union | | | | | | | | | | | | |
| France | 40.9 | 45.1 | 18.5 | 19.7 | 18.4 | 19.7 | — | — | 45.5 | 43.5 | 0.1 | — |
| Germany | 75.2 | 76.9 | 28.1 | 28.6 | 27.7 | 28.5 | 0.4 | 0.1 | 37.3 | 37.2 | 0.5 | 0.2 |
| Italy | 69.0 | 69.8 | 35.2 | 36.8 | 33.5 | 36.1 | 1.7 | 0.7 | 51.8 | 52.2 | 2.2 | 0.7 |
| Poland | 43.2 | 41.7 | 17.9 | 17.8 | 17.6 | 17.7 | 0.4 | 0.1 | 41.5 | 42.7 | 0.9 | 0.2 |
| Spain | 45.0 | 45.0 | 14.1 | 14.5 | 13.9 | 14.4 | 0.2 | 0.1 | 32.1 | 32.3 | 0.4 | 0.1 |
| Eastern Europe | | | | | | | | | | | | |
| Russia | 238.1 | 260.0 | 68.0 | 72.4 | 64.6 | 72.1 | 3.4 | 0.3 | 28.4 | 27.8 | 1.0 | 0.1 |
| Middle East & Africa | | | | | | | | | | | | |
| Saudi Arabia | 20.6 | 26.1 | 7.4 | 10.9 | 7.4 | 10.9 | — | — | 41.5 | 45.2 | — | — |
| Turkey | 118.5 | 106.2 | 55.0 | 49.6 | 55.0 | 49.6 | — | — | 46.4 | 46.7 | — | — |
| South & Southeast Asia | | | | | | | | | | | | |
| Indonesia | 307.0 | 307.4 | 101.4 | 101.3 | 101.4 | 101.3 | — | — | 33.0 | 33.0 | — | — |
| Philippines | 73.2 | 74.9 | 51.2 | 50.6 | 51.2 | 50.6 | — | — | 69.9 | 67.6 | — | — |
| East Asia & Australia | | | | | | | | | | | | |
| Australia | 12.8 | 13.9 | 3.8 | 4.3 | 3.8 | 4.3 | — | — | 29.7 | 30.6 | — | — |
| Japan | 167.3 | 171.5 | 52.3 | 66.1 | 30.8 | 34.9 | 21.4 | 31.3 | 34.0 | 32.1 | 15.5 | 10.8 |
| Korea | 69.5 | 70.6 | 17.4 | 14.9 | 12.0 | 13.5 | 5.4 | 1.4 | 25.0 | 21.2 | 7.8 | 2.0 |
| Latin America & Canada | | | | | | | | | | | | |
| Argentina | 35.0 | 36.2 | 25.8 | 27.0 | 25.8 | 27.0 | — | — | 73.7 | 74.7 | — | — |
| Canada | 23.4 | 24.6 | 8.9 | 9.3 | 8.9 | 9.3 | — | — | 38.1 | 37.3 | 0.1 | — |
| Mexico | 35.5 | 35.8 | 24.2 | 24.4 | 24.2 | 24.4 | — | — | 68.0 | 68.1 | — | — |

(1) Market share estimates are calculated using IMS data

Note: % change for Total Market and PMI shipments in the discussion below is computed based on millions of units

Financial Summary

| Financial Summary - Years Ended December 31, | | | Change Fav./ (Unfav.) | | Variance Fav./ (Unfav.) | | | | |
|---|------------------|-------------|----------------------------------|------------------------|------------------------------------|-----------------|--------------|---------------------|------------------------|
| | 2018 | 2017 | Total | Excl. Curr. | Total | Currency | Price | Vol/ Mix | Cost/ Other |
| (in millions) | | | | | | | | | |
| Net Revenues | \$ 29,625 | \$ 28,748 | 3.1 % | 3.4 % | \$ 877 | \$ (103) | \$ 1,488 | \$ (724) | \$ 216 |
| Cost of Sales | (10,758) | (10,432) | (3.1)% | (2.3)% | (326) | (83) | — | (180) | (63) |
| Marketing, Administration and Research Costs | (7,408) | (6,647) | (11.4)% | (11.0)% | (761) | (29) | — | — | (732) |
| Amortization of Intangibles | (82) | (88) | 6.8 % | 5.7 % | 6 | 1 | — | — | 5 |
| Operating Income | \$ 11,377 | \$ 11,581 | (1.8)% | 0.1 % | \$ (204) | \$ (214) | \$ 1,488 | \$ (904) | \$ (574) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles. “Cost/Other” also includes the currency-neutral net revenue variance, unrelated to volume/mix and price components, attributable to fees for certain distribution rights billed to customers in certain markets in the ME&A Region. This immaterial presentational change, made in conjunction with the new revenue recognition standard, is prospective only.

Net revenues, excluding unfavorable currency, increased by 3.4%, reflecting: a favorable pricing variance, notably in Argentina, Australia, Canada, Egypt, Germany, Indonesia, Italy, Japan, Mexico, the Philippines, Russia, Turkey, and Ukraine, partly offset by France, Korea, Saudi Arabia and Thailand; as well as a favorable "cost/other" variance as described above.

These favorable variances were partly offset by unfavorable volume/mix, primarily reflecting unfavorable cigarette volume/mix, notably in Australia, the GCC, notably Saudi Arabia and the UAE, Indonesia, Italy, Japan and Russia, partly offset by Pakistan, Thailand and Turkey. The unfavorable cigarette volume/mix was partly offset by favorable heated tobacco unit volume in the EU, notably the Czech Republic, Germany and Italy, as well as Korea, PMI Duty Free and Russia, partly offset by unfavorable heated tobacco unit volume in Japan, reflecting the net impact of estimated distributor inventory movements.

The unfavorable currency in net revenues was due primarily to the Argentine peso, Indonesian rupiah, Philippine peso, Russian ruble and Turkish lira, partially offset by the Euro, Japanese yen and Polish zloty.

Net revenues include \$4.1 billion in 2018 and \$3.6 billion in 2017 related to the sale of RRPs. In 2018, approximately \$0.9 billion of our \$4.1 billion in RRP net revenues were from IQOS devices and accessories.

Operating income, excluding unfavorable currency, was essentially flat, reflecting: a favorable pricing variance; partly offset by unfavorable volume/mix, due mainly to lower volume in Japan and Saudi Arabia and lower mix in Indonesia and Russia, partly offset by higher volume in the EU, driven by heated tobacco units, as well as Korea, PMI Duty Free, Thailand and Turkey. The favorable pricing variance was also partly offset by higher marketing, administration and research costs, primarily related to increased investment behind reduced-risk products across all Regions, predominantly the EU and EA&A.

Interest expense, net, of \$665 million decreased by \$249 million (27.2%), due primarily to our ongoing efforts to optimize our capital structure following the passage of the Tax Cuts and Jobs Act. This included the decision to use existing cash to repay the \$2.5 billion principal for our matured May 2018 ten-year U.S. bond, which had a coupon of 5.65%.

Our effective tax rate decreased by 17.8 percentage points to 22.9%. The change in the effective tax rate for 2018, as compared to 2017, was primarily due to the Tax Cuts and Jobs Act, which reduced the U.S. federal income tax rate from 35% to 21%, in addition to repatriation cost differences and earnings mix by taxing jurisdiction. We completed our analysis of the Tax Cuts and Jobs Act during 2018 and adjusted the 2017 provisional estimates to the final amounts based on our 2017 U.S. federal income tax return as filed. Accordingly, we recorded in our income tax provision a charge of \$31 million representing a current income tax charge of \$185 million primarily due to an increase in our final 2017 transition tax liability, mostly offset by a deferred income tax benefit of \$154 million primarily due to the recognition of deferred tax assets for net operating losses in the state of New York. The effective tax rate in 2017 was unfavorably impacted by \$1.6 billion due to the Tax Cuts and Jobs Act. We estimate that our 2019 effective tax rate will be approximately 23%, subject to future regulatory developments and earnings mix by taxing jurisdiction. For further details, see Item 8, Note 11. *Income Taxes*.

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

Net earnings attributable to PMI of \$7.9 billion increased by \$1.9 billion (31.1%). This increase was due primarily to a lower effective tax rate and lower interest expense, net, partially offset by lower operating income. Diluted and basic EPS of \$5.08 increased by 30.9%. Excluding a net favorable tax impact of \$0.82 primarily related to the implementation of the Tax Cuts and Jobs Act and an unfavorable currency impact of \$0.11, diluted EPS increased by 10.4%.

2017 compared with 2016

The following discussion compares our consolidated operating results for the year ended December 31, 2017, with the year ended December 31, 2016.

Estimated international cigarette and heated tobacco unit volume, excluding China and the United States, of 2.8 trillion was down by 2.8%.

Our total shipment volume decreased by 2.7%, principally due to:

- European Union, notably reflecting lower cigarette shipment volume in Greece, Italy and Spain, partly offset by higher heated tobacco unit shipment volume;
- Eastern Europe, notably reflecting lower cigarette shipment volume in Russia and Ukraine; partly offset by higher heated tobacco unit shipment volume;
- Middle East & Africa, notably reflecting lower cigarette shipment volume in Saudi Arabia - where our cigarette shipment volume declined by 35.8%, impacted by the new excise tax implemented in June 2017 that resulted in the doubling of retail prices; partly offset by higher cigarette shipment volume in North Africa, notably Algeria, and higher heated tobacco unit shipment volume;
- South & Southeast Asia, notably reflecting lower cigarette shipment volume in Indonesia and Pakistan - impacted by excise tax-driven price increases and an increase in the prevalence of illicit trade - and the Philippines; and
- Latin America & Canada, notably reflecting lower cigarette shipment volume in Argentina, Brazil, Canada, Colombia and Mexico;

partially offset by:

- East Asia & Australia, notably reflecting higher heated tobacco unit shipment volume, mainly in Japan and Korea, partly offset by lower cigarette shipment volume in Japan and Korea.

Excluding the favorable net impact of estimated cigarette and heated tobacco unit inventory movements of approximately 3.3 billion units, our total shipment volume decreased by 3.1%. The favorable inventory movements were driven primarily by approximately 8.5 billion units net in Japan reflecting: the increasing demand for *HeatSticks*, anticipated to further increase in the first quarter of 2018 following a planned lifting of the restriction on *IQOS* device sales; the establishment of appropriate distributor inventory levels of heated tobacco units, given the current high dependence on a single manufacturing center; and the transition from air freight to sea freight of heated tobacco units, largely completed in the fourth quarter of 2017. These favorable inventory movements were partly offset by a reduction of combustible product inventory levels, mainly in Italy, North Africa, Russia, Saudi Arabia and Spain.

Our cigarette shipment volume by brand and heated tobacco unit shipment volume was as follows:

PMI Cigarette Shipment Volume by Brand (Million Units)

| | <u>2017</u> | <u>Full-Year 2016</u> | <u>Change</u> |
|--|--------------------|----------------------------------|----------------------|
| <u>Cigarettes</u> | | | |
| <i>Marlboro</i> | 270,366 | 281,720 | (4.0)% |
| <i>L&M</i> | 90,817 | 96,770 | (6.2)% |
| <i>Chesterfield</i> | 55,075 | 46,291 | 19.0 % |
| <i>Philip Morris</i> | 48,522 | 35,914 | 35.1 % |
| <i>Parliament</i> | 43,965 | 45,671 | (3.7)% |
| <i>Bond Street</i> | 37,987 | 44,567 | (14.8)% |
| <i>Lark</i> | 24,530 | 27,571 | (11.0)% |
| Others* | 190,664 | 234,442 | (18.7)% |
| Total Cigarettes | 761,926 | 812,946 | (6.3)% |
| Heated Tobacco Units | 36,226 | 7,394 | +100.0% |
| Total Cigarettes and Heated Tobacco Units | 798,152 | 820,340 | (2.7)% |

*Others above also include cigarette shipment volumes of *Sampoerna A* (including *Sampoerna*) of 42,736 million units in 2017 and 44,548 million units in 2016; *Dji Sam Soe* of 22,757 million units in 2017 and 20,411 million units in 2016; and *Fortune* of 13,451 million units in 2017 and 18,570 million units in 2016.

Note: *Philip Morris* includes *Philip Morris/Dubliss*; and *Lark* includes *Lark Harmony*.

Cigarette shipment volume of *Marlboro* decreased in: the EU, mainly due to Greece, Italy and Spain; ME&A, predominantly due to Saudi Arabia, reflecting the impact of the new excise tax implemented in June 2017 that resulted in the doubling of the retail price of *Marlboro* from SAR 12 to SAR 24 per pack, partly offset by North Africa, notably Algeria and Egypt, and Turkey; EA&A, mainly due to Japan and Korea, principally reflecting out-switching to heated tobacco products; and LA&C, mainly due to Argentina and Brazil; partly offset by an increase in S&SA, mainly due to Indonesia and the Philippines.

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

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

Key market data regarding total market size, our shipments and market share were as follows:

| Market | Total Market (billion units) | | PMI Shipments (billion units) | | | | | | PMI Market Share (%) ⁽¹⁾ | | | |
|------------------------|---------------------------------|-------|-------------------------------|-------|-----------|-------|---------------------|------|-------------------------------------|------|---------------------|------|
| | | | Total | | Cigarette | | Heated Tobacco Unit | | Total | | Heated Tobacco Unit | |
| | | | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 |
| European Union | | | | | | | | | | | | |
| France | 45.1 | 45.7 | 19.7 | 19.7 | 19.7 | 19.7 | — | — | 43.5 | 42.8 | — | — |
| Germany | 76.9 | 78.1 | 28.6 | 29.0 | 28.5 | 29.0 | 0.1 | — | 37.2 | 37.1 | 0.2 | — |
| Italy | 69.8 | 72.1 | 36.8 | 38.7 | 36.1 | 38.6 | 0.7 | 0.1 | 52.2 | 52.5 | 0.7 | 0.1 |
| Poland | 41.7 | 41.3 | 17.8 | 17.5 | 17.7 | 17.5 | 0.1 | — | 42.7 | 42.3 | 0.2 | — |
| Spain | 45.0 | 46.7 | 14.5 | 16.4 | 14.4 | 16.4 | 0.1 | — | 32.3 | 33.9 | 0.1 | — |
| Eastern Europe | | | | | | | | | | | | |
| Russia | 260.0 | 280.0 | 72.4 | 79.7 | 72.1 | 79.7 | 0.3 | 0.1 | 27.8 | 27.9 | 0.1 | — |
| Middle East & Africa | | | | | | | | | | | | |
| Saudi Arabia | 26.1 | 31.6 | 10.9 | 17.0 | 10.9 | 17.0 | — | — | 45.2 | 52.1 | — | — |
| Turkey | 106.2 | 105.5 | 49.6 | 49.6 | 49.6 | 49.6 | — | — | 46.7 | 47.0 | — | — |
| South & Southeast Asia | | | | | | | | | | | | |
| Indonesia | 307.4 | 315.6 | 101.3 | 105.5 | 101.3 | 105.5 | — | — | 33.0 | 33.4 | — | — |
| Philippines | 74.9 | 79.3 | 50.6 | 56.6 | 50.6 | 56.6 | — | — | 67.6 | 71.3 | — | — |
| East Asia & Australia | | | | | | | | | | | | |
| Australia | 13.9 | 15.7 | 4.3 | 5.1 | 4.3 | 5.1 | — | — | 30.6 | 32.8 | — | — |
| Japan | 171.5 | 179.0 | 66.1 | 51.0 | 34.9 | 43.9 | 31.3 | 7.1 | 32.1 | 27.1 | 10.8 | 2.9 |
| Korea | 70.6 | 73.6 | 14.9 | 15.5 | 13.5 | 15.5 | 1.4 | — | 21.2 | 21.0 | 2.0 | — |
| Latin America & Canada | | | | | | | | | | | | |
| Argentina | 36.2 | 36.1 | 27.0 | 27.5 | 27.0 | 27.5 | — | — | 74.7 | 76.3 | — | — |
| Canada | 24.6 | 26.3 | 9.3 | 10.0 | 9.3 | 10.0 | — | — | 37.3 | 38.4 | — | — |
| Mexico | 35.8 | 36.2 | 24.4 | 25.1 | 24.4 | 25.1 | — | — | 68.1 | 69.3 | — | — |

(1) Market share estimates are calculated using IMS data

Note: % change for Total Market and PMI shipments in the discussion below is computed based on millions of units

| Financial Summary - Years Ended December 31, (in millions) | | | Change Fav./Unfav.) | | Variance Fav./Unfav.) | | | | |
|--|-------------|-------------|--------------------------------|------------------------|----------------------------------|-----------------------|--------------|---------------------|------------------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 28,748 | \$ 26,685 | 7.7 % | 9.4 % | \$2,063 | \$ (437) | \$1,386 | \$1,114 | \$ — |
| Cost of Sales | (10,432) | (9,391) | (11.1)% | (11.4)% | (1,041) | 30 | — | (1,107) | 36 |
| Marketing, Administration and Research Costs | (6,647) | (6,317) | (5.2)% | (9.2)% | (330) | 250 | — | — | (580) |
| Amortization of Intangibles | (88) | (74) | (18.9)% | (18.9)% | (14) | — | — | — | (14) |
| Operating Income | \$ 11,581 | \$ 10,903 | 6.2 % | 7.7 % | \$ 678 | \$ (157) | \$1,386 | \$ 7 | \$ (558) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues increased by 7.7%, due to price increases and favorable volume/mix, partially offset by unfavorable currency.

The unfavorable currency in net revenues was due primarily to the Argentine peso, Egyptian pound, Japanese yen, Philippine peso and Turkish lira, partially offset by the Russian ruble.

Net revenues for RRP were \$3.6 billion in 2017 and \$733 million in 2016 mainly in Japan. In 2017, approximately \$0.9 billion of our \$3.6 billion in RRP net revenues were from *IQOS* devices and accessories.

Cost of sales increased by 11.1%, due to higher cost of sales resulting from volume/mix, partly offset by lower manufacturing costs and favorable currency.

Marketing, administration and research costs increased by 5.2%, largely reflecting increased investment behind reduced-risk products, predominately in the European Union and East Asia & Australia, partly offset by favorable currency.

Operating income increased by 6.2%, due primarily to price increases, partly offset by higher marketing, administration and research costs and unfavorable currency.

Interest expense, net, of \$914 million increased by \$23 million, due primarily to unfavorable currency and higher average debt levels, partly offset by higher interest income.

Our effective tax rate increased by 12.8 percentage points to 40.7%. The 2017 effective tax rate was unfavorably impacted by \$1.6 billion due to the Tax Cuts and Jobs Act. For further details, see Item 8, Note 11. *Income Taxes* to our consolidated financial statements.

Net earnings attributable to PMI of \$6.0 billion decreased by \$932 million (13.4%). This decrease was due primarily to a higher effective tax rate as discussed above, partly offset by higher operating income. Diluted and basic EPS of \$3.88 decreased by 13.4%. Excluding an unfavorable tax impact of \$0.84 primarily related to the implementation of the Tax Cuts and Jobs Act and an unfavorable currency impact of \$0.21, diluted EPS increased by 10.0%.

Operating Results by Business Segment

Business Environment

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

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

- regulatory restrictions on our products, including restrictions on the packaging, marketing, and sale of tobacco or other nicotine-containing products that could reduce our competitiveness, eliminate our ability to communicate with adult consumers, or even ban certain of our products;
- fiscal challenges, such as excessive excise tax increases and discriminatory tax structures;
- illicit trade in cigarettes and other tobacco products, including counterfeit, contraband and so-called “illicit whites”;
- intense competition, including from non-tax paid volume by certain local manufacturers;
- pending and threatened litigation as discussed in Item 8, Note 18. *Contingencies*; and
- governmental investigations.

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

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

Much of the regulation that shapes the business environment in which we operate is driven by the World Health Organization's (“WHO”) Framework Convention on Tobacco Control (“FCTC”), which entered into force in 2005. The FCTC has as its main objective to establish a global agenda for tobacco regulation, with the purpose of reducing tobacco use. To date, 180 countries and the European Union are Parties to the FCTC. The treaty requires Parties to have in place various tobacco control measures and recommends others. The FCTC governing body, the Conference of the Parties (“CoP”), has also adopted non-binding guidelines and policy recommendations related to certain articles of the FCTC that go beyond the text of the treaty. In October 2018, the CoP recognized the need for more scientific assessment and improved reporting to define policy on heated tobacco products. Similar to its previous policy recommendations on e-cigarettes, the CoP invited countries to regulate, restrict or prohibit heated tobacco products, as appropriate under their national laws. It is not possible to predict whether or to what extent measures recommended by CoP, including the FCTC guidelines, will be implemented.

We continue to seek to engage in a dialogue with regulators with respect to those measures that we do not believe would protect public health and, if implemented, could disrupt competition, severely limit our ability to market and sell our products (including our RRP) to adult smokers, or increase illicit trade. We advocate for measures that would accelerate switching to better alternatives to continued smoking and embrace a regulatory framework that recognizes a risk continuum of tobacco and other nicotine-containing products.

Certain measures are discussed in more detail below and in the *Reduced-Risk Products (RRPs)* section.

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

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

- health warnings covering 65% of the front and back panels of cigarette packs, with an option for Member States to further standardize tobacco packaging, including the introduction of plain packaging;
- a ban on characterizing flavors in some tobacco products, with a transition period for menthol expiring in May 2020;
- security features and tracking and tracing measures that will become effective on May 20, 2019, and will increase our operating expenses; and
- a framework for the regulation of novel tobacco products and e-cigarettes, including requirements for health warnings and information leaflets, a prohibition on product packaging text related to reduced risk, and the introduction of notification requirements or authorization procedures in advance of commercialization.

Plain Packaging and Other Packaging Restrictions: Plain packaging legislation bans the use of branding, logos and colors on packaging other than the brand name and variant that may be printed only in specified locations and in a uniform font. To date, plain packaging

laws have been adopted in certain markets in all of our reporting segments, including the key markets of Australia, France, Saudi Arabia and Turkey, and are in various degrees of implementation. Some countries, such as New Zealand and Israel, adopted plain packaging regulations that apply to all tobacco products, including RRP. Other countries, including Canada, are also considering plain packaging legislation.

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

Restrictions and Bans on the Use of Ingredients: The WHO and others in the public health community have recommended restrictions or total bans on the use of some or all ingredients in tobacco products, including menthol. Broad restrictions and ingredient bans would require us to reformulate our American blend tobacco products and could reduce our ability to differentiate these products in the market in the long term. Menthol bans would eliminate the entire category of mentholated tobacco products. The European Union has banned flavored tobacco products, subject to an exemption until May 2020 for menthol. Other countries may follow the EU's approach. For instance, Turkey has banned menthol as of May 2020. Broader ingredient bans have been adopted by Canada and Brazil. Canada banned menthol in cigarettes as of October 2017 and in all tobacco products as of November 2018. In Brazil, an ingredient ban is currently on appeal by a tobacco industry union, of which our Brazilian subsidiary is a member. The tobacco union requested a stay of the enforcement of the ingredient ban while the appeal is pending. It is not possible to predict the outcome of these legal proceedings.

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

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

Restrictions on Product Design: Some members of the public health community are calling for the further standardization of tobacco products by requiring, for example, that cigarettes have a certain minimum diameter, which would amount to a ban on slim cigarettes, or requiring the use of standardized filter and cigarette paper designs. In addition, at its meeting in November 2016, the CoP adopted non-binding guidelines recommending that countries regulate product design features that increase the attractiveness of tobacco products, such as the diameter of cigarettes and the use of flavor capsules.

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

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

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

On December 19, 2018, the EU Council and the EU Parliament provisionally agreed on the Single-Use Plastics Directive, which would require tobacco manufacturers and importers to cover the costs of public collection systems for cigarette butts. The directive is expected to be finalized in the first half of 2019 and subsequently transposed by Member States into national law within two years. We cannot predict the impact of this initiative on our business at this time.

Illicit Trade: The illicit tobacco trade creates a cheap and unregulated supply of tobacco products, undermines efforts to reduce smoking prevalence, especially among youth, damages legitimate businesses, stimulates organized crime, increases corruption and reduces government tax revenue. Illicit trade may account for as much as 10% of global cigarette consumption; this includes counterfeit, contraband and the growing problem of "illicit whites," which are cigarettes legally produced in one jurisdiction for the sole purpose of being exported and illegally sold in another jurisdiction where they have no legitimate market. We estimate that illicit trade in the European Union accounted for approximately 10% of total cigarette consumption in 2018.

A number of jurisdictions are considering actions to prevent illicit trade. In November 2012, the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products (the “Protocol”), which includes supply chain control measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty free and Internet sales and the implementation of tracking and tracing technologies. To date, 54 Parties have signed the Protocol, and 48 Parties, including the European Union, have ratified it. The Protocol came into force on September 25, 2018. Parties must now start implementing its measures via national legislation. In October 2018, the first Meeting of the Parties to the Protocol decided to produce a comprehensive report on good practices for the implementation of tracking and tracing systems and to prepare a conceptual framework for global information sharing to combat illicit tobacco trade. We welcome this decision and expect that other Parties will ratify the Protocol.

The tracking and tracing regulations for cigarettes and roll-your-own products manufactured or destined for the EU will become effective on May 20, 2019. The effective date for other tobacco-containing products, including some of our RRP products such as the heated tobacco units used with *IQOS*, is May 20, 2024.

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

In May 2016, PMI launched PMI IMPACT, a global initiative that supports third-party projects dedicated to fighting illegal trade and related crimes such as corruption, organized criminal networks and money laundering. The centerpiece of PMI IMPACT is a council of external independent experts in the fields of law, anti-corruption and law enforcement. The experts are responsible for evaluating and approving funding proposals for PMI IMPACT grants. PMI has pledged \$100 million to fund projects within PMI IMPACT over three funding rounds. Substantially all grants under the first and second funding round were awarded in 2017 and 2018, respectively.

Reduced-Risk Products (RRPs)

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

Cigarettes burn tobacco, which produces smoke. As a result of the combustion process, the smoker inhales various toxic substances. In contrast, RRP products do not burn tobacco and produce an aerosol that contains significantly lower levels of harmful and potentially harmful constituents (“HPHCs”) than found in cigarette smoke.

For smokers who would otherwise continue to smoke, we believe that RRP products, while not risk-free, offer a much better consumer choice. Accordingly, our key strategic priorities are: to develop and commercialize products that present less risk of harm to adult smokers who switch to those products versus continued smoking; and to convince current adult smokers who would otherwise continue to smoke to switch to those products.

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

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

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

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

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

Platform 1 uses a precisely controlled heating device that we are commercializing under the *IQOS* brand name, into which a specially designed and proprietary tobacco unit is inserted and heated to generate an aerosol. We have conducted a series of clinical studies for this platform, the results of which were included in our submission to the U.S. Food and Drug Administration (“FDA”) described below. The results of the first six-month term of the 6+6 month exposure response study were received at the end of 2017, and the related report was completed and submitted to the FDA in the second quarter of 2018. The study showed that all eight of the primary clinical risk endpoints moved in the same direction in the group that switched to *IQOS* as observed for smoking cessation, with statistically significant changes in five of the eight endpoints compared with on-going smoking. The results of the second six-month term of the 6+6 month exposure response study were received for analysis in the second quarter of 2018; the related report is under preparation. In addition, as set out in our submission to the FDA referenced above, we completed an 18-month combined chronic toxicity and carcinogenicity study in mice, which was ongoing at the time of our FDA submission. We shared the results with the FDA in August 2018.

Platform 2 uses a pressed carbon heat source which, when ignited, generates a nicotine-containing aerosol by heating tobacco. The results of our pharmacokinetic study (that measured the nicotine pharmacokinetic profile as well as subjective effects) and of our five-day reduced exposure study indicate that this platform could be an acceptable substitute for adult smokers who seek an alternative to cigarettes. The reduced exposure study results showed a substantial reduction in relevant biomarkers of exposure to the measured HPHCs in those who switched to *Platform 2* compared to those who continued to smoke cigarettes over a five-day period. The sustainability of this reduction as well as changes in clinical risk markers were assessed in a three-month reduced exposure study. The results of this study were received at the end of 2017, and the related report was finalized in the second quarter of 2018.

Platform 3 provides an aerosol of nicotine salt formed by the chemical reaction of nicotine with a weak organic acid. We have explored two routes for this platform, one with electronics and one without, and conducted nicotine pharmacokinetic studies with both versions. The results of the pharmacokinetic study related to the version without electronics were received, and the related report was finalized in the fourth quarter of 2018. The results indicate this product's potential as an acceptable alternative to continued cigarette smoking in terms of product satisfaction. We will also initiate a clinical product use and adaptation study.

Platform 4 covers e-vapor products, which are battery-powered devices that produce an aerosol by vaporizing a nicotine-containing liquid solution. Our e-vapor products comprise devices using current generation technology and our new e-vapor mesh technology that addresses certain challenges presented by some e-vapor products currently on the market. Our *IQOS MESH* products are designed to ensure the consistency and quality of the generated aerosol. We conducted a nicotine pharmacokinetic study in 2017. The results of this study were received in the second quarter of 2018 for analysis, and the related report was finalized in the fourth quarter of 2018. The results of this study indicate that *IQOS MESH* products are an effective means of nicotine delivery while being a satisfying alternative for e-cigarette users. We will also initiate a clinical reduced exposure study to measure selected biomarkers of exposure to HPHCs and assess changes in clinical risk markers.

After we receive the results of our scientific studies mentioned above, in accordance with standard scientific practices, we intend to share the conclusions in scientific forums and to submit them for inclusion in peer-reviewed publications.

The research and development expense for our RRP portfolio accounted for 92%, 74% and 72% of our total research and development expense for the years ended December 31, 2018, 2017 and 2016, respectively. The research and development expense for the years ended December 31, 2018, 2017 and 2016, is set forth in Item 8, Note 14. *Additional Information* to the consolidated financial statements.

Commercialization of RRP: We are building a new product category and tailor our commercialization strategy to the characteristics of each specific market. We focus our commercialization efforts on consumer retail experience, guided consumer trials and customer care, as well as digital communication programs. In order to accelerate switching to *IQOS*, our initial market introductions typically entail one-on-one consumer engagement and introductory device discounts. These initial commercialization efforts require substantial investment, which we believe will moderate over time.

In 2014, we introduced the *IQOS* heated tobacco system in pilot city launches in Nagoya, Japan, and in Milan, Italy. Since then, we have continuously expanded our commercialization activities, and *IQOS* is currently available for sale in 44 markets in key cities or nationwide.

In Japan, we observed a slower-than-initially-projected growth in the first half of 2018, as we are now reaching different socio-economic strata with more conservative consumers who show a slower pace of adoption than early adopters. In late 2018 we began implementing a number of initiatives intended to specifically address the needs of these adult smokers.

We estimate that while some *IQOS* users are experimenting with competitive products, only a very small percentage of converted *IQOS* users in Japan switch to those products.

We estimate that only a very small percentage of adult smokers who convert to *IQOS* switch back to cigarettes.

We have been integrating the production of our heated tobacco units into a number of our existing manufacturing facilities and progressing with our plans to build manufacturing capacity for our other RRP platforms.

An adequate supply chain for our RRP portfolio, including the supply of electronic devices, is important to our business. We work with two electronics manufacturing service providers for the supply of our *IQOS* devices and a small number of other providers for other products in our RRP portfolio and related accessories. Although we work closely with these service providers on monitoring their production capability and financial health, the commercialization of our RRP could be adversely affected if they are unable to meet their commitments. The production of our RRP portfolio requires various metals, and we believe that there is an adequate supply of such metals in the world markets to satisfy our current and anticipated production requirements. However, some components and materials necessary for the production of our RRP, including those for the electronic devices, are obtained from single or limited sources, and can be subject to industry-wide shortages and price fluctuations. Our inability to secure an adequate supply of such components and materials could negatively impact the commercialization of our RRP.

Our *IQOS* devices are subject to standard product warranties generally for a period of 12 months from the date of purchase or such other periods as required by law. We discuss product warranties in more detail in Note 5. *Product Warranty*. The significance of warranty claims is dependent on a number of factors including warranty policies and product failure rates and may increase with the number of devices sold.

Our commercialization efforts for the other RRP platforms are as follows:

- We currently market our e-vapor products in several markets, including Ireland and the U.K. In July 2018, we pilot-launched *IQOS MESH*, one of our Platform 4 products, in London, U.K.
- We completed a small-scale city test of *TEEPS*, our Platform 2 product, that we had initiated in December 2017 in Santo Domingo, the Dominican Republic, and are working on improving this product and incorporating our learnings into our future plans.
- Depending on the outcome of the use and adaptation study described above, we plan to conduct a consumer test of our Platform 3 product.

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

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

In the United States, an established regulatory framework for assessing “Modified Risk Tobacco Products” and “New Tobacco Products” exists under the jurisdiction of the FDA. We submitted to the FDA a Modified Risk Tobacco Product Application (“MRTPA”) for *IQOS* in December 2016, and a Premarket Tobacco Product Application (“PMTA”) for *IQOS* in March 2017. In May 2017, the FDA formally accepted and filed our MRTPA for substantive scientific review and, in June 2017, the FDA opened the period for the public to provide comments on our application. The FDA recently announced the public comment period would close on February 11, 2019. In August 2017, the FDA completed a preliminary review of our PMTA and accepted our application for substantive review. The FDA referred our MRTPA to the Tobacco Product Scientific Advisory Committee (“TPSAC”). TPSAC held a meeting on January 24 and January 25, 2018 to discuss our MRTPA. The recommendations and votes of TPSAC are not binding on the FDA. By regulation, the FDA’s decision on our MRTPA will take into account, in addition to the views of TPSAC, scientific evidence as well as comments, data and information submitted by interested persons.

Separately, in July 2017, the FDA issued a policy announcement aiming to explore the potential of nicotine reduction in cigarettes in conjunction with the availability of less harmful products that deliver nicotine for adults who choose to use such products. In July 2018, as part of a public consultation procedure, we submitted our views on this topic to the FDA.

Following a rise in the use of e-vapor products among minors in the U.S., in November 2018, the FDA announced a policy framework for the prevention of the use of tobacco and nicotine-containing products by youth. Under the policy framework, flavored e-vapor products, other than tobacco, mint and menthol flavors, may be sold only in age-restricted retail outlets or through online sites with heightened age verification requirements. The FDA also announced its intention to remove from the market certain e-vapor products that are appealing or marketed to youth. While we do not sell products in the U.S. and therefore are not subject to these actions, we continue to support regulation and industry practices that reflect the fact that youth should not consume nicotine in any form.

Future FDA actions may influence the regulatory approach of other governments.

Until recently, there were no countries with specific product standards for heated tobacco products. Effective July 2017 and March 2018, respectively, Russia and Ukraine adopted standards that set minimum quality and safety requirements for the consumables and defined methods for demonstrating the absence of combustion, and the product standards in Kazakhstan that come into force in March 2019, also cover devices. We expect and encourage other governments to consider similar product standards going forward.

In the EU, all EU Member States and Norway have transposed the EU Tobacco Products Directive, including the provisions on novel tobacco products, such as heated tobacco units, and e-cigarettes. Most of the EU Member States require a notification submitted six months before the intended placing on the market of a novel tobacco product, while some require pre-market authorizations for the introduction of such products. To date, we have filed a comprehensive dossier summarizing our scientific assessment of *IQOS* in 22 Member States.

In addition, in Italy, in April 2018, we submitted under recent legislation an application for *HEETS*, used with the *IQOS* device, requesting regulatory recognition of the reduction of toxic substances and potential risk reduction resulting from switching to this product compared to continued cigarette smoking. In January 2019, our application was not granted primarily on the grounds of insufficient data and questions of methodology. Due to the constraints of the review process, we had been unable to supplement the application with all the data we subsequently filed with the FDA and to address methodological questions during the review. We plan to submit a new application where we will clarify the concerns raised by the decision and further strengthen our application by submitting additional evidence that became available since we submitted our first application, consistent with our FDA filing. We are confident that our evidence supports our application.

Also, pursuant to local regulations, in May 2018, we submitted a scientific dossier to regulatory authorities in Bulgaria with the notification of our intent to communicate to adult smokers the reduction of measured HPHCs and potential risk reduction resulting from switching to *IQOS* compared to continued cigarette smoking.

To date, several governmental agencies published their scientific findings that pertain to our RRP.

On December 12, 2017, at the request of the U.K. Department of Health and Public Health England, the U.K. Committee on Toxicity published its assessment of the risk of heated tobacco products relative to cigarette smoking. This assessment included analysis of scientific data for two heated tobacco products, one of which was *IQOS*. The assessment concluded that, while still harmful to health, compared with the known risks from cigarettes, heated tobacco products are probably less harmful. Subsequently, on February 6, 2018, Public Health England published a report stating that the available evidence suggests that heated tobacco products may be considerably less harmful than cigarettes and more harmful than e-cigarettes.

On May 5, 2018, the German Federal Institute for Risk Assessment (“BfR”) published a study on the *IQOS* aerosol relative to cigarette smoke using the Health Canada Intense Smoking Regimen. BfR found reductions in selected HPHCs in a range of 80-99%. This publication indicates that significant reductions in the levels of selected toxicants are likely to reduce toxicant exposure, which BfR stated might be regarded as a discrete benefit compared to combustible cigarettes.

On May 15, 2018, the Dutch National Institute for Public Health and Environment (“RIVM”) published a factsheet on novel tobacco products that heat rather than burn tobacco, focusing on *IQOS*. RIVM analyzed the *IQOS* aerosol and concluded that the use of heated tobacco units with *IQOS*, while still harmful to health, is probably less harmful than continued smoking.

On June 7, 2018, the Korean Food and Drug Administration (“KFDA”) issued a statement on products that heat rather than burn tobacco. The KFDA tested three heat-not-burn products, one of which was *IQOS*. The KFDA confirmed that the levels of the nine HPHCs tested in the aerosol of these products were on average approximately 90% lower compared to those measured in the cigarette smoke of the top five cigarette brands in South Korea. However, the KFDA stated that it could not establish that the tested heat-not-burn products are less harmful than cigarettes. In October 2018, our Korean affiliate filed a request with a local court seeking information underlying KFDA’s analysis, conclusions and public statements.

On August 17, 2018, the Science & Technology Committee of the U.K. House of Commons published a report of its inquiry into e-cigarettes and heat-not-burn tobacco products. The report concluded that e-cigarettes are significantly less harmful to health than smoking tobacco. The report also observed that for those smokers who don’t accept e-cigarettes, heat-not-burn tobacco products may offer a public health benefit despite their relative risk. The report called for a risk-proportionate regulatory environment for both e-cigarettes and heat-not-burn tobacco products and noted that e-cigarettes should remain the least taxed, cigarettes the most taxed, with heat-not-burn products falling between the two. The U.K. Committee on Advertising Practice announced the removal of a prohibition of health claims in the advertising of e-cigarettes in the U.K. effective November 2018, with a review of the impact of this decision on market practices 12 months thereafter.

We make our scientific findings publicly available for scrutiny and peer review through several channels, including our websites. From time to time, adult consumers, competitors, members of the scientific community, and others inquire into our scientific methodologies, challenge our scientific conclusions or request further study of certain aspects of our RRP and their health effects. We are committed to a robust and open scientific debate but believe that such debate should be based on accurate and reliable scientific information. We seek to provide accurate and reliable scientific information about our RRP; nonetheless, we may not be able to prevent third-party dissemination of false, misleading or unsubstantiated information about these products. The dissemination of scientifically unsubstantiated information or studies with a strong confirmation bias by third parties may cause confusion among adult smokers and affect their decision to switch to better alternatives to continued smoking, such as our RRP.

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

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

Legal Challenges to RRP: We face various administrative and legal challenges related to certain RRP activities, including allegations concerning product classification, advertising restrictions, corporate communications, *IQOS* coach activities, scientific substantiation, product liability, and unfair competition. While we design our programs to comply with relevant regulations, we expect these or similar challenges to continue as we expand our efforts to commercialize RRP and to communicate publicly. The outcomes of these matters may affect our RRP commercialization and public communication activities and performance in one or more countries.

Our RRP Business Development Initiatives: In December 2013, we established a strategic framework with Altria Group, Inc. (“Altria”) setting out terms on how the parties would collaborate to develop and commercialize e-vapor products and commercialize two of our RRP in the U.S. In late 2018, Altria announced that it will participate in the e-vapor category only through another e-vapor company in

which Altria has agreed to acquire a minority interest. We intend to hold discussions with Altria about e-vapor products following completion of its investment. Regarding heated tobacco products, as discussed above, we are seeking regulatory approval from the FDA to market *IQOS* in the U.S., and these efforts are not affected by Altria's e-vapor announcement.

Other Developments: On September 12, 2017, we announced our support of the Foundation for a Smoke-Free World. We agreed to contribute \$80 million per year over the next 12 years, as specified in the agreement. We made an initial contribution of \$4.5 million in 2017, the first annual contribution of \$80 million in the first quarter of 2018 and the second annual contribution of \$80 million in the first quarter of 2019. The Foundation is an independent body and is governed by its independent Board of Directors. The Foundation's role, as set out in its corporate charter, includes funding research in the field of tobacco harm reduction, encouraging measures that reduce the harm caused by smoking, and assessing the effect of reduced cigarette consumption on the industry value chain.

Governmental Investigations

From time to time, we are subject to governmental investigations on a range of matters, including tax, customs, antitrust, advertising, and labor practices. We describe certain matters pending in Thailand and South Korea in Item 8, Note 18. *Contingencies*.

In November 2010, a WTO panel issued its decision in a dispute relating to facts that arose from August 2006 between the Philippines and Thailand concerning a series of Thai customs and tax measures affecting cigarettes imported by PM Thailand into Thailand (see Item 8, Note 18. *Contingencies* for additional information). The WTO panel decision, which was upheld by the WTO Appellate Body, concluded that Thailand had no basis to find that PM Thailand's declared customs values and taxes paid were too low, as alleged by the DSI in 2009. The decision also created obligations for Thailand to revise its laws, regulations, or practices affecting the customs valuation and tax treatment of future cigarette imports. Thailand agreed in September 2011 to fully comply with the decision by October 2012. The Philippines asserts that to date Thailand has not fully complied with the WTO panel decision. The Philippines has repeatedly expressed concerns with ongoing investigations by Thailand of PM Thailand, including those that led to the criminal charges described in Item 8, Note 18. *Contingencies*, and has commenced two formal proceedings at the WTO to challenge criminal charges against PM Thailand arguing that the criminal charges appear to be based on grounds not supported by WTO customs valuation rules and inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies. The Philippines has also asserted that the demand notices received by PM Thailand from the Thai Customs Department in November 2017, described in Note 8. *Contingencies*, are inconsistent with Thailand's WTO obligations. On November 12, 2018, the WTO issued its decision agreeing with the Philippines that criminal charges against PM Thailand and seven former and current employees in connection with import entries of cigarettes from the Philippines during the period of July 2003 to June 2006 are inconsistent with WTO customs valuation rules. In January 2019, Thailand appealed this decision.

U.S. GAAP Treatment of Argentina as a Highly Inflationary Economy

Following the categorization of Argentina by the International Practices Task Force of the Center for Audit Quality as a country with a three-year cumulative inflation rate greater than 100%, the country is considered highly inflationary in accordance with U.S. GAAP. Consequently, we began to account for the operations of our Argentinian affiliates as highly inflationary, and to treat the U.S. dollar as the functional currency of the affiliates, effective July 1, 2018. The move to highly inflationary accounting in Argentina reduced our currency-neutral net revenue growth by approximately 0.6 points in 2018.

Acquisitions

We discuss our acquisitions in Item 8, Note 6. *Acquisitions* to our consolidated financial statements.

Investments in Unconsolidated Subsidiaries and Equity Securities

We discuss our investments in unconsolidated subsidiaries and equity securities in Item 8, Note 4. *Investments in Unconsolidated Subsidiaries and Other Related Party* and Item 8, Note 16. *Fair Value Measurements* to our consolidated financial statements.

Trade Policy

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

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

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

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

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.

2018 compared with 2017

The following discussion compares operating results within each of our reportable segments for 2018 with 2017.

Unless otherwise stated, references to total industry, total market, our shipment volume and our market share performance reflect cigarettes and heated tobacco units.

European Union:

| Financial Summary - Years Ended December 31, (in millions) | | | Change Fav./(Unfav.) | | Variance Fav./(Unfav.) | | | | |
|---|-------------|-------------|---------------------------------|------------------------|-----------------------------------|-----------------------|--------------|---------------------|------------------------|
| | 2018 | 2017 | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 9,298 | \$ 8,318 | 11.8% | 5.9% | \$ 980 | \$ 489 | \$ 248 | \$ 243 | \$ — |
| Operating Income | \$ 4,105 | \$ 3,691 | 11.2% | 2.9% | \$ 414 | \$ 308 | \$ 248 | \$ 116 | \$ (258) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding favorable currency, increased by 5.9%, reflecting a favorable pricing variance, driven notably by Germany and Italy, partly offset by France, and favorable volume/mix, driven predominantly by heated tobacco unit volume, notably in the Czech Republic, Germany and Italy, partly offset by unfavorable cigarette volume in France, Germany and Italy.

The net revenues of the European Union segment include \$865 million in 2018 and \$269 million in 2017 related to the sale of RRP.

Operating income, excluding favorable currency, increased by 2.9%, reflecting: a favorable pricing variance; favorable volume/mix, notably in Bulgaria, the Czech Republic and Poland, partly offset by France, Norway and the United Kingdom; partly offset by higher manufacturing costs and marketing, administration and research costs, primarily related to investments behind reduced-risk products across the Region.

European Union - Total Market, PMI Shipment & Market Share Commentaries

Total market, PMI shipment volume and market share performance are shown in the table below:

| European Union Key Data | Full-Year | | Change % / pp |
|--|----------------|---------|------------------|
| | 2018 | 2017 | |
| Total Market (billion units) | 484.3 | 492.4 | (1.7)% |
| PMI Shipment Volume (million units) | | | |
| Cigarettes | 179,622 | 187,293 | (4.1)% |
| Heated Tobacco Units | 5,977 | 1,889 | +100.0% |
| Total European Union | 185,599 | 189,182 | (1.9)% |
| PMI Market Share | | | |
| <i>Marlboro</i> | 18.5% | 18.8% | (0.3) |
| <i>L&M</i> | 6.9% | 6.9% | — |
| <i>Chesterfield</i> | 5.9% | 6.0% | (0.1) |
| <i>Philip Morris</i> | 2.9% | 3.1% | (0.2) |
| <i>HEETS</i> | 1.2% | 0.3% | 0.9 |
| Others | 3.1% | 3.2% | (0.1) |
| Total European Union | 38.5% | 38.3% | 0.2 |

The estimated total market in the EU decreased by 1.7% to 484.3 billion units, or by 1.5% excluding the net impact of estimated trade inventory movements, notably due to:

- France, down by 9.2%, primarily reflecting the impact of significant excise tax-driven price increases and an increase in the prevalence of illicit trade;
- Germany, down by 2.2%, primarily reflecting the impact of price increases;
- Italy, down by 1.3%, primarily reflecting the impact of price increases; and
- the United Kingdom, down by 6.9%, primarily reflecting the impact of price increases;

partly offset by

- Poland, up by 3.7%, primarily driven by a decrease in the prevalence of illicit trade.

Our total shipment volume decreased by 1.9% to 185.6 billion units, or by 1.0% excluding the net impact of estimated distributor inventory movements, notably due to:

- France, down by 6.4%, or by 5.0% excluding the net impact of estimated distributor inventory movements, primarily due to a lower total market, partly offset by higher market share, notably of *Marlboro* and *Philip Morris*;
- Germany, down by 1.8%, primarily due to the lower total market, partly offset by higher market share; and
- Italy, down by 4.1%, or by 1.9% excluding the net impact of estimated distributor inventory movements, primarily due to the lower total market and lower cigarette market share.

Our Regional market share increased by 0.2 points to 38.5%, with gains in Belgium, Bulgaria, the Canary Islands, Croatia, Denmark, France, Germany, Greece, Hungary, Latvia, Lithuania, Luxembourg, Portugal, Romania, the Slovak Republic and Slovenia.

Eastern Europe:

| <u>Financial Summary - Years Ended December 31,</u> | | | <u>Change Fav./ (Unfav.)</u> | | <u>Variance Fav./ (Unfav.)</u> | | | | |
|---|-------------|-------------|----------------------------------|------------------------|------------------------------------|-----------------------|--------------|---------------------|------------------------|
| <u>(in millions)</u> | <u>2018</u> | <u>2017</u> | <u>Total</u> | <u>Excl. Curr.</u> | <u>Total</u> | <u>Cur- rency</u> | <u>Price</u> | <u>Vol/ Mix</u> | <u>Cost/ Other</u> |
| Net Revenues | \$ 2,921 | \$ 2,711 | 7.7% | 12.1% | \$ 210 | \$ (118) | \$ 286 | \$ 42 | \$ — |
| Operating Income | \$ 902 | \$ 887 | 1.7% | 13.1% | \$ 15 | \$ (101) | \$ 286 | \$ (92) | \$ (78) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 12.1%, reflecting a favorable pricing variance, mainly driven by Russia and Ukraine, and favorable volume/mix, primarily driven by heated tobacco unit volume, notably in Russia, partly offset by unfavorable cigarette volume/mix, notably in Russia.

The net revenues of the Eastern Europe segment include \$324 million in 2018 and \$55 million in 2017 related to the sale of RRP.

Operating income, excluding unfavorable currency, increased by 13.1%, mainly reflecting a favorable pricing variance, partly offset by: unfavorable volume/mix, predominantly due to unfavorable mix in Russia, and higher manufacturing and marketing, administration and research costs, notably reflecting increased investments behind reduced-risk products, primarily in Russia.

Eastern Europe - Total Market, PMI Shipment Volume and Market Share Commentaries

The estimated total market in Eastern Europe decreased by 7.1% to 416.7 billion units, notably due to:

- Russia, down by 8.4%, primarily reflecting the timing and impact of excise tax-driven retail price increases, as well as an increase in the prevalence of illicit trade; and
- Ukraine, down by 8.1%, primarily reflecting the timing and impact of excise tax-driven retail price increases and an increase in the prevalence of illicit trade.

Our Regional market share increased by 0.6 points to 27.3%.

| <u>PMI Shipment Volume (million units)</u> | <u>Full-Year</u> | | |
|--|------------------|----------------|---------------|
| | 2018 | 2017 | Change |
| Cigarettes | 108,718 | 119,398 | (8.9)% |
| Heated Tobacco Units | 4,979 | 674 | +100.0% |
| Total Eastern Europe | 113,697 | 120,072 | (5.3)% |

Our total shipment volume decreased by 5.3% to 113.7 billion units, notably in:

- Russia, down by 6.1%, due to the lower total market, partly offset by higher total market share driven by heated tobacco unit share, partially offset by lower cigarette market share, notably due to mid-price *L&M* and low-price *Bond Street*, reflecting the impact of down-trading to competitive products, partly offset by *Philip Morris*; and
- Ukraine, down by 8.8%, mainly due to the lower total market, partly offset by higher total market share driven by heated tobacco unit volume.

Middle East & Africa:

| <u>Financial Summary -</u> <u>Years Ended December 31,</u> | | | <u>Change</u> <u>Fav./ (Unfav.)</u> | | <u>Variance</u> <u>Fav./ (Unfav.)</u> | | | | |
|---|-------------|-------------|--|------------------------------|--|-----------------------------|--------------|---------------------------|------------------------------|
| <u>(in millions)</u> | <u>2018</u> | <u>2017</u> | <u>Total</u> | <u>Excl.</u> <u>Curr.</u> | <u>Total</u> | <u>Cur-</u> <u>rency</u> | <u>Price</u> | <u>Vol/</u> <u>Mix</u> | <u>Cost/</u> <u>Other</u> |
| Net Revenues | \$ 4,114 | \$ 3,988 | 3.2 % | 8.0% | \$ 126 | \$ (193) | \$ 19 | \$ 84 | \$ 216 |
| Operating Income | \$ 1,627 | \$ 1,884 | (13.6)% | 0.3% | \$ (257) | \$ (263) | \$ 19 | \$ 13 | \$ (26) |

"Cost/Other" in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles. "Cost/Other" also includes the currency-neutral net revenue variance, unrelated to volume/mix and price components, attributable to fees for certain distribution rights billed to customers in certain markets in the ME&A Region. This immaterial presentational change, made in conjunction with the new revenue recognition standard, is prospective only.

Net revenues, excluding unfavorable currency, increased by 8.0%, reflecting: a favorable "cost/other" variance, as described above; a favorable pricing variance, driven notably by Egypt and Turkey, partly offset by Saudi Arabia; and favorable volume/mix, primarily driven by PMI Duty Free, reflecting higher heated tobacco unit volume, and Turkey, partly offset by the GCC, notably Saudi Arabia and the UAE, reflecting the impact of retail price increases following the introduction of excise tax in June and October 2017, respectively, and VAT in January 2018.

The net revenues of the Middle East & Africa segment include \$382 million in 2018 and \$94 million in 2017 related to the sale of RRP's.

Operating income, excluding unfavorable currency, increased by 0.3%, mainly reflecting: a favorable pricing variance, and favorable volume/mix, primarily driven by PMI Duty Free and Turkey, partly offset by Saudi Arabia and the UAE. These favorable variances were partly offset by higher manufacturing costs predominantly related to reduced-risk products, partly offset by lower marketing, administration and research costs.

Middle East & Africa - Total Market, PMI Shipment Volume and Market Share Commentaries

The estimated total market in the Middle East & Africa increased by 0.4% to 590.1 billion units, notably driven by:

- Turkey, up by 11.6%, primarily reflecting a reduction in the prevalence of illicit trade; partly offset by
- Algeria, down by 8.5%, or by 0.6% excluding the net impact of estimated trade inventory movements mainly associated with the timing of excise tax announcements in 2018 compared to 2017; and
- The GCC, notably Saudi Arabia and the UAE, down by 21.1% and 23.9%, respectively, primarily reflecting the impact of price increases and the introduction of the new excise tax in 2017, and VAT in January 2018.

Our Regional market share increased by 0.3 points to 23.8%.

| <u>PMI Shipment Volume (million units)</u> | <u>Full-Year</u> | | |
|--|------------------|----------------|--------------|
| | 2018 | 2017 | Change |
| Cigarettes | 136,605 | 136,759 | (0.1)% |
| Heated Tobacco Units | 3,403 | 907 | +100.0% |
| Total Middle East & Africa | 140,008 | 137,666 | 1.7 % |

Our total shipment volume increased by 1.7% to 140.0 billion units, notably in:

- Turkey, up by 10.8%, reflecting a higher total market, partly offset by lower market share; and
- PMI Duty Free, up by 6.6%, reflecting higher heated tobacco shipment volume; partly offset by

- the GCC, notably Saudi Arabia and the UAE, down by 32.5% and 55.6%, respectively, reflecting the lower total market and market share due to the impact of excise tax and VAT-driven price increases.

South & Southeast Asia:

| <u>Financial Summary - Years Ended December 31,</u> (in millions) | 2018 | 2017 | Change Fav./ (Unfav.) | | Variance Fav./ (Unfav.) | | | | |
|--|-------------|-------------|----------------------------------|------------------------|------------------------------------|-----------------------|--------------|---------------------|------------------------|
| | | | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 4,656 | \$ 4,417 | 5.4% | 10.9% | \$ 239 | \$ (244) | \$ 548 | \$ (65) | \$ — |
| Operating Income | \$ 1,747 | \$ 1,514 | 15.4% | 23.6% | \$ 233 | \$ (124) | \$ 548 | \$ (126) | \$ (65) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 10.9%, reflecting: a favorable pricing variance, driven principally by Indonesia and the Philippines, partly offset by Thailand; partly offset by unfavorable volume/mix, mainly due to unfavorable mix in Indonesia, partly offset by favorable volume in Pakistan, the Philippines and Thailand.

Operating income, excluding unfavorable currency, increased by 23.6%, mainly driven by a favorable pricing variance, partly offset by unfavorable volume/mix, mainly due to Indonesia, partly offset by Pakistan and Thailand, and higher manufacturing and marketing, administration and research costs.

South & Southeast Asia - Total Market, PMI Shipment Volume and Market Share Commentaries

The estimated total market in South & Southeast Asia increased by 1.8% to 756.7 billion, notably driven by:

- Pakistan, up by 31.2% or approximately 14.1 billion units, notably reflecting an increase in the duty-paid market driven by a reduction in the prevalence of illicit trade. Excluding the net impact of estimated trade inventory movements, the total market was up by 17.7%;

partly offset by

- the Philippines, down by 2.2%, primarily reflecting the impact of excise tax-driven retail price increases; and
- Thailand, down by 2.7%, primarily reflecting the impact of excise tax-driven price increases.

Our Regional market share increased by 0.4 points to 23.5%.

| PMI Shipment Volume (million units) | Full-Year | | |
|--|------------------|----------------|---------------|
| | 2018 | 2017 | Change |
| Cigarettes | 178,469 | 171,600 | 4.0 % |
| Heated Tobacco Units | — | — | — % |
| Total South & Southeast Asia | 178,469 | 171,600 | 4.0% |

Our total shipment volume increased by 4.0% to 178.5 billion units, notably driven by:

- Pakistan, up by 27.0%, reflecting the higher total market, partly offset by lower market share;
- the Philippines, up by 1.1%, mainly reflecting higher market share, driven by *Marlboro* and *Fortune*, partly offset by a lower total market; and
- Thailand, up by 67.1%, mainly reflecting higher market share driven by the price repositioning of the *L&M 7.1* variant in 2017 and its subsequent distribution expansion during 2018.

East Asia & Australia:

| <u>Financial Summary -</u> <u>Years Ended December 31,</u> | | | <u>Change</u> <u>Fav./ (Unfav.)</u> | | <u>Variance</u> <u>Fav./ (Unfav.)</u> | | | | |
|---|-------------|-------------|--|------------------------------|--|--------------------------------|--------------|---------------------------|------------------------------|
| <u>(in millions)</u> | <u>2018</u> | <u>2017</u> | <u>Total</u> | <u>Excl.</u> <u>Curr.</u> | <u>Total</u> | <u>Cur-</u> <u>currency</u> | <u>Price</u> | <u>Vol/</u> <u>Mix</u> | <u>Cost/</u> <u>Other</u> |
| Net Revenues | \$ 5,580 | \$ 6,373 | (12.4)% | (13.4)% | \$ (793) | \$ 62 | \$ 55 | \$ (910) | \$ — |
| Operating Income | \$ 1,851 | \$ 2,608 | (29.0)% | (28.9)% | \$ (757) | \$ (2) | \$ 55 | \$ (704) | \$ (106) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding favorable currency, decreased by 13.4%, reflecting an unfavorable volume/mix, substantially due to Japan, primarily related to the net impact of estimated distributor inventory movements described below, as well as Australia, partly offset by favorable heated tobacco unit volume in Korea. The unfavorable volume/mix was partly offset by a favorable pricing variance, driven by: Australia and Japan; partly offset by Korea, mainly due to higher excise tax.

The net revenues of the East Asia & Australia segment include \$2,506 million in 2018 and \$3,218 million in 2017 related to the sale of RRP.

Operating income, excluding unfavorable currency, decreased by 28.9%, mainly reflecting: unfavorable volume/mix, substantially due to Japan, as well as Australia, partly offset by favorable heated tobacco unit volume in Korea; and higher marketing, administration and research costs, primarily related to investments behind reduced-risk products. These unfavorable variances were partly offset by a favorable pricing variance, as well as favorable manufacturing costs related to Japan.

East Asia & Australia - Total Market, PMI Shipment Volume and Market Share Commentaries

The estimated total market in East Asia & Australia, excluding China, decreased by 3.4% to 311.5 billion units, notably due to:

- Australia, down by 8.4%, primarily reflecting the impact of excise tax-driven retail price increases;
- Japan, down by 2.4%, or down by 2.8% excluding the impact of estimated trade and consumer inventory movements following the October 1 excise tax-driven retail price increases;
- Korea, down by 1.5%, or by 2.2% excluding the net impact of estimated trade inventory movements, partly related to the implementation of graphic health warnings in December 2018; and
- Taiwan, down by 13.5%, or by 12.7% excluding the net impact of estimated trade inventory movements, mainly due to excise tax-driven retail price increases in 2017.

Our Regional market share, excluding China, increased by 2.0 points to 27.4%.

| PMI Shipment Volume (million units) | Full-Year | | |
|--|---------------|---------------|----------------|
| | 2018 | 2017 | Change |
| Cigarettes | 56,163 | 62,653 | (10.4)% |
| Heated Tobacco Units | 26,866 | 32,729 | (17.9)% |
| Total East Asia & Australia | 83,029 | 95,382 | (13.0)% |

Our total shipment volume decreased by 13.0% to 83.0 billion units, due to lower cigarette shipment volume, principally in Japan and Korea, and lower heated tobacco unit shipment volume in Japan, reflecting the net impact of estimated distributor inventory movements, partly offset by higher heated tobacco unit shipment volume in Korea.

Excluding the net impact of an estimated 15.5 billion units of total distributor inventory movements, primarily due to Japan, reflecting net unfavorable heated tobacco unit inventory movements of approximately 17.3 billion units, partly offset by net favorable cigarette inventory movements of approximately 1.8 billion units, our total shipment volume increased by 3.7%.

Our total shipment volume in Japan was down by 21.0%. Excluding the net impact of estimated distributor inventory movements of approximately 15.6 billion units, our total shipment volume in Japan was up by 3.1%, reflecting an increase of heated tobacco unit volume of 40.3%, partly offset by a decline of cigarette volume of 15.8%.

Latin America & Canada:

| <u>Financial Summary - Years Ended December 31,</u> | | | <u>Change Fav./ (Unfav.)</u> | | <u>Variance Fav./ (Unfav.)</u> | | | | |
|---|-------------|-------------|----------------------------------|------------------------|------------------------------------|-----------------------|--------------|---------------------|------------------------|
| <u>(in millions)</u> | <u>2018</u> | <u>2017</u> | <u>Total</u> | <u>Excl. Curr.</u> | <u>Total</u> | <u>Cur- rency</u> | <u>Price</u> | <u>Vol/ Mix</u> | <u>Cost/ Other</u> |
| Net Revenues | \$ 3,056 | \$ 2,941 | 3.9% | 7.3% | \$ 115 | \$ (99) | \$ 332 | \$ (118) | \$ — |
| Operating Income | \$ 1,145 | \$ 997 | 14.8% | 18.1% | \$ 148 | \$ (32) | \$ 332 | \$ (111) | \$ (41) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 7.3%, reflecting a favorable pricing variance across the Region, notably in Argentina, Canada and Mexico, partly offset by unfavorable volume/mix, mainly due to Argentina and Canada.

The net revenues of the Latin America & Canada segment include \$19 million in 2018 and \$4 million in 2017 related to the sale of RRP.

Operating income, excluding unfavorable currency, increased by 18.1%, largely reflecting a favorable pricing variance, partly offset by: unfavorable volume/mix, mainly in Argentina and Canada, as well as higher marketing, administration and research costs, primarily related to increased investment behind reduced-risk products in the Region, coupled with an unfavorable comparison to 2017 related to the sale of assets, primarily in the Dominican Republic.

Latin America & Canada - Total Market, PMI Shipment Volume and Market Share Commentaries

The estimated total market in Latin America & Canada decreased by 4.8% to 202.7 billion units, primarily due to the impact of cumulative price increases in Argentina, down by 3.2%, Brazil, down by 6.2%, Canada, down by 5.1% and Colombia, down by 12.1%, where excise tax reform drove an approximate 25% increase in retail prices in January 2018.

Our Regional market share increased by 0.4 points to 40.0%.

| <u>PMI Shipment Volume (million units)</u> | <u>Full-Year</u> | | |
|--|------------------|---------------|---------------|
| | 2018 | 2017 | Change |
| Cigarettes | 80,738 | 84,223 | (4.1)% |
| Heated Tobacco Units | 147 | 27 | +100.0% |
| Total Latin America & Canada | 80,885 | 84,250 | (4.0)% |

Our total shipment volume decreased by 4.0% to 80.9 billion units, notably due to:

- Argentina, down by 4.6%, reflecting the lower total market and lower market share; and
- Colombia, down by 11.0%, reflecting the lower total market.

2017 compared with 2016

The following discussion compares operating results within each of our reportable segments for 2017 with 2016.

Unless otherwise stated, references to total industry, total market, our shipment volume and our market share performance reflect cigarettes and heated tobacco units.

European Union:

| <u>Financial Summary - Years Ended December 31,</u> (in millions) | | | <u>Change Fav./(Unfav.)</u> | | <u>Variance Fav./(Unfav.)</u> | | | | |
|--|----------|----------|---------------------------------|----------------|-----------------------------------|---------------|--------|-------------|----------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 8,318 | \$ 8,162 | 1.9 % | 1.4 % | \$ 156 | \$ 45 | \$ 156 | \$ (45) | \$ — |
| Operating Income | \$ 3,691 | \$ 3,920 | (5.8)% | (4.7)% | \$ (229) | \$ (43) | \$ 156 | \$ (119) | \$ (223) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding favorable currency, increased by 1.4%, due to price increases, partially offset by unfavorable volume/mix.

The net revenues of the European Union segment include \$269 million in 2017 and \$57 million in 2016 related to the sale of RRP's.

Operating income, excluding unfavorable currency, decreased by 4.7%, due primarily to higher marketing, administration and research costs (primarily related to increased investment behind reduced-risked products) and unfavorable volume/mix, partly offset by price increases and lower manufacturing costs.

European Union - Total Market, PMI Shipment & Market Share Commentaries

Total market, PMI shipment volume and market share performance were as follows:

| <u>European Union Key Data</u> | <u>Full-Year</u> | | |
|--|------------------|---------|------------------|
| | 2017 | 2016 | Change % / pp |
| Total Market (billion units) | 492.4 | 501.8 | (1.9)% |
| PMI Shipment Volume (million units) | | | |
| Cigarettes | 187,293 | 193,586 | (3.3)% |
| Heated Tobacco Units | 1,889 | 224 | +100.0% |
| Total European Union | 189,182 | 193,810 | (2.4)% |
| PMI Market Share | | | |
| Marlboro | 18.8% | 19.0% | (0.2) |
| L&M | 6.9% | 6.9% | — |
| Chesterfield | 6.0% | 5.9% | 0.1 |
| Philip Morris | 3.1% | 3.2% | (0.1) |
| HEETS | 0.3% | —% | 0.3 |
| Others | 3.2% | 3.3% | (0.1) |
| Total European Union | 38.3% | 38.3% | — |

The estimated total market in the European Union decreased by 1.9% to 492.4 billion units. Our Regional market share was flat at 38.3%, with gains in France, Germany and Poland offset by declines in Italy and Spain.

Our total shipment volume decreased by 2.4% to 189.2 billion units, or by 1.9% excluding estimated net inventory movements, notably in Italy and Spain.

Eastern Europe:

| <u>Financial Summary - Years Ended December 31,</u> (in millions) | | | <u>Change Fav./((Unfav.))</u> | | <u>Variance Fav./((Unfav.))</u> | | | | |
|--|----------|----------|-----------------------------------|----------------|-------------------------------------|---------------|--------|-------------|----------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 2,711 | \$ 2,484 | 9.1 % | (0.1)% | \$ 227 | \$ 229 | \$ 157 | \$ (159) | \$ — |
| Operating Income | \$ 887 | \$ 890 | (0.3)% | (9.8)% | \$ (3) | \$ 84 | \$ 157 | \$ (164) | \$ (80) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding favorable currency, decreased by 0.1%, due to unfavorable volume/mix, partially offset by price increases.

The net revenues of the Eastern Europe segment include \$55 million in 2017 and \$6 million in 2016 related to the sale of RRP's.

Operating income, excluding favorable currency, decreased by 9.8%, due primarily to unfavorable volume/mix and higher marketing, administration and research costs, partly offset by price increases.

Eastern Europe - Total Market, PMI Shipment Volume & Market Share Commentaries

The estimated total market in Eastern Europe decreased by 6.2% to 448.4 billion units. Our Regional market share was down at 26.7%.

| <u>PMI Shipment Volume (million units)</u> | <u>Full-Year</u> | | |
|--|------------------|----------------|---------------|
| | 2017 | 2016 | Change |
| Cigarettes | 119,398 | 129,456 | (7.8)% |
| Heated Tobacco Units | 674 | 64 | +100.0% |
| Total Eastern Europe | 120,072 | 129,520 | (7.3)% |

Our total shipment volume decreased by 7.3% to 120.1 billion units, mainly reflecting: lower cigarette shipment volume in Russia and Ukraine; partly offset by higher heated tobacco unit shipment volume.

Middle East & Africa:

| <u>Financial Summary - Years Ended December 31,</u> (in millions) | | | <u>Change Fav./((Unfav.))</u> | | <u>Variance Fav./((Unfav.))</u> | | | | |
|--|----------|----------|-----------------------------------|----------------|-------------------------------------|---------------|--------|-------------|----------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Cur- rency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 3,988 | \$ 4,516 | (11.7)% | (0.2)% | \$ (528) | \$ (520) | \$ 207 | \$ (215) | \$ — |
| Operating Income | \$ 1,884 | \$ 1,990 | (5.3)% | (5.0)% | \$ (106) | \$ (6) | \$ 207 | \$ (180) | \$ (127) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, decreased by 0.2% due to unfavorable volume/mix, partially offset by price increases.

The net revenues of the Middle East & Africa segment include \$94 million in 2017 and \$4 million in 2016 related to the sale of RRP's.

Operating income, excluding unfavorable currency, decreased by 5.0%, due primarily to unfavorable volume/mix and higher marketing, administration and research costs, partly offset by price increases.

Middle East & Africa - Total Market, PMI Shipment Volume & Market Share Commentaries

The estimated total market in Middle East & Africa was flat at 587.5 billion units. Our Regional market share decreased by 0.4 points to 23.5%.

| PMI Shipment Volume (million units) | Full-Year | | |
|---------------------------------------|----------------|----------------|---------------|
| | 2017 | 2016 | Change |
| Cigarettes | 136,759 | 141,937 | (3.6)% |
| Heated Tobacco Units | 907 | 36 | +100.0% |
| Total Middle East & Africa | 137,666 | 141,973 | (3.0)% |

Our total shipment volume decreased by 3.0% to 137.7 billion units, mainly reflecting: lower cigarette shipment volume in Saudi Arabia - where our cigarette shipment volume declined by 35.8%, impacted by the new excise tax implemented in June 2017 that resulted in the doubling of retail prices; partly offset by higher cigarette shipment volume in North Africa, notably Algeria, and higher heated tobacco unit shipment volume.

South & Southeast Asia:

| <u>Financial Summary - Years Ended December 31,</u> (in millions) | | | Change Fav./(Unfav.) | | Variance Fav./(Unfav.) | | | | |
|--|----------|----------|-------------------------|----------------|---------------------------|----------|--------|-------------|----------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Currency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 4,417 | \$ 4,396 | 0.5% | 1.9% | \$ 21 | \$ (63) | \$ 353 | \$ (269) | \$ — |
| Operating Income | \$ 1,514 | \$ 1,474 | 2.7% | 5.9% | \$ 40 | \$ (47) | \$ 353 | \$ (236) | \$ (30) |

"Cost/Other" in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 1.9%, due to price increases, partially offset by unfavorable volume/mix.

Operating income, excluding unfavorable currency, increased by 5.9%, due primarily to price increases, partially offset by unfavorable volume/mix, higher marketing, administration and research costs and higher manufacturing costs.

South & Southeast Asia - Total Market, PMI Shipment Volume & Market Share Commentaries

The estimated total market in South & Southeast Asia decreased by 2.5% to 743.6 billion units. Our Regional market share decreased by 1.2 points to 23.1%.

| PMI Shipment Volume (million units) | Full-Year | | |
|-------------------------------------|-----------|---------|--------|
| | 2017 | 2016 | Change |
| Cigarettes | 171,600 | 185,279 | (7.4)% |
| Heated Tobacco Units | — | — | — % |
| Total South & Southeast Asia | 171,600 | 185,279 | (7.4)% |

Our total shipment volume decreased by 7.4% to 171.6 billion units, mainly reflecting: lower cigarette shipment volume in Indonesia, Pakistan - impacted by excise tax-driven price increases in 2017 and an increase in the prevalence of illicit trade - and the Philippines.

East Asia & Australia:

| <u>Financial Summary -</u> <u>Years Ended December 31,</u> (in millions) | | | Change Fav./(Unfav.) | | Variance Fav./(Unfav.) | | | | |
|--|----------|----------|-------------------------|----------------|---------------------------|----------|--------|-------------|----------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Currency | Price | Vol/ Mix | Cost/ Other |
| Net Revenues | \$ 6,373 | \$ 4,285 | 48.7% | 50.5% | \$ 2,088 | (74) | \$ 206 | \$ 1,956 | \$ — |
| Operating Income | \$ 2,608 | \$ 1,691 | 54.2% | 58.7% | \$ 917 | (75) | \$ 206 | \$ 858 | \$ (72) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 50.5%, due to favorable volume/mix and price increases.

The net revenues of the East Asia & Australia segment include \$3.2 billion in 2017 and \$666 million in 2016 related to the sale of RRP.

Operating income, excluding unfavorable currency, increased by 58.7%, due primarily to favorable volume/mix, price increases and lower manufacturing costs, partially offset by higher marketing, administration and research costs (principally related to increased investment behind reduced-risk products).

East Asia & Australia - Total Market, PMI Shipment Volume & Market Share Commentaries

The estimated total market in East Asia & Australia, excluding China, decreased by 4.5% to 322.5 billion units. Our Regional market share, excluding China, increased by 2.6 points to 25.4%.

| PMI Shipment Volume (million units) | Full-Year | | |
|-------------------------------------|-----------|--------|---------|
| | 2017 | 2016 | Change |
| Cigarettes | 62,653 | 74,750 | (16.2)% |
| Heated Tobacco Units | 32,729 | 7,070 | +100.0% |
| Total East Asia & Australia | 95,382 | 81,820 | 16.6 % |

Our total shipment volume increased by 16.6% to 95.4 billion units, reflecting: higher heated tobacco unit shipment volume, mainly in Japan and Korea, partly offset by lower cigarette shipment volume in Japan and Korea.

Our total shipment volume benefited from the favorable net impact of estimated combustible and heated tobacco unit inventory movements, which were driven by approximately 8.5 billion units net in Japan, reflecting: the increasing demand for *HeatSticks*, anticipated to further increase in the first quarter of 2018 following a planned lifting of the restriction on *IQOS* device sales; the establishment of appropriate distributor inventory levels of heated tobacco units, given the current high dependence on a single manufacturing center; and the transition

from air freight to sea freight of heated tobacco units, largely completed in the fourth quarter of 2017. Excluding the impact of total estimated net inventory movements, our total shipment volume increased by 6.3%.

Latin America & Canada:

| <u>Financial Summary -</u> <u>Years Ended December 31,</u> (in millions) | | | Change Fav./(Unfav.) | | Variance Fav./(Unfav.) | | | | |
|--|----------|----------|---------------------------------------|-------------|---|----------|--------|----------|------------|
| | 2017 | 2016 | Total | Excl. Curr. | Total | Currency | Price | Vol/Mix | Cost/Other |
| Net Revenues | \$ 2,941 | \$ 2,842 | 3.5% | 5.4% | \$ 99 | \$ (54) | \$ 307 | \$ (154) | \$ — |
| Operating Income | \$ 997 | \$ 938 | 6.3% | 13.8% | \$ 59 | \$ (70) | \$ 307 | \$ (152) | \$ (26) |

“Cost/Other” in the above table reflects the currency-neutral variances of: cost of sales (excluding the volume/mix cost component); marketing, administration and research costs; asset impairment and exit costs; and amortization of intangibles.

Net revenues, excluding unfavorable currency, increased by 5.4%, due to price increases, partially offset by unfavorable volume/mix.

The net revenues of the Latin America & Canada segment include \$4 million in 2017 and \$1 million in 2016 related to the sale of RRP.

Operating income, excluding unfavorable currency, increased by 13.8%, due primarily to price increases, partially offset by unfavorable volume/mix and higher manufacturing costs.

Latin America & Canada - Total Market, PMI Shipment Volume & Market Share Commentaries

The estimated total market in Latin America & Canada decreased by 3.9% to 212.9 billion units. Our Regional market share decreased by 0.1 point to 39.6%.

| PMI Shipment Volume (million units) | Full-Year | | |
|--|------------------|--------|--------|
| | 2017 | 2016 | Change |
| Cigarettes | 84,223 | 87,938 | (4.2)% |
| Heated Tobacco Units | 27 | — | — % |
| Total Latin America & Canada | 84,250 | 87,938 | (4.2)% |

Our total shipment volume decreased by 4.2% to 84.3 billion units, mainly due to lower cigarette shipment volume in Argentina, Brazil, Canada, Colombia and Mexico.

Financial Review

• **Net Cash Provided by Operating Activities**

Net cash provided by operating activities of \$9.5 billion for the year ended December 31, 2018, increased by \$0.6 billion from the comparable 2017 period. Excluding the 2017 cash flow movements resulting from the Tax Cuts and Jobs Act as described below, as well as unfavorable currency movements of \$0.2 billion, the increase in cash flows provided by operating activities was attributable to higher net earnings and the 2017 payment in the South Korean tax matter (see Item 8, Note 18. *Contingencies* for additional information), partially offset by other movements.

The variance in our working capital movements was essentially flat, excluding the 2017 movements related to the Tax Cuts and Jobs Act, as the positive impact of timing of receivables collections and the timing of inventory movements and related excise tax payments were largely offset by the transition tax installment payments in 2018 of \$0.2 billion and cash used for accounts payable in 2018 reflecting higher IQOS device purchases in the fourth quarter of 2017.

Net cash provided by operating activities of \$8.9 billion for the year ended December 31, 2017, increased by \$0.8 billion from the comparable 2016 period. While the impacts of the Tax Cuts and Jobs Act reduced net earnings by \$1.6 billion, there was no net impact on operating cash flows for the year, as the changes in deferred taxes and income taxes payable offset the net earnings impact. Excluding the impact of the Tax Cuts and Jobs Act as well as favorable currency movements of \$0.4 billion, the increase in cash flows provided by operating activities can be attributed to higher net earnings offset by working capital and other movements.

At December 31, 2017, PMI recorded an income tax payable of \$1.7 billion representing the transition tax of \$2.2 billion, partially offset by foreign tax credits related to foreign withholding taxes previously paid of \$0.5 billion. The income tax payable is due over an 8-year period beginning in 2018. For further details, see Item 8, Note 11. *Income Taxes* to our consolidated financial statements.

- **Net Cash Used in Investing Activities**

Net cash used in investing activities of \$1.0 billion for the year ended December 31, 2018, decreased by \$2.1 billion from the comparable 2017 period. This decrease was due principally to lower cash collateral posted to secure derivatives designated as net investment hedges of Euro assets principally related to changes in exchange rates between the Euro and the U.S. dollar, and lower capital expenditures. For further details on our derivatives designated as net investment hedges, see Item 8, Note 15. *Financial Instruments*.

Net cash used in investing activities of \$3.1 billion for the year ended December 31, 2017, increased by \$2.2 billion from the comparable 2016 period. This increase in net cash used of \$2.2 billion was due principally to cash collateral posted to secure derivatives designated as net investment hedges of Euro assets following the strengthening of the Euro versus the U.S. dollar, and higher capital expenditures. For further details on our derivatives designated as net investment hedges, see Item 8, Note 15. *Financial Instruments*.

Our capital expenditures were \$1.4 billion in 2018, \$1.5 billion in 2017 and \$1.2 billion in 2016. The 2018 expenditures were primarily related to our ongoing investments in RRP's to support capacity expansion (notably for heated tobacco units). We expect total capital expenditures in 2019 of approximately \$1.1 billion (including capital expenditures related to our ongoing investment in RRP's), to be funded by operating cash flows.

- **Net Cash Used in Financing Activities**

During 2018, net cash used in financing activities was \$9.7 billion, compared with net cash used in financing activities of \$2.8 billion during 2017 and \$5.4 billion in 2016.

The 2018 change was due primarily to lower proceeds from long-term debt issuances (primarily the \$6.9 billion proceeds in 2017 from our U.S. dollar and Euro debt issuances), and the purchase of the remaining 49% interest in our Costa Rican affiliates in 2018. For further details on the purchase of the remaining 49% interest in our Costa Rican affiliates, see Item 8, Note 6. *Acquisitions*.

The 2017 change was due primarily to higher proceeds from long-term debt issuances (primarily the \$6.9 billion proceeds in 2017 from our U.S. dollar and Euro debt issuances versus the \$3.5 billion proceeds in 2016 from our U.S. dollar and Euro debt issuances).

Dividends paid in 2018, 2017 and 2016 were \$6.9 billion, \$6.5 billion and \$6.4 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 demand deposits with institutions that have investment-grade long-term credit rating. As part of our cash management strategy and in order to manage counterparty exposure, we also enter into reverse repurchase agreements. Such agreements are collateralized with government or corporate securities held by a custodial bank and, at maturity, cash is paid back to PMI, and the collateral is returned to the bank. While we entered into these agreements during the periods and had an average balance during 2018 and 2017 of \$0.3 billion and \$0.9 billion, respectively, we had a zero balance both at December 31, 2018, and December 31, 2017.

We utilize long-term and short-term debt financing, including a commercial paper program that is regularly used to finance ongoing liquidity requirements, as part of our overall cash management strategy. Our ability to access the capital and credit markets as well as overall dynamics of these markets may impact borrowing costs. We expect that the combination of our long-term and short-term debt financing, the commercial paper program and the committed credit facilities, coupled with our operating cash flows, will enable us to meet our liquidity requirements.

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. On March 1, 2018, Standard & Poor's affirmed our long-term credit rating at "A" and short-term at "A-1", and revised our outlook to "Stable" from "Negative." On August 3, 2018, Fitch affirmed our long-term credit rating at "A" and short-term at "F1", and revised our outlook to "Stable" from "Negative." At February 7, 2019, 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 28, 2019, we entered into an agreement to extend the term of our \$2.0 billion 364-day revolving credit facility from February 5, 2019, to February 4, 2020.

At February 7, 2019, our committed credit facilities were as follows:

(in billions)

| Type | Committed Credit Facilities |
|---|-----------------------------|
| 364-day revolving credit, expiring February 4, 2020 | \$ 2.0 |
| Multi-year revolving credit, expiring February 28, 2021 | 2.5 |
| Multi-year revolving credit, expiring October 1, 2022 | 3.5 |
| Total facilities | \$ 8.0 |

At February 7, 2019, there were no borrowings under the committed credit facilities, and the entire committed amounts were available for borrowing.

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

Each of these facilities requires us to maintain a ratio of consolidated earnings before interest, taxes, depreciation and amortization ("consolidated EBITDA") to consolidated interest expense of not less than 3.5 to 1.0 on a rolling four-quarter basis. At December 31, 2018, our ratio calculated in accordance with the agreements was 10.5 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 \$3.3 billion at December 31, 2018, and \$2.8 billion at December 31, 2017, are for the sole use of our subsidiaries. Borrowings under these arrangements amounted to \$730 million at December 31, 2018, and \$499 million at December 31, 2017.

Commercial Paper Program – We continue to have access to liquidity in the commercial paper market through programs in place in the U.S. and in Europe having an aggregate issuance capacity of \$8.0 billion. At December 31, 2018, and December 31, 2017, we had no commercial paper outstanding. The average commercial paper balance outstanding during 2018 and 2017 was \$3.4 billion and \$5.2 billion, respectively.

Sale of Accounts Receivable – To mitigate credit risk and enhance cash and liquidity management we sell trade receivables to unaffiliated financial institutions. These arrangements allow us to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the consolidated balance sheets. We sell trade receivables under two types of arrangements, servicing and nonservicing.

Our operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the consolidated balance sheets, which remained outstanding with the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of December 31, 2018, 2017 and 2016, were \$1.0 billion, \$1.1 billion and \$0.7 billion, respectively. The net proceeds received are included in cash provided by operating activities in the consolidated statements of cash flows.

For further details, see Item 8, Note 20. *Sale of Accounts Receivable* to our consolidated financial statements.

Debt – Our total debt was \$31.8 billion at December 31, 2018, and \$34.3 billion at December 31, 2017. Our total debt is primarily fixed rate in nature. For further details, see Item 8, Note 7. *Indebtedness*. The weighted-average all-in financing cost of our total debt was 2.5% in 2018, compared to 2.6% in 2017. 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 14, 2017, 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.

During 2018, we had no public debt issuances.

The weighted-average time to maturity of our long-term debt was 9.6 years at the end of 2018 and 9.4 years at the end of 2017.

- **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, 2018, we were contingently liable for \$0.3 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, 2018, our third-party guarantees were insignificant.

Aggregate Contractual Obligations – The following table summarizes our contractual obligations at December 31, 2018:

| (in millions) | Total | Payments Due | | | |
|--|----------|--------------|-----------|-----------|---------------------|
| | | 2019 | 2020-2021 | 2022-2023 | 2024 and Thereafter |
| Long-term debt ⁽¹⁾ | \$31,268 | \$4,054 | \$7,098 | \$4,358 | \$15,758 |
| Interest on borrowings ⁽²⁾ | 10,360 | 902 | 1,542 | 1,258 | 6,658 |
| Operating leases ⁽³⁾ | 772 | 147 | 176 | 95 | 354 |
| Purchase obligations ⁽⁴⁾ : | | | | | |
| Inventory and production costs | 4,217 | 2,492 | 1,165 | 406 | 154 |
| Other | 2,629 | 1,070 | 842 | 227 | 490 |
| | 6,846 | 3,562 | 2,007 | 633 | 644 |
| Other long-term liabilities ⁽⁵⁾ | 1,916 | 78 | 346 | 448 | 1,044 |
| | \$51,162 | \$8,743 | \$11,169 | \$6,792 | \$24,458 |

⁽¹⁾ Amounts represent the expected cash payments at the face value of our long-term debt and capital lease obligations. For further details, see Item 8, Note 7. *Indebtedness* to our consolidated financial statements.

⁽²⁾ 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 debt is estimated using the rate in effect at December 31, 2018. 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.

⁽³⁾ Amounts represent the minimum rental commitments under non-cancelable operating leases.

⁽⁴⁾ 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. Other purchase obligations also include the expected future contributions to the Foundation for a Smoke-Free World. For further details see *Business Environment—Other Developments*. 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.

⁽⁵⁾ Other long-term liabilities consist primarily of transition tax (as discussed in Item 8, Note 11. *Income Taxes* to our consolidated financial statements), 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 \$119 million in 2019, based on current tax and benefit laws (as discussed in Item 8, Note 13. *Benefit Plans* to our consolidated financial statements).

• Equity and Dividends

We discuss our stock awards as of December 31, 2018, in Item 8, Note 9. *Stock Plans* to our consolidated financial statements.

During 2018, 2017 and 2016, we did not repurchase any shares under a share repurchase program, and we do not presently intend to repurchase shares of our common stock in 2019.

Dividends paid in 2018 were \$6.9 billion. During the second quarter of 2018, our Board of Directors approved a 6.5% increase in the quarterly dividend to \$1.14 per common share. As a result, the present annualized dividend rate is \$4.56 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 demand 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 and interest 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 19. *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/covariance” 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, 2018 and 2017, 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 December 31, 2018 | Average | High | Low |
| Instruments sensitive to: | | | | |
| Foreign currency rates | \$19 | \$20 | \$23 | \$19 |
| Fair Value Impact | | | | |
| (in millions) | At December 31, 2018 | Average | High | Low |
| Instruments sensitive to: | | | | |
| Interest rates | \$142 | \$132 | \$152 | \$96 |
| Pre-Tax Earnings Impact | | | | |
| (in millions) | At December 31, 2017 | Average | High | Low |
| Instruments sensitive to: | | | | |
| Foreign currency rates | \$27 | \$49 | \$58 | \$27 |
| Fair Value Impact | | | | |
| (in millions) | At December 31, 2017 | Average | High | Low |
| Instruments sensitive to: | | | | |
| Interest rates | \$118 | \$150 | \$173 | \$118 |

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 18. *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. Our RRP's constitute a new product category in its early stages that is less predictable than our mature cigarette business. 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 this discussion of potential risks or uncertainties to be complete. 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*.

Item 8. Financial Statements and Supplementary Data.

Consolidated Statements of Earnings

(in millions of dollars, except per share data)

| for the years ended December 31, | 2018 | 2017 | 2016 |
|---|-----------|-----------|-----------|
| Revenues including excise taxes | \$ 79,823 | \$ 78,098 | \$ 74,953 |
| Excise taxes on products | 50,198 | 49,350 | 48,268 |
| Net revenues (Notes 2 & 21) | 29,625 | 28,748 | 26,685 |
| Cost of sales | 10,758 | 10,432 | 9,391 |
| Gross profit | 18,867 | 18,316 | 17,294 |
| Marketing, administration and research costs | 7,408 | 6,647 | 6,317 |
| Amortization of intangibles | 82 | 88 | 74 |
| Operating income | 11,377 | 11,581 | 10,903 |
| Interest expense, net (Note 14) | 665 | 914 | 891 |
| Pension and other employee benefit costs (Note 13) | 41 | 78 | 88 |
| Earnings before income taxes | 10,671 | 10,589 | 9,924 |
| Provision for income taxes (Note 11) | 2,445 | 4,307 | 2,768 |
| Equity investments and securities (income)/loss, net | (60) | (59) | (94) |
| Net earnings | 8,286 | 6,341 | 7,250 |
| Net earnings attributable to noncontrolling interests | 375 | 306 | 283 |
| Net earnings attributable to PMI | \$ 7,911 | \$ 6,035 | \$ 6,967 |
| Per share data (Note 10): | | | |
| Basic earnings per share | \$ 5.08 | \$ 3.88 | \$ 4.48 |
| Diluted earnings per share | \$ 5.08 | \$ 3.88 | \$ 4.48 |

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Earnings

(in millions of dollars)

| for the years ended December 31, | 2018 | 2017 | 2016 |
|--|----------|----------|----------|
| Net earnings | \$ 8,286 | \$ 6,341 | \$ 7,250 |
| Other comprehensive earnings (losses), net of income taxes: | | | |
| Change in currency translation adjustments: | | | |
| Unrealized gains (losses), net of income taxes of (\$47) in 2018, \$620 in 2017 and (\$101) in 2016 | (812) | 330 | (14) |
| (Gains)/losses transferred to earnings, net of income taxes of \$0 in 2018, 2017 and 2016 | — | (2) | 5 |
| Change in net loss and prior service cost: | | | |
| Net gains (losses) and prior service costs, net of income taxes of \$65 in 2018, (\$17) in 2017 and \$78 in 2016 | (1,046) | 523 | (460) |
| Amortization of net losses, prior service costs and net transition costs, net of income taxes of (\$43) in 2018, (\$31) in 2017 and (\$43) in 2016 | 218 | 228 | 224 |
| Change in fair value of derivatives accounted for as hedges: | | | |
| Gains (losses) recognized, net of income taxes of (\$4) in 2018, \$8 in 2017 and (\$4) in 2016 | 24 | (44) | 8 |
| (Gains) losses transferred to earnings, net of income taxes of \$5 in 2018, \$2 in 2017 and (\$3) in 2016 | (31) | (11) | 30 |
| Total other comprehensive earnings (losses) | (1,647) | 1,024 | (207) |
| Total comprehensive earnings | 6,639 | 7,365 | 7,043 |
| Less comprehensive earnings attributable to: | | | |
| Noncontrolling interests | 304 | 306 | 233 |
| Comprehensive earnings attributable to PMI | \$ 6,335 | \$ 7,059 | \$ 6,810 |

See notes to consolidated financial statements.

Consolidated Balance Sheets

(in millions of dollars, except share data)

| at December 31, | 2018 | 2017 |
|--|-------------------------|-------------------------|
| Assets | | |
| Cash and cash equivalents | \$ 6,593 | \$ 8,447 |
| Trade receivables (less allowances of \$25 in 2018 and \$25 in 2017) | 2,950 | 3,194 |
| Other receivables | 614 | 544 |
| Inventories: | | |
| Leaf tobacco | 2,318 | 2,606 |
| Other raw materials | 1,405 | 1,563 |
| Finished product | 5,081 | 4,637 |
| | <u>8,804</u> | <u>8,806</u> |
| Other current assets | 481 | 603 |
| Total current assets | <u>19,442</u> | <u>21,594</u> |
| Property, plant and equipment, at cost: | | |
| Land and land improvements | 600 | 639 |
| Buildings and building equipment | 3,975 | 3,989 |
| Machinery and equipment | 9,096 | 8,976 |
| Construction in progress | 886 | 962 |
| | <u>14,557</u> | <u>14,566</u> |
| Less: accumulated depreciation | 7,356 | 7,295 |
| | <u>7,201</u> | <u>7,271</u> |
| Goodwill (Note 3) | 7,189 | 7,666 |
| Other intangible assets, net (Note 3) | 2,278 | 2,432 |
| Investments in unconsolidated subsidiaries and equity securities (Notes 4 & 16) | 1,269 | 1,074 |
| Deferred income taxes | 977 | 1,007 |
| Other assets | 1,445 | 1,924 |
| Total Assets | <u><u>\$ 39,801</u></u> | <u><u>\$ 42,968</u></u> |

See notes to consolidated financial statements.

| at December 31, | 2018 | 2017 |
|---|------------------|------------------|
| Liabilities | | |
| Short-term borrowings (Note 7) | \$ 730 | \$ 499 |
| Current portion of long-term debt (Note 7) | 4,054 | 2,506 |
| Accounts payable | 2,068 | 2,242 |
| Accrued liabilities: | | |
| Marketing and selling | 732 | 708 |
| Taxes, except income taxes | 5,088 | 5,324 |
| Employment costs | 794 | 856 |
| Dividends payable | 1,783 | 1,669 |
| Other | 1,366 | 1,346 |
| Income taxes (Note 11) | 576 | 812 |
| Total current liabilities | 17,191 | 15,962 |
| Long-term debt (Note 7) | 26,975 | 31,334 |
| Deferred income taxes | 898 | 799 |
| Employment costs | 3,083 | 2,271 |
| Income taxes and other liabilities (Note 11) | 2,393 | 2,832 |
| Total liabilities | 50,540 | 53,198 |
| Contingencies (Note 18) | | |
| Stockholders' (Deficit) Equity | | |
| Common stock, no par value (2,109,316,331 shares issued in 2018 and 2017) | — | — |
| Additional paid-in capital | 1,939 | 1,972 |
| Earnings reinvested in the business | 31,014 | 29,859 |
| Accumulated other comprehensive losses | (10,111) | (8,535) |
| | 22,842 | 23,296 |
| Less: cost of repurchased stock (554,736,610 and 556,098,569 shares in 2018 and 2017, respectively) | 35,301 | 35,382 |
| Total PMI stockholders' deficit | (12,459) | (12,086) |
| Noncontrolling interests | 1,720 | 1,856 |
| Total stockholders' deficit | (10,739) | (10,230) |
| Total Liabilities and Stockholders' (Deficit) Equity | \$ 39,801 | \$ 42,968 |

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in millions of dollars)

| for the years ended December 31, | 2018 | 2017 | 2016 |
|--|----------|----------|----------|
| CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | | | |
| Net earnings | \$ 8,286 | \$ 6,341 | \$ 7,250 |
| Adjustments to reconcile net earnings to operating cash flows: | | | |
| Depreciation and amortization | 989 | 875 | 743 |
| Deferred income tax (benefit) provision | (100) | (501) | 182 |
| Cash effects of changes in: | | | |
| Receivables, net | 53 | (92) | (1,009) |
| Inventories | (613) | 730 | (695) |
| Accounts payable | (51) | 425 | 373 |
| Accrued liabilities and other current assets | 910 | (554) | 1,477 |
| Income taxes | (135) | 1,370 | (209) |
| Pension plan contributions | (110) | (66) | (191) |
| Other | 249 | 384 | 156 |
| Net cash provided by operating activities | 9,478 | 8,912 | 8,077 |
| CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | | | |
| Capital expenditures | (1,436) | (1,548) | (1,172) |
| Investments in unconsolidated subsidiaries and equity securities | (63) | (111) | (41) |
| Net investment hedges | 416 | (1,527) | 295 |
| Other | 85 | 103 | 84 |
| Net cash used in investing activities | (998) | (3,083) | (834) |

See notes to consolidated financial statements.

| for the years ended December 31, | 2018 | 2017 | 2016 |
|--|-----------------|-----------------|-----------------|
| CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | | | |
| Short-term borrowing activity by original maturity: | | | |
| Net issuances (repayments) - maturities of 90 days or less | \$ 255 | \$ (127) | \$ (12) |
| Issuances - maturities longer than 90 days | — | 1,634 | — |
| Repayments - maturities longer than 90 days | — | (1,634) | — |
| Long-term debt proceeds | — | 6,850 | 3,536 |
| Long-term debt repaid | (2,484) | (2,551) | (2,393) |
| Dividends paid | (6,885) | (6,520) | (6,378) |
| Sale (purchase) of subsidiary shares to/(from) noncontrolling interests (Note 6) | (81) | 5 | 7 |
| Other | (456) | (426) | (173) |
| Net cash used in financing activities | (9,651) | (2,769) | (5,413) |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (685) | 1,085 | (965) |
| Cash, cash equivalents and restricted cash ⁽¹⁾ : | | | |
| Increase (Decrease) | (1,856) | 4,145 | 865 |
| Balance at beginning of year | 8,476 | 4,331 | 3,466 |
| Balance at end of year | <u>\$ 6,620</u> | <u>\$ 8,476</u> | <u>\$ 4,331</u> |
| Cash Paid: | | | |
| Interest | \$ 882 | \$ 1,050 | \$ 1,052 |
| Income taxes | \$ 2,749 | \$ 3,403 | \$ 2,829 |

⁽¹⁾ Following the adoption of Financial Accounting Standards Update ASU 2016-18, "Statement of Cash Flows: Restricted Cash," the amounts for cash and cash equivalents shown above include restricted cash of \$27 million, \$29 million and \$92 million as of December 31, 2018, 2017 and 2016, respectively, which were included in other current assets in the consolidated balance sheets.

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' (Deficit) Equity

(in millions of dollars, except per share data)

| | PMI Stockholders' (Deficit) Equity | | | | | | |
|---|------------------------------------|----------------------------------|--|---|---------------------------------|-----------------------------|-------------|
| | Common Stock | Additional Paid-in Capital | Earnings Reinvested in the Business | Accumulated Other Comprehensive Losses | Cost of Repurchased Stock | Noncontrolling Interests | Total |
| Balances, January 1, 2016 | \$ — | \$ 1,929 | \$ 29,842 | \$ (9,402) | \$ (35,613) | \$ 1,768 | \$ (11,476) |
| Net earnings | | | 6,967 | | | 283 | 7,250 |
| Other comprehensive earnings (losses), net of income taxes | | | | (157) | | (50) | (207) |
| Issuance of stock awards | | 37 | | | 123 | | 160 |
| Dividends declared (\$4.12 per share) | | | (6,412) | | | | (6,412) |
| Payments to noncontrolling interests | | | | | | (219) | (219) |
| Other | | (2) | | | | 6 | 4 |
| Balances, December 31, 2016 | — | 1,964 | 30,397 | (9,559) | (35,490) | 1,788 | (10,900) |
| Net earnings | | | 6,035 | | | 306 | 6,341 |
| Other comprehensive earnings (losses), net of income taxes | | | | 1,024 | | | 1,024 |
| Issuance of stock awards | | 20 | | | 108 | | 128 |
| Dividends declared (\$4.22 per share) | | | (6,573) | | | | (6,573) |
| Payments to noncontrolling interests | | | | | | (255) | (255) |
| Other | | (12) | | | | 17 | 5 |
| Balances, December 31, 2017 | — | 1,972 | 29,859 | (8,535) | (35,382) | 1,856 | (10,230) |
| Net earnings | | | 7,911 | | | 375 | 8,286 |
| Other comprehensive earnings (losses), net of income taxes | | | | (1,572) | | (75) | (1,647) |
| Issuance of stock awards | | 47 | | | 81 | | 128 |
| Dividends declared (\$4.49 per share) | | | (6,994) | | | | (6,994) |
| Payments to noncontrolling interests | | | | | | (435) | (435) |
| Adoption of new accounting standards (Note 21) | | | 238 | | | | 238 |
| Other (Note 6) | | (80) | | (4) | | (1) | (85) |
| Balances, December 31, 2018 | \$ — | \$ 1,939 | \$ 31,014 | \$ (10,111) | \$ (35,301) | \$ 1,720 | \$ (10,739) |

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1.

Background and Basis of Presentation:

Background

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

Reduced-risk products ("RRPs") is the term PMI uses to refer to products that present, are likely to present, or have the potential to present less risk of harm to smokers who switch to these products versus continued smoking. PMI has a range of RRP's in various stages of development, scientific assessment and commercialization.

Basis of presentation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of net revenues and expenses during the reporting periods. Significant estimates and assumptions include, among other things: pension and benefit plan assumptions; useful lives and valuation assumptions of goodwill and other intangible assets; marketing programs, and income taxes. Actual results could differ from those estimates.

The consolidated financial statements include PMI, as well as its wholly owned and majority-owned subsidiaries. Investments in which PMI exercises significant influence (generally 20%-50% ownership interest) are accounted for under the equity method of accounting. Investments not accounted for under the equity method of accounting are measured at fair value, if it is readily determinable, with changes in fair value recognized in net income. All intercompany transactions and balances have been eliminated.

To provide a greater focus on both parts of PMI's business — combustible and reduced-risk products — and to support PMI's transformation towards a smoke-free future, effective January 1, 2018, PMI began managing its business in six reportable segments as follows: European Union; Eastern Europe; Middle East & Africa; South & Southeast Asia; East Asia & Australia; and Latin America & Canada. For further details, see Note 12. *Segment Reporting*.

Certain prior years' amounts have been reclassified to conform with the current year's presentation, due primarily to new accounting guidance related to revenue recognition, pension costs and restricted cash and PMI's decision to reorganize its reportable segments. For further details, see the consolidated statements of cash flows, Note 3. *Goodwill and Other Intangible Assets, net*, Note 4. *Investments in Unconsolidated Subsidiaries and Other Related Party*, Note 12. *Segment Reporting*, Note 13. *Benefit Plans* and Note 21. *New Accounting Standards*. The changes did not have a material impact on PMI's consolidated financial position, results of operations or cash flows in any of the periods presented.

Note 2.

Summary of Significant Accounting Policies:

Cash and cash equivalents

Cash equivalents include demand deposits with banks and all highly liquid investments with original maturities of three months or less.

Depreciation

Property, plant and equipment are stated at historical cost and depreciated by the straight-line method over the estimated useful lives of the assets. Machinery and equipment are depreciated over periods ranging from 3 to 15 years, and buildings and building improvements over periods up to 40 years.

Employee benefit plans

PMI provides a range of benefits to its employees and retired employees, including pensions, postretirement health care and postemployment benefits (primarily severance). PMI records annual amounts relating to these plans based on calculations specified under U.S. GAAP. PMI recognizes the funded status of its defined pension and postretirement plans on the consolidated balance sheets. The funded status is measured as the difference between the fair value of the plans assets and the benefit obligation. PMI measures the plan assets and liabilities at the end of the fiscal year. For defined benefit pension plans, the benefit obligation is the projected benefit obligation. For the postretirement health care plans, the benefit obligation is the accumulated postretirement benefit obligation. Any plan with an overfunded status is recognized as an asset, and any plan with an underfunded status is recognized as a liability. Any gains or losses and prior service costs or credits that have not been recognized as a component of net periodic benefit costs are recorded as a component of other comprehensive earnings (losses), net of deferred taxes. PMI elects to recognize actuarial gains/(losses) using the corridor approach.

Foreign currency translation

PMI translates the results of operations of its subsidiaries and affiliates using average exchange rates during each period, whereas balance sheet accounts are translated using exchange rates at the end of each period. Currency translation adjustments are recorded as a component of stockholders' (deficit) equity. In addition, some of PMI's subsidiaries have assets and liabilities denominated in currencies other than their functional currencies, and to the extent those are not designated as net investment hedges, these assets and liabilities generate transaction gains and losses when translated into their respective functional currencies.

Goodwill and non-amortizable intangible assets valuation

PMI tests goodwill and non-amortizable intangible assets for impairment annually or more frequently if events occur that would warrant such review. PMI performs its annual impairment analysis in the second 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.

Hedging instruments

Derivative financial instruments are recorded at fair value on the consolidated balance sheets as either assets or liabilities. Changes in the fair value of derivatives are recorded each period either in accumulated other comprehensive losses on the consolidated balance sheet or in earnings, depending on whether a derivative is designated and effective as part of a hedge transaction and, if it is, the type of hedge transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive losses are reclassified to the consolidated statements of earnings, into the same line item as the impact of the underlying transaction, in the periods in which operating results are affected by the hedged item. Cash flows from hedging instruments are classified in the same manner as the affected hedged item in the consolidated statements of cash flows.

Impairment of long-lived assets

PMI reviews long-lived assets, including amortizable intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. PMI performs undiscounted operating cash flow analyses to determine if an impairment exists. For purposes of recognition and measurement of an impairment for assets held for use, PMI groups assets and liabilities at the lowest level for which cash flows are separately identifiable. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

Impairment of investments in unconsolidated subsidiaries

Investments in unconsolidated subsidiaries are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. An impairment loss would be recorded whenever a decline in value of an equity investment below its carrying amount is determined to be other than temporary. PMI determines whether a loss is other than temporary by considering the length of time and extent to which the fair value of the equity investment has been less than the carrying amount, the financial condition of the equity investment, and the intent to retain the investment for a period of time is sufficient to allow for any anticipated recovery in market value.

Income taxes

Income taxes are provided on all earnings for jurisdictions outside the United States. These provisions, 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 PMI's consolidated balance sheets. Significant judgment is required in determining income tax provisions and in evaluating tax positions. PMI recognizes accrued interest and penalties associated with uncertain tax positions as part of the provision for income taxes on the consolidated statements of earnings.

Inventories

Inventories are stated at the lower of cost or market. The first-in, first-out and average cost methods are used to cost substantially all inventories. It is a generally recognized industry practice to classify leaf tobacco inventory as a current asset, although part of such inventory, because of the duration of the aging process, ordinarily would not be utilized within one year.

Marketing costs

PMI supports its products with advertising, adult consumer engagement and trade promotions. Such programs include, but are not limited to, discounts, rebates, in-store display incentives, e-commerce, mobile and other digital platforms, adult consumer activation and promotion activities, as well as costs associated with adult consumer experience outlets and other adult consumer touchpoints and volume-based incentives. Advertising, as well as certain consumer engagement and trade activities costs, are expensed as incurred. Trade promotions are recorded as a reduction of revenues based on amounts estimated as being due to customers at the end of a period, based principally on historical utilization. For interim reporting purposes, advertising and certain consumer engagement expenses are charged to earnings based on estimated sales and related expenses for the full year.

Revenue recognition

PMI recognizes revenue primarily through the manufacture and sale of cigarettes and other nicotine-containing products, including reduced-risk products. The majority of PMI revenues are generated by sales through direct and indirect distribution networks with short-term payment conditions and where control is typically transferred to the customer either upon shipment or delivery of goods. PMI evaluates the transfer of control through evidence of the customer's receipt and acceptance, transfer of title, PMI's right to payment for those products and the customer's ability to direct the use of those products upon receipt. Typically, PMI's performance obligations are satisfied and revenue is recognized either upon shipment or delivery of goods.

In certain instances, PMI facilitates shipping and handling activities after control has transferred to the customer. PMI has elected to record all shipping and handling activities as costs to fulfill a contract. The shipping and handling costs that have not been incurred at the time revenue is recognized are accrued. The transaction price is typically based on the amount billed to the customer and includes estimated variable consideration, where applicable. Such variable consideration is typically not constrained and is estimated based on the most likely amount that PMI expects to be entitled to under the terms of the contracts with customers, historical experience of discount or rebate redemption, where relevant, and the terms of any underlying discount or rebate programs, which may change from time to time as the business and product categories evolve. PMI has elected to exclude excise taxes collected from customers from the measurement of the transaction price, thereby presenting revenues net of excise taxes. Estimated costs associated with warranty programs are generally provided for in cost of sales in the period the related revenues are recognized.

On May 28, 2014, the Financial Accounting Standards Board issued Accounting Standards Update ASU 2014-09, "Revenue from Contracts with Customers." For further details, see Note 21. *New Accounting Standards*.

Stock-based compensation

PMI measures compensation cost for all stock-based awards at fair value on date of grant and recognizes the compensation costs over the service periods for awards expected to vest. PMI's accounting policy is to estimate the number of awards expected to be forfeited and adjust the expense when it is no longer probable that the employee will fulfill the service condition. For further details, see Note 9. *Stock Plans*.

Note 3.

Goodwill and Other Intangible Assets, net:

The movements in goodwill were as follows:

| (in millions) | European Union | Eastern Europe | Middle East & Africa | South & Southeast Asia | East Asia & Australia | Latin America & Canada | Total |
|-----------------------------|----------------|----------------|----------------------|------------------------|-----------------------|------------------------|----------|
| Balance at January 1, 2017 | \$ 1,238 | \$ 281 | \$ 91 | \$ 3,030 | \$ 566 | \$ 2,118 | \$ 7,324 |
| Changes due to: | | | | | | | |
| Currency | 181 | 40 | 11 | (20) | 1 | 129 | 342 |
| Balances, December 31, 2017 | 1,419 | 321 | 102 | 3,010 | 567 | 2,247 | 7,666 |
| Changes due to: | | | | | | | |
| Currency | (62) | (18) | (15) | (215) | (31) | (136) | (477) |
| Balances, December 31, 2018 | \$ 1,357 | \$ 303 | \$ 87 | \$ 2,795 | \$ 536 | \$ 2,111 | \$ 7,189 |

Goodwill primarily reflects PMI's acquisitions in Canada, Colombia, Greece, Indonesia, Mexico, Pakistan and Serbia, as well as the business combination in the Philippines.

Details of other intangible assets were as follows:

| (in millions) | Weighted-Average Remaining Useful Life | December 31, 2018 | | | December 31, 2017 | | |
|-----------------------------------|--|-----------------------|--------------------------|----------|-----------------------|--------------------------|----------|
| | | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Non-amortizable intangible assets | | \$ 1,269 | | \$ 1,269 | \$ 1,323 | | \$ 1,323 |
| Amortizable intangible assets: | | | | | | | |
| Trademarks | 19 years | 1,488 | \$ 608 | 880 | 1,559 | \$ 575 | 984 |
| Distribution networks | 8 years | 141 | 82 | 59 | 152 | 79 | 73 |
| Other* | 10 years | 107 | 37 | 70 | 87 | 35 | 52 |
| Total other intangible assets | | \$ 3,005 | \$ 727 | \$ 2,278 | \$ 3,121 | \$ 689 | \$ 2,432 |

* Includes farmer contracts and intellectual property rights

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia and Mexico.

The decrease in the gross carrying amount of other intangible assets from December 31, 2017, was due primarily to currency movements, partially offset by the purchase of additional intellectual property rights related to PMI's reduced-risk products.

Amortization expense for each of the next five years is estimated to be \$82 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

During the second quarter of 2018, PMI completed its annual review of goodwill and non-amortizable intangible assets for potential impairment, and no impairment charges were required as a result of this review.

Note 4.

Investments in Unconsolidated Subsidiaries and Other Related Party:

Investments in unconsolidated subsidiaries:

At December 31, 2018 and 2017, PMI had total investments in unconsolidated subsidiaries of \$981 million and \$1,074 million, respectively, which were accounted for under the equity method of accounting. Equity method investments are initially recorded at cost. Under the equity method of accounting, the investment is adjusted for PMI's proportionate share of earnings or losses, dividends, capital contributions and movements in currency translation adjustments. The carrying value of our equity method investments at December 31, 2018 and 2017, exceeded our share of the unconsolidated subsidiaries' book value by \$835 million and \$927 million, respectively. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding \$793 million and \$873 million attributable to goodwill as of December 31, 2018 and 2017, respectively, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 10 to 20 years. At December 31, 2018 and 2017, PMI received year-to-date dividends from unconsolidated subsidiaries of \$118 million and \$120 million, respectively.

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

PMI holds a 23% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis, PMI's distributor in Russia.

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

Other related party:

United Arab Emirates-based Trans-Emirates Trading and Investments (FZC) ("TTI") holds a 33% non-controlling interest in Philip Morris Misr LLC ("PMM"), an entity incorporated in Egypt which is consolidated in PMI's financial statements. PMM sells, under license, PMI brands in Egypt through an exclusive distribution agreement with a local entity that is also controlled by TTI. Amounts in the tables below have been updated to reflect the transactions with this other related party for all periods.

Additionally net revenues in the table below have been updated for all periods to reflect the adoption of ASU 2014-09 "Revenue from Contracts with Customers." For further details, see Note 21. *New Accounting Standards*.

Financial activity with unconsolidated subsidiaries and other related party:

PMI's net revenues with unconsolidated subsidiaries and the other related party were as follows:

| (in millions) | For the Years Ended December 31, | | |
|-----------------------------|----------------------------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Net revenues ^(a) | \$ 2,714 | \$ 2,521 | \$ 2,465 |

^(a) Net revenues excludes excise taxes and VAT billed to customers.

PMI's balance sheet activity related to unconsolidated subsidiaries and the other related party was as follows:

| (in millions) | At December 31, | |
|---------------|-----------------|--------|
| | 2018 | 2017 |
| Receivables | \$ 308 | \$ 358 |

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

Note 5.

Product Warranty:

PMI's IQOS devices are subject to standard product warranties generally for a period of 12 months from the date of purchase or such other periods as required by law. PMI generally provides in cost of sales for the estimated cost of warranty in the period the related revenue is recognized. PMI assesses the adequacy of its accrued product warranties and adjusts the amounts as necessary based on actual experience and changes in future estimates. Factors that affect product warranties may vary across markets but typically include product failure rates, logistics and service delivery costs, and warranty policies. PMI accounts for its product warranties within other accrued liabilities. At December 31, 2018 and December 31, 2017, these amounts were as follows:

| (in millions) | At December 31, | |
|--------------------------------|-----------------|-------|
| | 2018 | 2017 |
| Balance at beginning of period | \$ 71 | \$ 51 |
| Changes due to: | | |
| Warranties issued | 179 | 168 |
| Settlements | (183) | (148) |
| Balance at end of period | \$ 67 | \$ 71 |

Note 6.

Acquisitions:

On March 21, 2018, PMI acquired the remaining 49% interest in Tabacalera Costarricense, S.A. and Mendiola y Compañía, S.A. for a net purchase price of \$95 million, which includes \$2 million of contingent consideration. As a result, PMI now owns 100% of these Costa Rican affiliates. The purchase of the remaining 49% interest resulted in a decrease to PMI's additional paid-in capital of \$86 million.

Note 7.

Indebtedness:

Short-Term Borrowings

At December 31, 2018 and 2017, PMI's short-term borrowings and related average interest rates consisted of the following:

| (in millions) | December 31, 2018 | | December 31, 2017 | |
|------------------|--------------------|-----------------------|--------------------|-----------------------|
| | Amount Outstanding | Average Year-End Rate | Amount Outstanding | Average Year-End Rate |
| Commercial paper | \$ — | —% | \$ — | —% |
| Bank loans | 730 | 5.8 | 499 | 5.7 |
| | \$ 730 | | \$ 499 | |

Given the mix of subsidiaries and their respective local economic environments, the average interest rate for bank loans above can vary significantly from day to day and country to country.

The fair values of PMI's short-term borrowings at December 31, 2018 and 2017, based upon current market interest rates, approximate the amounts disclosed above.

Long-Term Debt

At December 31, 2018 and 2017, PMI's long-term debt consisted of the following:

| (in millions) | December 31, | |
|--|--------------|-----------|
| | 2018 | 2017 |
| U.S. dollar notes, 1.375% to 6.375% (average interest rate 3.328%), due through 2044 | \$ 20,819 | \$ 23,291 |
| Foreign currency obligations: | | |
| Euro notes, 0.625% to 3.125% (average interest rate 2.250%), due through 2037 | 8,656 | 8,997 |
| Swiss franc notes, 0.750% to 2.000% (average interest rate 1.269%), due through 2024 | 1,374 | 1,376 |
| Other (average interest rate 3.351%), due through 2024 | 180 | 176 |
| | 31,029 | 33,840 |
| Less current portion of long-term debt | 4,054 | 2,506 |
| | \$ 26,975 | \$ 31,334 |

Other debt:

Other foreign currency debt above includes mortgage debt in Switzerland and capital lease obligations at December 31, 2018 and December 31, 2017.

Debt Issuances Outstanding:

PMI's debt issuances outstanding at December 31, 2018, were as follows:

| (in millions) | | | | |
|-------------------|------------|---------------|---------------|---------------|
| Type | Face Value | Interest Rate | Issuance | Maturity |
| U.S. dollar notes | \$750 | 1.875% | November 2013 | January 2019 |
| U.S. dollar notes | \$700 | 1.625% | February 2017 | February 2019 |
| U.S. dollar notes | \$500 | 1.375% | February 2016 | February 2019 |
| U.S. dollar notes | \$750 | 1.875% | November 2017 | November 2019 |
| U.S. dollar notes | \$300 | Floating | February 2017 | February 2020 |
| U.S. dollar notes | \$1,000 | 2.000% | February 2017 | February 2020 |
| U.S. dollar notes | \$1,000 | 4.500% | March 2010 | March 2020 |
| U.S. dollar notes | \$750 | 1.875% | February 2016 | February 2021 |
| U.S. dollar notes | \$350 | 4.125% | May 2011 | May 2021 |
| U.S. dollar notes | \$750 | 2.900% | November 2011 | November 2021 |
| U.S. dollar notes | \$500 | 2.625% | February 2017 | February 2022 |
| U.S. dollar notes | \$750 | 2.375% | August 2017 | August 2022 |
| U.S. dollar notes | \$750 | 2.500% | August 2012 | August 2022 |
| U.S. dollar notes | \$750 | 2.500% | November 2017 | November 2022 |
| U.S. dollar notes | \$600 | 2.625% | March 2013 | March 2023 |
| U.S. dollar notes | \$500 | 2.125% | May 2016 | May 2023 |
| U.S. dollar notes | \$500 | 3.600% | November 2013 | November 2023 |
| U.S. dollar notes | \$750 | 3.250% | November 2014 | November 2024 |
| U.S. dollar notes | \$750 | 3.375% | August 2015 | August 2025 |
| U.S. dollar notes | \$750 | 2.750% | February 2016 | February 2026 |
| U.S. dollar notes | \$500 | 3.125% | August 2017 | August 2027 |
| U.S. dollar notes | \$500 | 3.125% | November 2017 | March 2028 |

(in millions)

| Type | Face Value | Interest Rate | Issuance | Maturity |
|----------------------------------|--------------------------------|---------------|----------------|----------------|
| U.S. dollar notes | \$1,500 | 6.375% | May 2008 | May 2038 |
| U.S. dollar notes | \$750 | 4.375% | November 2011 | November 2041 |
| U.S. dollar notes | \$700 | 4.500% | March 2012 | March 2042 |
| U.S. dollar notes | \$750 | 3.875% | August 2012 | August 2042 |
| U.S. dollar notes | \$850 | 4.125% | March 2013 | March 2043 |
| U.S. dollar notes | \$750 | 4.875% | November 2013 | November 2043 |
| U.S. dollar notes | \$750 | 4.250% | November 2014 | November 2044 |
| U.S. dollar notes ^(a) | \$500 | 4.250% | May 2016 | November 2044 |
| EURO notes ^(b) | €750 (approximately \$951) | 2.125% | May 2012 | May 2019 |
| EURO notes ^(b) | €1,250 (approximately \$1,621) | 1.750% | March 2013 | March 2020 |
| EURO notes ^(b) | €750 (approximately \$1,029) | 1.875% | March 2014 | March 2021 |
| EURO notes ^(b) | €600 (approximately \$761) | 2.875% | May 2012 | May 2024 |
| EURO notes ^(b) | €500 (approximately \$582) | 0.625% | November 2017 | November 2024 |
| EURO notes ^(b) | €750 (approximately \$972) | 2.750% | March 2013 | March 2025 |
| EURO notes ^(b) | €1,000 (approximately \$1,372) | 2.875% | March 2014 | March 2026 |
| EURO notes ^(b) | €500 (approximately \$697) | 2.875% | May 2014 | May 2029 |
| EURO notes ^(b) | €500 (approximately \$648) | 3.125% | June 2013 | June 2033 |
| EURO notes ^(b) | €500 (approximately \$578) | 2.000% | May 2016 | May 2036 |
| EURO notes ^(b) | €500 (approximately \$582) | 1.875% | November 2017 | November 2037 |
| Swiss franc notes ^(b) | CHF200 (approximately \$217) | 0.875% | March 2013 | March 2019 |
| Swiss franc notes ^(b) | CHF275 (approximately \$311) | 0.750% | May 2014 | December 2019 |
| Swiss franc notes ^(b) | CHF325 (approximately \$334) | 1.000% | September 2012 | September 2020 |
| Swiss franc notes ^(b) | CHF300 (approximately \$335) | 2.000% | December 2011 | December 2021 |
| Swiss franc notes ^(b) | CHF250 (approximately \$283) | 1.625% | May 2014 | May 2024 |

^(a) These notes are a further issuance of the 4.250% notes issued by PMI in November 2014.

^(b) USD 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 were used for general corporate purposes, including working capital requirements and repurchase of PMI's common stock until 2015.

Aggregate maturities:

Aggregate maturities of long-term debt are as follows:

| (in millions) | |
|-----------------------------|------------------|
| 2019 | \$ 4,054 |
| 2020 | 4,074 |
| 2021 | 3,024 |
| 2022 | 2,756 |
| 2023 | 1,602 |
| 2024-2028 | 6,913 |
| 2029-2033 | 1,147 |
| Thereafter | 7,698 |
| | 31,268 |
| Debt discounts | (239) |
| Total long-term debt | \$ 31,029 |

See Note 16. *Fair Value Measurements* for additional disclosures related to the fair value of PMI's debt.

Credit Facilities

On January 29, 2018, PMI entered into an agreement to extend the term of its \$2.0 billion 364-day revolving credit facility from February 6, 2018 to February 5, 2019.

At December 31, 2018, PMI's total committed credit facilities and commercial paper outstanding were as follows:

| Type (in billions of dollars) | Committed Credit Facilities | Commercial Paper |
|---|--|-----------------------------|
| 364-day revolving credit, expiring February 5, 2019 | \$ 2.0 | |
| Multi-year revolving credit, expiring February 28, 2021 | 2.5 | |
| Multi-year revolving credit, expiring October 1, 2022 | 3.5 | |
| Total facilities | \$ 8.0 | |
| Commercial paper outstanding | | \$ — |

At December 31, 2018, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

On January 28, 2019, PMI entered into an agreement to extend the term of its \$2.0 billion 364-day revolving credit facility from February 5, 2019, to February 4, 2020.

Each of these facilities requires PMI 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, 2018, PMI's ratio calculated in accordance with the agreements was 10.5 to 1.0. These facilities do not include any credit rating triggers, material adverse change clauses or any provisions that could require PMI to post collateral. The terms "consolidated EBITDA" and "consolidated interest expense," both of which include certain adjustments, are defined in the facility agreements previously filed with the Securities and Exchange Commission.

In addition to the committed credit facilities discussed above, certain subsidiaries maintain short-term credit arrangements to meet their respective working capital needs. These credit arrangements, which amounted to approximately \$3.3 billion at December 31, 2018, and

\$2.8 billion at December 31, 2017, are for the sole use of the subsidiaries. Borrowings under these arrangements amounted to \$730 million at December 31, 2018, and \$499 million at December 31, 2017.

Note 8.

Capital Stock:

Shares of authorized common stock are 6.0 billion; issued, repurchased and outstanding shares were as follows:

| | Shares Issued | Shares Repurchased | Shares Outstanding |
|-----------------------------|---------------|--------------------|--------------------|
| Balances, January 1, 2016 | 2,109,316,331 | (559,972,262) | 1,549,344,069 |
| Issuance of stock awards | | 2,041,478 | 2,041,478 |
| Balances, December 31, 2016 | 2,109,316,331 | (557,930,784) | 1,551,385,547 |
| Issuance of stock awards | | 1,832,215 | 1,832,215 |
| Balances, December 31, 2017 | 2,109,316,331 | (556,098,569) | 1,553,217,762 |
| Issuance of stock awards | | 1,361,959 | 1,361,959 |
| Balances, December 31, 2018 | 2,109,316,331 | (554,736,610) | 1,554,579,721 |

At December 31, 2018, 29,594,929 shares of common stock were reserved for stock awards under PMI's stock plans, and 250 million shares of preferred stock, without par value, were authorized but unissued. PMI currently has no plans to issue any shares of preferred stock.

Note 9.

Stock Plans:

In May 2017, PMI's shareholders approved the Philip Morris International Inc. 2017 Performance Incentive Plan (the "2017 Plan"). The 2017 Plan replaced the 2012 Performance Incentive Plan, and there will be no additional grants under the replaced plan. Under the 2017 Plan, PMI may grant to eligible employees restricted shares and restricted share units, performance-based cash incentive awards and performance-based equity awards. Up to 25 million shares of PMI's common stock may be issued under the 2017 Plan. At December 31, 2018, shares available for grant under the 2017 Plan were 22,911,850.

In May 2017, PMI's shareholders also approved the Philip Morris International Inc. 2017 Stock Compensation Plan for Non-Employee Directors (the "2017 Non-Employee Directors Plan"). The 2017 Non-Employee Directors Plan replaced the 2008 Stock Compensation Plan for Non-Employee Directors, and there will be no additional grants under the replaced plan. A non-employee director is defined as a member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1 million shares of PMI common stock may be awarded under the 2017 Non-Employee Directors Plan. At December 31, 2018, shares available for grant under the plan were 974,344.

Restricted share unit (RSU) awards

PMI may grant RSU awards to eligible employees; recipients may not sell, assign, pledge or otherwise encumber such awards. Such awards are subject to forfeiture if certain employment conditions are not met. RSU awards generally vest on the third anniversary of the grant date. RSU awards do not carry voting rights, although they do earn dividend equivalents.

During 2018, the activity for RSU awards was as follows:

| | Number of Shares | Weighted- Average Grant Date Fair Value Per Share |
|------------------------------|---------------------|--|
| Balance at January 1, 2018 | 3,612,400 | \$ 89.65 |
| Granted | 1,288,700 | 100.19 |
| Vested | (1,451,876) | 83.29 |
| Forfeited | (130,429) | 96.24 |
| Balance at December 31, 2018 | 3,318,795 | \$ 96.26 |

During the years ended December 31, 2018, 2017 and 2016, the weighted-average grant date fair value of the RSU awards granted to PMI employees and the recorded compensation expense related to RSU awards were as follows:

| (in millions, except per RSU award granted) | Total Weighted- Average Grant Date Fair Value of RSU Awards Granted | Weighted- Average Grant Date Fair Value Per RSU Award Granted | Compensation Expense related to RSU Awards |
|--|---|---|--|
| 2018 | \$ 129 | \$ 100.19 | \$ 114 |
| 2017 | \$ 119 | \$ 98.59 | \$ 111 |
| 2016 | \$ 108 | \$ 89.03 | \$ 126 |

The fair value of the RSU awards at the date of grant is amortized to expense over the restriction period, typically three years after the date of the award, or upon death, disability or reaching the age of 58. As of December 31, 2018, PMI had \$118 million of total unrecognized compensation costs related to non-vested RSU awards. These costs are expected to be recognized over a weighted-average period of two years, or upon death, disability or reaching the age of 58.

During the years ended December 31, 2018, 2017 and 2016, share and fair value information for PMI RSU awards that vested were as follows:

| (dollars in millions) | Shares of RSU Awards that Vested | Grant Date Fair Value of Vested Shares of RSU Awards | Total Fair Value of RSU Awards that Vested |
|-----------------------|-------------------------------------|---|--|
| 2018 | 1,451,876 | \$ 121 | \$ 149 |
| 2017 | 2,022,856 | \$ 158 | \$ 208 |
| 2016 | 2,302,525 | \$ 202 | \$ 210 |

Performance share unit (PSU) awards

PMI may grant PSU awards to certain executives; recipients may not sell, assign, pledge or otherwise encumber such awards. The PSU awards require the achievement of certain performance factors, which are predetermined at the time of grant, over a three-year performance cycle. PMI's performance metrics consist of PMI's Total Shareholder Return (TSR) relative to a predetermined peer group and on an absolute basis (50% weight), PMI's currency-neutral compound annual adjusted operating income growth rate, excluding acquisitions (30% weight), and PMI's performance against specific measures of PMI's transformation (20% weight). The aggregate of the weighted performance factors for the three metrics determines the percentage of PSUs that will vest at the end of the three-year performance cycle. The minimum percentage of PSUs that can vest is zero, with a target percentage of 100 and a maximum percentage of 200. Each vested PSU entitles the participant to one share of common stock. An aggregate weighted PSU performance factor of 100 will result in the targeted number of PSUs being vested. At the end of the performance cycle, participants are entitled to an amount equivalent to the accumulated dividends paid on common stock during the performance cycle for the number of shares earned. PSU awards do not carry voting rights.

During 2018, the activity for PSU awards was as follows:

| | Number of Shares | Grant Date Fair Value Subject to Other Performance Factors Per Share | Grant Date Fair Value Subject to TSR Performance Factor Per Share |
|------------------------------|---------------------|--|---|
| Balance at January 1, 2018 | 821,030 | \$ 93.46 | \$ 116.16 |
| Granted | 401,500 | 100.69 | 118.98 |
| Vested | — | — | — |
| Forfeited | (27,560) | 94.98 | 116.71 |
| Balance at December 31, 2018 | 1,194,970 | \$ 95.85 | \$ 117.09 |

During the years ended December 31, 2018, 2017 and 2016, the grant date fair value of the PSU awards granted to PMI employees and the recorded compensation expense related to PSU awards were as follows:

| (in millions, except per PSU award granted) | PSU Grant Date Fair Value Subject to Other Performance Factors | | PSU Grant Date Fair Value Subject to TSR Performance Factor | | Compensation Expense related to PSU Awards |
|---|--|------------------|---|------------------|--|
| | Total | Per PSU Award | Total | Per PSU Award | Total |
| 2018 | \$ 20 | \$ 100.69 | \$ 24 | \$ 118.98 | \$ 24 |
| 2017 | \$ 19 | \$ 98.29 | \$ 25 | \$ 128.72 | \$ 37 |
| 2016 | \$ 19 | \$ 89.02 | \$ 22 | \$ 104.60 | \$ 27 |

The grant date fair value of the PSU awards subject to the other performance factors was determined by using the average of the high and low market price of PMI's stock at the date of the grant. The grant date fair value of the PSU market based awards subject to the TSR performance factor was determined by using the Monte Carlo simulation model. The following assumptions were used to determine the grant date fair value of the PSU awards subject to the TSR performance factor for the years ended December 31, 2018, 2017 and 2016:

| | For the Years Ended December 31, | | |
|--|----------------------------------|-------|-------|
| | 2018 | 2017 | 2016 |
| Risk-free interest rate ^(a) | 2.3% | 1.5% | 1.0% |
| Expected volatility ^(b) | 19.6% | 15.8% | 17.5% |

^(a) Based on the U.S. Treasury yield curve.

^(b) Determined using a weighted-average of historical and implied volatility.

The fair value of the PSU award at the date of grant is amortized to expense over the performance period, which is typically three years after the date of the award, or upon death, disability or reaching the age of 58. As of December 31, 2018, PMI had \$25 million of total unrecognized compensation cost related to non-vested PSU awards. This cost is recognized over a weighted-average performance cycle period of two years, or upon death, disability or reaching the age of 58.

During the years ended December 31, 2018, 2017 and 2016, there were no PSU awards that vested.

Note 10.

Earnings per Share:

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

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

| (in millions) | For the Years Ended December 31, | | |
|--|----------------------------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Net earnings attributable to PMI | \$ 7,911 | \$ 6,035 | \$ 6,967 |
| Less distributed and undistributed earnings attributable to share-based payment awards | 16 | 14 | 19 |
| Net earnings for basic and diluted EPS | \$ 7,895 | \$ 6,021 | \$ 6,948 |
| Weighted-average shares for basic EPS | 1,555 | 1,552 | 1,551 |
| Plus contingently issuable performance stock units (PSUs) | — | 1 | — |
| Weighted-average shares for diluted EPS | 1,555 | 1,553 | 1,551 |

For the 2018, 2017 and 2016 computations, there were no antidilutive stock options.

Note 11.

Income Taxes:

Earnings before income taxes and provision for income taxes consisted of the following for the years ended December 31, 2018, 2017 and 2016:

| (in millions) | 2018 | 2017 | 2016 |
|----------------------------------|-----------|-----------|----------|
| Earnings before income taxes | \$ 10,671 | \$ 10,589 | \$ 9,924 |
| Provision for income taxes: | | | |
| United States federal and state: | | | |
| Current | \$ 120 | \$ 1,662 | \$ (39) |
| Deferred | (113) | (384) | 293 |
| Total United States | 7 | 1,278 | 254 |
| Outside United States: | | | |
| Current | 2,425 | 3,146 | 2,625 |
| Deferred | 13 | (117) | (111) |
| Total outside United States | 2,438 | 3,029 | 2,514 |
| Total provision for income taxes | \$ 2,445 | \$ 4,307 | \$ 2,768 |

In December 2017, the Tax Cuts and Jobs Act was signed into law. Accordingly, PMI recorded a provisional charge of \$1.6 billion in its 2017 income tax provision, including a charge for the transition tax on accumulated foreign earnings of \$1.4 billion (which represented the transition tax of \$2.2 billion, net of a reversal of \$0.7 billion of previously recorded deferred tax liabilities on part of its accumulated foreign earnings and other items of \$0.1 billion) and \$0.2 billion due to the re-measurement of U.S. deferred tax assets and liabilities applying the U.S. federal corporate tax rate of 21%.

PMI completed its analysis of the Tax Cuts and Jobs Act during 2018 and adjusted the 2017 provisional estimates to the final amounts based on its 2017 U.S. federal income tax return as filed. Accordingly, PMI recorded in its income tax provision a charge of \$31 million representing a current income tax charge of \$185 million, primarily due to an increase in its aggregate foreign cash position used to determine PMI's final 2017 transition tax liability, mostly offset by a deferred income tax benefit of \$154 million primarily due to the recognition of deferred tax assets for net operating losses in the state of New York. Updates to the provisional estimates have been recorded in accordance with Staff Accounting Bulletin No. 118 ("SAB 118").

At December 31, 2017, PMI recorded an income tax payable of \$1.7 billion attributable to the Tax Cuts and Jobs Act, of which \$1.6 billion was recorded in "income taxes and other liabilities" on PMI's consolidated balance sheet. The income tax payable of \$1.7 billion

represented the transition tax of \$2.2 billion, partially offset by foreign tax credits related to foreign withholding taxes previously paid of \$0.5 billion. The income tax payable is due over an 8-year period beginning in 2018. In December 2018, PMI recorded an increase to income tax payable of \$0.1 billion related to PMI's transition tax liability, in accordance with SAB 118. At December 31, 2018, \$1.5 billion of PMI's remaining transition tax liability was recorded in "income taxes and other liabilities" on PMI's consolidated balance sheet.

At December 31, 2018, U.S. federal and foreign deferred income taxes have been provided on all accumulated earnings of PMI's foreign subsidiaries.

In accordance with the alternatives provided by ASU 2018-02 "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," PMI has elected not to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive losses to retained earnings.

PMI has made an accounting policy election to treat Global Intangible Low-Taxed Income ("GILTI") taxes as a current period expense rather than including these amounts in the measurement of deferred taxes.

PMI is regularly examined by tax authorities around the world and is currently under examination in a number of jurisdictions. The U.S. federal statute of limitations remains open for the years 2015 and onward. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from three to five years. Years still open to examination by foreign tax authorities in major jurisdictions include Germany (2015 onward), Indonesia (2014 onward), Russia (2015 onward) and Switzerland (2017 onward).

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

A reconciliation of the beginning and ending amount of unrecognized tax benefits was as follows:

| (in millions) | 2018 | 2017 | 2016 |
|--|--------|--------|-------|
| Balance at January 1, | \$ 145 | \$ 79 | \$ 88 |
| Additions based on tax positions related to the current year | 10 | 71 | 13 |
| Additions for tax positions of previous years | 15 | 5 | 1 |
| Reductions for tax positions of prior years | (94) | — | (7) |
| Reductions due to lapse of statute of limitations | (3) | (7) | (14) |
| Settlements | (19) | (4) | (2) |
| Other | 2 | 1 | — |
| Balance at December 31, | \$ 56 | \$ 145 | \$ 79 |

Unrecognized tax benefits and PMI's liability for contingent income taxes, interest and penalties were as follows:

| (in millions) | December 31, 2018 | December 31, 2017 | December 31, 2016 |
|---|-------------------|-------------------|-------------------|
| Unrecognized tax benefits | \$ 56 | \$ 145 | \$ 79 |
| Accrued interest and penalties | 12 | 23 | 15 |
| Tax credits and other indirect benefits | (14) | (35) | (31) |
| Liability for tax contingencies | \$ 54 | \$ 133 | \$ 63 |

The amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$41 million at December 31, 2018. The remainder, if recognized, would principally affect deferred taxes.

For the years ended December 31, 2018, 2017 and 2016, PMI recognized income (expense) in its consolidated statements of earnings of \$4 million, \$(11) million and \$13 million, respectively, related to interest and penalties.

The effective income tax rate on pre-tax earnings differed from the U.S. federal statutory rate for the following reasons for the years ended December 31, 2018, 2017 and 2016:

| | 2018 | 2017 | 2016 |
|-------------------------------------|-------|--------|--------|
| U.S. federal statutory rate | 21.0% | 35.0% | 35.0% |
| Increase (decrease) resulting from: | | | |
| Foreign rate differences | 1.3 | (12.2) | (12.6) |
| Dividend repatriation cost | 2.5 | 16.4 | 5.8 |
| Global intangible low-taxed income | 1.2 | | |
| Net operating losses | (1.1) | | |
| Foreign derived intangible income | (1.1) | | |
| Other | (0.9) | 1.5 | (0.3) |
| Effective tax rate | 22.9% | 40.7% | 27.9% |

The 2018 effective tax rate decreased 17.8 percentage points to 22.9%. The change in the effective tax rate for 2018, as compared to 2017, was primarily due to the Tax Cuts and Jobs Act, which reduced the U.S. federal income tax rate from 35% to 21%, in addition to repatriation cost differences and earnings mix by taxing jurisdiction.

The 2017 effective tax rate increased 12.8 percentage points to 40.7%. The change in the effective tax rate for 2017, as compared to 2016, was primarily due to the Tax Cuts and Jobs Act. In addition to the transition tax, which resulted in a net tax charge of \$1.4 billion, the Tax Cuts and Jobs Act also included a reduction in the U.S. income tax rate from 35% to 21%, as of January 1, 2018. This change in income tax rate required a re-measurement of PMI's U.S. deferred tax assets and liabilities at December 31, 2017, resulting in a tax charge of \$0.2 billion.

The 2016 effective tax rate decreased 0.1 percentage point to 27.9%. The change in the effective tax rate for 2016, as compared to 2015, was primarily due to earnings mix by taxing jurisdiction and repatriation cost differences.

The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities consisted of the following:

| (in millions) | At December 31, | |
|--|-----------------|--------|
| | 2018 | 2017 |
| Deferred income tax assets: | | |
| Accrued postretirement and postemployment benefits | \$ 193 | \$ 239 |
| Accrued pension costs | 390 | 334 |
| Inventory | 136 | 131 |
| Accrued liabilities | 138 | 117 |
| Net operating losses | 452 | 213 |
| Foreign exchange | — | 91 |
| Other | 37 | 57 |
| Total deferred income tax assets | 1,346 | 1,182 |
| Less: valuation allowance | (257) | (156) |
| Deferred income tax assets, net of valuation allowance | 1,089 | 1,026 |
| Deferred income tax liabilities: | | |
| Trade names | (508) | (546) |
| Property, plant and equipment | (222) | (223) |
| Unremitted earnings | (123) | (49) |
| Foreign exchange | (157) | — |
| Total deferred income tax liabilities | (1,010) | (818) |
| Net deferred income tax assets | \$ 79 | \$ 208 |

At December 31, 2018, PMI has recorded deferred tax assets for net operating loss carryforwards of \$452 million, with varying dates of expiration, primarily after 2023, including \$87 million with an unlimited carryforward period. At December 31, 2018, PMI has recorded a valuation allowance of \$257 million against deferred tax assets that do not meet the more-likely-than-not recognition threshold. The increases in deferred tax assets for net operating loss carryforwards and the valuation allowance during 2018 are primarily due to law changes associated with the Tax Cuts and Jobs Act, as discussed above.

Note 12.

Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes and other nicotine-containing products, including RRP's, in markets outside of the United States of America. Reportable segments for PMI are organized by geographic region and managed by segment managers who are responsible for the operating and financial results of the regions inclusive of all product categories sold in the region. Effective January 1, 2018, PMI began managing its business in six reportable segments. PMI's reportable segments are the European Union; Eastern Europe; Middle East & Africa; South & Southeast Asia; East Asia & Australia; and Latin America & Canada. PMI records net revenues and operating income to its segments based upon the geographic area in which the customer resides.

PMI's chief operating decision maker evaluates segment performance and allocates resources based on regional operating income, which includes results from all product categories sold in each region. Effective January 1, 2018, PMI began using operating income to evaluate business segment performance and allocate resources, replacing operating companies income used previously. Interest expense, net, and provision for income taxes are centrally managed and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by management. Information about total assets by segment is not disclosed because such information is not reported to or used by PMI's chief operating decision maker. Segment goodwill and other intangible assets, net, are disclosed in Note 3. *Goodwill and Other Intangible Assets, net*. The accounting policies of the segments are the same as those described in Note 2. *Summary of Significant Accounting Policies*.

On January 1, 2018, PMI adopted Financial Accounting Standards Update ASU 2014-09, "Revenue from Contracts with Customers." PMI adopted this standard retrospectively to each prior period presented. For further details on this standard and its impact on PMI, see Note 21. *New Accounting Standards*. The amounts presented for the reportable segments reflect this adoption.

PMI disaggregates its net revenue from contracts with customers by both geographic location and product category for each of PMI's six reportable segments, as PMI believes this best depicts how the nature, amount, timing and uncertainty of its revenue and cash flows are affected by economic factors.

Net revenues by segment were as follows:

| (in millions) | For the Years Ended December 31, | | |
|------------------------|----------------------------------|-----------|-----------|
| | 2018 | 2017 | 2016 |
| Net revenues: | | | |
| European Union | \$ 9,298 | \$ 8,318 | \$ 8,162 |
| Eastern Europe | 2,921 | 2,711 | 2,484 |
| Middle East & Africa | 4,114 | 3,988 | 4,516 |
| South & Southeast Asia | 4,656 | 4,417 | 4,396 |
| East Asia & Australia | 5,580 | 6,373 | 4,285 |
| Latin America & Canada | 3,056 | 2,941 | 2,842 |
| Net revenues | \$ 29,625 | \$ 28,748 | \$ 26,685 |

Total net revenues attributable to customers located in Japan, PMI's largest market in terms of net revenues, were \$3.8 billion, \$4.7 billion and \$2.8 billion in 2018, 2017 and 2016, respectively. Total net revenues attributable to customers located in Indonesia were \$3.1 billion, \$3.2 billion and \$3.2 billion in 2018, 2017 and 2016, respectively. PMI had one customer in the East Asia & Australia segment that accounted for 13%, 16% and 11% of PMI's consolidated net revenues, and one customer in the European Union segment that accounted for 10%, 10% and 11% of PMI's consolidated net revenues in 2018, 2017 and 2016, respectively.

PMI's net revenues by product category were as follows:

| (in millions) | For the Years Ended December 31, | | |
|-------------------------------|----------------------------------|------------------|------------------|
| | 2018 | 2017 | 2016 |
| Combustible products: | | | |
| European Union | \$ 8,433 | \$ 8,048 | \$ 8,105 |
| Eastern Europe | 2,597 | 2,657 | 2,478 |
| Middle East & Africa | 3,732 | 3,893 | 4,513 |
| South & Southeast Asia | 4,656 | 4,417 | 4,396 |
| East Asia & Australia | 3,074 | 3,156 | 3,619 |
| Latin America & Canada | 3,037 | 2,937 | 2,841 |
| Total combustible products | \$ 25,529 | \$ 25,107 | \$ 25,952 |
| Reduced-risk products: | | | |
| European Union | \$ 865 | \$ 269 | 57 |
| Eastern Europe | 324 | 55 | 6 |
| Middle East & Africa | 382 | 94 | 4 |
| South & Southeast Asia | — | — | — |
| East Asia & Australia | 2,506 | 3,218 | 666 |
| Latin America & Canada | 19 | 4 | 1 |
| Total reduced-risk products | \$ 4,096 | \$ 3,640 | \$ 733 |
| Total PMI net revenues | \$ 29,625 | \$ 28,748 | \$ 26,685 |

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

Net revenues related to combustible products refer to the operating revenues generated from the sale of these products, including shipping and handling charges billed to customers, net of sales and promotion incentives, and excise taxes. These net revenue amounts consist of the sale of PMI's cigarettes and other tobacco products combined. Other tobacco products primarily include roll-your-own and make-your-own cigarettes, pipe tobacco, cigars and cigarillos and do not include reduced-risk products.

Net revenues related to reduced-risk products refer to the operating revenues generated from the sale of these products, including shipping and handling charges billed to customers, net of sales and promotion incentives, and excise taxes. These net revenue amounts consist of the sale of PMI's heated tobacco units, *IQOS* devices and related accessories, and other nicotine-containing products, which primarily include our e-vapor products.

PMI recognizes revenue, when control is transferred to the customer, typically either upon shipment or delivery of goods.

Other segment data were as follows:

| (in millions) | For the Years Ended December 31, | | |
|--------------------------|----------------------------------|------------------|------------------|
| | 2018 | 2017 | 2016 |
| Operating income: | | | |
| European Union | \$ 4,105 | \$ 3,691 | \$ 3,920 |
| Eastern Europe | 902 | 887 | 890 |
| Middle East & Africa | 1,627 | 1,884 | 1,990 |
| South & Southeast Asia | 1,747 | 1,514 | 1,474 |
| East Asia & Australia | 1,851 | 2,608 | 1,691 |
| Latin America & Canada | 1,145 | 997 | 938 |
| Operating income | \$ 11,377 | \$ 11,581 | \$ 10,903 |

| (in millions) | For the Years Ended December 31, | | |
|----------------------------|----------------------------------|--------|--------|
| | 2018 | 2017 | 2016 |
| Depreciation expense: | | | |
| European Union | \$ 269 | \$ 213 | \$ 184 |
| Eastern Europe | 101 | 76 | 62 |
| Middle East & Africa | 105 | 88 | 88 |
| South & Southeast Asia | 154 | 153 | 147 |
| East Asia & Australia | 173 | 160 | 100 |
| Latin America & Canada | 94 | 85 | 79 |
| | 896 | 775 | 660 |
| Other | 11 | 12 | 9 |
| Total depreciation expense | \$ 907 | \$ 787 | \$ 669 |

| (in millions) | For the Years Ended December 31, | | |
|----------------------------|----------------------------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Capital expenditures: | | | |
| European Union | \$ 813 | \$ 956 | \$ 665 |
| Eastern Europe | 136 | 97 | 69 |
| Middle East & Africa | 65 | 85 | 154 |
| South & Southeast Asia | 129 | 140 | 156 |
| East Asia & Australia | 215 | 87 | 24 |
| Latin America & Canada | 74 | 175 | 103 |
| | 1,432 | 1,540 | 1,171 |
| Other | 4 | 8 | 1 |
| Total capital expenditures | \$ 1,436 | \$ 1,548 | \$ 1,172 |

| (in millions) | At December 31, | | |
|---|-----------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Long-lived assets: | | | |
| European Union | \$ 4,216 | \$ 4,130 | \$ 3,282 |
| Eastern Europe | 547 | 546 | 466 |
| Middle East & Africa | 362 | 430 | 400 |
| South & Southeast Asia | 1,297 | 1,419 | 1,413 |
| East Asia & Australia | 781 | 659 | 503 |
| Latin America & Canada | 779 | 885 | 765 |
| Total long-lived assets | 7,982 | 8,069 | 6,829 |
| Other | 664 | 1,126 | 750 |
| Total property, plant and equipment, net and Other assets | \$ 8,646 | \$ 9,195 | \$ 7,579 |

Long-lived assets consist of non-current assets other than goodwill; other intangible assets, net; deferred tax assets, investments in unconsolidated subsidiaries and equity securities, and financial instruments. PMI's largest markets in terms of long-lived assets are Italy, Switzerland and Indonesia. Total long-lived assets located in Italy, which is reflected in the European Union segment above, were \$1.1 billion, \$1.2 billion and \$0.7 billion at December 31, 2018, 2017 and 2016, respectively. Total long-lived assets located in Switzerland, which is reflected in the European Union segment above, were \$1.0 billion, \$0.9 billion and \$0.9 billion at December 31, 2018, 2017 and 2016, respectively. Total long-lived assets located in Indonesia, which is reflected in the South & Southeast Asia segment above, were \$0.7 billion, \$0.8 billion and \$0.8 billion at December 31, 2018, 2017 and 2016, respectively.

Note 13.

Benefit Plans:

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

In the fourth quarter of 2018, PMI elected to early adopt ASU 2018-14 "Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans." The adoption of ASU 2018-14 did not have a material impact on PMI's consolidated financial position or results of operations.

PMI adopted ASU 2017-07 "Compensation - Retirement Benefits" on January 1, 2018, retrospectively for all periods. Following adoption, the service cost component of net periodic benefit cost continues to be included within operating income, while all other cost components are included below operating income, within pension and other employee benefit costs. Pension and other employee benefit costs per the consolidated statements of earnings consisted of the following for December 31, 2018, 2017 and 2016:

| (in millions) | 2018 | 2017 | 2016 |
|--|---------|---------|--------|
| Net pension costs (income) | \$ (51) | \$ (20) | \$ (6) |
| Net postemployment costs | 80 | 85 | 83 |
| Net postretirement costs | 12 | 13 | 11 |
| Total pension and other employee benefit costs | \$ 41 | \$ 78 | \$ 88 |

Pension and Postretirement Benefit Plans

Obligations and Funded Status

The postretirement health care plans are not funded. The projected benefit obligations, plan assets and funded status of PMI's pension plans, and the accumulated benefit obligation and net amount accrued for PMI's postretirement health care plans, at December 31, 2018 and 2017, were as follows:

| (in millions) | Pension ⁽¹⁾ | | Postretirement | |
|---|------------------------|------------|----------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Benefit obligation at January 1, | \$ 9,028 | \$ 8,387 | \$ 248 | \$ 227 |
| Service cost | 210 | 208 | 4 | 4 |
| Interest cost | 109 | 108 | 9 | 8 |
| Benefits paid | (218) | (226) | (8) | (10) |
| Settlement and curtailment | 1 | — | — | — |
| Actuarial losses (gains) | 210 | (93) | (34) | 12 |
| Currency | (196) | 621 | (9) | 7 |
| Other | 8 | 23 | (1) | — |
| Benefit obligation at December 31, | 9,152 | 9,028 | 209 | 248 |
| Fair value of plan assets at January 1, | 7,598 | 6,457 | | |
| Actual return on plan assets | (447) | 742 | | |
| Employer contributions | 110 | 66 | | |
| Employee contributions | 24 | 40 | | |
| Benefits paid | (218) | (226) | | |
| Settlement and curtailment | — | — | | |
| Currency | (179) | 519 | | |
| Fair value of plan assets at December 31, | 6,888 | 7,598 | | |
| Net pension and postretirement liability recognized at December 31, | \$ (2,264) | \$ (1,430) | \$ (209) | \$ (248) |

(1) Primarily non-U.S. based defined benefit retirement plans.

At December 31, 2018, actuarial losses (gains) consisted of losses for experience differences related to the change in population profile, coupled with updated mortality table assumptions for the Swiss plan. At December 31, 2017, actuarial losses (gains) consisted of gains due to changes in the pension indexation rate assumption for the Holland plan, which was partially offset by losses for experience differences related to the change in population profile, primarily for the Swiss plan.

At December 31, 2018 and 2017, the Swiss pension plan represented 60% and 57% of the benefit obligation, respectively, and approximately 57% of the fair value of plan assets for each of the years. At December 31, 2018 and 2017, the U.S. pension plan represented 4% and 5% of the benefit obligation, respectively, and approximately 4% and 4% of the fair value of plan assets at December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, the amounts recognized on PMI's consolidated balance sheets for the pension and postretirement plans were as follows:

| (in millions) | Pension | | Postretirement | |
|--|------------|------------|----------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Other assets | \$ 37 | \$ 47 | | |
| Accrued liabilities — employment costs | (20) | (26) | (10) | (10) |
| Long-term employment costs | (2,281) | (1,451) | (199) | (238) |
| | \$ (2,264) | \$ (1,430) | \$ (209) | \$ (248) |

The accumulated benefit obligation, which represents benefits earned to date, for the pension plans was \$8,557 million and \$8,496 million at December 31, 2018 and 2017, respectively.

For pension plans with accumulated benefit obligations in excess of plan assets, the accumulated benefit obligation and fair value of plan assets were \$7,641 million and \$5,866 million, respectively, as of December 31, 2018. The accumulated benefit obligation and fair value of plan assets were \$6,953 million and \$5,835 million, respectively, as of December 31, 2017.

For pension plans with projected benefit obligations in excess of plan assets, the projected benefit obligation and fair value of plan assets were \$8,807 million and \$6,504 million, respectively, as of December 31, 2018. The projected benefit obligation and fair value of plan assets were \$8,609 million and \$7,135 million, respectively, as of December 31, 2017.

The following weighted-average assumptions were used to determine PMI's pension and postretirement benefit obligations at December 31:

| | Pension | | Postretirement | |
|---|---------|-------|----------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Discount rate | 1.61% | 1.51% | 3.97% | 3.79% |
| Rate of compensation increase | 1.86 | 1.65 | | |
| Interest crediting rate | 3.40 | 3.40 | | |
| Health care cost trend rate assumed for next year | | | 6.17 | 6.17 |
| Ultimate trend rate | | | 4.59 | 4.62 |
| Year that rate reaches the ultimate trend rate | | | 2040 | 2029 |

The discount rate for the largest pension plans is based on a yield curve constructed from a portfolio of high quality corporate bonds that produces a cash flow pattern equivalent to each plan's expected benefit payments. The discount rate for the remaining plans is developed from local bond indices that match local benefit obligations as closely as possible.

Components of Net Periodic Benefit Cost

Net periodic pension and postretirement health care costs consisted of the following for the years ended December 31, 2018, 2017 and 2016:

| (in millions) | Pension | | | Postretirement | | |
|---|---------|--------|--------|----------------|-------|-------|
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| Service cost | \$ 210 | \$ 208 | \$ 207 | \$ 4 | \$ 4 | \$ 3 |
| Interest cost | 109 | 108 | 146 | 9 | 8 | 9 |
| Expected return on plan assets | (349) | (326) | (346) | — | — | — |
| Amortization: | | | | | | |
| Net losses | 172 | 186 | 186 | 4 | 5 | 2 |
| Prior service cost | 2 | 6 | 4 | (1) | — | — |
| Settlement and curtailment | 15 | 6 | 4 | — | — | — |
| Net periodic pension and postretirement costs | \$ 159 | \$ 188 | \$ 201 | \$ 16 | \$ 17 | \$ 14 |

As of December 31, 2016, PMI elected to change the method used to calculate the service and interest cost components of the net periodic pension benefit costs. Historically, these costs were determined utilizing a single weighted-average discount rate based on a yield curve used to measure the benefit obligation at the beginning of the period. As of January 1, 2017, PMI utilized a full yield curve approach in the estimation of the service and interest costs by applying the specific spot rates along the yield curve to the relevant projected cash flows. Specifically, service costs were determined based on duration-specific spot rates applied to service cost cash flows, and interest costs were determined by applying duration-specific spot rates to the year-by-year projected benefit payments. PMI changed to the new

method to provide a more precise measurement of service and interest costs by improving the correlation between the projected benefit cash flows to the corresponding spot rates along the yield curve. PMI accounted for this change as a change in accounting estimate on a prospective basis. This change did not affect the measurement of PMI's pension plan obligations and did not have a material impact on PMI's consolidated results of operations, financial position or cash flows.

Settlement and curtailment charges were due primarily to employee severance and early retirement programs.

The following weighted-average assumptions were used to determine PMI's net pension and postretirement health care costs:

| | Pension | | | Postretirement | | |
|--|--------------|-------|-------|----------------|-------|-------|
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| Discount rate - service cost | 1.92% | 1.68% | 1.81% | 3.79% | 3.68% | 4.45% |
| Discount rate - interest cost | 1.25 | 1.27 | 1.81 | 3.79 | 3.68 | 4.45 |
| Expected rate of return on plan assets | 4.76 | 4.80 | 5.36 | | | |
| Rate of compensation increase | 1.65 | 1.68 | 2.03 | | | |
| Interest crediting rate | 3.40 | 3.40 | 3.00 | | | |
| Health care cost trend rate | | | | 6.17 | 7.15 | 6.23 |

PMI's expected rate of return on pension plan assets is determined by the plan assets' historical long-term investment performance, current asset allocation and estimates of future long-term returns by asset class.

PMI and certain of its subsidiaries sponsor defined contribution plans. Amounts charged to expense for defined contribution plans totaled \$66 million, \$58 million and \$56 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Plan Assets

PMI's investment strategy for pension plans is based on an expectation that equity securities will outperform debt securities over the long term. Accordingly, the target allocation of PMI's plan assets is broadly characterized as approximately a 60%/40% split between equity and debt securities. The strategy primarily utilizes indexed U.S. equity securities, international equity securities and investment-grade debt securities. PMI's plans have no investments in hedge funds, private equity or derivatives. PMI attempts to mitigate investment risk by rebalancing between equity and debt asset classes once a year or as PMI's contributions and benefit payments are made.

The fair value of PMI's pension plan assets at December 31, 2018 and 2017, by asset category was as follows:

| Asset Category (in millions) | At December 31, 2018 | Quoted Prices In Active Markets for Identical Assets/Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|----------------------------|---|---|--|
| Cash and cash equivalents | \$ 84 | \$ 84 | | |
| Equity securities: | | | | |
| U.S. securities | 139 | 139 | | |
| International securities | 442 | 442 | | |
| Investment funds ^(a) | 5,508 | 3,595 | \$ 1,913 | |
| International government bonds | 176 | 120 | 56 | |
| Corporate bonds | 232 | 232 | | |
| Other | 19 | 19 | | |
| Total assets in the fair value hierarchy | \$ 6,600 | \$ 4,631 | \$ 1,969 | \$ — |
| Investment funds measured at net asset value ^(b) | 288 | | | |
| Total assets | \$ 6,888 | | | |

^(a) Investment funds whose objective seeks to replicate the returns and characteristics of specified market indices (primarily MSCI — Europe, Switzerland, North America, Asia Pacific, Japan; Russell 3000; S&P 500 for equities, and Citigroup EMU and Barclays Capital U.S. for bonds), primarily consist of mutual funds, common trust funds and commingled funds. Of these funds, 57% are invested in U.S. and international equities; 20% are invested in U.S. and international government bonds; 12% are invested in real estate and other money markets, and 11% are invested in corporate bonds.

^(b) In accordance with FASB ASC Subtopic 820-10, certain investments measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

| Asset Category (in millions) | At December 31, 2017 | Quoted Prices In Active Markets for Identical Assets/Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|----------------------------|---|---|--|
| Cash and cash equivalents | \$ 17 | \$ 17 | | |
| Equity securities: | | | | |
| U.S. securities | 146 | 146 | | |
| International securities | 518 | 518 | | |
| Investment funds ^(a) | 6,219 | 4,191 | \$ 2,028 | |
| International government bonds | 119 | 119 | | |
| Corporate bonds | 247 | 247 | | |
| Other | 22 | 22 | | |
| Total assets in the fair value hierarchy | \$ 7,288 | \$ 5,260 | \$ 2,028 | \$ — |
| Investment funds measured at net asset value ^(b) | 310 | | | |
| Total assets | \$ 7,598 | | | |

^(a) Investment funds whose objective seeks to replicate the returns and characteristics of specified market indices (primarily MSCI — Europe, Switzerland, North America, Asia Pacific, Japan; Russell 3000; S&P 500 for equities, and Citigroup EMU and Barclays Capital U.S. for bonds), primarily consist of mutual funds, common trust funds and commingled funds. Of these funds, 60% were invested in U.S. and international equities; 20% were invested in U.S. and international government bonds; 10% were invested in real estate and other money markets, and 10% were invested in corporate bonds.

^(b) In accordance with FASB ASC Subtopic 820-10, certain investments measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

See Note 16. *Fair Value Measurements* for a discussion of the fair value of pension plan assets.

PMI makes, and plans to make, contributions to the extent that they are tax deductible and to meet specific funding requirements of its funded pension plans. Currently, PMI anticipates making contributions of approximately \$119 million in 2019 to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest and currency rates.

The estimated future benefit payments from PMI pension plans at December 31, 2018, are as follows:

| (in millions) | |
|---------------|--------|
| 2019 | \$ 290 |
| 2020 | 315 |
| 2021 | 319 |
| 2022 | 329 |
| 2023 | 347 |
| 2024 - 2028 | 1,971 |

PMI's expected future annual benefit payments for its postretirement health care plans are estimated to be not material through 2028.

Postemployment Benefit Plans

PMI and certain of its subsidiaries sponsor postemployment benefit plans covering substantially all salaried and certain hourly employees. The cost of these plans is charged to expense over the working life of the covered employees. Net postemployment costs were \$158 million, \$144 million and \$166 million for the years ended December 31, 2018, 2017 and 2016, respectively.

The amounts recognized in accrued postemployment costs on PMI's consolidated balance sheets at December 31, 2018 and 2017, were \$708 million and \$671 million, respectively. The change in the liability is primarily due to actuarial losses of \$147 in 2018 resulting from increased employee severance cost in Switzerland and countries in the European Union segment, coupled with the periodic expense, partially offset by cash payments.

The accrued postemployment costs were determined using a weighted-average discount rate of 3.1% and 3.0% in 2018 and 2017, respectively; an assumed ultimate annual weighted-average turnover rate of 3.2% and 2.6% in 2018 and 2017, respectively; assumed compensation cost increases of 2.6% in 2018 and 2.3% in 2017, and assumed benefits as defined in the respective plans. In accordance with local regulations, certain postemployment plans are funded. As a result, the accrued postemployment costs disclosed above are presented net of the related assets of \$38 million and \$33 million at December 31, 2018 and 2017, respectively. Postemployment costs arising from actions that offer employees benefits in excess of those specified in the respective plans are charged to expense when incurred.

Comprehensive Earnings (Losses)

The amounts recorded in accumulated other comprehensive losses at December 31, 2018, consisted of the following:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---------------------------|------------|-----------------|-----------------|------------|
| Net losses | \$ (3,438) | \$ (41) | \$ (702) | \$ (4,181) |
| Prior service cost | (27) | 3 | — | (24) |
| Net transition obligation | (4) | — | — | (4) |
| Deferred income taxes | 379 | 20 | 164 | 563 |
| Losses to be amortized | \$ (3,090) | \$ (18) | \$ (538) | \$ (3,646) |

The amounts recorded in accumulated other comprehensive losses at December 31, 2017, consisted of the following:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---------------------------|------------|-----------------|-----------------|------------|
| Net losses | \$ (2,624) | \$ (80) | \$ (617) | \$ (3,321) |
| Prior service cost | (35) | 4 | — | (31) |
| Net transition obligation | (5) | — | — | (5) |
| Deferred income taxes | 327 | 28 | 186 | 541 |
| Losses to be amortized | \$ (2,337) | \$ (48) | \$ (431) | \$ (2,816) |

The amounts recorded in accumulated other comprehensive losses at December 31, 2016, consisted of the following:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---------------------------|------------|-----------------|-----------------|------------|
| Net losses | \$ (3,314) | \$ (73) | \$ (713) | \$ (4,100) |
| Prior service cost | (53) | 4 | — | (49) |
| Net transition obligation | (5) | — | — | (5) |
| Deferred income taxes | 350 | 24 | 215 | 589 |
| Losses to be amortized | \$ (3,022) | \$ (45) | \$ (498) | \$ (3,565) |

The movements in other comprehensive earnings (losses) during the year ended December 31, 2018, were as follows:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---|----------|-----------------|-----------------|----------|
| Amounts transferred to earnings as components of net periodic benefit cost: | | | | |
| Amortization: | | | | |
| Net losses | \$ 180 | \$ 5 | \$ 62 | \$ 247 |
| Prior service cost | — | (1) | — | (1) |
| Net transition obligation | 1 | — | — | 1 |
| Other income/expense: | | | | |
| Net losses | 14 | — | — | 14 |
| Prior service cost | — | — | — | — |
| Deferred income taxes | (28) | (1) | (14) | (43) |
| | 167 | 3 | 48 | 218 |
| Other movements during the year: | | | | |
| Net losses | (1,008) | 34 | (147) | (1,121) |
| Prior service cost | 8 | — | — | 8 |
| Deferred income taxes | 80 | (7) | (8) | 65 |
| | (920) | 27 | (155) | (1,048) |
| Total movements in other comprehensive earnings (losses) | \$ (753) | \$ 30 | \$ (107) | \$ (830) |

The movements in other comprehensive earnings (losses) during the year ended December 31, 2017, were as follows:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---|---------|-----------------|-----------------|--------|
| Amounts transferred to earnings as components of net periodic benefit cost: | | | | |
| Amortization: | | | | |
| Net losses | \$ 175 | \$ 5 | \$ 68 | \$ 248 |
| Prior service cost | 5 | — | — | 5 |
| Other income/expense: | | | | |
| Net losses | 6 | — | — | 6 |
| Prior service cost | — | — | — | — |
| Deferred income taxes | (10) | (1) | (20) | (31) |
| | 176 | 4 | 48 | 228 |
| Other movements during the year: | | | | |
| Net losses | 509 | (12) | 28 | 525 |
| Prior service cost | 13 | — | — | 13 |
| Deferred income taxes | (13) | 5 | (9) | (17) |
| | 509 | (7) | 19 | 521 |
| Total movements in other comprehensive earnings (losses) | \$ 685 | \$ (3) | \$ 67 | \$ 749 |

The movements in other comprehensive earnings (losses) during the year ended December 31, 2016, were as follows:

| (in millions) | Pension | Post-retirement | Post-employment | Total |
|---|----------|-----------------|-----------------|----------|
| Amounts transferred to earnings as components of net periodic benefit cost: | | | | |
| Amortization: | | | | |
| Net losses | \$ 193 | \$ 2 | \$ 62 | \$ 257 |
| Prior service cost | 6 | — | — | 6 |
| Other income/expense: | | | | |
| Net losses | 4 | — | — | 4 |
| Prior service cost | — | — | — | — |
| Deferred income taxes | (26) | — | (17) | (43) |
| | 177 | 2 | 45 | 224 |
| Other movements during the year: | | | | |
| Net losses | (437) | (15) | (65) | (517) |
| Prior service cost | (18) | — | — | (18) |
| Deferred income taxes | 55 | 4 | 19 | 78 |
| | (400) | (11) | (46) | (457) |
| Total movements in other comprehensive earnings (losses) | \$ (223) | \$ (9) | \$ (1) | \$ (233) |

Note 14.

Additional Information:

| (in millions) | For the Years Ended December 31, | | |
|---|----------------------------------|----------|----------|
| | 2018 | 2017 | 2016 |
| Research and development expense | \$ 383 | \$ 453 | \$ 429 |
| Advertising expense | \$ 896 | \$ 830 | \$ 405 |
| Foreign currency net transaction losses | \$ 21 | \$ 49 | \$ 272 |
| Interest expense | \$ 855 | \$ 1,096 | \$ 1,069 |
| Interest income | (190) | (182) | (178) |
| Interest expense, net | \$ 665 | \$ 914 | \$ 891 |
| Rent expense | \$ 312 | \$ 313 | \$ 284 |

Minimum rental commitments under non-cancelable operating leases in effect at December 31, 2018, were as follows:

| (in millions) | |
|---------------|--------|
| 2019 | \$ 147 |
| 2020 | 103 |
| 2021 | 73 |
| 2022 | 52 |
| 2023 | 43 |
| Thereafter | 354 |
| | \$ 772 |

Note 15.

Financial Instruments:**Overview**

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

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts ("foreign exchange contracts"), and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Canadian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Philippine

peso, Russian ruble, Swiss franc and Turkish lira. At December 31, 2018 and 2017, PMI had contracts with aggregate notional amounts of \$27.4 billion and \$26.1 billion, respectively. Of the \$27.4 billion aggregate notional amount at December 31, 2018, \$3.2 billion related to cash flow hedges, \$10.1 billion related to hedges of net investments in foreign operations and \$14.1 billion related to other derivatives that primarily offset currency exposures on intercompany financing. Of the \$26.1 billion aggregate notional amount at December 31, 2017, \$3.4 billion related to cash flow hedges, \$11.3 billion related to hedges of net investments in foreign operations and \$11.4 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

Effective January 1, 2018, PMI elected to early adopt Accounting Standard Update 2017-12 “Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedging Activities,” which did not have a material impact on PMI’s consolidated financial position or results of operations.

The fair value of PMI’s foreign exchange contracts included in the consolidated balance sheet as of December 31, 2018 and 2017, were as follows:

| (in millions) | Derivative Assets | | | | Derivative Liabilities | | | |
|--|------------------------------|------------|--------|------------------------------|------------------------|----------|--|--|
| | Balance Sheet Classification | Fair Value | | Balance Sheet Classification | Fair Value | | | |
| | | 2018 | 2017 | | 2018 | 2017 | | |
| Foreign exchange contracts designated as hedging instruments | Other current assets | \$ 54 | \$ 84 | Other accrued liabilities | \$ 47 | \$ 197 | | |
| | Other assets | 99 | 34 | Other liabilities | 525 | 880 | | |
| Foreign exchange contracts not designated as hedging instruments | Other current assets | 67 | 22 | Other accrued liabilities | 46 | 37 | | |
| | Other assets | — | — | Other liabilities | 13 | 14 | | |
| Total derivatives | | \$ 220 | \$ 140 | | \$ 631 | \$ 1,128 | | |

For the years ended December 31, 2018, 2017 and 2016, PMI’s cash flow and net investment hedging instruments impacted the consolidated statements of earnings and comprehensive earnings as follows:

| (pre-tax, millions) | For the Year Ended December 31, | | | | | |
|---|--|------------|--------|---|-------|-------|
| | Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives | | | Statement of Earnings Classification of Gain/(Loss) Reclassified from Other Comprehensive Earnings/(Losses) into Earnings | | |
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| Derivatives in Cash Flow Hedging Relationship | | | | | | |
| Foreign exchange contracts | \$ 28 | \$ (52) | \$ 12 | | | |
| | | | | Net revenues | \$ 18 | \$ 60 |
| | | | | Cost of sales | — | 1 |
| | | | | Marketing, administration and research costs | 6 | (7) |
| | | | | Interest expense, net | (1) | (41) |
| Derivatives in Net Investment Hedging Relationship | | | | | | |
| Foreign exchange contracts | 324 | (1,644) | 296 | | | |
| Total | \$ 352 | \$ (1,696) | \$ 308 | | \$ 23 | \$ 13 |

Cash Flow Hedges

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to certain forecasted transactions. Gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's consolidated statements of earnings. Amounts reclassified from other comprehensive losses into earnings as a result of the discontinuance of cash flow hedges when the originally forecasted transaction is no longer probable of occurring were not material during the periods presented. As of December 31, 2018, PMI has hedged forecasted transactions for periods not exceeding the next eighteen months, with the exception of one foreign exchange contract that expires in May 2024. The impact of these hedges is primarily included in operating cash flows on PMI's consolidated statements of cash flows.

Hedges of Net Investments in Foreign Operations

PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges, primarily of its Euro net assets. For the years ended December 31, 2018, 2017 and 2016, these hedges of net investments resulted in gains (losses), net of income taxes, of \$521 million, \$(1,725) million and \$430 million, respectively, principally related to changes in the exchange rates between the Euro and U.S. dollar. These gains (losses) were reported as a component of accumulated other comprehensive losses within currency translation adjustments and were substantially offset by the losses and gains generated on the underlying assets. For the year ended December 31, 2018, the gains for amounts excluded from the effectiveness testing recognized in earnings were \$260 million and were accounted for in interest expense, net, on the consolidated statement of earnings. The premiums paid for, and settlements of, net investment hedges are included in investing cash flows on PMI's consolidated statements of cash flows.

Other Derivatives

PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in marketing, administration and research costs in PMI's consolidated statements of earnings. For the years ended December 31, 2018, 2017 and 2016, the gains (losses) from contracts for which PMI did not apply hedge accounting were \$405 million, \$382 million and \$(85) million, respectively. The gains (losses) from these contracts substantially offset the losses and gains generated by the underlying intercompany and third-party loans being hedged.

As a result, for the years ended December 31, 2018, 2017 and 2016, these items impacted the consolidated statement of earnings as follows:

(pre-tax, in millions)

| Derivatives not Designated as Hedging Instruments | Statement of Earnings Classification of Gain/(Loss) | Amount of Gain/(Loss) Recognized in Earnings | | |
|---|---|--|---------|---------|
| | | 2018 | 2017 | 2016 |
| Foreign exchange contracts | | | | |
| | Interest expense, net | \$ 62 | \$ (60) | \$ (24) |
| Total | | \$ 62 | \$ (60) | \$ (24) |

Qualifying Hedging Activities Reported in Accumulated Other Comprehensive Losses

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

| (in millions) | For the Years Ended December 31, | | |
|---|----------------------------------|-------|-------|
| | 2018 | 2017 | 2016 |
| Gain as of January 1, | \$ 42 | \$ 97 | \$ 59 |
| Derivative (gains)/losses transferred to earnings | (31) | (11) | 30 |
| Change in fair value | 24 | (44) | 8 |
| Gain as of December 31, | \$ 35 | \$ 42 | \$ 97 |

At December 31, 2018, PMI expects \$21 million of derivative gains that are included in accumulated other comprehensive losses to be reclassified to the consolidated statement of earnings within the next 12 months. These gains are expected to be substantially offset by the statement of earnings impact of the respective hedged transactions.

Contingent Features

PMI's derivative instruments do not contain contingent features.

Credit Exposure and Credit Risk

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

Fair Value

See Note 16. *Fair Value Measurements* and Note 19. *Balance Sheet Offsetting* for additional discussion of derivative financial instruments.

Note 16.

Fair Value Measurements:

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

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

In the fourth quarter of 2018, PMI elected to early adopt ASU 2018-13 "Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement." The adoption of ASU 2018-13 did not have a material impact on PMI's consolidated financial position or results of operations.

Equity Securities

The fair value of PMI's equity securities, which are determined by using quoted prices in active markets, have been classified within Level 1.

Derivative Financial Instruments

PMI assesses the fair value of its foreign exchange contracts and interest rate contracts using standard valuation models that use, as their basis, readily observable market inputs. The fair value of PMI's foreign exchange forward contracts is determined by using the prevailing foreign exchange spot rates and interest rate differentials, and the respective maturity dates of the instruments. The fair value of PMI's currency options is determined by using a Black-Scholes methodology based on foreign exchange spot rates and interest rate differentials, currency volatilities and maturity dates. PMI's derivative financial instruments have been classified within Level 2 at December 31, 2018 and 2017. See Note 15. *Financial Instruments* for additional discussion of derivative financial instruments.

Pension Plan Assets

The fair value of pension plan assets determined by using readily available quoted market prices in active markets has been classified within Level 1 of the fair value hierarchy at December 31, 2018 and 2017. The fair value of pension plan assets determined by using quoted prices in markets that are not active has been classified within Level 2 at December 31, 2018 and 2017. See Note 13. *Benefit Plans* for additional discussion of pension plan assets.

Debt

The fair value of PMI's outstanding debt, which is utilized solely for disclosure purposes, is determined using quotes and market interest rates currently available to PMI for issuances of debt with similar terms and remaining maturities. The aggregate carrying value of PMI's debt, excluding short-term borrowings and \$33 million of capital lease obligations, was \$30,996 million at December 31, 2018. The aggregate carrying value of PMI's debt, excluding short-term borrowings and \$28 million of capital lease obligations, was \$33,812 million at December 31, 2017. The fair value of PMI's outstanding debt, excluding the aforementioned short-term borrowings and capital lease obligations, was classified within Level 1 and Level 2 at December 31, 2018 and 2017.

The aggregate fair values of PMI's equity securities, derivative financial instruments, pension plan assets and debt as of December 31, 2018, were as follows:

| (in millions) | Fair Value At December 31, 2018 | Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|------------------------------------|---|---|--|
| Assets: | | | | |
| Equity securities | \$ 288 | \$ 288 | \$ — | \$ — |
| Foreign exchange contracts | 220 | — | 220 | — |
| Pension plan assets | 6,600 | 4,631 | 1,969 | — |
| Total assets in fair value hierarchy | \$ 7,108 | \$ 4,919 | \$ 2,189 | \$ — |
| Pension plan assets measured at net asset value ^(a) | 288 | | | |
| Total assets | \$ 7,396 | | | |
| Liabilities: | | | | |
| Debt | \$ 31,162 | \$ 30,997 | \$ 165 | \$ — |
| Foreign exchange contracts | 631 | — | 631 | — |
| Total liabilities | \$ 31,793 | \$ 30,997 | \$ 796 | \$ — |

^(a) In accordance with FASB ASC Subtopic 820-10, certain investments measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in these tables are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

The aggregate fair values of PMI's derivative financial instruments, pension plan assets and debt as of December 31, 2017, were as follows:

| (in millions) | Fair Value At December 31, 2017 | Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|------------------------------------|---|---|--|
| Assets: | | | | |
| Foreign exchange contracts | \$ 140 | \$ — | \$ 140 | \$ — |
| Pension plan assets | 7,288 | 5,260 | 2,028 | — |
| Total assets in fair value hierarchy | \$ 7,428 | \$ 5,260 | \$ 2,168 | \$ — |
| Pension plan assets measured at net asset value ^(a) | 310 | | | |
| Total assets | \$ 7,738 | | | |
| Liabilities: | | | | |
| Debt | \$ 35,856 | \$ 35,685 | \$ 171 | \$ — |
| Foreign exchange contracts | 1,128 | — | 1,128 | — |
| Total liabilities | \$ 36,984 | \$ 35,685 | \$ 1,299 | \$ — |

^(a) In accordance with FASB ASC Subtopic 820-10, certain investments measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in these tables are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

Note 17.

Accumulated Other Comprehensive Losses:

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

| (Losses) Earnings (in millions) | At December 31, | | |
|--|-----------------|------------|------------|
| | 2018 | 2017 | 2016 |
| Currency translation adjustments | \$ (6,500) | \$ (5,761) | \$ (6,091) |
| Pension and other benefits | (3,646) | (2,816) | (3,565) |
| Derivatives accounted for as hedges | 35 | 42 | 97 |
| Total accumulated other comprehensive losses | \$ (10,111) | \$ (8,535) | \$ (9,559) |

Reclassifications from Other Comprehensive Earnings

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that are due to current period activity and reclassifications to the income statement are shown on the consolidated statements of comprehensive earnings for the years ended December 31, 2018, 2017, and 2016. For the years ended December 31, 2017, and 2016, \$2 million and \$(5) million of net currency translation adjustment gains/(losses) were transferred from other comprehensive earnings to marketing, administration and research costs in the consolidated statements of earnings, respectively, upon liquidation of subsidiaries. For additional information, see Note 13. *Benefit Plans* and Note 15. *Financial Instruments* for disclosures related to PMI's pension and other benefits and derivative financial instruments.

Note 18.

Contingencies:

Tobacco-Related Litigation

Legal proceedings covering a wide range of matters are pending or threatened against us, and/or our subsidiaries, and/or our indemnitees in various jurisdictions. Our indemnitees include distributors, licensees, and others that have been named as parties in certain cases and that we have agreed to defend, as well as to pay costs and some or all of judgments, if any, that may be entered against them. Pursuant to the terms of the Distribution Agreement between Altria Group, Inc. ("Altria") and PMI, PMI will indemnify Altria and Philip Morris USA Inc. ("PM USA"), a U.S. tobacco subsidiary of Altria, for tobacco product claims based in substantial part on products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for tobacco product claims based in substantial part on products manufactured by PM USA, excluding tobacco products contract manufactured for PMI.

It is possible that there could be adverse developments in pending cases against us and our subsidiaries. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation.

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

We and our subsidiaries record provisions in the consolidated financial statements for pending litigation when we determine that an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, after assessing the information available to it (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss for any of the pending tobacco-related cases; and (iii) accordingly, no estimated loss has been accrued in the consolidated financial statements for unfavorable outcomes in these cases, if any. Legal defense costs are expensed as incurred.

It is possible that our consolidated results of operations, cash flows or financial position could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Nevertheless, although litigation is subject to uncertainty, we and each of our subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that we have valid defenses to the litigation pending against us, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be, vigorously defended. However, we and our subsidiaries may enter into settlement discussions in particular cases if we believe it is in our best interests to do so.

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

The table below lists the number of tobacco-related cases pertaining to combustible products pending against us and/or our subsidiaries or indemnitees as of February 4, 2019, February 9, 2018 and December 31, 2016:

| Type of Case | Number of Cases Pending as of February 4, 2019 | Number of Cases Pending as of February 9, 2018 | Number of Cases Pending as of December 31, 2016 |
|-------------------------------------|--|--|---|
| Individual Smoking and Health Cases | 55 | 57 | 64 |
| Smoking and Health Class Actions | 10 | 11 | 11 |
| Health Care Cost Recovery Actions | 16 | 16 | 16 |
| Label-Related Class Actions | 1 | 1 | — |
| Individual Label-Related Cases | 7 | 1 | 3 |
| Public Civil Actions | 2 | 2 | 2 |

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 491 Smoking and Health, Label-Related, Health Care Cost Recovery, and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees were a defendant have been terminated in our favor. Thirteen cases have had decisions in favor of plaintiffs. Nine of these cases have subsequently reached final resolution in our favor and four remain on appeal.

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

| Date | Location of Court/Name of Plaintiff | Type of Case | Verdict | Post-Trial Developments |
|---------------|--|--------------|---|--|
| February 2004 | Brazil/The Smoker Health Defense Association | Class Action | The Civil Court of São Paulo found defendants liable without hearing evidence. In April 2004, the court awarded “moral damages” of R\$1,000 (approximately \$273) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not assess actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling. | Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. In March 2017, plaintiff filed an <i>en banc</i> appeal to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. Both appeals are still pending. |

| Date | Location of Court/Name of Plaintiff | Type of Case | Verdict | Post-Trial Developments |
|--------------|-------------------------------------|--------------|---|---|
| May 27, 2015 | Canada/Cecilia Létourneau | Class Action | On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the <i>Létourneau</i> class on liability and awarded a total of CAD 131 million (approximately \$100 million) in punitive damages, allocating CAD 46 million (approximately \$35 million) to our subsidiary. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days. The court did not order the payment of compensatory damages. | In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court’s order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court’s ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal covering both the <i>Létourneau</i> case and the <i>Blais</i> case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$172.5 million) to cover both the <i>Létourneau</i> and <i>Blais</i> cases. The hearing for the merits appeal took place in November 2016. (See below for further detail.) |

| Date | Location of Court/Name of Plaintiff | Type of Case | Verdict | Post-Trial Developments |
|--------------|---|---------------------|---|--|
| May 27, 2015 | Canada/Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais | Class Action | On May 27, 2015, the Superior Court of the District of Montreal, Province of Quebec ruled in favor of the <i>Blais</i> class on liability and found the class members' compensatory damages totaled approximately CAD 15.5 billion (approximately \$11.8 billion), including pre-judgment interest. The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion including pre-judgment interest (approximately \$2.37 billion)). The trial court awarded CAD 90,000 (approximately \$69,000) in punitive damages, allocating CAD 30,000 (approximately \$23,000) to our subsidiary. The trial court ordered defendants to pay CAD 1 billion (approximately \$763 million) of the compensatory damage award, CAD 200 million (approximately \$153 million) of which is our subsidiary's portion, into a trust within 60 days. | In June 2015, our subsidiary commenced the appellate process with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust. In August 2015, plaintiffs filed a motion for security with the Court of Appeal. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling, together with the <i>Létourneau</i> case, CAD 226 million (approximately \$172.5 million). The hearing for the merits appeal took place in November 2016. (See below for further detail.) |

| Date | Location of Court/Name of Plaintiff | Type of Case | Verdict | Post-Trial Developments |
|----------------|--|---------------------|--|--|
| August 5, 2016 | Argentina/Hugo Lespada | Individual Action | On August 5, 2016, the Civil Court No. 14 - Mar del Plata, issued a verdict in favor of plaintiff, an individual smoker, and awarded him ARS 110,000 (approximately \$2,960), plus interest, in compensatory and moral damages. The trial court found that our subsidiary failed to warn plaintiff of the risk of becoming addicted to cigarettes. | On August 23, 2016, our subsidiary filed its notice of appeal. On October 31, 2017, the Civil and Commercial Court of Appeals of Mar del Plata ruled that plaintiff's claim was barred by the statute of limitations and it reversed the trial court's decision. On November 28, 2017, plaintiff filed an extraordinary appeal of the reversal of the trial court's decision to the Supreme Court of the Province of Buenos Aires. |

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

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

As of February 4, 2019, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

- 55 cases brought by individual plaintiffs in Argentina (32), Brazil (8), Canada (2), Chile (4), Costa Rica (1), Italy (3), the Philippines (1), Poland (2), Turkey (1) and Scotland (1), compared with 57 such cases on February 9, 2018, and 64 cases on December 31, 2016; and
- 10 cases brought on behalf of classes of individual plaintiffs in Brazil (1) and Canada (9), compared with 11 such cases on February 9, 2018, and 11 such cases on December 31, 2016.

In the class action pending in Brazil, *The Smoker Health Defense Association (ADESF) v. Souza Cruz, S.A. and Philip Morris Marketing, S.A.*, Nineteenth Lower Civil Court of the Central Courts of the Judiciary District of São Paulo, Brazil, filed July 25, 1995, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer organization, is seeking damages for all addicted smokers and former smokers, and injunctive relief. In 2004, the trial court found defendants liable without hearing evidence and awarded “moral damages” of R\$1,000 (approximately \$273) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. In February 2015, the appellate court unanimously dismissed plaintiff's appeal. In September 2015, plaintiff appealed to the Superior Court of Justice. In February 2017, the Chief Justice of the Superior Court of Justice denied plaintiff's appeal. In March 2017, plaintiff filed an *en banc* appeal to the Superior Court of Justice. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that plaintiff did not have standing to bring the lawsuit. Both appeals are still pending.

In the first class action pending in Canada, *Cecilia Létourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in September 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiff, an individual smoker, sought compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and awarded a total of CAD 131 million (approximately \$100 million) in punitive damages, allocating CAD 46 million (approximately \$35 million) to our subsidiary. The trial court found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' addiction. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the size of the addiction class at 918,000 members but declined to award compensatory damages to the addiction class because the evidence did not establish the claims with sufficient accuracy. The trial court ordered defendants to pay the full punitive damage award into a trust within 60 days and found that a claims process to allocate the awarded damages to individual class members would be too expensive and difficult to administer. The trial court ordered a briefing on the proposed process for the distribution of sums remaining from the punitive damage award after payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make the payment into a trust within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking security in both the *Létourneau* case and the *Blais* case described below. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$172.5 million), in the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$28.7 million) beginning in December 2015 through March 2017. See the *Blais* description for further detail concerning

the security order. The Court of Appeal heard oral arguments on the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) holding that the addiction class members' claims for punitive damages were not time-barred even though the case was filed more than three years after a prominent addiction warning appeared on all packages, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the second class action pending in Canada, *Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers (Imperial Tobacco Canada Ltd. and JTI-MacDonald Corp.) are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, sought compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. Trial began in March 2012 and concluded in December 2014. The trial court issued its judgment on May 27, 2015. The trial court found our subsidiary and two other Canadian manufacturers liable and found that the class members' compensatory damages totaled approximately CAD 15.5 billion, including pre-judgment interest (approximately \$11.8 billion). The trial court awarded compensatory damages on a joint and several liability basis, allocating 20% to our subsidiary (approximately CAD 3.1 billion, including pre-judgment interest (approximately \$2.37 billion)). In addition, the trial court awarded CAD 90,000 (approximately \$69,000) in punitive damages, allocating CAD 30,000 (approximately \$23,000) to our subsidiary and found that defendants violated the Civil Code of Quebec, the Quebec Charter of Human Rights and Freedoms, and the Quebec Consumer Protection Act by failing to warn adequately of the dangers of smoking. The trial court also found that defendants conspired to prevent consumers from learning the dangers of smoking. The trial court further held that these civil faults were a cause of the class members' diseases. The trial court rejected other grounds of fault advanced by the class, holding that: (i) the evidence was insufficient to show that defendants marketed to youth, (ii) defendants' advertising did not convey false information about the characteristics of cigarettes, and (iii) defendants did not commit a fault by using the descriptors light or mild for cigarettes with a lower tar delivery. The trial court estimated the disease class at 99,957 members. The trial court ordered defendants to pay CAD 1 billion (approximately \$763 million) of the compensatory damage award into a trust within 60 days, CAD 200 million (approximately \$153 million) of which is our subsidiary's portion and ordered briefing on a proposed claims process for the distribution of damages to individual class members and for payment of attorneys' fees and legal costs. In June 2015, our subsidiary commenced the appellate process by filing its inscription of appeal of the trial court's judgment with the Court of Appeal of Quebec. Our subsidiary also filed a motion to cancel the trial court's order for payment into a trust within 60 days notwithstanding appeal. In July 2015, the Court of Appeal granted the motion to cancel and overturned the trial court's ruling that our subsidiary make an initial payment within 60 days. In August 2015, plaintiffs filed a motion with the Court of Appeal seeking an order that defendants place irrevocable letters of credit totaling CAD 5 billion (approximately \$3.8 billion) into trust, to secure the judgments in both the *Létourneau* and *Blais* cases. Plaintiffs subsequently withdrew their motion for security against JTI-MacDonald Corp. and proceeded only against our subsidiary and Imperial Tobacco Canada Ltd. In October 2015, the Court of Appeal granted the motion and ordered our subsidiary to furnish security totaling CAD 226 million (approximately \$172.5 million) to cover both the *Létourneau* and *Blais* cases. Such security may take the form of cash into a court trust or letters of credit, in six equal consecutive quarterly installments of approximately CAD 37.6 million (approximately \$28.7 million) beginning in December 2015 through March 2017. The Court of Appeal ordered Imperial Tobacco Canada Ltd. to furnish security totaling CAD 758 million (approximately \$578 million) in seven equal consecutive quarterly installments of approximately CAD 108 million (approximately \$82.4 million) beginning in December 2015 through June 2017. In March 2017, our subsidiary made its sixth and final quarterly installment of security for approximately CAD 37.6 million (approximately \$28.7 million) into a court trust. This payment is included in other assets on the consolidated balance sheets and in cash used in operating activities in the consolidated statements of cash flows. The Court of Appeal ordered that the security is payable upon a final judgment of the Court of Appeal affirming the trial court's judgment or upon further order of the Court of Appeal. The Court of Appeal heard oral arguments on the merits appeal in November 2016. Our subsidiary and PMI believe that the findings of liability and damages were incorrect and should ultimately be set aside on any one of many grounds, including the following: (i) holding that defendants violated Quebec law by failing to warn class members of the risks of smoking even after the court found that class members knew, or should have known, of the risks, (ii) finding that plaintiffs were not required to prove that defendants' alleged misconduct caused injury to each class member in direct contravention of binding precedent, (iii) creating a factual presumption, without any evidence from class members or otherwise, that defendants' alleged misconduct caused all smoking by all class members, (iv) relying on epidemiological evidence that did not meet recognized scientific standards, and (v) awarding punitive damages to punish defendants without proper consideration as to whether punitive damages were necessary to deter future misconduct.

In the third class action pending in Canada, *Kunta v. Canadian Tobacco Manufacturers' Council, et al., The Queen's Bench, Winnipeg, Canada*, filed June 12, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges her own addiction to tobacco products and chronic obstructive pulmonary disease ("COPD"), severe asthma, and mild reversible lung disease resulting from the use of tobacco products. She is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. In September 2009,

plaintiff's counsel informed defendants that he did not anticipate taking any action in this case while he pursues the class action filed in Saskatchewan (see description of *Adams*, below).

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

In the fifth class action pending in Canada, *Semple v. Canadian Tobacco Manufacturers' Council, et al., The Supreme Court (trial court), Nova Scotia, Canada*, filed June 18, 2009, we, our subsidiaries, and our indemnitees (PM USA and Altria), and other members of the industry are defendants. The plaintiff, an individual smoker, alleges his own addiction to tobacco products and COPD resulting from the use of tobacco products. He is seeking compensatory and punitive damages on behalf of a proposed class comprised of all smokers, their estates, dependents and family members, as well as restitution of profits, and reimbursement of government health care costs allegedly caused by tobacco products. No activity in this case is anticipated while plaintiff's counsel pursues the class action filed in Saskatchewan (see description of *Adams*, above).

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

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

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

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

Health Care Cost Recovery Litigation: These cases, brought by governmental and non-governmental plaintiffs, seek reimbursement of health care cost expenditures allegedly caused by tobacco products. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including unjust enrichment, negligence, negligent design, strict liability, breach of express and implied warranties, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, defective product, failure to warn, sale of cigarettes to minors, and claims under statutes governing competition and deceptive trade practices. Plaintiffs in these cases seek various forms of relief including compensatory and other damages, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, remoteness of injury, failure to state a claim, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), and statute of limitations.

As of February 4, 2019, there were 16 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (10), Korea (1) and Nigeria (5), compared with 16 such cases on February 9, 2018 and 16 such cases on December 31, 2016.

In the first health care cost recovery case pending in Canada, *Her Majesty the Queen in Right of British Columbia v. Imperial Tobacco Limited, et al.*, Supreme Court, British Columbia, Vancouver Registry, Canada, filed January 24, 2001, we, our subsidiaries, our indemnitee (PM USA), and other members of the industry are defendants. The plaintiff, the government of the province of British Columbia, brought a claim based upon legislation enacted by the province authorizing the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, resulting from a “tobacco related wrong.” The Supreme Court of Canada has held that the statute is constitutional. We and certain other non-Canadian defendants challenged the jurisdiction of the court. The court rejected the jurisdictional challenge. Pre-trial discovery is ongoing.

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

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

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

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

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

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

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

result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. While discovery initially was scheduled to begin in 2017 by agreement of the parties, to date, the discovery process has not started.

In the ninth health care cost recovery case filed in Canada, *Her Majesty the Queen in Right of the Province of Prince Edward Island v. Rothmans, Benson & Hedges Inc., et al., Supreme Court of Prince Edward Island (General Section), Canada*, filed September 10, 2012, we, our subsidiaries, our indemnitees (PM USA and Altria), and other members of the industry are defendants. The claim was filed by the government of the province of Prince Edward Island based on legislation enacted in the province that is similar to the laws enacted in several other Canadian provinces. The legislation authorizes the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a “tobacco related wrong.” Defendants filed their defenses in February 2015. While discovery initially was scheduled to begin in 2017 by agreement of the parties, to date, the discovery process has not started.

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

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

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

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

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

In the fifth health care cost recovery case in Nigeria, *The Attorney General of Ogun State v. British American Tobacco (Nigeria) Limited, et al., High Court of Ogun State, Abeokuta, Nigeria*, filed February 26, 2008, we and other members of the industry are defendants. Plaintiff seeks reimbursement for the cost of treating alleged smoking-related diseases for the past 20 years, payment of anticipated costs of treating alleged smoking-related diseases for the next 20 years, various forms of injunctive relief, plus punitive damages. In May 2010, the trial court rejected our service objections. We have appealed.

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

Label-Related Cases: These cases, brought by individual plaintiffs, or on behalf of a class or purported class of individual plaintiffs, allege that the use of the descriptor “Lights” or other alleged misrepresentations or omissions of labeling information constitute fraudulent and misleading conduct. Plaintiffs’ allegations of liability in these cases are based on various theories of recovery including misrepresentation, deception, and breach of consumer protection laws. Plaintiffs seek various forms of relief including restitution, injunctive relief, and compensatory and other damages. Defenses raised include lack of causation, lack of reliance, assumption of the risk, and statute of limitations.

As of February 4, 2019, there were 7 cases brought by individual plaintiffs in Italy (1) and Chile (6) pending against our subsidiaries, compared with 1 such case on February 9, 2018, and 3 such cases on December 31, 2016, and one purported class action in Israel (1).

An individual plaintiff filed a purported class action certification motion, *Aharon Ringer v. Philip Morris Ltd. and Globrands Ltd.*, on July 18, 2017, in the Central District Court of Israel. Our Israeli affiliate and an Israeli importer and distributor for other multinational tobacco companies are defendants. Plaintiff seeks to represent a class of smokers in Israel who have purchased cigarettes imported by defendants since July 18, 2010. Plaintiff estimates the class size to be 7,000,000 smokers. Plaintiff alleges that defendants misled consumers by not disclosing sufficient information about carbon monoxide, tar, and nicotine yields of, and tobacco contained in, the imported cigarettes. Plaintiff seeks various forms of relief, including an order for defendants to label cigarette packs in accordance with plaintiff’s demands, and damages for misleading consumers, breach of autonomy and unjust enrichment. Pre-class certification hearings have been scheduled to begin in March 2019.

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

As of February 4, 2019, there were 2 public civil actions pending against our subsidiaries in Argentina (1) and Venezuela (1), compared with 2 such cases on February 9, 2018, and 2 such cases on December 31, 2016.

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

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

Reduced-Risk Products

In Israel, an individual filed a purported class action certification motion in June 2017 against our subsidiary with the Israeli District Court of Haifa related to the marketing of *IQOS*. Plaintiff alleges that our affiliate misleads consumers by marketing *IQOS* as a “better alternative to smoking” and as a reduced-risk product, while not disclosing the risks associated with the product. Plaintiff alleges that *IQOS* is more addictive and more dangerous than cigarettes. Plaintiff claims that the first time he used *IQOS*, he experienced tightness in the chest, difficulty breathing, chills, nausea and dizziness. Plaintiff seeks damages on his behalf, and on behalf of the class (defined as all *IQOS* consumers in Israel), for personal injuries, emotional distress, breach of autonomy, and unjust enrichment. Pre-class certification hearings have been scheduled to begin in May 2019.

Other Litigation

The Department of Special Investigations of the government of Thailand ("DSI") conducted an investigation into alleged underpayment by our subsidiary, Philip Morris (Thailand) Limited ("PM Thailand"), of customs duties and excise taxes relating to imports from the Philippines covering the period 2003-2007. On January 18, 2016, the Public Prosecutor filed charges against our subsidiary and seven former and current employees in the Bangkok Criminal Court alleging that PM Thailand and the individual defendants jointly and with the intention to defraud the Thai government, under-declared import prices of cigarettes to avoid full payment of taxes and duties in connection with import entries of cigarettes from the Philippines during the period of July 2003 to June 2006. The government is seeking a fine of approximately THB 80.8 billion (approximately \$2.57 billion). In May 2017, the King of Thailand signed a new customs act. The new act, which took effect in November 2017, substantially limits the amount of fines that Thailand could seek in these proceedings. PM Thailand believes that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law and that the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and other Thai governmental agencies. Trial in the case began in November 2017. In March 2018, acting on a request from the Public Prosecutor, the court suspended the trial proceedings indefinitely and struck the case from the court list. In June 2018, the court reinstated the case and scheduled the remaining trial proceedings for May 2019.

The DSI also conducted an investigation into alleged underpayment by PM Thailand of customs duties and excise taxes relating to imports from Indonesia covering the period 2000-2003. On January 26, 2017, the Public Prosecutor filed charges against PM Thailand and its former Thai employee in the Bangkok Criminal Court alleging that PM Thailand and its former employee jointly and with the intention to defraud the Thai government under-declared import prices of cigarettes to avoid full payment of taxes and duties in connection with import entries during the period from January 2002 to July 2003. The government is seeking a fine of approximately THB 19.8 billion (approximately \$630 million). In May 2017, the King of Thailand signed a new customs act. The new act, which took effect in November 2017, substantially limits the amount of fines that Thailand could seek in these proceedings. PM Thailand believes that its declared import prices are in compliance with the Customs Valuation Agreement of the World Trade Organization and Thai law, and that the allegations of the Public Prosecutor are inconsistent with several decisions already taken by Thai Customs and a Thai court. Trial in the case began in November 2018.

On November 29, 2017, PM Thailand received notices of assessment in the aggregate amount of approximately THB 25.6 billion (approximately \$814 million) from the Thai Customs Department alleging that PM Thailand under-declared customs values for the imports from Indonesia covering the period 2001-2003. The notices include the Indonesian import entries subject to the proceedings discussed above and are in addition to the fine sought by the government in the criminal proceedings. PM Thailand filed its appeal against the notices with the Thai Customs Board of Appeal in December 2017, asserting that all of the notices of assessment are barred by the applicable statutes of limitations and are otherwise without merit. On August 30, 2018, the Thai Customs Board of Appeal issued a ruling striking out or revoking all notices of assessment. Accordingly, there are no pending notices of assessment in the matter.

The South Korean Board of Audit and Inspection ("BAI") conducted an audit of certain Korean government agencies and the tobacco industry into whether inventory movements ahead of the January 1, 2015 increase of cigarette-related taxes by tobacco companies, including Philip Morris Korea Inc. ("PM Korea"), our South Korean affiliate, were in compliance with South Korean tax laws. In November 2016, the tax authorities completed their audit and assessed allegedly underpaid taxes and penalties. In order to avoid nonpayment financial costs, PM Korea paid approximately KRW 272 billion (approximately \$243 million), of which KRW 100 billion (approximately \$89 million) was paid in 2016 and KRW 172 billion (approximately \$154 million) was paid in the first quarter of 2017. These amounts are included in other assets in the consolidated balance sheets and in cash used in operating activities in the consolidated statements of cash flows. PM Korea is appealing the assessments. The tax authorities have also referred the matter to the Public Prosecutor. On June 19, 2018, the Public Prosecutor decided not to file criminal charges against PM Korea and/or other alleged co-offenders. This decision is being appealed by the tax authorities and, if reversed, the Public Prosecutor may seek up to three times the underpaid tax for company criminal penalties and up to five times the underpaid tax for individual criminal penalties. The Public Prosecutor also decided not to prosecute PM Korea and its managing director in connection with a criminal complaint against them that had been filed by the South Korean Ministry of Strategy and Finance ("MOSF"). In this criminal complaint, the MOSF alleged that PM Korea exceeded the monthly product withdrawal limits that the MOSF had set in its notice. This decision is being appealed by the MOSF. PM Korea believes that it has paid cigarette-related taxes in compliance with the South Korean tax laws and disagrees with the MOSF's allegations.

A putative shareholder class action lawsuit, *Rubenstein v. Philip Morris International Inc., et al.*, was filed in December 2017, in the United States District Court for the District of New Jersey, purportedly on behalf of purchasers of Philip Morris International Inc. stock between July 26, 2016 and December 20, 2017. The lawsuit names Philip Morris International Inc. and certain officers as defendants and includes allegations that the defendants made false and/or misleading statements and/or failed to disclose information about PMI's business, operations, financial condition, and prospects related to alleged irregularities in clinical studies of PMI's IQOS tobacco heating system. The lawsuit seeks various forms of relief, including damages. We believe that this lawsuit is without merit and intend to defend it vigorously.

A putative shareholder class action lawsuit, *City of Westland Police and Fire Retirement System v. Philip Morris International Inc., et al.*, was filed in September 2018, in the United States District Court for the Southern District of New York, purportedly on behalf of purchasers of Philip Morris International Inc. stock between February 8, 2018 and April 18, 2018. The lawsuit names Philip Morris International Inc. and certain officers as defendants and includes allegations that the defendants made false and/or misleading statements and/or failed to disclose information about PMI's business, operations, financial condition, and prospects related to product sales, including those of PMI's *IQOS* tobacco heating system. The lawsuit seeks various forms of relief, including damages. We believe that this lawsuit is without merit and intend to defend it vigorously. In November 2018, the Court consolidated this lawsuit with the other putative shareholder class action lawsuits pending in the Southern District of New York.

A putative shareholder class action lawsuit, *Greater Pennsylvania Carpenters' Pension Fund v. Philip Morris International Inc., et al.*, was filed in September 2018, in the United States District Court for the Southern District of New York, purportedly on behalf of purchasers of Philip Morris International Inc. stock between July 26, 2016 and April 18, 2018. The lawsuit names Philip Morris International Inc. and certain officers as defendants and seeks to combine the allegations and putative classes of the two cases discussed immediately above. The lawsuit seeks various forms of relief, including damages. We believe that this lawsuit is without merit and intend to defend it vigorously.

A putative shareholder class action lawsuit, *Gilchrist v. Philip Morris International Inc., et al.*, was filed in October 2018, in the United States District Court for the Southern District of New York, purportedly on behalf of purchasers of Philip Morris International Inc. stock between February 8, 2018 and April 18, 2018. The lawsuit names Philip Morris International Inc. and certain officers as defendants and includes allegations that the defendants made false and/or misleading statements and/or failed to disclose information about PMI's business, operations, financial condition, and prospects related to product sales, including those of PMI's *IQOS* tobacco heating system. The lawsuit seeks various forms of relief, including damages. We have not yet been served with the complaint, but believe this lawsuit is without merit and intend to defend it vigorously.

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

Note 19.

Balance Sheet Offsetting:

Derivative Financial Instruments

PMI uses foreign exchange contracts and interest rate contracts to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. Substantially all of PMI's derivative financial instruments are subject to master netting arrangements, whereby the right to offset occurs in the event of default by a participating party. While these contracts contain the enforceable right to offset through close-out netting rights, PMI elects to present them on a gross basis in the consolidated balance sheets. Collateral associated with these arrangements is in the form of cash and is unrestricted. See Note 15. *Financial Instruments* for disclosures related to PMI's derivative financial instruments.

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

| (in millions) | Gross Amounts Recognized | Gross Amount Offset in the Consolidated Balance Sheet | Net Amounts Presented in the Consolidated Balance Sheet | Gross Amounts Not Offset in the Consolidated Balance Sheet | | |
|------------------------------------|--------------------------|---|---|--|-----------------------------------|------------|
| | | | | Financial Instruments | Cash Collateral Received/ Pledged | Net Amount |
| | | | | | | |
| <u>At December 31, 2018</u> | | | | | | |
| Assets | | | | | | |
| Foreign exchange contracts | \$ 220 | \$ — | \$ 220 | \$ (124) | \$ (80) | 16 |
| Liabilities | | | | | | |
| Foreign exchange contracts | \$ 631 | \$ — | \$ 631 | \$ (124) | \$ (427) | 80 |
| <u>At December 31, 2017</u> | | | | | | |
| Assets | | | | | | |
| Foreign exchange contracts | \$ 140 | \$ — | \$ 140 | \$ (50) | \$ (78) | 12 |
| Liabilities | | | | | | |
| Foreign exchange contracts | \$ 1,128 | \$ — | \$ 1,128 | \$ (50) | \$ (1,004) | 74 |

Note 20.

Sale of Accounts Receivable:

To mitigate risk and enhance cash and liquidity management PMI sells trade receivables to unaffiliated financial institutions. These arrangements allow PMI to sell, on an ongoing basis, certain trade receivables without recourse. The trade receivables sold are generally short-term in nature and are removed from the consolidated balance sheets. PMI sells trade receivables under two types of arrangements, servicing and non-servicing. For servicing arrangements, PMI continues to service the sold trade receivables on an administrative basis and does not act on behalf of the unaffiliated financial institutions. When applicable, a servicing liability is recorded for the estimated fair value of the servicing. The amounts associated with the servicing liability were not material for the years ended December 31, 2018 and 2017. Under the non-servicing arrangements, PMI does not provide any administrative support or servicing after the trade receivables have been sold to the unaffiliated financial institutions.

Cumulative trade receivables sold, including excise taxes, for the years ended December 31, 2018 and 2017, were \$11.0 billion and \$10.0 billion, respectively. PMI's operating cash flows were positively impacted by the amount of the trade receivables sold and derecognized from the consolidated balance sheets, which remained outstanding with the unaffiliated financial institutions. The trade receivables sold that remained outstanding under these arrangements as of December 31, 2018, 2017 and 2016, were \$1.0 billion, \$1.1 billion and \$0.7 billion, respectively. The net proceeds received are included in cash provided by operating activities in the consolidated statements of cash flows. The difference between the carrying amount of the trade receivables sold and the sum of the cash received is recorded as a loss on sale of trade receivables within marketing, administration and research costs in the consolidated statements of earnings. For the years ended December 31, 2018, 2017 and 2016 the loss on sale of trade receivables was immaterial.

Note 21.

New Accounting Standards:

Recently adopted

On January 1, 2018, PMI adopted Financial Accounting Standards Update ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 contains principles that an entity will need to apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for these goods or services. PMI adopted ASU 2014-09 retrospectively to each prior period presented. PMI elected this transition method solely to reflect the change in excise tax presentation in all prior periods presented resulting from PMI’s accounting policy election to exclude excise taxes collected from customers from the measurement of the transaction price, thereby presenting revenues net of excise taxes. Based on PMI’s assessment, the underlying principles of the new standard, relating to the measurement of revenue and the timing of recognition, are closely aligned with PMI’s current business model and practices. As a result, the adoption of ASU 2014-09 did not have a material impact on the consolidated financial position or results of operations.

The adoption of ASU 2014-09 resulted in the following changes for net revenues to reflect the net presentation for revenues, excluding excise taxes, for the years ended December 31, 2017 and 2016:

| (in millions) | For the Year Ended December 31, 2017 | | | For the Year Ended December 31, 2016 | | |
|---------------|--------------------------------------|---------------|------------------------|--------------------------------------|---------------|------------------------|
| Net Revenues: | | | | | | |
| | As reported | | Retrospective Adoption | As reported | | Retrospective Adoption |
| | Net revenues | Excises taxes | Net revenues | Net revenues | Excises taxes | Net revenues |
| | \$ 78,098 | \$ 49,350 | \$ 28,748 | \$ 74,953 | \$ 48,268 | \$ 26,685 |

The change in presentation of net revenues also impacts segment disclosure requirements, primarily information for significant customers and geographic areas. While there is no change in the underlying business or customers, the amounts used to calculate what is disclosed are different following the change in presentation of revenues net of excise taxes and the associated segment revenues. Prior to this change, revenues including excise taxes were the basis for determining if sales to a customer or in a foreign country met the thresholds for disclosure. On the basis of revenues including excise taxes and due to the fact that PMI is not responsible for collecting excise taxes in certain markets, no customers met the requirements for disclosure. For the effects of the change in presentation using net revenue excluding excise taxes as the basis for determining the disclosure, see Note 12. *Segment Reporting*.

On January 1, 2018, PMI adopted Financial Accounting Standard Update ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”), on a prospective basis. ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Additionally, ASU 2016-01 also changed certain disclosure requirements and other aspects of current U.S. GAAP. PMI identified certain cost investments, which are applicable to ASU 2016-01 requiring them to be measured at fair value with the changes in fair value recognized in net income. At January 1, 2018, the cumulative effect of this change resulted in an increase to investments in unconsolidated subsidiaries and equity securities, deferred income tax liability and earnings reinvested in the business of \$301 million, \$63 million and \$238 million, respectively.

Recently issued

On February 25, 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ASU 2016-02, “Leases” (“ASU 2016-02”). ASU 2016-02 requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Additionally, ASU 2016-02 modifies current guidance for lessors’ accounting. ASU 2016-02 is effective for interim and annual reporting periods beginning on or after January 1, 2019, with early adoption permitted. PMI has identified its lease management system and has identified and evaluated the applicable leases. In addition to the guidance in ASU 2016-02, PMI has evaluated ASU 2018-11, which was issued in July 2018 and provides an optional transitional method. As a result of this evaluation, PMI elected to use the optional transition method, which allows companies to use the effective date as the date of initial application

on transition and not adjust comparative period financial information or make the new required disclosures for periods prior to the effective date. Additionally, PMI elected to use the hindsight practical expedient, as well as the package of practical expedients permitted under the transition guidance within the new standard. Upon adoption, PMI recognized lease liabilities and the corresponding right-of-use assets (at the present value of future payments) for predominately all of its operating leases in place at that time. At January 1, 2019, PMI's adoption of ASU 2016-02 resulted in an increase of approximately \$0.7 billion on its assets and liabilities in its statement of financial position. ASU 2016-02 did not have a material impact on its results of operations or cash flows.

Note 22.

Quarterly Financial Data (Unaudited):

| (in millions, except per share data) | 2018 Quarters | | | |
|--------------------------------------|---------------|----------|----------|----------|
| | 1st | 2nd | 3rd | 4th |
| Net revenues | \$ 6,896 | \$ 7,726 | \$ 7,504 | \$ 7,499 |
| Gross profit | \$ 4,281 | \$ 4,982 | \$ 4,886 | \$ 4,718 |
| Net earnings attributable to PMI | \$ 1,556 | \$ 2,198 | \$ 2,247 | \$ 1,910 |
| Per share data: | | | | |
| Basic EPS | \$ 1.00 | \$ 1.41 | \$ 1.44 | \$ 1.23 |
| Diluted EPS | \$ 1.00 | \$ 1.41 | \$ 1.44 | \$ 1.23 |
| Dividends declared | \$ 1.07 | \$ 1.14 | \$ 1.14 | \$ 1.14 |
| (in millions, except per share data) | 2017 Quarters | | | |
| | 1st | 2nd | 3rd | 4th |
| Net revenues | \$ 6,064 | \$ 6,917 | \$ 7,473 | \$ 8,294 |
| Gross profit | \$ 3,887 | \$ 4,398 | \$ 4,738 | \$ 5,293 |
| Net earnings attributable to PMI | \$ 1,590 | \$ 1,781 | \$ 1,970 | \$ 694 |
| Per share data: | | | | |
| Basic EPS | \$ 1.02 | \$ 1.14 | \$ 1.27 | \$ 0.44 |
| Diluted EPS | \$ 1.02 | \$ 1.14 | \$ 1.27 | \$ 0.44 |
| Dividends declared | \$ 1.04 | \$ 1.04 | \$ 1.07 | \$ 1.07 |

Basic and diluted EPS are computed independently for each of the periods presented. Accordingly, the sum of the quarterly EPS amounts may not agree to the total for the year.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Philip Morris International Inc. and Subsidiaries:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Philip Morris International Inc. and its subsidiaries (PMI) as of December 31, 2018 and 2017, and the related consolidated statements of earnings, comprehensive earnings, stockholders' (deficit) equity and of cash flows for each of the three years in the periods ended December 31, 2018, including the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PMI as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, PMI maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control —Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Basis for Opinions

PMI's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express opinions on PMI's consolidated financial statements and on PMI's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/S/ PRICEWATERHOUSECOOPERS SA

PricewaterhouseCoopers SA

/S/ CHAD MUELLER

Chad Mueller

Lausanne, Switzerland

February 7, 2019

/S/ DR. MICHAEL ABRESCH

Dr. Michael Abresch

We have served as the Company's auditor since 2008.

Report of Management on Internal Control Over Financial Reporting

Management of Philip Morris International Inc. (“PMI”) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. PMI’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of PMI;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that receipts and expenditures of PMI are being made only in accordance with the authorization of management and directors of PMI; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices and actions taken to correct deficiencies as identified.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of PMI’s internal control over financial reporting as of December 31, 2018. Management based this assessment on criteria for effective internal control over financial reporting described in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management’s assessment included an evaluation of the design of PMI’s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors.

Based on this assessment, management determined that, as of December 31, 2018, PMI maintained effective internal control over financial reporting.

PricewaterhouseCoopers SA, an independent registered public accounting firm, who audited and reported on the consolidated financial statements of PMI included in this report, has audited the effectiveness of PMI’s internal control over financial reporting as of December 31, 2018, as stated in their report herein.

February 7, 2019

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.*

None.

Item 9A. *Controls and Procedures.*

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

The Report of Management on Internal Control over Financial Reporting and the Report of Independent Registered Public Accounting Firm are included in Item 8.

Item 9B. *Other Information.*

None.

PART III

Except for the information relating to the executive officers set forth in Item 10 and the information relating to equity compensation plans set forth in Item 12, the information called for by Items 10-14 is hereby incorporated by reference to PMI's definitive proxy statement for use in connection with its annual meeting of stockholders to be held on May 1, 2019, that will be filed with the SEC on or about March 21, 2019 (the "proxy statement"), and, except as indicated therein, made a part hereof.

Item 10. *Directors, Executive Officers and Corporate Governance.*

Executive Officers as of February 7, 2019:

| Name | Office | Age |
|----------------------|--|-----|
| André Calantzopoulos | Chief Executive Officer | 61 |
| Massimo Andolina | Senior Vice President, Operations | 50 |
| Drago Azinovic | President, Middle East & Africa Region and PMI Duty Free | 56 |
| Werner Barth | Senior Vice President, Commercial | 54 |
| Charles Bendotti | Senior Vice President, People and Culture | 46 |
| Frank de Rooij | Vice President, Treasury and Corporate Finance | 53 |
| Frederic de Wilde | President, European Union Region | 51 |
| Marc S. Firestone | President, External Affairs and General Counsel | 59 |
| Stacey Kennedy | President, South and Southeast Asia Region | 46 |
| Martin G. King | Chief Financial Officer | 54 |
| Michael Kunst | Senior Vice President, Commercial Transformation | 50 |
| Andreas Kurali | Vice President and Controller | 53 |
| Marco Mariotti | President, Eastern Europe Region | 54 |
| Mario Masseroli | President, Latin America & Canada Region | 48 |
| Deepak Mishra | Chief Strategy Officer | 47 |
| Jacek Olczak | Chief Operating Officer | 54 |
| Paul Riley | President, East Asia and Australia Region | 53 |
| Marian Salzman | Senior Vice President, Global Communications | 60 |
| Jaime Suarez | Chief Digital Officer | 45 |
| Michael Voegele | Chief Technology Officer | 46 |
| Jerry E. Whitson | Deputy General Counsel and Corporate Secretary | 63 |
| Mirosław Zielinski | President, Science and Innovation | 57 |

All of the above-mentioned officers, except Mr. Mishra, Ms. Salzman, Mr. Kunst, and Mr. Voegele, have been employed by us in various capacities during the past five years.

Before joining Philip Morris International Inc. in September 2018, Mr. Mishra was Managing Director, Portfolio Operations at Centerbridge Partners, a private equity firm from 2014, where he led commercial, operational and digital transformation in various business sectors. From 2001 to 2014, Mr. Mishra was Partner and part of the Consumer Goods, Retail and Operations leadership team of McKinsey & Co where he supported clients in their transformation projects.

Before joining Philip Morris International Inc. in April 2018, Ms. Salzman headed Havas PR North America, where she had served as Chief Executive Officer from 2011.

Before joining Philip Morris International Inc. in January 2019, Mr. Kunst was Partner at Bain & Company from 2009, most recently working with us on our transformation projects.

Before joining Philip Morris International Inc. in February 2019, Mr. Voegele had served in various senior capacities at Adidas Group from 2011, most recently, as Global CIO and part of the core leadership team at Adidas Group.

Codes of Conduct and Corporate Governance

We have adopted the Philip Morris International Code of Conduct, which complies with requirements set forth in Item 406 of Regulation S-K. This Code of Conduct applies to all of our employees, including our principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. We have also adopted a code of business conduct and ethics that applies to the members of our Board of Directors. These documents are available free of charge on our website at www.pmi.com.

In addition, we have adopted corporate governance guidelines and charters for our Audit, Finance, Compensation and Leadership Development, Product Innovation and Regulatory Affairs and Nominating and Corporate Governance committees of the Board of

Directors. All of these documents are available free of charge on our website at www.pmi.com. Any waiver granted by Philip Morris International Inc. to its principal executive officer, principal financial officer or controller or any person performing similar functions under the Code of Conduct, or certain amendments to the Code of Conduct, will be disclosed on our website at www.pmi.com.

The information on our website is not, and shall not be deemed to be, a part of this Report or incorporated into any other filings made with the SEC.

Also refer to *Board Operations and Governance—Committees of the Board*, *Election of Directors—Process for Nominating Directors* and *Election of Directors—Director Nominees* and *Section 16(a) Beneficial Ownership Reporting Compliance* sections of the proxy statement.

Item 11. *Executive Compensation.*

Refer to *Compensation Discussion and Analysis* and *Compensation of Directors* sections of the proxy statement.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.*

The number of shares to be issued upon exercise or vesting and the number of shares remaining available for future issuance under PMI's equity compensation plans at December 31, 2018, were as follows:

| | Number of Securities to be Issued upon Exercise of Outstanding Options and Vesting of RSUs and PSUs (a) | Weighted Average Exercise Price of Outstanding Options (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding Securities reflected in column (a)) (c) |
|---|--|---|---|
| Equity compensation plans approved by stockholders | 5,708,735 ⁽¹⁾ | \$ — | 23,886,194 |

⁽¹⁾ Represents 3,318,795 shares of common stock that may be issued upon vesting of the restricted share units and 2,389,940 shares that may be issued upon vesting of the performance share units if maximum performance targets are achieved for each performance cycle. PMI has not granted options since the spin-off from Altria on March 28, 2008.

Also refer to *Stock Ownership Information—Ownership of Equity Securities* section of the proxy statement.

Item 13. *Certain Relationships and Related Transactions, and Director Independence.*

Refer to *Related Person Transactions and Code of Conduct* and *Election of Directors—Independence of Nominees* sections of the proxy statement.

Item 14. *Principal Accounting Fees and Services.*

Refer to *Audit Committee Matters* section of the proxy statement.

PART IV

Item 15. *Exhibits and Financial Statement Schedules.*

(a) Index to Consolidated Financial Statements and Schedules

| | <u>Page</u> |
|--|--------------------|
| Consolidated Statements of Earnings for the years ended December 31, 2018, 2017 and 2016 | 57 |
| Consolidated Statements of Comprehensive Earnings for the years ended December 31, 2018, 2017 and 2016 | 58 |
| Consolidated Balance Sheets at December 31, 2018 and 2017 | 59 - 60 |
| Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016 | 61 - 62 |
| Consolidated Statements of Stockholders' (Deficit) Equity for the years ended December 31, 2018, 2017 and 2016 | 63 |
| Notes to Consolidated Financial Statements | 64 - 109 |
| Report of Independent Registered Public Accounting Firm | 110 - 111 |
| Report of Management on Internal Control Over Financial Reporting | 112 |

Schedules have been omitted either because such schedules are not required or are not applicable.

(b) The following exhibits are filed as part of this Report:

| | | |
|------|---|---|
| 2.1 | — | <u>Distribution Agreement between Altria Group, Inc. and Philip Morris International Inc. dated January 30, 2008 (incorporated by reference to Exhibit 2.1 to the Registration Statement on Form 10 filed February 7, 2008).</u> |
| 3.1 | — | <u>Amended and Restated Articles of Incorporation of Philip Morris International Inc. (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form 10 filed February 7, 2008).</u> |
| 3.2 | — | <u>Amended and Restated By-Laws of Philip Morris International Inc., effective as of March 29, 2018 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed March 29, 2018).</u> |
| 4.1 | — | <u>Specimen Stock Certificate of Philip Morris International Inc. (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form 10 filed February 7, 2008).</u> |
| 4.2 | — | <u>Indenture dated as of April 25, 2008, between Philip Morris International Inc. and HSBC Bank USA, National Association, as Trustee (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-3, dated April 25, 2008).</u> |
| 4.6 | — | The Registrant agrees to furnish copies of any instruments defining the rights of holders of long-term debt of the Registrant and its consolidated subsidiaries that does not exceed 10 percent of the total assets of the Registrant and its consolidated subsidiaries to the Commission upon request. |
| 10.1 | — | <u>Employee Matters Agreement between Altria Group, Inc. and Philip Morris International Inc., dated as of March 28, 2008 (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed March 31, 2008).</u> |
| 10.2 | — | <u>Intellectual Property Agreement between Philip Morris International Inc. and Philip Morris USA Inc., dated as of January 1, 2008 (incorporated by reference to Exhibit 10.4 to the Registration Statement on Form 10 filed March 5, 2008).</u> |

| | | |
|-------|---|---|
| 10.3 | — | <u>Credit Agreement relating to a US\$3,500,000,000 Revolving Credit Facility (including a US \$800,000,000 swingline option) dated as of October 25, 2011, among Philip Morris International Inc. and the Initial Lenders named therein and Citibank International plc, as Facility Agent, and Citibank, N.A., as Swingline Agent, and Citigroup Global Markets Limited, Barclays Capital, BNP Paribas, Credit Suisse AG, Cayman Islands Branch, Deutsche Bank Securities Inc., Goldman Sachs International, HSBC Bank PLC, J.P. Morgan Limited, RBS Securities Inc. and Société Générale as Mandated Lead Arrangers and Bookrunners (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed October 26, 2011).</u> |
| 10.4 | — | <u>Amendment No. 1, dated as of August 31, 2012, to the Credit Agreement, dated as of October 25, 2011, among Philip Morris International Inc., the lenders named therein and Citibank International plc, as Facility Agent (incorporated by reference to Exhibit 10.6 to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012).</u> |
| 10.5 | — | <u>Credit Agreement, dated as of February 12, 2013, among Philip Morris International Inc., the lenders named therein and Citibank Europe PLC, UK Branch (formerly, The Royal Bank of Scotland plc), as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 15, 2013).</u> |
| 10.6 | — | <u>Extension Agreement, effective February 7, 2017, to the Credit Agreement, dated as of February 12, 2013, among Philip Morris International Inc., the lenders party thereto, Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as administrative agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed January 30, 2017).</u> |
| 10.7 | — | <u>Extension Agreement, effective January 31, 2014, to Credit Agreement, dated as of February 12, 2013, among Philip Morris International Inc., the lenders party thereto and Citibank Europe PLC, UK Branch (formerly, The Royal Bank of Scotland plc), as Administrative Agent (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).</u> |
| 10.8 | — | <u>Credit Agreement, dated as of February 28, 2014, among Philip Morris International Inc., the lenders named therein, J.P. Morgan Europe Limited, as Facility Agent, and JPMorgan Chase Bank, N.A., as Swingline Agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed March 3, 2014).</u> |
| 10.9 | — | <u>Extension Agreement, effective as of February 10, 2015, to Credit Agreement dated as of February 12, 2013, among Philip Morris International Inc., the lenders named therein and Citibank Europe PLC, UK Branch (formerly, The Royal Bank of Scotland plc), as Administrative Agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed January 29, 2015).</u> |
| 10.10 | — | <u>Extension Agreement, effective as of February 28, 2015, to the Credit Agreement, dated as of February 28, 2014, among Philip Morris International Inc., the lenders named therein, J.P. Morgan Europe Limited, as Facility Agent, and JPMorgan Chase Bank, N.A. as Swingline Agent (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed January 29, 2015).</u> |
| 10.11 | — | <u>Amendment No. 1, dated as of July 20, 2015, to the Credit Agreement, dated as of February 12, 2013, among Philip Morris International Inc., the lenders named therein, The Royal Bank of Scotland plc, as resigning administrative agent, and Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as successor administrative agent (incorporated by reference to Exhibit 10.52 to the Annual Report on Form 10-K for the year ended December 31, 2015).</u> |
| 10.12 | — | <u>Credit Agreement, dated as of October 1, 2015, among Philip Morris International Inc., the lenders named therein, Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as Facility Agent, and Citibank, N.A., as Swingline Agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed October 5, 2015).</u> |
| 10.13 | — | <u>Amendment No. 2, effective as of February 9, 2016, to the Credit Agreement dated as of February 12, 2013, with the lenders named therein and Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as administrative agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed January 28, 2016).</u> |

| | | |
|-------|---|---|
| 10.14 | — | <u>Extension Agreement, effective as of February 28, 2016, to the Credit Agreement, dated as of February 28, 2014, among Philip Morris International Inc., each lender named therein, J.P. Morgan Europe Limited, as facility agent, and JPMorgan Chase Bank, N.A., as swingline agent (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed January 28, 2016).</u> |
| 10.15 | — | <u>Extension Agreement, effective as of October 1, 2016, to the Credit Agreement dated as of October 1, 2015, among Philip Morris International Inc., lenders named therein, Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as facility agent, and Citibank, N.A., as swingline agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed August 31, 2016).</u> |
| 10.16 | — | <u>Extension Agreement, effective as of October 1, 2017, to the Credit Agreement, dated as of October 1, 2015, among Philip Morris International Inc., the lenders party thereto and Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as facility agent, and Citibank N.A., as swingline agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed August 29, 2017).</u> |
| 10.17 | — | <u>Extension Agreement, effective as of February 6, 2018, to the Credit Agreement, dated as of February 12, 2013, among Philip Morris International Inc., the lenders named therein, Citibank Europe PLC, UK Branch (formerly, Citibank International Limited), as administrative agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed January 29, 2018).</u> |
| 10.18 | — | <u>Philip Morris International Inc. Automobile Policy (incorporated by reference to Exhibit 10.8 to the Registration Statement on Form 10 filed February 7, 2008).</u> * |
| 10.19 | — | <u>Philip Morris International Benefit Equalization Plan, as amended and in effect on August 6, 2012 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012).</u> * |
| 10.20 | — | <u>Philip Morris International Inc. 2012 Performance Incentive Plan, effective May 9, 2012 (incorporated by reference to Exhibit A to the Definitive Proxy Statement filed on March 30, 2012).</u> * |
| 10.21 | — | <u>Philip Morris International Inc. 2017 Performance Incentive Plan, effective May 3, 2017 (incorporated by reference to Exhibit B to the Definitive Proxy Statement filed on March 23, 2017).</u> * |
| 10.22 | — | <u>Pension Fund of Philip Morris in Switzerland (IC) (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2015).</u> * |
| 10.23 | — | <u>Summary of Supplemental Pension Plan of Philip Morris in Switzerland (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2015).</u> * |
| 10.24 | — | <u>Form of Restated Employee Grantor Trust Enrollment Agreement (Executive Trust Arrangement) (incorporated by reference to Exhibit 10.18 to the Registration Statement on Form 10 filed February 7, 2008).</u> * |
| 10.25 | — | <u>Form of Restated Employee Grantor Trust Enrollment Agreement (Secular Trust Arrangement) (incorporated by reference to Exhibit 10.19 to the Registration Statement on Form 10 filed February 7, 2008).</u> * |
| 10.26 | — | <u>Philip Morris International Inc. 2017 Stock Compensation Plan for Non-Employee Directors, effective May 3, 2017 (incorporated by reference to Exhibit C to the Definitive Proxy Statement filed on March 23, 2017).</u> * |
| 10.27 | — | <u>Philip Morris International Inc. 2017 Stock Compensation Plan for Non-Employee Directors (as amended and restated as of January 1, 2018) (incorporated by reference to Exhibit 10.26 to the Annual Report on Form 10-K for the year ended December 31, 2017).</u> * |
| 10.28 | — | <u>Philip Morris International Inc. 2008 Deferred Fee Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.21 to the Registration Statement on Form 10 filed February 7, 2008).</u> * |
| 10.29 | — | <u>Supplemental Letter to the Employment Agreement (as amended) with André Calantzopoulos (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017). The Employment Agreement was previously filed as Exhibit 10.22 to the Registration Statement on Form 10 filed February 7, 2008 and is incorporated by reference to this Exhibit 10.29. The Amendment to the Employment Agreement was previously filed as Exhibit 10.1 to the Current Report on Form 8-K/A filed June 13, 2013, and is incorporated by reference to this Exhibit 10.29.</u> * |

| | | |
|-------|---|---|
| 10.30 | — | <u>Supplemental Letter to Employment Agreement with Marc S. Firestone (incorporated by reference to Exhibit 10.5 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017). The Employment Agreement was previously filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and is incorporated by reference to this Exhibit 10.30. The Amendment to the Employment Agreement was previously filed as Exhibit 10.25 to the Annual Report on Form 10-K for the year ended December 31, 2013, and is incorporated by reference to this Exhibit 10.30.*</u> |
| 10.31 | — | <u>Employment Agreement as of January 1, 2018 with Martin G. King (incorporated by reference to Exhibit 10.30 to the Annual Report on Form 10-K for the year ended December 31, 2017). The previous Employment Agreement was filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2015, and is incorporated by reference to this Exhibit 10.31. The Amendments to the previous Employment Agreement were filed as Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2015 and as Exhibit 10.6 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 and are incorporated by reference to this Exhibit 10.31.*</u> |
| 10.32 | — | <u>Supplemental Letter to the Employment Agreement (as amended) with Jacek Olczak (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K/A filed December 12, 2017). The Employment Agreement was previously filed as Exhibit 10.4 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, and is incorporated by reference to this Exhibit 10.32. The Amendments to the Employment Agreement were previously filed as Exhibit 10.33 to the Annual Report on Form 10-K for the year ended December 31, 2013 and as Exhibit 10.7 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 and are incorporated by reference to this Exhibit 10.32.*</u> |
| 10.33 | — | <u>Supplemental Letter to the Employment Agreement (as amended) with Miroslaw Zielinski (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2017). The Employment Agreement was previously filed as Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and is incorporated by reference to this Exhibit 10.33. The Amendments to the Employment Agreement were previously filed as Exhibit 10.28 to the Annual Report on Form 10-K for the year ended December 31, 2013 and as Exhibit 10.8 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2017, and are incorporated by reference to this Exhibit 10.33.*</u> |
| 10.34 | — | <u>Time Sharing Agreement between PMI Global Services Inc. and Louis C. Camilleri dated August 18, 2010 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed August 19, 2010).*</u> |
| 10.35 | — | <u>Amendment No. 1 to the Time Sharing Agreement between PMI Global Services Inc. and Louis C. Camilleri, dated August 22, 2012 (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012).*</u> |
| 10.36 | — | <u>Amendment No. 2 to the Time Sharing Agreement between PMI Global Services Inc. and Louis C. Camilleri, dated October 23, 2012 (incorporated by reference to Exhibit 10.27 to the Annual Report on Form 10-K for the year ended December 31, 2012).*</u> |
| 10.37 | — | <u>Amendment No. 3 to the Time Sharing Agreement between PMI Global Services Inc. and Louis C. Camilleri, dated December 31, 2014 (incorporated by reference to Exhibit 10.34 to the Annual Report on Form 10-K for the year ended December 31, 2014).*</u> |
| 10.38 | — | <u>Termination of Time Sharing Agreement between PMI Global Services Inc. and Louis C. Camilleri, dated September 12, 2018 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 filed October 25, 2018).*</u> |
| 10.39 | — | <u>Time Sharing Agreement between PMI Global Services Inc. and André Calantzopoulos, dated May 8, 2013 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2013).*</u> |
| 10.40 | — | <u>Amendment No. 1 to the Time Sharing Agreement between PMI Global Services Inc. and André Calantzopoulos, dated December 23, 2014 (incorporated by reference to Exhibit 10.36 to the Annual Report on Form 10-K for the year ended December 31, 2014).*</u> |
| 10.41 | — | <u>Agreement with Louis C. Camilleri (incorporated by reference to Exhibit 10.25 to the Registration Statement on Form 10 filed February 7, 2008).*</u> |
| 10.42 | — | <u>Amended and Restated Supplemental Management Employees' Retirement Plan (incorporated by reference to Exhibit 10.27 to the Annual Report on Form 10-K for the year ended December 31, 2008).*</u> |

| | | |
|---------|---|--|
| 10.43 | — | <u>Supplemental Equalization Plan, amended and restated as of June 29, 2015 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2015).</u> * |
| 10.44 | — | <u>Form of Supplemental Equalization Plan Employee Grantor Trust Enrollment Agreement (Secular Trust) (incorporated by reference to Exhibit 10.31 to the Annual Report on Form 10-K for the year ended December 31, 2008).</u> * |
| 10.45 | — | <u>Form of Supplemental Equalization Plan Employee Grantor Trust Enrollment Agreement (Executive Trust) (incorporated by reference to Exhibit 10.32 to the Annual Report on Form 10-K for the year ended December 31, 2008).</u> * |
| 10.46 | — | <u>Philip Morris International Inc. Form of Indemnification Agreement with Directors and Executive Officers (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed September 18, 2009).</u> * |
| 10.47 | — | <u>Form of Deferred Stock Agreement (2015 Grants) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 10, 2015).</u> * |
| 10.48 | — | <u>Philip Morris International Inc. Tax Return Preparation Services Policy (incorporated by reference to Exhibit 10.51 to the Annual Report on Form 10-K for the year ended December 31, 2014).</u> * |
| 10.49 | — | <u>Form of Restricted Stock Unit Agreement (2016 Grants) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 9, 2016).</u> * |
| 10.50 | — | <u>Form of Performance Share Unit Agreement (2016 Grants) (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed February 9, 2016).</u> * |
| 10.51 | — | <u>Form of Restricted Stock Unit Agreement (2017 Grants) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 7, 2017).</u> * |
| 10.52 | — | <u>Form of Performance Share Unit Agreement (2017 Grants) (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed February 7, 2017).</u> * |
| 10.53 | — | <u>Form of Restricted Stock Unit Agreement (2018 Grants) (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 13, 2018).</u> * |
| 10.54 | — | <u>Form of Performance Share Unit Agreement (2018 Grants) (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed February 13, 2018).</u> * |
| 21 | — | <u>Subsidiaries of Philip Morris International Inc.</u> |
| 23 | — | <u>Consent of independent registered public accounting firm.</u> |
| 24 | — | <u>Powers of attorney.</u> |
| 31.1 | — | <u>Certification of the Registrant’s Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | — | <u>Certification of the Registrant’s Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | — | <u>Certification of the Registrant’s Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.2 | — | <u>Certification of the Registrant’s Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | — | XBRL Instance Document. |
| 101.SCH | — | XBRL Taxonomy Extension Schema. |

| | | |
|---------|---|--|
| 101.CAL | — | XBRL Taxonomy Extension Calculation Linkbase. |
| 101.DEF | — | XBRL Taxonomy Extension Definition Linkbase. |
| 101.LAB | — | XBRL Taxonomy Extension Label Linkbase. |
| 101.PRE | — | XBRL Taxonomy Extension Presentation Linkbase. |

* Denotes management contract or compensatory plan or arrangement in which directors or executive officers are eligible to participate.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PHILIP MORRIS INTERNATIONAL INC.

By: /s/ ANDRÉ CALANTZOPOULOS

(André Calantzopoulos
Chief Executive Officer)

Date: February 7, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|-------------------------------|------------------|
| <u>/s/ ANDRÉ CALANTZOPOULOS</u> (André Calantzopoulos) | Chief Executive Officer | February 7, 2019 |
| <u>/s/ MARTIN G. KING</u> (Martin G. King) | Chief Financial Officer | February 7, 2019 |
| <u>/s/ ANDREAS KURALI</u> (Andreas Kurali) | Vice President and Controller | February 7, 2019 |
| | Directors | |

*LOUIS C. CAMILLERI,
MASSIMO FERRAGAMO,
WERNER GEISSLER,
LISA A. HOOK,
JENNIFER LI,
JUN MAKIHARA,
KALPANA MORPARIA,
LUCIO A. NOTO,
FREDERIK PAULSEN,
ROBERT B. POLET,
STEPHEN M. WOLF

*By: /s/ ANDRÉ CALANTZOPOULOS
(André Calantzopoulos
Attorney-in-fact)

February 7, 2019

Reconciliation of Non-GAAP Measures

Reconciliation of Reported Diluted EPS to Reported Diluted EPS, excluding Currency

| For the Years Ended December 31, (Unaudited) | 2018 | 2017 | % Change |
|--|---------|---------|----------|
| Reported Diluted EPS | \$ 5.08 | \$ 3.88 | 30.9% |
| Less: | | | |
| Currency impact | (0.11) | | |
| Reported Diluted EPS, excluding Currency | \$ 5.19 | \$ 3.88 | 33.8% |

Reconciliation of Reported Diluted EPS to Adjusted Diluted EPS and Adjusted Diluted EPS, excluding Currency

| For the Years Ended December 31, (Unaudited) | 2018 | 2017 | % Change |
|--|---------|---------|----------|
| Reported Diluted EPS | \$ 5.08 | \$ 3.88 | 30.9% |
| Adjustments: | | | |
| Asset impairment and exit costs | — | — | |
| Tax items | 0.02 | 0.84 | |
| Adjusted Diluted EPS | \$ 5.10 | \$ 4.72 | 8.1% |
| Less: | | | |
| Currency impact | (0.11) | | |
| Adjusted Diluted EPS, excluding Currency | \$ 5.21 | \$ 4.72 | 10.4% |

Reconciliation of Operating Cash Flow to Operating Cash Flow, excluding Currency

| For the Years Ended December 31, (in millions) (Unaudited) | 2018 | 2017 | % Change |
|---|----------|----------|----------|
| Net cash provided by operating activities (1) | \$ 9,478 | \$ 8,912 | 6.4% |
| Less: | | | |
| Currency impact | (223) | | |
| Net cash provided by operating activities, excluding currency | \$ 9,701 | \$ 8,912 | 8.9% |

(1) Operating cash flow.

Reconciliation of Net Revenues to Net Revenues, excluding Currency and Acquisitions

For the Years Ended December 31,

| (in millions) (Unaudited) | | | | | | | | | | | |
|------------------------------|------------------|---------------------------------------|----------------------|---|---------------------------|------------------|--------------|--------------------------|---|--|--|
| 2018 | | | | | | 2017 | | % Change in Net Revenues | | | |
| Net Revenues | Less Currency | Net Revenues excluding Currency | Less Acquisitions | Net Revenues excluding Currency & Acquisitions | | Net Revenues | Total | Excluding Currency | Excluding Currency & Acquisitions | | |
| \$ 9,298 | \$ 489 | \$ 8,809 | \$ — | \$ 8,809 | European Union | \$ 8,318 | 11.8 % | 5.9 % | 5.9 % | | |
| 2,921 | (118) | 3,039 | — | 3,039 | Eastern Europe | 2,711 | 7.7 % | 12.1 % | 12.1 % | | |
| 4,114 | (193) | 4,307 | — | 4,307 | Middle East & Africa | 3,988 | 3.2 % | 8.0 % | 8.0 % | | |
| 4,656 | (244) | 4,900 | — | 4,900 | South & Southeast Asia | 4,417 | 5.4 % | 10.9 % | 10.9 % | | |
| 5,580 | 62 | 5,518 | — | 5,518 | East Asia & Australia | 6,373 | (12.4)% | (13.4)% | (13.4)% | | |
| 3,056 | (99) | 3,155 | — | 3,155 | Latin America & Canada | 2,941 | 3.9 % | 7.3 % | 7.3 % | | |
| \$ 29,625 | \$ (103) | \$ 29,728 | \$ — | \$ 29,728 | PMI Total | \$ 28,748 | 3.1 % | 3.4 % | 3.4 % | | |

Reconciliation of Operating Income to Operating Income, excluding Currency and Acquisitions

For the Years Ended December 31,

| (in millions) (Unaudited) | | | | | | | | | | | |
|------------------------------|------------------|--|----------------------|--|---------------------------|---------------------|---------------|---------------------------------|---|--|--|
| 2018 | | | | | | 2017 | | % Change in Operating Income | | | |
| Operating Income | Less Currency | Operating Income excluding Currency | Less Acquisitions | Operating Income excluding Currency & Acquisitions | | Operating Income | Total | Excluding Currency | Excluding Currency & Acquisitions | | |
| \$ 4,105 | \$ 308 | \$ 3,797 | \$ — | \$ 3,797 | European Union | \$ 3,691 | 11.2 % | 2.9 % | 2.9 % | | |
| 902 | (101) | 1,003 | — | 1,003 | Eastern Europe | 887 | 1.7 % | 13.1 % | 13.1 % | | |
| 1,627 | (263) | 1,890 | — | 1,890 | Middle East & Africa | 1,884 | (13.6)% | 0.3 % | 0.3 % | | |
| 1,747 | (124) | 1,871 | — | 1,871 | South & Southeast Asia | 1,514 | 15.4 % | 23.6 % | 23.6 % | | |
| 1,851 | (2) | 1,853 | — | 1,853 | East Asia & Australia | 2,608 | (29.0)% | (28.9)% | (28.9)% | | |
| 1,145 | (32) | 1,177 | — | 1,177 | Latin America & Canada | 997 | 14.8 % | 18.1 % | 18.1 % | | |
| \$ 11,377 | \$ (214) | \$ 11,591 | \$ — | \$ 11,591 | PMI Total | \$ 11,581 | (1.8)% | 0.1 % | 0.1 % | | |

Operating Income Margin, excluding Currency and Acquisitions

For the Years Ended December 31,

(in millions)

| (Unaudited) 2018 | | | | | | | 2017 | | | % Points Change | |
|---|-------------------------------------|--|--|--|---|------------------------|------------------|--------------|-----------------------------|--|---|
| Operating Income excluding Currency (1) | Net Revenues excluding Currency (2) | Operating Income Margin excluding Currency | Operating Income excluding Currency & Acquisitions (1) | Net Revenues excluding Currency & Acquisitions (2) | Operating Income Margin excluding Currency & Acquisitions | | Operating Income | Net Revenues | Operating Income Margin (3) | Operating Income Margin excluding Currency | Operating Income Margin excluding Currency & Acquisitions |
| \$ 3,797 | \$ 8,809 | 43.1 % | \$ 3,797 | \$ 8,809 | 43.1 % | European Union | \$ 3,691 | \$ 8,318 | 44.4 % | (1.3) | (1.3) |
| 1,003 | 3,039 | 33.0 % | 1,003 | 3,039 | 33.0 % | Eastern Europe | 887 | 2,711 | 32.7 % | 0.3 | 0.3 |
| 1,890 | 4,307 | 43.9 % | 1,890 | 4,307 | 43.9 % | Middle East & Africa | 1,884 | 3,988 | 47.2 % | (3.3) | (3.3) |
| 1,871 | 4,900 | 38.2 % | 1,871 | 4,900 | 38.2 % | South & Southeast Asia | 1,514 | 4,417 | 34.3 % | 3.9 | 3.9 |
| 1,853 | 5,518 | 33.6 % | 1,853 | 5,518 | 33.6 % | East Asia & Australia | 2,608 | 6,373 | 40.9 % | (7.3) | (7.3) |
| 1,177 | 3,155 | 37.3 % | 1,177 | 3,155 | 37.3 % | Latin America & Canada | 997 | 2,941 | 33.9 % | 3.4 | 3.4 |
| \$ 11,591 | \$ 29,728 | 39.0% | \$ 11,591 | \$ 29,728 | 39.0% | PMI Total | \$ 11,581 | \$ 28,748 | 40.3% | (1.3) | (1.3) |

(1) For the calculation of operating income, excluding currency and acquisitions, refer to the "Reconciliation of Operating Income to Operating Income, excluding Currency and Acquisitions" in this section.

(2) For the calculation of net revenues, excluding currency and acquisitions, refer to the "Reconciliation of Net Revenues to Net Revenues, excluding Currency and Acquisitions" in this section.

(3) 2018 Operating Income Margin for PMI Total was 38.4%, calculated as 2018 Operating Income of \$11,377 divided by 2018 Net Revenues of \$29,625.