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 RRPs 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:

		December 31, 2018			December 31, 2017		
(in millions)	Weighted-Average Remaining Useful Life	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:

	For the Years Ended December 31,		
(in millions)	**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:

	At December 31,	
(in millions)	**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:

	At December 31,	
(in millions)	**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:

	December 31, 2018		December 31, 2017	
(in millions)	**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	December 31, 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:

	At December 31,	
(in millions)	**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 RRPs, 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:

	For the Years Ended December 31,		
(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

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:

	Pension[(1)]		Postretirement	
(in millions)	**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:

	Pension		Postretirement	
(in millions)	**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:

	Pension			**Postretirement**		
(in millions)	**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:

	Derivative Assets			**Derivative Liabilities**		
		Fair Value			**Fair Value**	
(in millions)	**Balance Sheet Classification**	**2018**	**2017**	**Balance Sheet Classification**	**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**	**Amount 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	$ (38)
				Cost of sales	**—**	1	46
				Marketing, administration and research costs	**6**	(7)	(11)
				Interest expense, net	**(1)**	(41)	(30)
Derivatives in Net Investment Hedging Relationship							
Foreign exchange contracts	**324**	(1,644)	296				
Total	**$ 352**	$ (1,696)	$ 308		**$ 23**	$ 13	$ (33)

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:

	For the Years Ended December 31,		
(in millions)	**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	At December 31,		
(in millions)	**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 *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.

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 *Létourneau* 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 *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) to cover both the *Létourneau* and *Blais* 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 *Blais* 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 *Létourneau* 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, *Rubenstahl 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	Gross Amounts Not Offset in the Consolidated Balance Sheet: Cash Collateral Received/ Pledged	Net Amount
At December 31, 2018						
Assets						
Foreign exchange contracts	**$ 220**	**$ —**	**$ 220**	**$ (124)**	**$ (80)**	**$ 16**
Liabilities						
Foreign exchange contracts	**$ 631**	**$ —**	**$ 631**	**$ (124)**	**$ (427)**	**$ 80**
At December 31, 2017						
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):

	2018 Quarters			
(in millions, except per share data)	**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**

	2017 Quarters			
(in millions, except per share data)	**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.