

# 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 tobacco products in markets outside of the United States of America. Throughout these financial statements, the term “PMI” refers to Philip Morris International Inc. and its subsidiaries.

● **Basis of presentation:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 in which PMI has an ownership interest of less than 20%, or does not exercise significant influence, are accounted for under the cost method of accounting. All intercompany transactions and balances have been eliminated.

Certain prior years’ amounts have been reclassified to conform with the current year’s presentation, due to the separate disclosure of investments in unconsolidated subsidiaries. For further details, see Note 4. *Investments in Unconsolidated Subsidiaries*.

## 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. Depreciation expense for 2013, 2012 and 2011 was \$789 million, \$801 million and \$895 million, respectively.

### ● 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 first quarter of each year. The impairment analysis involves comparing the fair value of each reporting unit or non-amortizable intangible asset to the carrying value. If the carrying value exceeds the fair value, goodwill or a non-amortizable intangible asset is considered impaired. To determine the fair value of goodwill, PMI primarily uses a discounted cash flow model, supported by the market approach using earnings multiples of comparable companies. To determine the fair value of non-amortizable intangible assets, PMI primarily uses a discounted cash flow model applying the relief-from-royalty method. These discounted cash flow models include management assumptions relevant for forecasting operating cash flows, which are subject to changes in business conditions, such as volumes and prices, costs to produce, discount rates and estimated capital needs. Management considers historical experience and all available information at the time the fair values are estimated, and PMI believes these assumptions are consistent with the assumptions a hypothetical marketplace participant would use. PMI concluded that the fair value of our reporting units and non-amortizable intangible assets exceeded the carrying value, and any reasonable movement in the assumptions would not result in an impairment. Since the March 28, 2008, spin-off from Altria Group, Inc. (“Altria”), PMI has not recorded a charge to earnings for an impairment of goodwill or non-amortizable intangible assets.

● **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. PMI recorded net transaction losses of \$123 million, \$51 million and \$24 million for the years ended December 31, 2013, 2012 and 2011, respectively, in marketing, administration and research costs on the consolidated statements of earnings.

● **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 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.

● **Income taxes:** Income tax provisions for jurisdictions outside the United States, as well as state and local income tax provisions, are determined on a separate company basis, and the related assets and liabilities are recorded in 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 promotes its products with advertising, consumer incentives and trade promotions. Such programs include, but are not limited to, discounts, rebates, in-store display incentives and volume-based incentives.

Advertising 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 incentive expenses are charged to earnings based on estimated sales and related expenses for the full year.

● **Revenue recognition:** PMI recognizes revenues, net of sales incentives and including shipping and handling charges billed to customers, either upon shipment or delivery of goods when title and risk of loss pass to customers. Excise taxes billed by PMI to customers are reported in net revenues. Shipping and handling costs are classified as part of cost of sales and were \$833 million, \$802 million and \$905 million for the years ended December 31, 2013, 2012 and 2011, respectively.

● **Software costs:** PMI capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use. Capitalized software costs are included in property, plant and equipment on PMI's consolidated balance sheets and are amortized on a straight-line basis over the estimated useful lives of the software, which do not exceed five years.

● **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. The fair value of restricted stock and deferred stock is determined based on the number of shares granted and the market value at date of grant.

Excess tax benefits from the vesting of stock-based awards of \$13 million, \$24 million and \$19 million were recognized in additional paid-in capital as of December 31, 2013, 2012 and 2011, respectively, and were presented as financing cash flows.

### Note 3.

#### Goodwill and Other Intangible Assets, net:

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

| (in millions)                        | Goodwill          |                   | Other Intangible Assets, net |                   |
|--------------------------------------|-------------------|-------------------|------------------------------|-------------------|
|                                      | December 31, 2013 | December 31, 2012 | December 31, 2013            | December 31, 2012 |
| European Union                       | \$1,472           | \$1,448           | \$ 604                       | \$ 647            |
| Eastern Europe, Middle East & Africa | 617               | 637               | 228                          | 242               |
| Asia                                 | 3,960             | 4,791             | 1,251                        | 1,542             |
| Latin America & Canada               | 2,844             | 3,024             | 1,110                        | 1,188             |
| Total                                | \$8,893           | \$9,900           | \$3,193                      | \$3,619           |

Goodwill is due primarily to PMI's acquisitions in Canada, Indonesia, Mexico, Greece, Serbia, Colombia and Pakistan, as well as the business combination in the Philippines. The movements in goodwill were as follows:

| (in millions)                | European Union | Eastern Europe, Middle East & Africa | Asia    | Latin America & Canada | Total    |
|------------------------------|----------------|--------------------------------------|---------|------------------------|----------|
| Balance at January 1, 2012   | \$1,392        | \$666                                | \$4,966 | \$2,904                | \$ 9,928 |
| Changes due to:              |                |                                      |         |                        |          |
| Currency                     | 56             | (29)                                 | (175)   | 120                    | (28)     |
| Balances, December 31, 2012  | 1,448          | 637                                  | 4,791   | 3,024                  | 9,900    |
| Changes due to:              |                |                                      |         |                        |          |
| Currency                     | 24             | (20)                                 | (831)   | (180)                  | (1,007)  |
| Balance at December 31, 2013 | \$1,472        | \$617                                | \$3,960 | \$2,844                | \$ 8,893 |

Additional details of other intangible assets were as follows:

| (in millions)                     | December 31, 2013     |                          | December 31, 2012     |                          |
|-----------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                                   | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Non-amortizable intangible assets | \$1,798               |                          | \$2,046               |                          |
| Amortizable intangible assets     | 1,940                 | \$545                    | 2,046                 | \$473                    |
| Total other intangible assets     | \$3,738               | \$545                    | \$4,092               | \$473                    |

Non-amortizable intangible assets substantially consist of trademarks from PMI's acquisitions in Indonesia in 2005 and Mexico in 2007. Amortizable intangible assets primarily consist of certain trademarks, distribution networks and non-compete agreements associated with business combinations. The gross carrying amount, range of useful lives as well as the weighted-average remaining useful life of amortizable intangible assets at December 31, 2013, were as follows:

| Description<br>(in millions)  | Gross Carrying Amount | Initial Estimated Useful Lives | Weighted-Average Remaining Useful Life |
|---|-----------------------|--------------------------------|--|
| Trademarks  | \$1,586               | 2–40 years                     | 24 years                               |
| Distribution networks   | 160                   | 20–30 years                    | 14 years                               |
| Non-compete agreements  | 135                   | 3–10 years                     | 1 year                                 |
| Other (including farmer contracts and intellectual property rights) | 59                    | 12.5–17 years                  | 12 years                               |
|   | <u>\$1,940</u>        |                                |  |

Pre-tax amortization expense for intangible assets during the years ended December 31, 2013, 2012 and 2011, was \$93 million, \$97 million and \$98 million, respectively. Amortization expense for each of the next five years is estimated to be approximately \$93 million, assuming no additional transactions occur that require the amortization of intangible assets.

The decrease in the gross carrying amount of other intangible assets from December 31, 2012, was due primarily to currency movements.

#### Note 4.

#### Investments in Unconsolidated Subsidiaries:

At December 31, 2013 and 2012, PMI had total investments in unconsolidated subsidiaries of \$1,536 million and \$24 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. The carrying value of our equity method investments at December 31, 2013, exceeded our share of the unconsolidated subsidiaries book value by \$579 million, including \$519 million attributable to goodwill. The difference between the investment carrying value and the amount of underlying equity in net assets, excluding the \$519 million attributable to goodwill, is being amortized on a straight-line basis over the underlying assets' estimated useful lives of 4 to 20 years.

On September 30, 2013, PMI acquired a 49% equity interest in United Arab Emirates-based Arab Investors-TA (FZC) ("AITA") for approximately \$625 million. As a result of this transaction, PMI holds an approximate 25% economic interest in Société des Tabacs Algéro-Emirat ( "STAEM"), an Algerian joint venture that is 51% owned by AITA and 49% by the Algerian state-owned enterprise Société Nationale des Tabacs et Allumettes SpA. STAEM manufactures and distributes under license some of PMI's brands. The initial investment in AITA was recorded at cost and is included in investments in unconsolidated subsidiaries on the consolidated balance sheet at December 31, 2013.

On December 12, 2013, PMI acquired from Megapolis Investment BV a 20% equity interest in Megapolis Distribution BV, the holding company of CJSC TK Megapolis ("Megapolis"), PMI's distributor in Russia, for a purchase price of \$750 million. An additional payment of up to \$100 million, which is contingent on Megapolis' operational performance over the four fiscal years following the closing of the transaction, will also be made by PMI if the performance criteria are satisfied. PMI has also agreed to provide Megapolis Investment BV with a \$100 million interest-bearing loan. PMI and Megapolis Investment BV have agreed to set off any future contingent payments owed by PMI against the future repayments due under the loan agreement. Any loan repayments in

excess of the contingent consideration earned by the performance of Megapolis are due to be repaid, in cash, to PMI on March 31, 2017. At December 31, 2013, PMI has recorded a \$100 million asset related to the loan receivable and a discounted liability of \$86 million related to the contingent consideration. The initial investment in Megapolis was recorded at cost and is included in investments in unconsolidated subsidiaries on the consolidated balance sheet at December 31, 2013. The determination of the basis difference for Megapolis was not finalized as of December 31, 2013.

At December 31, 2013 and 2012, PMI's investments in other unconsolidated subsidiaries were \$42 million and \$24 million, respectively, with ownership percentages ranging from 40% to 50%.

As of December 31, 2013, PMI had approximately \$345 million of net sales (since the related acquisition dates of AITA and Megapolis), \$470 million in receivables, \$100 million in notes receivable and \$86 million in debt relating to agreements with its unconsolidated subsidiaries within the EEMA Region. These agreements, which are in the ordinary course of business, are primarily for distribution, contract manufacturing and licenses. PMI eliminated its respective share of all significant intercompany transactions with the equity method investees.

## Note 5.

### Asset Impairment and Exit Costs:

During 2013, 2012 and 2011, pre-tax asset impairment and exit costs consisted of the following:

| (in millions)                        | 2013  | 2012 | 2011  |
|--------------------------------------|-------|------|-------|
| Separation programs:                 |       |      |       |
| European Union                       | \$ 13 | \$ — | \$ 35 |
| Eastern Europe, Middle East & Africa | 14    | —    | 6     |
| Asia                                 | 19    | 13   | 7     |
| Latin America & Canada               | 5     | 29   | 15    |
| Total separation programs            | 51    | 42   | 63    |
| Contract termination charges:        |       |      |       |
| Eastern Europe, Middle East & Africa | 250   | —    | 12    |
| Asia                                 | 8     | 13   | —     |
| Total contract termination charges   | 258   | 13   | 12    |
| Asset impairment charges:            |       |      |       |
| European Union                       | —     | 5    | 10    |
| Eastern Europe, Middle East & Africa | —     | 5    | 7     |
| Asia                                 | —     | 13   | 8     |
| Latin America & Canada               | —     | 5    | 9     |
| Total asset impairment charges       | —     | 28   | 34    |
| Asset impairment and exit costs      | \$309 | \$83 | \$109 |

## Exit Costs

● **Separation Programs:** PMI recorded pre-tax separation program charges of \$51 million, \$42 million and \$63 million for the years ended December 31, 2013, 2012 and 2011, respectively. The 2013 pre-tax separation program charges primarily related to the restructuring of global and regional functions based in Switzerland and Australia. The 2012 pre-tax separation program charges primarily related to severance costs associated with factory restructurings. The 2011 pre-tax separation program charges primarily related to severance costs for factory and R&D restructurings.

● **Contract Termination Charges:** During 2013, PMI recorded exit costs of \$258 million related to the termination of distribution agreements in Eastern Europe, Middle East & Africa (due to a new business model in Egypt) and Asia. During 2012, PMI recorded exit costs of \$13 million related to the termination of distribution agreements in Asia. During 2011, PMI recorded exit costs of \$12 million related to the termination of a distribution agreement in Eastern Europe, Middle East & Africa.

● **Movement in Exit Cost Liabilities:** The movement in exit cost liabilities for PMI was as follows:

| (in millions)                        |       |
|--------------------------------------|-------|
| Liability balance, January 1, 2012   | \$ 28 |
| Charges                              | 55    |
| Cash spent                           | (57)  |
| Currency/other                       | (6)   |
| Liability balance, December 31, 2012 | \$ 20 |
| Charges                              | 309   |
| Cash spent                           | (21)  |
| Currency/other                       | —     |
| Liability balance, December 31, 2013 | \$308 |

Cash payments related to exit costs at PMI were \$21 million, \$57 million and \$98 million for the years ended December 31, 2013, 2012 and 2011, respectively. Future cash payments for exit costs incurred to date are expected to be approximately \$308 million, and these costs will be substantially paid in 2014.

## Asset Impairment Charges

PMI recorded pre-tax asset impairment charges of \$28 million and \$34 million for the years ended December 31, 2012 and 2011, respectively, primarily related to the consolidation of R&D activities as well as charges for factory restructurings.

## Note 6.

### Acquisitions and Other Business Arrangements:

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

● **Other:** In June 2011, PMI completed the acquisition of a cigarette business in Jordan, consisting primarily of cigarette manufacturing assets and inventories, for \$42 million. In January 2011, PMI acquired a cigar business, consisting primarily of trademarks in the Australian and New Zealand markets, for \$20 million.

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

## Note 7.

### Indebtedness:

● **Short-Term Borrowings:** At December 31, 2013 and 2012, PMI's short-term borrowings and related average interest rates consisted of the following:

| (in millions)    | December 31, 2013  |                       | December 31, 2012  |                       |
|------------------|--------------------|-----------------------|--------------------|-----------------------|
|                  | Amount Outstanding | Average Year-End Rate | Amount Outstanding | Average Year-End Rate |
| Commercial paper | \$1,387            | 0.1%                  | \$1,972            | 0.2%                  |
| Bank loans       | 1,013              | 5.7                   | 447                | 6.6                   |
|                  | <b>\$2,400</b>     |                       | <b>\$2,419</b>     |                       |

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, 2013 and 2012, based upon current market interest rates, approximate the amounts disclosed above.

● **Long-Term Debt:** At December 31, 2013 and 2012, PMI's long-term debt consisted of the following:

| (in millions)  | 2013            | 2012            |
|--|-----------------|-----------------|
| U.S. dollar notes, 0.287% to 6.875% (average interest rate 4.105%), due through 2043 | \$16,500        | \$14,702        |
| Foreign currency obligations:  |                 |                 |
| Euro notes, 1.750% to 5.875% (average interest rate 3.340%), due through 2033        | 7,303           | 3,724           |
| Swiss franc notes, 0.875% to 2.000% (average interest rate 1.240%), due through 2021 | 1,289           | 1,579           |
| Other (average interest rate 3.621%), due through 2024                               | 186             | 415             |
|  | <b>25,278</b>   | <b>20,420</b>   |
| Less current portion of long-term debt   | <b>1,255</b>    | <b>2,781</b>    |
|  | <b>\$24,023</b> | <b>\$17,639</b> |

### Other debt

Other foreign currency debt above includes mortgage debt in Switzerland at December 31, 2013 and 2012, and debt from our business combination in the Philippines at December 31, 2012. Other foreign currency debt also includes capital lease obligations.



## Debt Issuances Outstanding

PMI's debt issuances outstanding at December 31, 2013 were as follows:

| (in millions)                    |                                |               |                            |                |
|----------------------------------|--------------------------------|---------------|----------------------------|----------------|
| Type                             | Face Value                     | Interest Rate | Issuance                   | Maturity       |
| U.S. dollar notes                | \$1,250                        | 6.875%        | November 2008              | March 2014     |
| U.S. dollar notes                | \$ 400                         | Floating      | March 2013                 | February 2015  |
| U.S. dollar notes                | \$ 650                         | 2.500         | May 2011                   | May 2016       |
| U.S. dollar notes                | \$ 600                         | 2.500         | August 2011 <sup>(a)</sup> | May 2016       |
| U.S. dollar notes                | \$ 550                         | 1.625         | March 2012                 | March 2017     |
| U.S. dollar notes                | \$ 750                         | 1.125         | August 2012                | August 2017    |
| U.S. dollar notes                | \$2,500                        | 5.650         | May 2008                   | May 2018       |
| U.S. dollar notes                | \$ 750                         | 1.875         | November 2013              | January 2019   |
| U.S. dollar notes                | \$1,000                        | 4.500         | March 2010                 | March 2020     |
| 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                | \$ 750                         | 2.500         | August 2012                | August 2022    |
| U.S. dollar notes                | \$ 600                         | 2.625         | March 2013                 | March 2023     |
| U.S. dollar notes                | \$ 500                         | 3.600         | November 2013              | November 2023  |
| 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  |
| EURO notes <sup>(b)</sup>        | € 750 (approximately \$1,105)  | 5.875         | September 2008             | September 2015 |
| EURO notes <sup>(b)</sup>        | € 750 (approximately \$976)    | 5.750         | March 2009                 | March 2016     |
| EURO notes <sup>(b)</sup>        | € 750 (approximately \$951)    | 2.125         | May 2012                   | May 2019       |
| EURO notes <sup>(b)</sup>        | €1,250 (approximately \$1,621) | 1.750         | March 2013                 | March 2020     |
| EURO notes <sup>(b)</sup>        | € 600 (approximately \$761)    | 2.875         | May 2012                   | May 2024       |
| EURO notes <sup>(b)</sup>        | € 750 (approximately \$972)    | 2.750         | March 2013                 | March 2025     |
| EURO notes <sup>(b)</sup>        | € 500 (approximately \$648)    | 3.125         | June 2013                  | June 2033      |
| Swiss franc notes <sup>(b)</sup> | CHF325 (approximately \$362)   | 1.000         | December 2011              | December 2016  |
| Swiss franc notes <sup>(b)</sup> | CHF200 (approximately \$217)   | 0.875         | March 2013                 | March 2019     |
| Swiss franc notes <sup>(b)</sup> | CHF325 (approximately \$334)   | 1.000         | September 2012             | September 2020 |
| Swiss franc notes <sup>(b)</sup> | CHF300 (approximately \$335)   | 2.000         | December 2011              | December 2021  |

(a) The notes are a further issuance of the 2.500% notes issued by PMI in May 2011.

(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 to meet PMI's working capital requirements, to repurchase PMI's common stock, to refinance debt and for general corporate purposes.

## Aggregate maturities

Aggregate maturities of long-term debt are as follows:

| (in millions)        |          |
|----------------------|----------|
| 2014                 | \$ 1,255 |
| 2015                 | 1,439    |
| 2016                 | 2,654    |
| 2017                 | 1,302    |
| 2018                 | 2,502    |
| 2019–2023            | 8,389    |
| 2024–2028            | 2,010    |
| Thereafter           | 5,988    |
|                      | 25,539   |
| Debt discounts       | (261)    |
| Total long-term debt | \$25,278 |

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

• **Credit Facilities:** On February 12, 2013, PMI entered into a 364-day revolving credit facility in the amount of \$2.0 billion.

At December 31, 2013, PMI's total committed credit facilities and commercial paper outstanding were as follows:

| Type<br>(in billions of dollars)                          | Committed<br>Credit<br>Facilities | Commercial<br>Paper |
|---|-----------------------------------|---------------------|
| 364-day revolving credit, expiring<br>February 11, 2014   | \$2.0                             |                     |
| Multi-year revolving credit, expiring<br>March 31, 2015   | 2.5                               |                     |
| Multi-year revolving credit, expiring<br>October 25, 2016 | 3.5                               |                     |
| Total facilities  | \$8.0                             |                     |
| Commercial paper outstanding                              |                                   | \$1.4               |

At December 31, 2013, there were no borrowings under these committed credit facilities, and the entire committed amounts were available for borrowing.

On January 31, 2014, PMI extended the term of its existing \$2.0 billion 364-day revolving credit facility until February 10, 2015.

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, 2013, PMI's ratio calculated in accordance with the agreements was 14.6 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 \$2.4 billion at December 31, 2013, and \$2.0 billion at December 31, 2012, are for the sole use of the subsidiaries. Borrowings under these arrangements amounted to \$1.0 billion at December 31, 2013, and \$447 million at December 31, 2012.

## Note 8.

### Capital Stock:

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

|  | Shares<br>Issued | Shares<br>Repurchased | Shares<br>Outstanding |
|--|------------------|-----------------------|-----------------------|
| Balances,<br>January 1,<br>2011  | 2,109,316,331    | (307,532,841)         | 1,801,783,490         |
| Repurchase of<br>shares  |                  | (80,514,257)          | (80,514,257)          |
| Exercise of stock<br>options and<br>issuance of<br>other stock<br>awards |                  | 4,639,433             | 4,639,433             |
| Balances,<br>December 31,<br>2011  | 2,109,316,331    | (383,407,665)         | 1,725,908,666         |
| Repurchase of<br>shares  |                  | (74,897,499)          | (74,897,499)          |
| Issuance of stock<br>awards and<br>exercise of<br>stock options          |                  | 2,601,817             | 2,601,817             |
| Balances,<br>December 31,<br>2012  | 2,109,316,331    | (455,703,347)         | 1,653,612,984         |
| Repurchase of<br>shares  |                  | (67,231,392)          | (67,231,392)          |
| Issuance of stock<br>awards and<br>exercise of<br>stock options          |                  | 2,620,820             | 2,620,820             |
| Balances,<br>December 31,<br>2013  | 2,109,316,331    | (520,313,919)         | 1,589,002,412         |

On May 1, 2010, PMI commenced a \$12.0 billion three-year share repurchase program. On July 31, 2012, PMI completed, ahead of schedule, the \$12.0 billion share repurchase program, which resulted in the purchase of 179.1 million shares at an average price of \$66.99 per share. On August 1, 2012, PMI commenced a three-year \$18 billion share repurchase program that was authorized by PMI's Board of Directors in June 2012. From August 1, 2012, through December 31, 2013, PMI repurchased 99.4 million shares of its common stock at a cost of \$8.9 billion, or \$89.03 per share, under this repurchase program. During 2013, 2012 and 2011, PMI repurchased \$6.0 billion, \$6.5 billion and \$5.4 billion, respectively, of its common stock.

At December 31, 2013, 36,591,569 shares of common stock were reserved for stock options and other 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:

#### • Performance Incentive Plan and Stock Compensation Plan for Non-Employee Directors:

In May 2012, PMI's stockholders approved the Philip Morris International Inc. 2012 Performance Incentive Plan (the "2012 Plan"). The 2012 Plan replaced the 2008 Performance Incentive Plan (the "2008 Plan") and, as a result, there will be no additional grants under the 2008 Plan. Under the 2012 Plan, PMI may grant to eligible employees restricted stock, restricted stock units and deferred stock units, performance-based cash incentive awards and performance-based equity awards. While the 2008 Plan authorized incentive stock options, non-qualified stock options and stock appreciation rights, the 2012 Plan does not authorize any stock options or stock appreciation rights. Up to 30 million shares of PMI's common stock may be issued under the 2012 Plan. At December 31, 2013, shares available for grant under the 2012 Plan were 27,211,610.

In 2008, PMI adopted the Philip Morris International Inc. 2008 Stock Compensation Plan for Non-Employee Directors (the "Non-Employee Directors Plan"). A non-employee director is defined as a member of the PMI Board of Directors who is not a full-time employee of PMI or of any corporation in which PMI owns, directly or indirectly, stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote in the election of directors in such corporation. Up to 1 million shares of PMI common stock may be awarded under the Non-Employee Directors Plan. As of December 31, 2013, shares available for grant under the plan were 783,905.

#### Restricted and Deferred Stock Awards

PMI may grant restricted stock and deferred stock awards to eligible employees; recipients may not sell, assign, pledge or otherwise encumber such shares or awards. Such shares or awards are subject to forfeiture if certain employment conditions are not met. Restricted stock and deferred stock awards generally vest on the third anniversary of the grant date.

Shares of restricted stock carry voting and dividend rights. Deferred stock awards carry no such rights, although they do earn dividend equivalents.

During 2013, the activity for restricted stock and deferred stock awards was as follows:

|                              | Number of<br>Shares | Weighted-<br>Average Grant<br>Date Fair Value<br>Per Share |
|------------------------------|---------------------|--|
| Balance at January 1, 2013   | 9,484,865           | \$62.44  |
| Granted                      | 2,783,310           | 88.43  |
| Vested                       | (3,276,901)         | 50.02  |
| Forfeited                    | (171,974)           | 73.02  |
| Balance at December 31, 2013 | 8,819,300           | \$75.05  |

The weighted-average grant date fair value of the restricted stock and deferred stock awards granted to PMI employees during the years ended December 31, 2013, 2012 and 2011, was \$246 million, \$258 million and \$229 million, or \$88.43, \$79.59 and \$59.44 per restricted or deferred share, respectively. The fair value of the restricted stock and deferred stock awards at the date of grant is amortized to expense ratably over the restriction period. PMI recorded compensation expense for the restricted and deferred stock awards of \$220 million, \$242 million and \$162 million for the years ended December 31, 2013, 2012 and 2011, respectively. During the first quarter of 2012, compensation expense included approximately \$27 million of accelerated expense primarily associated with employees approaching or reaching certain age milestones that accelerate the vesting. As of December 31, 2013, PMI had \$225 million of total unrecognized compensation costs related to non-vested restricted and deferred stock awards. These costs are expected to be recognized over a weighted-average period of two years, subject to earlier vesting on death or disability or normal retirement, or separation from employment by mutual agreement after reaching age 58.

During the year ended December 31, 2013, 3.3 million shares of PMI restricted and deferred stock awards vested. The grant date fair value of all the vested shares was approximately \$164 million. The total fair value of the awards that vested in 2013 was approximately \$296 million.

During the year ended December 31, 2012, 3.7 million shares of PMI restricted and deferred stock awards vested. The grant date fair value of all the vested shares was approximately \$148 million. The total fair value of the awards that vested in 2012 was approximately \$298 million.

During the year ended December 31, 2011, 1.8 million shares of PMI restricted and deferred stock awards vested. The grant date fair value of all the vested shares was approximately \$84 million. The total fair value of the awards that vested in 2011 was approximately \$107 million.

## Stock Option Awards

At December 31, 2013, PMI shares subject to option that remain under the 2008 Plan were as follows:

|  | Shares<br>Subject<br>to Option | Weighted-<br>Average<br>Exercise<br>Price | Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|--|--------------------------------|---|---|---------------------------------|
| Balance at January 1, 2013               | 36,811                         | \$26.13                                   |   |                                 |
| Options exercised                        | (14,097)                       | 22.50                                     |   |                                 |
| Options cancelled                        | —                              | —   |   |                                 |
| Balance/Exercisable at December 31, 2013 | 22,714                         | \$28.38                                   | 0.4 years                                   | \$1 million                     |

For the years ended December 31, 2013, 2012 and 2011, the total intrinsic value of PMI stock options exercised was \$1 million, \$2 million and \$129 million, respectively.

## 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, |         |         |
|--|----------------------------------|---------|---------|
|  | 2013                             | 2012    | 2011    |
| Net earnings attributable to PMI   | \$8,576                          | \$8,800 | \$8,591 |
| Less distributed and undistributed earnings attributable to share-based payment awards | 45                               | 48      | 49      |
| Net earnings for basic and diluted EPS   | \$8,531                          | \$8,752 | \$8,542 |
| Weighted-average shares for basic EPS  | 1,622                            | 1,692   | 1,761   |
| Plus incremental shares from assumed conversions:                                      |                                  |         |         |
| Stock options  | —                                | —       | 1       |
| Weighted-average shares for diluted EPS  | 1,622                            | 1,692   | 1,762   |

For the 2013, 2012 and 2011 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, 2013, 2012 and 2011:

| (in millions)                    | 2013            | 2012     | 2011     |
|----------------------------------|-----------------|----------|----------|
| Earnings before income taxes     | <b>\$12,542</b> | \$13,004 | \$12,542 |
| Provision for income taxes:      |                 |          |          |
| United States federal:           |                 |          |          |
| Current                          | <b>\$ 247</b>   | \$ 226   | \$ 270   |
| Deferred                         | <b>(5)</b>      | (61)     | 118      |
| Total United States              | <b>242</b>      | 165      | 388      |
| Outside United States:           |                 |          |          |
| Current                          | <b>3,451</b>    | 3,855    | 3,368    |
| Deferred                         | <b>(23)</b>     | (187)    | (103)    |
| Total outside United States      | <b>3,428</b>    | 3,668    | 3,265    |
| Total provision for income taxes | <b>\$ 3,670</b> | \$ 3,833 | \$ 3,653 |

United States income tax is primarily attributable to repatriation costs.

At December 31, 2013, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately \$20 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested. These earnings have been or will be invested to support the growth of PMI's international business. Further, PMI does not foresee a need to repatriate these earnings to the U.S. since its U.S. cash requirements are supported by distributions from foreign entities of earnings that have not been designated as permanently reinvested and existing credit facilities. Repatriation of earnings from foreign subsidiaries for which PMI has asserted that the earnings are permanently reinvested would result in additional U.S. income and foreign withholding taxes. The determination of the amount of deferred tax related to these earnings is not practicable due to the complexity of the U.S. foreign tax credit regime, as well as differences between earnings determined for book and tax purposes mainly resulting from intercompany transactions, purchase accounting and currency fluctuations.

On March 28, 2008, PMI entered into a Tax Sharing Agreement (the "Tax Sharing Agreement") with Altria. The Tax Sharing Agreement generally governs PMI's and Altria's respective rights, responsibilities and obligations for pre-distribution periods and for potential taxes on the spin-off of PMI by Altria. With respect to any potential tax resulting from the spin-off of PMI by Altria, responsibility for the tax will be allocated to the party that acted (or failed to act) in a manner that resulted in the tax.

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

| (in millions)  | 2013         | 2012   | 2011  |
|--|--------------|--------|-------|
| Balance at January 1,  | <b>\$124</b> | \$ 104 | \$ 95 |
| Additions based on tax positions related to the current year | <b>15</b>    | 9      | 17    |
| Additions for tax positions of previous years                | <b>3</b>     | 309    | 8     |
| Reductions for tax positions of prior years                  | <b>(2)</b>   | (1)    | (8)   |
| Reductions due to lapse of statute of limitations            | <b>(16)</b>  | —      | (7)   |
| Settlements  | <b>(10)</b>  | (297)  | —     |
| Other  | —            | —      | (1)   |
| Balance at December 31,                                      | <b>\$114</b> | \$ 124 | \$104 |

During 2012, PMI recorded additions to the unrecognized tax benefits liability for tax positions of previous years of \$309 million. Included in this amount is \$287 million, which is related to the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004–2006. The settlement with the IRS resulted in a reduction of the unrecognized tax benefits liability of \$296 million in the same period (reflected in the \$297 million of settlements in the table above). After consideration of the impact of the settlement on repatriation costs for subsequent tax years as well as interest costs, the net impact on the 2012 effective tax rate was \$79 million, as noted below.

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

| (in millions)                           | December 31, 2013 | December 31, 2012 | December 31, 2011 |
|---|-------------------|-------------------|-------------------|
| Unrecognized tax benefits               | <b>\$114</b>      | \$124             | \$104             |
| Accrued interest and penalties          | <b>24</b>         | 37                | 28                |
| Tax credits and other indirect benefits | <b>(56)</b>       | (72)              | (55)              |
| Liability for tax contingencies         | <b>\$ 82</b>      | \$ 89             | \$ 77             |

The amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate was \$56 million at December 31, 2013. The remainder, if recognized, would principally affect deferred taxes.

For the years ended December 31, 2013, 2012 and 2011, PMI recognized (expense) income in its consolidated statements of earnings of \$10 million, \$(65) million and less than \$1 million, respectively, related to interest and penalties.

PMI is regularly examined by tax authorities around the world and is currently under examination in a number of jurisdictions. The U.S. federal statute of limitations remains open for the years 2007 and onward. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from three to five years. Years still open to examination by foreign tax authorities in major jurisdictions include Germany (2007 onward), Indonesia (2008 onward), Russia (2010 onward) and Switzerland (2012 onward).

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

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, 2013, 2012 and 2011:

|                                     | 2013   | 2012   | 2011   |
|-------------------------------------|--------|--------|--------|
| U.S. federal statutory rate         | 35.0%  | 35.0%  | 35.0%  |
| Increase (decrease) resulting from: |        |        |        |
| Foreign rate differences            | (12.2) | (11.8) | (12.5) |
| Dividend repatriation cost          | 6.6    | 6.0    | 6.5    |
| Other                               | (0.1)  | 0.3    | 0.1    |
| Effective tax rate                  | 29.3%  | 29.5%  | 29.1%  |

The American Taxpayer Relief Act of 2012 (the "Act") was enacted on January 2, 2013. Included in the Act were extensions through 2013 of several expired or expiring temporary business tax provisions, commonly referred to as "extenders." The tax impact of new legislation is recognized in the reporting period in which it is enacted. Therefore, PMI recognized the impact of the Act, which was \$17 million of expense, in the consolidated financial statements in the first quarter of 2013.

The 2013 effective tax rate decreased 0.2 percentage points to 29.3%. The 2013 effective tax rate was unfavorably impacted by the additional expense associated with the Act (\$17 million) and the enactment of tax law changes in Mexico (\$14 million). Excluding these special tax items, the change in the effective tax rate for the year ended December 31, 2013, was primarily due to earnings mix and repatriation cost differences.

The 2012 effective tax rate increased 0.4 percentage points to 29.5%. The 2012 effective tax rate was unfavorably impacted by an additional income tax provision of \$79 million following the conclusion of the IRS examination of Altria's consolidated tax returns for the years 2004–2006, partially offset by a \$40 million benefit from a tax accounting method change in Germany. Prior to March 28, 2008, PMI was a wholly owned subsidiary of Altria.

The 2011 effective tax rate increased 1.7 percentage points to 29.1%. The 2011 effective tax rate was favorably impacted by an enacted decrease in corporate income tax rates in Greece (\$11 million) and the reversal of a valuation allowance in Brazil (\$15 million).

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)                                      | 2013            | 2012     |
| Deferred income tax assets:                        |                 |          |
| Accrued postretirement and postemployment benefits | \$ 264          | \$ 279   |
| Accrued pension costs                              | 135             | 262      |
| Inventory  | 170             | 135      |
| Accrued liabilities                                | 139             | 150      |
| Foreign exchange                                   | 146             | 52       |
| Other  | 144             | 139      |
| Total deferred income tax assets                   | 998             | 1,017    |
| Deferred income tax liabilities:                   |                 |          |
| Trade names  | (738)           | (816)    |
| Property, plant and equipment                      | (311)           | (320)    |
| Unremitted earnings                                | (735)           | (845)    |
| Total deferred income tax liabilities              | (1,784)         | (1,981)  |
| Net deferred income tax liabilities                | \$ (786)        | \$ (964) |

## Note 12.

### Segment Reporting:

PMI's subsidiaries and affiliates are engaged in the manufacture and sale of cigarettes and other tobacco products in markets outside of the United States of America. Reportable segments for PMI are organized and managed by geographic region. PMI's reportable segments are European Union; Eastern Europe, Middle East & Africa; Asia, and Latin America & Canada. PMI records net revenues and operating companies income to its segments based upon the geographic area in which the customer resides.

PMI's management evaluates segment performance and allocates resources based on operating companies income, which PMI defines as operating income, excluding general corporate expenses and amortization of intangibles, plus equity (income)/loss in unconsolidated subsidiaries, net. Interest expense, net, and provision for income taxes are centrally managed; 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*.

Segment data were as follows:

|  | For the Years Ended December 31, |          |          |
|--|----------------------------------|----------|----------|
| (in millions)  | 2013                             | 2012     | 2011     |
| Net revenues:  |                                  |          |          |
| European Union   | \$28,303                         | \$27,338 | \$29,768 |
| Eastern Europe, Middle East & Africa                     | 20,695                           | 19,272   | 17,452   |
| Asia   | 20,987                           | 21,071   | 19,590   |
| Latin America & Canada                                   | 10,044                           | 9,712    | 9,536    |
| Net revenues <sup>(1)</sup>                              | \$80,029                         | \$77,393 | \$76,346 |
| Earnings before income taxes:                            |                                  |          |          |
| Operating companies income:                              |                                  |          |          |
| European Union   | \$ 4,238                         | \$ 4,187 | \$ 4,560 |
| Eastern Europe, Middle East & Africa                     | 3,779                            | 3,726    | 3,229    |
| Asia   | 4,622                            | 5,197    | 4,836    |
| Latin America & Canada                                   | 1,134                            | 1,043    | 988      |
| Amortization of intangibles                              | (93)                             | (97)     | (98)     |
| General corporate expenses                               | (187)                            | (210)    | (183)    |
| Less:  |                                  |          |          |
| Equity (income)/loss in unconsolidated subsidiaries, net | 22                               | 17       | 10       |
| Operating income   | 13,515                           | 13,863   | 13,342   |
| Interest expense, net                                    | (973)                            | (859)    | (800)    |
| Earnings before income taxes                             | \$12,542                         | \$13,004 | \$12,542 |

(1) Total net revenues attributable to customers located in Germany, PMI's largest market in terms of net revenues, were \$7.8 billion, \$7.7 billion and \$8.1 billion for the years ended December 31, 2013, 2012 and 2011, respectively.

| (in millions)                        | For the Years Ended December 31, |         |       |
|--------------------------------------|----------------------------------|---------|-------|
|                                      | 2013                             | 2012    | 2011  |
| Depreciation expense:                |                                  |         |       |
| European Union                       | \$ 190                           | \$ 181  | \$210 |
| Eastern Europe, Middle East & Africa | 227                              | 211     | 227   |
| Asia                                 | 277                              | 315     | 358   |
| Latin America & Canada               | 85                               | 84      | 90    |
|                                      | 779                              | 791     | 885   |
| Other                                | 10                               | 10      | 10    |
| Total depreciation expense           | \$ 789                           | \$ 801  | \$895 |
| Capital expenditures:                |                                  |         |       |
| European Union                       | \$ 480                           | \$ 391  | \$382 |
| Eastern Europe, Middle East & Africa | 247                              | 197     | 133   |
| Asia                                 | 317                              | 277     | 208   |
| Latin America & Canada               | 156                              | 127     | 140   |
|                                      | 1,200                            | 992     | 863   |
| Other                                | —                                | 64      | 34    |
| Total capital expenditures           | \$1,200                          | \$1,056 | \$897 |

| (in millions)                        | At December 31, |         |         |
|--------------------------------------|-----------------|---------|---------|
|                                      | 2013            | 2012    | 2011    |
| Long-lived assets:                   |                 |         |         |
| European Union                       | \$3,403         | \$3,065 | \$2,938 |
| Eastern Europe, Middle East & Africa | 1,265           | 1,215   | 1,094   |
| Asia                                 | 1,758           | 1,824   | 1,681   |
| Latin America & Canada               | 759             | 719     | 678     |
|                                      | 7,185           | 6,823   | 6,391   |
| Other                                | 208             | 139     | 146     |
| Total long-lived assets              | \$7,393         | \$6,962 | \$6,537 |

Long-lived assets consist of non-current assets other than goodwill; other intangible assets, net; deferred tax assets, and investments in unconsolidated subsidiaries. PMI's largest market in terms of long-lived assets is Switzerland. Total long-lived assets located in Switzerland, which is reflected in the European Union segment above, were \$1.1 billion, \$1.1 billion and \$1.0 billion at December 31, 2013, 2012 and 2011, respectively.

Items affecting the comparability of results from operations were as follows:

● **Asset Impairment and Exit Costs**— See Note 5. *Asset Impairment and Exit Costs* for a breakdown of asset impairment and exit costs by segment.

● **Acquisitions and Other Business Arrangements**— For further details, see Note 6. *Acquisitions and Other Business Arrangements*.

## 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.

#### ● Pension Plans

#### Obligations and Funded Status

The benefit obligations, plan assets and funded status of PMI's pension plans at December 31, 2013 and 2012, were as follows:

| (in millions)                                    | U.S. Plans |         | Non-U.S. Plans |            |
|--|------------|---------|----------------|------------|
|  | 2013       | 2012    | 2013           | 2012       |
| Benefit obligation at                            |            |         |                |            |
| January 1,                                       | \$383      | \$352   | \$7,262        | \$5,625    |
| Service cost                                     | 7          | 6       | 255            | 189        |
| Interest cost                                    | 16         | 16      | 169            | 189        |
| Benefits paid                                    | (13)       | (16)    | (156)          | (160)      |
| Termination, settlement and curtailment          | —          | —       | (3)            | (8)        |
| Assumption changes                               | (45)       | 28      | (894)          | 1,176      |
| Actuarial losses (gains)                         | 16         | (3)     | 76             | 41         |
| Currency   | —          | —       | 141            | 167        |
| Other  | —          | —       | 43             | 43         |
| Benefit obligation at December 31,               | 364        | 383     | 6,893          | 7,262      |
| Fair value of plan assets at                     |            |         |                |            |
| January 1,                                       | 284        | 269     | 5,627          | 4,778      |
| Actual return on plan assets                     | 33         | 27      | 731            | 625        |
| Employer contributions                           | 1          | 4       | 149            | 203        |
| Employee contributions                           | —          | —       | 47             | 47         |
| Benefits paid                                    | (13)       | (16)    | (156)          | (160)      |
| Termination, settlement and curtailment          | —          | —       | (2)            | (5)        |
| Currency   | —          | —       | 170            | 139        |
| Fair value of plan assets at December 31,        | 305        | 284     | 6,566          | 5,627      |
| Net pension liability recognized at December 31, | \$ (59)    | \$ (99) | \$ (327)       | \$ (1,635) |

At December 31, 2013 and 2012, the Swiss pension plan represented 58% of the non-U.S. benefit obligation and approximately 60% of the non-U.S. fair value of plan assets, respectively.

At December 31, 2013 and 2012, the combined U.S. and non-U.S. pension plans resulted in a net pension liability of \$386 million and \$1,734 million, respectively. These amounts were recognized in PMI's consolidated balance sheets at December 31, 2013 and 2012, as follows:

| (in millions)                        | 2013           | 2012             |
|--------------------------------------|----------------|------------------|
| Other assets                         | \$ 151         | \$ 29            |
| Accrued liabilities—employment costs | (55)           | (22)             |
| Long-term employment costs           | (482)          | (1,741)          |
|                                      | <b>\$(386)</b> | <b>\$(1,734)</b> |

The accumulated benefit obligation, which represents benefits earned to date, for the U.S. pension plans was \$339 million and \$354 million at December 31, 2013 and 2012, respectively. The accumulated benefit obligation for non-U.S. pension plans was \$6,257 million and \$6,469 million at December 31, 2013 and 2012, respectively.

For U.S. pension plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligation and accumulated benefit obligation were \$86 million and \$77 million, respectively, as of December 31, 2013. The projected benefit obligation and accumulated benefit obligation were \$86 million and \$78 million, respectively, as of December 31, 2012. The underfunding relates to plans for salaried employees that cannot be funded under IRS regulations. For non-U.S. plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were \$1,429 million, \$1,295 million, and \$1,034 million, respectively, as of December 31, 2013, and \$6,786 million, \$6,058 million, and \$5,162 million, respectively, as of December 31, 2012.

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

|                               | U.S. Plans   |       | Non-U.S. Plans |       |
|-------------------------------|--------------|-------|----------------|-------|
|                               | 2013         | 2012  | 2013           | 2012  |
| Discount rate                 | <b>4.80%</b> | 4.05% | <b>3.09%</b>   | 2.38% |
| Rate of compensation increase | <b>3.00</b>  | 3.50  | <b>2.34</b>    | 2.61  |

The discount rate for the largest U.S. and non-U.S. 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 non-U.S. 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 cost consisted of the following for the years ended December 31, 2013, 2012 and 2011:

| (in millions)                           | U.S. Plans   |       |       | Non-U.S. Plans |        |        |
|---|--------------|-------|-------|----------------|--------|--------|
|   | 2013         | 2012  | 2011  | 2013           | 2012   | 2011   |
| Service cost                            | <b>\$ 7</b>  | \$ 6  | \$ 5  | <b>\$ 255</b>  | \$ 189 | \$ 178 |
| Interest cost                           | <b>16</b>    | 16    | 16    | <b>169</b>     | 189    | 205    |
| Expected return on plan assets          | <b>(16)</b>  | (15)  | (15)  | <b>(347)</b>   | (320)  | (323)  |
| Amortization:                           |              |       |       |                |        |        |
| Net losses                              | <b>11</b>    | 9     | 5     | <b>205</b>     | 120    | 58     |
| Prior service cost                      | <b>1</b>     | 1     | 1     | <b>9</b>       | 9      | 8      |
| Net transition obligation               | —            | —     | —     | —              | 1      | 1      |
| Termination, settlement and curtailment | —            | 2     | 2     | <b>1</b>       | —      | 1      |
| Net periodic pension cost               | <b>\$ 19</b> | \$ 19 | \$ 14 | <b>\$ 292</b>  | \$ 188 | \$ 128 |

Termination, settlement and curtailment charges were due primarily to early retirement programs.

For the combined U.S. and non-U.S. pension plans, the estimated net loss and prior service cost that are expected to be amortized from accumulated other comprehensive earnings into net periodic benefit cost during 2014 are \$117 million and \$7 million, respectively.

The following weighted-average assumptions were used to determine PMI's net pension cost:

|  | U.S. Plans   |       |       | Non-U.S. Plans |       |       |
|--|--------------|-------|-------|----------------|-------|-------|
|  | 2013         | 2012  | 2011  | 2013           | 2012  | 2011  |
| Discount rate                          | <b>4.05%</b> | 4.50% | 5.40% | <b>2.38%</b>   | 3.40% | 4.00% |
| Expected rate of return on plan assets | <b>5.70</b>  | 5.70  | 6.25  | <b>6.11</b>    | 6.21  | 6.21  |
| Rate of compensation increase          | <b>3.50</b>  | 3.50  | 3.50  | <b>2.61</b>    | 2.66  | 2.90  |

PMI's expected rate of return on 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 \$69 million, \$66 million and \$61 million for the years ended December 31, 2013, 2012 and 2011, respectively.

## Plan Assets

PMI's investment strategy for U.S. and non-U.S. 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, 2013 and 2012, by asset category was as follows:

| Asset Category<br>(in millions) | At<br>December 31,<br>2013 | Quoted<br>Prices<br>In Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---------------------------------|----------------------------|--|---|--|
| Cash and cash equivalents       | \$ 608                     | \$ 608   | \$ —  | \$—  |
| Equity securities:              |                            |  |   |  |
| U.S. securities                 | 119                        | 119  | —   | —  |
| International securities        | 1,280                      | 1,280  | —   | —  |
| Investment funds <sup>(a)</sup> | 4,508                      | 2,805  | 1,703   | —  |
| International government bonds  | 317                        | 313  | 4   | —  |
| Corporate bonds                 | 2                          | 2  | —   | —  |
| Other                           | 37                         | 37   | —   | —  |
| Total                           | \$6,871                    | \$5,164  | \$1,707   | \$—  |

(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, 61% are invested in U.S. and international equities; 24% are invested in U.S. and international government bonds; 8% are invested in corporate bonds, and 7% are invested in real estate and other money markets.

| Asset Category<br>(in millions)    | At<br>December 31,<br>2012 | Quoted<br>Prices<br>In Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------------------------|----------------------------|--|---|--|
| Cash and cash equivalents          | \$ 420                     | \$ 420   | \$ —  | \$—  |
| Equity securities:                 |                            |  |   |  |
| U.S. securities                    | 106                        | 106  | —   | —  |
| International securities           | 1,129                      | 1,129  | —   | —  |
| Investment funds <sup>(b)(c)</sup> | 3,805                      | 2,313  | 1,492   | —  |
| International government bonds     | 411                        | 411  | —   | —  |
| Corporate bonds                    | 3                          | 3  | —   | —  |
| Other                              | 37                         | 37   | —   | —  |
| Total                              | \$5,911                    | \$4,419  | \$1,492   | \$—  |

(b) 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% are invested in U.S. and international equities; 24% are invested in U.S. and international government bonds; 9% are invested in corporate bonds, and 7% are invested in real estate and other money markets.

(c) Mutual funds in the amount of \$1,363 million were transferred from Level 2 to Level 1 because they are actively traded on a daily basis.

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 U.S. and non-U.S. plans. Currently, PMI anticipates making contributions of approximately \$171 million in 2014 to its pension plans, based on current tax and benefit laws. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest rates.

The estimated future benefit payments from PMI pension plans at December 31, 2013, are as follows:

| (in millions) | U.S. Plans | Non-U.S. Plans |
|---------------|------------|----------------|
| 2014          | \$ 48      | \$ 246         |
| 2015          | 18         | 255            |
| 2016          | 18         | 250            |
| 2017          | 21         | 260            |
| 2018          | 19         | 276            |
| 2019–2023     | 119        | 1,576          |

#### • Postretirement Benefit Plans

Net postretirement health care costs consisted of the following for the years ended December 31, 2013, 2012 and 2011:

| (in millions)                        | U.S. Plans |      |      | Non-U.S. Plans |      |      |
|--------------------------------------|------------|------|------|----------------|------|------|
|                                      | 2013       | 2012 | 2011 | 2013           | 2012 | 2011 |
| Service cost                         | \$ 3       | \$2  | \$2  | \$2            | \$2  | \$2  |
| Interest cost                        | 5          | 5    | 5    | 5              | 5    | 5    |
| Amortization:                        |            |      |      |                |      |      |
| Net losses                           | 3          | 2    | 1    | 2              | 1    | 1    |
| Net postretirement health care costs | \$11       | \$9  | \$8  | \$9            | \$8  | \$8  |

The following weighted-average assumptions were used to determine PMI's net postretirement costs for the years ended December 31, 2013, 2012 and 2011:

|                             | U.S. Plans |       |       | Non-U.S. Plans |       |       |
|-----------------------------|------------|-------|-------|----------------|-------|-------|
|                             | 2013       | 2012  | 2011  | 2013           | 2012  | 2011  |
| Discount rate               | 4.05%      | 4.50% | 5.40% | 4.59%          | 5.45% | 5.14% |
| Health care cost trend rate | 7.50       | 7.50  | 8.00  | 6.46           | 6.55  | 6.29  |

PMI's postretirement health care plans are not funded. The changes in the accumulated benefit obligation and net amount accrued at December 31, 2013 and 2012, were as follows:

| (in millions)   | U.S. Plans |       | Non-U.S. Plans |       |
|---|------------|-------|----------------|-------|
|   | 2013       | 2012  | 2013           | 2012  |
| Accumulated postretirement benefit obligation at January 1,   | \$132      | \$115 | \$113          | \$ 96 |
| Service cost  | 3          | 2     | 2              | 2     |
| Interest cost   | 5          | 5     | 5              | 5     |
| Benefits paid   | (5)        | (4)   | (5)            | (5)   |
| Assumption changes  | (23)       | 10    | (5)            | 11    |
| Actuarial losses (gains)                                      | 1          | 4     | (3)            | 6     |
| Plan changes  | —          | —     | (1)            | (3)   |
| Currency  | —          | —     | (6)            | 1     |
| Accumulated postretirement benefit obligation at December 31, | \$113      | \$132 | \$100          | \$113 |



The current portion of PMI's accrued postretirement health care costs of \$11 million at December 31, 2013 and December 31, 2012, is included in accrued employment costs on the consolidated balance sheet.

The following weighted-average assumptions were used to determine PMI's postretirement benefit obligations at December 31, 2013 and 2012:

|   | U.S. Plans   |       | Non-U.S. Plans |       |
|---|--------------|-------|----------------|-------|
|   | 2013         | 2012  | 2013           | 2012  |
| Discount rate                                     | <b>4.95%</b> | 4.05% | <b>5.07%</b>   | 4.59% |
| Health care cost trend rate assumed for next year | <b>7.00</b>  | 7.50  | <b>6.14</b>    | 6.46  |
| Ultimate trend rate                               | <b>5.00</b>  | 5.00  | <b>4.87</b>    | 4.88  |
| Year that rate reaches the ultimate trend rate    | <b>2018</b>  | 2018  | <b>2029</b>    | 2029  |

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care trend rates would have the following effects as of December 31, 2013:

|   | One-Percentage-Point Increase | One-Percentage-Point Decrease |
|---|-------------------------------|-------------------------------|
| Effect on total service and interest cost   | <b>18.2%</b>                  | <b>(14.0)%</b>                |
| Effect on postretirement benefit obligation | <b>14.1</b>                   | <b>(11.6)</b>                 |

PMI's estimated future benefit payments for its postretirement health care plans at December 31, 2013, are as follows:

| (in millions) | U.S. Plans | Non-U.S. Plans |
|---------------|------------|----------------|
| 2014          | \$ 5       | \$ 6           |
| 2015          | 5          | 5              |
| 2016          | 6          | 5              |
| 2017          | 6          | 5              |
| 2018          | 6          | 5              |
| 2019–2023     | 33         | 26             |

#### ● 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 consisted of the following:

| (in millions)            | For the Years Ended December 31, |       |       |
|--------------------------|----------------------------------|-------|-------|
|                          | 2013                             | 2012  | 2011  |
| Service cost             | <b>\$ 34</b>                     | \$ 30 | \$ 28 |
| Interest cost            | <b>20</b>                        | 22    | 22    |
| Amortization of net loss | <b>60</b>                        | 53    | 39    |
| Other expense            | <b>84</b>                        | 75    | 106   |
| Net postemployment costs | <b>\$198</b>                     | \$180 | \$195 |

During 2013, 2012 and 2011, certain salaried employees left PMI under separation programs. These programs resulted in incremental postemployment costs, which are included in other expense, above.

The estimated net loss for the postemployment benefit plans that will be amortized from accumulated other comprehensive losses into net postemployment costs during 2014 is approximately \$66 million.

The changes in the benefit obligations of the plans at December 31, 2013 and 2012, were as follows:

| (in millions)                                | 2013          | 2012   |
|--|---------------|--------|
| Accrued postemployment costs at January 1,   | <b>\$ 682</b> | \$ 619 |
| Service cost                                 | <b>34</b>     | 30     |
| Interest cost                                | <b>20</b>     | 22     |
| Benefits paid                                | <b>(173)</b>  | (196)  |
| Actuarial losses                             | <b>109</b>    | 129    |
| Other  | <b>91</b>     | 78     |
| Accrued postemployment costs at December 31, | <b>\$ 763</b> | \$ 682 |

The accrued postemployment costs were determined using a weighted-average discount rate of 5.5% and 4.4% in 2013 and 2012, respectively; an assumed ultimate annual weighted-average turnover rate of 2.2% and 2.1% in 2013 and 2012, respectively; assumed compensation cost increases of 3.8% in 2013 and 3.9% in 2012 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 shown above are presented net of the related assets of \$33 million and \$28 million at December 31, 2013 and 2012, 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, 2013, consisted of the following:

| (in millions)             | Pension          | Post-retirement | Post-employment | Total            |
|---------------------------|------------------|-----------------|-----------------|------------------|
| Net losses                | <b>\$(1,746)</b> | <b>\$(47)</b>   | <b>\$(661)</b>  | <b>\$(2,454)</b> |
| Prior service cost        | <b>(51)</b>      | 7               | —               | <b>(44)</b>      |
| Net transition obligation | <b>(6)</b>       | —               | —               | <b>(6)</b>       |
| Deferred income taxes     | <b>245</b>       | 14              | 199             | <b>458</b>       |
| Losses to be amortized    | <b>\$(1,558)</b> | <b>\$(26)</b>   | <b>\$(462)</b>  | <b>\$(2,046)</b> |

The amounts recorded in accumulated other comprehensive losses at December 31, 2012, consisted of the following:

| (in millions)             | Pension          | Post-retirement | Post-employment | Total            |
|---------------------------|------------------|-----------------|-----------------|------------------|
| Net losses                | <b>\$(3,199)</b> | <b>\$(82)</b>   | <b>\$(612)</b>  | <b>\$(3,893)</b> |
| Prior service cost        | <b>(60)</b>      | 7               | —               | <b>(53)</b>      |
| Net transition obligation | <b>(7)</b>       | —               | —               | <b>(7)</b>       |
| Deferred income taxes     | <b>377</b>       | 26              | 185             | <b>588</b>       |
| Losses to be amortized    | <b>\$(2,889)</b> | <b>\$(49)</b>   | <b>\$(427)</b>  | <b>\$(3,365)</b> |

The amounts recorded in accumulated other comprehensive losses at December 31, 2011, consisted of the following:

| (in millions)             | Pension   | Post-retirement | Post-employment | Total     |
|---------------------------|-----------|-----------------|-----------------|-----------|
| Net losses                | \$(2,401) | \$(54)          | \$(536)         | \$(2,991) |
| Prior service cost        | (70)      | 3               | —               | (67)      |
| Net transition obligation | (8)       | —               | —               | (8)       |
| Deferred income taxes     | 299       | 19              | 163             | 481       |
| Losses to be amortized    | \$(2,180) | \$(32)          | \$(373)         | \$(2,585) |

The movements in other comprehensive earnings (losses) during the year ended December 31, 2013, 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  | \$ 216  | \$ 5            | \$ 60           | \$ 281  |
| Prior service cost  | 10      | —               | —               | 10      |
| Net transition obligation   | —       | —               | —               | —       |
| Other income/expense:   |         |                 |                 |         |
| Net losses  | 1       | —               | —               | 1       |
| Deferred income taxes   | (29)    | (2)             | (18)            | (49)    |
|   | 198     | 3               | 42              | 243     |
| Other movements during the year:  |         |                 |                 |         |
| Net losses  | 1,236   | 30              | (109)           | 1,157   |
| Prior service cost  | (1)     | —               | —               | (1)     |
| Net transition obligation   | 1       | —               | —               | 1       |
| Deferred income taxes   | (103)   | (10)            | 32              | (81)    |
|   | 1,133   | 20              | (77)            | 1,076   |
| Total movements in other comprehensive earnings (losses)                    | \$1,331 | \$ 23           | \$ (35)         | \$1,319 |

The movements in other comprehensive earnings (losses) during the year ended December 31, 2012, 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  | \$ 129  | \$ 3            | \$ 53           | \$ 185   |
| Prior service cost  | 10      | —               | —               | 10       |
| Net transition obligation   | 1       | —               | —               | 1        |
| Other income/expense:   |         |                 |                 |          |
| Net losses  | 4       | —               | —               | 4        |
| Deferred income taxes   | (20)    | (1)             | (16)            | (37)     |
|   | 124     | 2               | 37              | 163      |
| Other movements during the year:  |         |                 |                 |          |
| Net losses  | (931)   | (31)            | (129)           | (1,091)  |
| Prior service cost  | —       | 4               | —               | 4        |
| Deferred income taxes   | 98      | 8               | 38              | 144      |
|   | (833)   | (19)            | (91)            | (943)    |
| Total movements in other comprehensive losses                               | \$(709) | \$(17)          | \$ (54)         | \$ (780) |

  

| (in millions)   | Pension  | Post-retirement | Post-employment | Total    |
|---|----------|-----------------|-----------------|----------|
| Amounts transferred to earnings as components of net periodic benefit cost: |          |                 |                 |          |
| Amortization:   |          |                 |                 |          |
| Net losses  | \$ 63    | \$ 3            | \$ 39           | \$ 105   |
| Prior service cost  | 9        | (1)             | —               | 8        |
| Net transition obligation   | 1        | —               | —               | 1        |
| Other income/expense:   |          |                 |                 |          |
| Net losses  | 3        | —               | —               | 3        |
| Deferred income taxes   | (10)     | (1)             | (12)            | (23)     |
|   | 66       | 1               | 27              | 94       |
| Other movements during the year:  |          |                 |                 |          |
| Net losses  | (1,042)  | (11)            | (107)           | (1,160)  |
| Prior service cost  | (17)     | —               | —               | (17)     |
| Deferred income taxes   | 110      | 5               | 33              | 148      |
|   | (949)    | (6)             | (74)            | (1,029)  |
| Total movements in other comprehensive losses                               | \$ (883) | \$ (5)          | \$ (47)         | \$ (935) |

**Note 14.****Additional Information:**

| (in millions)                    | For the Years Ended December 31, |         |        |
|----------------------------------|----------------------------------|---------|--------|
|                                  | 2013                             | 2012    | 2011   |
| Research and development expense | \$ 449                           | \$ 415  | \$ 413 |
| Advertising expense              | \$ 435                           | \$ 483  | \$ 464 |
| Interest expense                 | \$1,104                          | \$1,007 | \$ 934 |
| Interest income                  | (131)                            | (148)   | (134)  |
| Interest expense, net            | \$ 973                           | \$ 859  | \$ 800 |
| Rent expense                     | \$ 334                           | \$ 318  | \$ 308 |

Minimum rental commitments under non-cancelable operating leases in effect at December 31, 2013, were as follows:

| (in millions) |       |
|---------------|-------|
| 2014          | \$218 |
| 2015          | 160   |
| 2016          | 124   |
| 2017          | 81    |
| 2018          | 52    |
| Thereafter    | 211   |
|               | \$846 |

**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 rates by creating offsetting exposures. PMI is not a party to leveraged derivatives and, by policy, does not use derivative financial instru-

ments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. PMI formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss would be recognized in earnings. PMI reports its net transaction gains or losses in marketing, administration and research costs on the consolidated statements of earnings.

PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange contracts, to mitigate its exposure to changes in exchange and interest rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which PMI is exposed include the Australian dollar, Euro, Indonesian rupiah, Japanese yen, Mexican peso, Russian ruble, Swiss franc and Turkish lira. At December 31, 2013 and 2012, PMI had contracts with aggregate notional amounts of \$16.8 billion and \$13.7 billion, respectively. Of the \$16.8 billion aggregate notional amount at December 31, 2013, \$2.3 billion related to cash flow hedges, \$3.3 billion related to hedges of net investments in foreign operations and \$11.2 billion related to other derivatives that primarily offset currency exposures on intercompany financing. Of the \$13.7 billion aggregate notional amount at December 31, 2012, \$2.7 billion related to cash flow hedges, \$1.1 billion related to hedges of net investments in foreign operations and \$9.9 billion related to other derivatives that primarily offset currency exposures on intercompany financing.

The fair value of PMI's foreign exchange contracts included in the consolidated balance sheet as of December 31, 2013 and 2012, were as follows:

| (in millions)  | Asset Derivatives            |            |       | Liability Derivatives        |            |      |
|--|------------------------------|------------|-------|------------------------------|------------|------|
|  | Balance Sheet Classification | Fair Value |       | Balance Sheet Classification | Fair Value |      |
|  |                              | 2013       | 2012  |                              | 2013       | 2012 |
| Foreign exchange contracts designated as hedging instruments     | Other current assets         | \$111      | \$146 | Other accrued liabilities    | \$ 44      | \$ 8 |
|  | Other assets                 | —          | —     | Other liabilities            | 46         | —    |
| Foreign exchange contracts not designated as hedging instruments | Other current assets         | 42         | 14    | Other accrued liabilities    | 12         | 47   |
|  |                              |            |       | Other liabilities            | 14         | —    |
| Total derivatives  |                              | \$153      | \$160 |                              | \$116      | \$55 |

Hedging activities, which represent movement in derivatives as well as the respective underlying transactions, had the following effect on PMI's consolidated statements of earnings and other comprehensive earnings:

| (in millions)                                | For the Year Ended December 31, 2013 |                       |                   |              |         |
|--|--------------------------------------|-----------------------|-------------------|--------------|---------|
|  | Cash Flow Hedges                     | Net Investment Hedges | Other Derivatives | Income Taxes | Total   |
| Gain (Loss)                                  |                                      |                       |                   |              |         |
| Statement of Earnings:                       |                                      |                       |                   |              |         |
| Net revenues                                 | \$ 319                               |                       | \$ —              |              | \$ 319  |
| Cost of sales                                | 6                                    |                       | —                 |              | 6       |
| Marketing, administration and research costs | —                                    |                       | 1                 |              | 1       |
| Operating income                             | 325                                  |                       | 1                 |              | 326     |
| Interest expense, net                        | (56)                                 |                       | 3                 |              | (53)    |
| Earnings before income taxes                 | 269                                  |                       | 4                 |              | 273     |
| Provision for income taxes                   | (34)                                 |                       | 2                 |              | (32)    |
| Net earnings attributable to PMI             | \$ 235                               |                       | \$ 6              |              | \$ 241  |
| Other Comprehensive Earnings/(Losses):       |                                      |                       |                   |              |         |
| Gains transferred to earnings                | \$(269)                              |                       |                   | \$ 34        | \$(235) |
| Recognized gains                             | 236                                  |                       |                   | (30)         | 206     |
| Net impact on equity                         | \$ (33)                              |                       |                   | \$ 4         | \$ (29) |
| Currency translation adjustments             |                                      | \$(79)                |                   | \$ 27        | \$ (52) |

| (in millions)                                | For the Year Ended December 31, 2012 |                       |                   |              |         |
|--|--------------------------------------|-----------------------|-------------------|--------------|---------|
|  | Cash Flow Hedges                     | Net Investment Hedges | Other Derivatives | Income Taxes | Total   |
| Gain (Loss)                                  |                                      |                       |                   |              |         |
| Statement of Earnings:                       |                                      |                       |                   |              |         |
| Net revenues                                 | \$ 66                                |                       | \$ —              |              | \$ 66   |
| Cost of sales                                | 19                                   |                       | —                 |              | 19      |
| Marketing, administration and research costs | —                                    |                       | —                 |              | —       |
| Operating income                             | 85                                   |                       | —                 |              | 85      |
| Interest expense, net                        | (60)                                 |                       | 14                |              | (46)    |
| Earnings before income taxes                 | 25                                   |                       | 14                |              | 39      |
| Provision for income taxes                   | (3)                                  |                       | 1                 |              | (2)     |
| Net earnings attributable to PMI             | \$ 22                                |                       | \$15              |              | \$ 37   |
| Other Comprehensive Earnings/(Losses):       |                                      |                       |                   |              |         |
| Gains transferred to earnings                | \$ (25)                              |                       |                   | \$ 3         | \$ (22) |
| Recognized gains                             | 113                                  |                       |                   | (14)         | 99      |
| Net impact on equity                         | \$ 88                                |                       |                   | \$(11)       | \$ 77   |
| Currency translation adjustments             |                                      | \$(19)                |                   | \$ 5         | \$ (14) |

| (in millions)                                | For the Year Ended December 31, 2011 |                       |                   |              |        |
|--|--------------------------------------|-----------------------|-------------------|--------------|--------|
|  | Cash Flow Hedges                     | Net Investment Hedges | Other Derivatives | Income Taxes | Total  |
| Gain (Loss)                                  |                                      |                       |                   |              |        |
| Statement of Earnings:                       |                                      |                       |                   |              |        |
| Net revenues                                 | \$(17)                               |                       | \$ —              |              | \$(17) |
| Cost of sales                                | 34                                   |                       | —                 |              | 34     |
| Marketing, administration and research costs | —                                    |                       | —                 |              | —      |
| Operating income                             | 17                                   |                       | —                 |              | 17     |
| Interest expense, net                        | (37)                                 |                       | 56                |              | 19     |
| Earnings before income taxes                 | (20)                                 |                       | 56                |              | 36     |
| Provision for income taxes                   | 2                                    |                       | (13)              |              | (11)   |
| Net earnings attributable to PMI             | \$(18)                               |                       | \$ 43             |              | \$25   |
| Other Comprehensive Earnings/(Losses):       |                                      |                       |                   |              |        |
| Losses transferred to earnings               | \$ 20                                |                       |                   | \$(2)        | \$18   |
| Recognized losses                            | (4)                                  |                       |                   | (1)          | (5)    |
| Net impact on equity                         | \$ 16                                |                       |                   | \$(3)        | \$13   |
| Currency translation adjustments             |                                      | \$ 2                  |                   | \$—          | \$ 2   |

Each type of hedging activity is described in greater detail below.

● **Cash Flow Hedges:** PMI has entered into foreign exchange contracts to hedge foreign currency exchange risk related to certain forecasted transactions. The effective portion of gains and losses associated with qualifying cash flow hedge contracts is deferred as a component of accumulated other comprehensive losses until the underlying hedged transactions are reported in PMI's consolidated statements of earnings. During the years ended December 31, 2013, 2012

and 2011, ineffectiveness related to cash flow hedges was not material. As of December 31, 2013, PMI has hedged forecasted transactions for periods not exceeding the next twelve months. The impact of these hedges is included in operating cash flows on PMI's consolidated statement of cash flows.

For the years ended December 31, 2013, 2012 and 2011, foreign exchange contracts that were designated as cash flow hedging instruments impacted the consolidated statements of earnings and comprehensive earnings as follows:

| (pre-tax, in millions)                        |   | For the Years Ended December 31,  |       |        |  |       |       |
|---|---|---|-------|--------|--|-------|-------|
| Derivatives in Cash Flow Hedging Relationship | 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 |       |        | Amount of Gain/(Loss) Recognized in Other Comprehensive Earnings/(Losses) on Derivatives |       |       |
|   |   | 2013  | 2012  | 2011   | 2013   | 2012  | 2011  |
| Foreign exchange contracts                    |   |   |       |        | \$236  | \$113 | \$(4) |
|   | Net revenues  | \$319   | \$ 66 | \$(17) |  |       |       |
|   | Cost of sales   | 6   | 19    | 34     |  |       |       |
|   | Interest expense, net   | (56)  | (60)  | (37)   |  |       |       |
| Total   |   | \$269   | \$ 25 | \$(20) | \$236  | \$113 | \$(4) |

● **Hedges of Net Investments in Foreign Operations:** PMI designates certain foreign currency denominated debt and foreign exchange contracts as net investment hedges of its foreign operations. For the years ended December 31, 2013, 2012 and 2011, these hedges of net investments resulted in losses, net of income taxes, of \$285 million, \$95 million and \$37 million, respectively. These losses were reported as a

component of accumulated other comprehensive losses within currency translation adjustments. For the years ended December 31, 2013, 2012 and 2011, ineffectiveness related to net investment hedges was not material. Other investing cash flows on PMI's consolidated statements of cash flows include the premiums paid for and settlements of net investment hedges.



For the years ended December 31, 2013, 2012 and 2011, foreign exchange contracts that were designated as net investment hedging instruments impacted the consolidated statements of earnings and comprehensive earnings as follows:

| (pre-tax, in millions)     | For the Years Ended December 31,   |   |      |      |  |            |
|----------------------------|--|---|------|------|--|------------|
|                            | Statement of Earnings<br>Classification of Gain/(Loss)<br>Reclassified from Other<br>Comprehensive Earnings/<br>(Losses) into Earnings | Amount of Gain/(Loss)<br>Reclassified from Other<br>Comprehensive Earnings/<br>(Losses) into Earnings |      |      | Amount of Gain/(Loss)<br>Recognized in Other<br>Comprehensive Earnings/<br>(Losses) on Derivatives |            |
|                            |  | Derivatives in Net Investment<br>Hedging Relationship   |      |      |  |            |
|                            |  | 2013  | 2012 | 2011 | 2013   | 2012 2011  |
| Foreign exchange contracts |  |   |      |      | <b>\$(79)</b>  | \$(19) \$2 |
|                            | Interest expense, net  | \$—   | \$—  | \$—  |  |            |

● **Other Derivatives:** PMI has entered into foreign exchange contracts to hedge the foreign currency exchange and interest rate risks related to intercompany loans between certain subsidiaries, and third-party loans. While effective as economic hedges, no hedge accounting is applied for these contracts; therefore, the unrealized gains (losses) relating to these contracts are reported in PMI's consolidated statement of earnings. For the years ended December 31, 2013, 2012

and 2011, the gains from contracts for which PMI did not apply hedge accounting were \$99 million, \$102 million and \$34 million, respectively. The gains from these contracts substantially offset the losses generated by the underlying intercompany and third-party loans being hedged.

As a result, for the years ended December 31, 2013, 2012 and 2011, these items impacted the consolidated statement of earnings as follows:

| (pre-tax, in millions)                               |  | For the Years Ended December 31,                |      |      |
|--|--|---|------|------|
| Derivatives not Designated<br>as Hedging Instruments | Statement of Earnings<br>Classification of Gain/(Loss) | Amount of Gain/(Loss)<br>Recognized in Earnings |      |      |
|  |  | 2013  | 2012 | 2011 |
| Foreign exchange contracts                           | Marketing,<br>administration and<br>research costs     | <b>\$1</b>                                      | \$ — | \$ — |
|  | Interest expense, net                                  | <b>3</b>  | 14   | 56   |
| Total  |  | <b>\$4</b>                                      | \$14 | \$56 |

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

| (in millions)                                     | For the Years Ended December 31, |       |      |
|---|----------------------------------|-------|------|
|   | 2013                             | 2012  | 2011 |
| Gain as of January 1,                             | <b>\$ 92</b>                     | \$ 15 | \$ 2 |
| Derivative (gains)/losses transferred to earnings | <b>(235)</b>                     | (22)  | 18   |
| Change in fair value                              | <b>206</b>                       | 99    | (5)  |
| Gain as of December 31,                           | <b>\$ 63</b>                     | \$ 92 | \$15 |

At December 31, 2013, PMI expects \$68 million of derivative gains that are included in accumulated other comprehensive losses to be reclassified to the consolidated statement of earnings within the next twelve months. These gains are expected to be substantially offset by the statement of earnings impact of the respective hedged transactions.

● **Contingent Features:** PMI's derivative instruments do not contain contingent features.

● **Credit Exposure and Credit Risk:** PMI is exposed to credit loss in the event of non-performance by counterparties. While PMI does not anticipate non-performance, its risk is limited to the fair value of the financial instruments less any cash collateral received or pledged. PMI actively monitors 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 22. *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.

PMI's policy is to reflect transfers between hierarchy levels at the end of the reporting period.

#### ● Derivative Financial Instruments—Foreign

**Exchange Contracts:** PMI assesses the fair value of its derivative financial instruments, which consist of deliverable and non-deliverable foreign exchange forward contracts, foreign currency swaps and foreign currency options, using internally developed 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, 2013 and 2012. 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, 2013 and 2012. 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, 2013 and 2012. 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 \$17 million of capital lease obligations, was \$25,261 million at December 31, 2013. The aggregate carrying value of PMI's debt, excluding short-term borrowings and \$37 million of capital lease obligations, was \$20,383 million at December 31, 2012. The fair value of PMI's outstanding debt, excluding the aforementioned short-term borrowings and capital lease obligations, has been classified within Level 1 and Level 2 at December 31, 2013 and 2012.

The aggregate fair values of PMI's derivative financial instruments, pension plan assets and debt as of December 31, 2013 and 2012, were as follows:

| (in millions)              | Fair Value<br>at<br>December 31,<br>2013 | Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|----------------------------|--|--|---|--|
| Assets:                    |  |  |   |  |
| Foreign exchange contracts | \$ 153                                   | \$ —   | \$ 153  | \$—  |
| Pension plan assets        | 6,871                                    | 5,164  | 1,707   | —  |
| Total assets               | \$ 7,024                                 | \$ 5,164   | \$1,860   | \$—  |

|                            |          |          |        |     |
|----------------------------|----------|----------|--------|-----|
| Liabilities:               |          |          |        |     |
| Debt                       | \$26,141 | \$25,961 | \$ 180 | \$— |
| Foreign exchange contracts | 116      | —        | 116    | —   |
| Total liabilities          | \$26,257 | \$25,961 | \$ 296 | \$— |

| (in millions)                      | Fair Value<br>at<br>December 31,<br>2012 | Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets/<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------------------------|--|--|---|--|
| Assets:                            |  |  |   |  |
| Foreign exchange contracts         | \$ 160                                   | \$ —   | \$ 160  | \$—  |
| Pension plan assets <sup>(a)</sup> | 5,911                                    | 4,419  | 1,492   | —  |
| Total assets                       | \$ 6,071                                 | \$ 4,419   | \$1,652   | \$—  |

|                            |          |          |        |     |
|----------------------------|----------|----------|--------|-----|
| Liabilities:               |          |          |        |     |
| Debt                       | \$22,719 | \$22,316 | \$ 403 | \$— |
| Foreign exchange contracts | 55       | —        | 55     | —   |
| Total liabilities          | \$22,774 | \$22,316 | \$ 458 | \$— |

(a) Mutual funds in the amount of \$1,363 million were transferred from Level 2 to Level 1 because they are actively traded on a daily basis.

---

**Note 17.****Accumulated Other Comprehensive Losses:**

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

| (Losses) Earnings<br>(in millions)           | At December 31,  |           |           |
|--|------------------|-----------|-----------|
|  | 2013             | 2012      | 2011      |
| Currency translation adjustments             | <b>\$(2,207)</b> | \$ (331)  | \$ (293)  |
| Pension and other benefits                   | <b>(2,046)</b>   | (3,365)   | (2,585)   |
| Derivatives accounted for as hedges          | <b>63</b>        | 92        | 15        |
| Total accumulated other comprehensive losses | <b>\$(4,190)</b> | \$(3,604) | \$(2,863) |

**Reclassifications from Other Comprehensive Earnings**

The movements in accumulated other comprehensive losses and the related tax impact, for each of the components above, that is 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, 2013, 2012 and 2011. The movement in currency translation adjustments for the year ended December 31, 2013, was also impacted by the purchase of the remaining shares of the Mexican tobacco business. In addition, \$12 million of net currency translation adjustment gains were transferred from other comprehensive earnings to marketing, administration and research costs in the consolidated statements of earnings for the year ended December 31, 2013 upon liquidation of a subsidiary. 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.****Colombian Investment and Cooperation Agreement:**

On June 19, 2009, PMI announced that it had signed an agreement with the Republic of Colombia, together with the Departments of Colombia and the Capital District of Bogota, to promote investment and cooperation with respect to the Colombian tobacco market and to fight counterfeit and contraband tobacco products. The Investment and Cooperation Agreement provides \$200 million in funding to the Colombian governments over a 20-year period to address issues of mutual interest, such as combating the illegal cigarette trade, including the threat of counterfeit tobacco products, and increasing the quality and quantity of locally grown tobacco. As a result of the Investment and Cooperation Agreement, PMI recorded a pre-tax charge of \$135 million in the operating results of the Latin America & Canada segment during the second quarter of 2009.

At December 31, 2013 and 2012, PMI had \$74 million and \$77 million, respectively, of discounted liabilities associated with the Colombian Investment and Cooperation Agreement. These discounted liabilities are primarily reflected in other long-term liabilities on the consolidated balance sheets and are expected to be paid through 2028.

---

**Note 19.****RBH Legal Settlement:**

On July 31, 2008, Rothmans Inc. ("Rothmans") announced the finalization of a CAD 550 million settlement (or approximately \$540 million, based on the prevailing exchange rate at that time) between itself and Rothmans, Benson & Hedges Inc. ("RBH"), on the one hand, and the Government of Canada and all 10 provinces, on the other hand. The settlement resolves the Royal Canadian Mounted Police's investigation relating to products exported from Canada by RBH during the 1989–1996 period. Rothmans' sole holding was a 60% interest in RBH. The remaining 40% interest in RBH was owned by PMI.

Subsequent to the finalization of the settlement, PMI announced that it had entered into an agreement with Rothmans to purchase, by way of a tender offer, all of the outstanding common shares of Rothmans. In October 2008, PMI completed the acquisition of all of Rothmans shares.

At December 31, 2013 and 2012, PMI had \$152 million and \$190 million, respectively, of discounted accrued settlement charges associated with the RBH legal settlement. These accrued settlement charges are primarily reflected in other long-term liabilities on the consolidated balance sheets and are expected to be paid through 2019.

---

**Note 20.****E.C. Agreement:**

In 2004, PMI entered into an agreement with the European Commission ("E.C.") and 10 Member States of the European Union that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. This agreement has been signed by all 27 Member States. The agreement resolves all disputes between the parties relating to these issues. Under the terms of the agreement, PMI will make 13 payments over 12 years, including an initial payment of \$250 million, which was recorded as a pre-tax charge against its earnings in 2004. The agreement calls for additional payments of approximately \$150 million on the first anniversary of the agreement (this payment was made in July 2005), approximately \$100 million on the second anniversary (this payment was made in July 2006) and approximately \$75 million each year thereafter for 10 years, each of which is to be adjusted based on certain variables, including PMI's market share in the European Union in the year preceding payment. Because future additional payments are subject to these variables, PMI records charges for them as an expense in cost of sales when product is shipped. In addition, PMI is also responsible to pay the excise taxes, VAT and customs duties on qualifying product seizures of up

to 90 million cigarettes and is subject to payments of five times the applicable taxes and duties if qualifying product seizures exceed 90 million cigarettes in a given year. To date, PMI's annual payments related to product seizures have been immaterial. Total charges related to the E.C. Agreement of \$81 million, \$78 million and \$86 million were recorded in cost of sales in 2013, 2012 and 2011, respectively.

## Note 21.

### 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 and PMI, PMI will indemnify Altria and PM USA 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, if any. All such cases are, and will continue to be, vigorously defended. However, we and our subsidiaries may enter into settlement discussions in particular cases if we believe it is in our best interests to do so.

To date, we have paid only one judgment in a tobacco-related case. That judgment, including costs, was approximately €1,400 (approximately \$1,900), and that payment was made in order to appeal an Italian small claims case, which was subsequently reversed on appeal. To date, no tobacco-related case has been finally resolved in favor of a plaintiff against us, our subsidiaries or indemnitees.

The table below lists the number of tobacco-related cases pending against us and/or our subsidiaries or indemnitees as of December 31, 2013, December 31, 2012 and December 31, 2011:

| Type of Case                        | Number of Cases Pending as of December 31, 2013 | Number of Cases Pending as of December 31, 2012 | Number of Cases Pending as of December 31, 2011 |
|-------------------------------------|---|---|---|
| Individual Smoking and Health Cases | 62  | 76  | 75  |
| Smoking and Health Class Actions    | 11  | 11  | 10  |
| Health Care Cost Recovery Actions   | 15  | 15  | 11  |
| Lights Class Actions                | 1   | 2   | 2   |
| Individual Lights Cases             | 2   | 7   | 9   |
| Public Civil Actions                | 3   | 4   | 3   |

Since 1995, when the first tobacco-related litigation was filed against a PMI entity, 416 Smoking and Health, Lights, Health Care Cost Recovery, and Public Civil Actions in which we and/or one of our subsidiaries and/or indemnitees were a defendant have been terminated in our favor. Ten cases have had decisions in favor of plaintiffs. Eight of these cases have subsequently reached final resolution in our favor and two remain on appeal.

The table below lists the verdicts and post-trial developments in the following cases where verdicts were returned in favor of plaintiffs:

| Date           | Location of Court/Name of Plaintiff                  | Type of Case                  | Verdict  | Post-Trial Developments   |
|----------------|--|-------------------------------|--|---|
| September 2009 | Brazil/ <i>Bernhardt</i>                             | Individual Smoking and Health | The Civil Court of Rio de Janeiro found for plaintiff and ordered Philip Morris Brasil to pay R\$13,000 (approximately \$5,500) in "moral damages."  | Philip Morris Brasil filed its appeal against the decision on the merits with the Court of Appeals in November 2009. In February 2010, without addressing the merits, the Court of Appeals annulled the trial court's decision and remanded the case to the trial court to issue a new ruling, which was required to address certain compensatory damage claims made by the plaintiff that the trial court did not address in its original ruling. In July 2010, the trial court reinstated its original decision, while specifically rejecting the compensatory damages claim. Philip Morris Brasil appealed this decision. In March 2011, the Court of Appeals affirmed the trial court's decision and denied Philip Morris Brasil's appeal. The Court of Appeals increased the amount of damages awarded to the plaintiff to R\$100,000 (approximately \$42,300). Philip Morris Brasil has appealed this decision. |
| February 2004  | Brazil/ <i>The Smoker Health Defense Association</i> | Class Action                  | The Civil Court of São Paulo found defendants liable without hearing evidence. The court did not assess moral or actual damages, which were to be assessed in a second phase of the case. The size of the class was not defined in the ruling. | In April 2004, the court clarified its ruling, awarding "moral damages" of R\$1,000 (approximately \$420) per smoker per full year of smoking plus interest at the rate of 1% per month, as of the date of the ruling. The court did not award actual damages, which were to be assessed in the second phase of the case. The size of the class was not estimated. Defendants appealed to the São Paulo Court of Appeals, which annulled the ruling in November 2008, finding that the trial court had inappropriately ruled without hearing evidence and returned the case to the trial court for further proceedings. In May 2011, the trial court dismissed the claim. Plaintiff has appealed. In addition, the defendants filed a constitutional appeal to the Federal Supreme Tribunal on the basis that the plaintiff did not have standing to bring the lawsuit. This appeal is still pending.                 |



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

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

As of December 31, 2013, there were a number of smoking and health cases pending against us, our subsidiaries or indemnitees, as follows:

- 62 cases brought by individual plaintiffs in Argentina (24), Brazil (24), Canada (2), Chile (4), Costa Rica (2), Greece (1), Italy (3), the Philippines (1) and Scotland (1), compared with 76 such cases on December 31, 2012, and 75 cases on December 31, 2011; and
- 11 cases brought on behalf of classes of individual plaintiffs in Brazil (2) and Canada (9), compared with 11 such cases on December 31, 2012 and 10 such cases on December 31, 2011.

In the first class action pending in Brazil, *The Smoker Health Defense Association (ADESF) v. Souza Cruz, S.A. and Philip Morris Marketing, S.A.*, Nineteenth Lower Civil Court of the Central Courts of the Judiciary District of São Paulo, Brazil, filed July 25, 1995, our subsidiary and another member of the industry are defendants. The plaintiff, a consumer organization, is seeking damages for smokers and former smokers and injunctive relief. The verdict and post-trial developments in this case are described in the above table.

In the second class action pending in Brazil, *Public Prosecutor of São Paulo v. Philip Morris Brasil Industria e Comercio Ltda.*, Civil Court of the City of São Paulo, Brazil, filed August 6, 2007, our subsidiary is a defendant. The plaintiff, the Public Prosecutor of the State of São Paulo, is seeking (i) damages on behalf of all smokers nationwide, former smokers, and their relatives; (ii) damages on behalf of people exposed to environmental tobacco smoke ("ETS") nationwide, and their relatives; and (iii) reimbursement of the health care costs allegedly incurred for the treatment of tobacco-related diseases by all Brazilian States and Municipalities, and the Federal District. In an interim ruling issued in December 2007, the trial court limited the scope of this claim to the State of São Paulo only. In December 2008, the Seventh Civil Court of São Paulo issued a decision declaring that it lacked jurisdiction because the case involved issues similar to the ADESF case discussed above and should be transferred to the Nineteenth Lower Civil Court in São Paulo where the ADESF case is pending. The court further stated that these cases should be consolidated for the purposes of judgment. In April 2010, the São Paulo Court of Appeals reversed the

Seventh Civil Court's decision that consolidated the cases, finding that they are based on different legal claims and are progressing at different stages of proceedings. This case was returned to the Seventh Civil Court of São Paulo, and our subsidiary filed its closing arguments in December 2010. In March 2012, the trial court dismissed the case on the merits. In January 2014, the São Paulo Court of Appeals rejected plaintiff's appeal and affirmed the trial court decision.

In the first class action pending in Canada, *Cecilia Letourneau v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in September 1998, our subsidiary and other Canadian manufacturers are defendants. The plaintiff, an individual smoker, is seeking compensatory and punitive damages for each member of the class who is deemed addicted to smoking. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began on March 12, 2012. At the present pace, trial is expected to conclude in 2014, with a judgment to follow at an indeterminate point after the conclusion of the trial proceedings.

In the second class action pending in Canada, *Conseil Québécois Sur Le Tabac Et La Santé and Jean-Yves Blais v. Imperial Tobacco Ltd., Rothmans, Benson & Hedges Inc. and JTI Macdonald Corp.*, Quebec Superior Court, Canada, filed in November 1998, our subsidiary and other Canadian manufacturers are defendants. The plaintiffs, an anti-smoking organization and an individual smoker, are seeking compensatory and punitive damages for each member of the class who allegedly suffers from certain smoking-related diseases. The class was certified in 2005. In February 2011, the trial court ruled that the federal government would remain as a third party in the case. In November 2012, the Court of Appeals dismissed defendants' third-party claims against the federal government. Trial began on March 12, 2012. At the present pace, trial is expected to conclude in 2014, with a judgment to follow at an indeterminate point after the conclusion of the trial proceedings.

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 Group, Inc.), 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 Group, Inc.), 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 Group, Inc.), 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 Group, Inc.), 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 Group, Inc.), 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. Defendants have filed jurisdictional challenges on the

grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of *Adams*, above).

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 Group, Inc.), 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. Defendants have filed jurisdictional challenges on the grounds that this action should not proceed during the pendency of the Saskatchewan class action (see description of *Adams*, above).

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 Group, Inc.), 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 December 31, 2013, there were 15 health care cost recovery cases pending against us, our subsidiaries or indemnitees in Canada (9), Nigeria (5) and Spain (1), compared with 15 such cases on December 31, 2012 and 11 such cases on December 31, 2011.

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 Group, Inc.), 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 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 Group, Inc.), and other members of the industry are defendants. The claim was filed by the government of the province of Ontario based on legislation enacted in the province. This legislation is similar to the laws introduced in British Columbia and New Brunswick that authorize the government to file a direct action against cigarette manufacturers to recover the health care costs it has incurred, and will incur, as a result of a "tobacco related wrong." Preliminary motions are pending.

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

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

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 Group, Inc.), 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." We, our subsidiaries and our indemnitees have all been served with the statement of claim.

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 Group, Inc.), 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." Preliminary motions are pending.

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 Group, Inc.), 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." Preliminary motions are pending.

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 Group, Inc.), 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." Preliminary motions are pending.

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. We currently have no employees, operations or assets in Nigeria.

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 a series of proceedings in Spain, *Junta de Andalucia, et al. v. Philip Morris Spain, et al., Court of First Instance, Madrid, Spain*, the first of which was filed February 21, 2002, our subsidiary and other members of the industry were defendants. The plaintiffs sought reimbursement for the cost of treating certain of their citizens for various alleged smoking-related illnesses. In May 2004, the first instance court dismissed the initial case, finding that the State was a necessary party to the claim, and thus, the claim must be filed in the Administrative Court. In September 2007, the plaintiffs filed their complaint in the Administrative Court, which dismissed the claim based on a procedural issue in November 2007. In November 2009, the Supreme Court rejected plaintiffs' appeal, resulting in the final dismissal of the claim. However, plaintiffs have filed a second claim in the Administrative Court against the Ministry of Economy. This second claim seeks the same relief as the original claim, but relies on a different procedural posture. In December 2013, the Administrative Court rejected plaintiffs' reimbursement claim. Plaintiffs may appeal.

● **Lights Cases:** These cases, brought by individual plaintiffs, or on behalf of a class of individual plaintiffs, allege that the use of the term "lights" constitutes fraudulent and misleading conduct. Plaintiffs' allegations of liability in these cases are based on various theories of recovery including misrepresentation, deception, and breach of consumer protection laws. Plaintiffs seek various forms of relief including restitution, injunctive relief, and compensatory and other damages. Defenses raised include lack of causation, lack of reliance, assumption of the risk, and statute of limitations.

As of December 31, 2013, the following lights cases were pending against our subsidiaries or indemnitees:

- 1 case brought on behalf of individual plaintiffs in Israel, compared with 2 such cases on December 31, 2012 and December 31, 2011, respectively; and
- 2 cases brought by individual plaintiffs in Chile (1) and Italy (1), compared with 7 such cases on December 31, 2012, and 9 such cases on December 31, 2011.

In the class action pending in Israel, *El-Roy, et al. v. Philip Morris Incorporated, et al., District Court of Tel-Aviv/Jaffa, Israel*, filed January 18, 2004, our subsidiary and our indemnitees (PM USA and our former importer) are defendants. The plaintiffs filed a purported class action claiming that the class members were misled by the descriptor "lights" into believing that lights cigarettes are safer than full flavor cigarettes. The claim seeks recovery of the purchase price of lights cigarettes and compensation for distress for

each class member. Hearings took place in November and December 2008 regarding whether the case meets the legal requirements necessary to allow it to proceed as a class action. The parties' briefing on class certification was completed in March 2011. In November 2012, the court denied class certification and dismissed the individual claims. Plaintiffs have appealed and an oral hearing has been scheduled for September 2014.

● **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 December 31, 2013, there were 3 public civil actions pending against our subsidiaries in Argentina (1), Brazil (1), and Venezuela (1), compared with 4 such cases on December 31, 2012, and 3 such cases on December 31, 2011.

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

In the public civil action in Brazil, *The Brazilian Association for the Defense of Consumer Health ("SAUDECON") v. Philip Morris Brasil Industria e Comercio Ltda. and Souza Cruz S.A.*, Civil Court of City of Porto Alegre, Brazil, filed November 3, 2008, our subsidiary is a defendant. The plaintiff, a consumer organization, is asking the court to establish a fund that will be used to provide treatment to smokers who claim to be addicted and who do not otherwise have access to smoking cessation treatment. Plaintiff requests that each defendant's liability be determined according to its market share. In May 2009, the trial court dismissed the case on the merits. In December 2013, the court of appeals affirmed the trial court's dismissal of the case. Plaintiff may appeal further.

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

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

---

## Note 22.

### Balance Sheet Offsetting:

● **Foreign Exchange Contracts:** PMI uses deliverable and non-deliverable forward foreign exchange contracts, foreign currency swaps and foreign currency options, collectively referred to as foreign exchange 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 foreign exchange contracts 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 foreign exchange contract assets and liabilities on PMI's consolidated balance sheets were as follows:

| (in millions)              | Gross<br>Amounts<br>Recognized | Gross Amount<br>Offset in the<br>Consolidated<br>Balance Sheet | Net Amounts<br>Presented in the<br>Consolidated<br>Balance Sheet | Gross Amounts Not Offset<br>in the Consolidated<br>Balance Sheet |   | Net Amount |
|----------------------------|--------------------------------|--|--|--|---|------------|
|                            |                                |  |  | Financial<br>Instruments   | Cash Collateral<br>Received/<br>Pledged |            |
| At December 31, 2013       |                                |  |  |  |   |            |
| Assets                     |                                |  |  |  |   |            |
| Foreign exchange contracts | \$153                          | \$—  | \$153  | \$(52)   | \$(79)                                  | \$ 22      |
| Liabilities                |                                |  |  |  |   |            |
| Foreign exchange contracts | \$116                          | \$—  | \$116  | \$(52)   | \$(47)                                  | \$ 17      |
| At December 31, 2012       |                                |  |  |  |   |            |
| Assets                     |                                |  |  |  |   |            |
| Foreign exchange contracts | \$160                          | \$—  | \$160  | \$(24)   | \$ —                                    | \$136      |
| Liabilities                |                                |  |  |  |   |            |
| Foreign exchange contracts | \$ 55                          | \$—  | \$ 55  | \$(24)   | \$ —                                    | \$ 31      |

### Note 23.

#### Redeemable Noncontrolling Interest:

On February 25, 2010, PMI's affiliate, Philip Morris Philippines Manufacturing Inc. ("PMPMI"), and Fortune Tobacco Corporation ("FTC") combined their respective business activities by transferring selected assets and liabilities of PMPMI and FTC to a new company called PMFTC Inc. ("PMFTC"). PMPMI and FTC hold equal economic interests in PMFTC, while PMI manages the day-to-day operations of PMFTC and has a majority of its Board of Directors. Consequently, PMI accounted for the contributed assets and liabilities of FTC as a business combination.

The fair value of the assets and liabilities contributed by FTC in this non-cash transaction was determined to be \$1.17 billion. At the time of the business combination, FTC was given the right to sell its interest in PMFTC to PMI, except in certain circumstances, during the period from February 25, 2015, through February 24, 2018, at an agreed-upon value of \$1.17 billion, which was recorded on PMI's consolidated balance sheet as a redeemable noncontrolling interest at the date of the business combination. On December 10, 2013, FTC terminated the agreement related to this exit right. As a result, the amount included in the consolidated balance sheet as redeemable noncontrolling interest was reclassified to noncontrolling interests within stockholders' deficit on the December 31, 2013 consolidated balance sheet.

The movement in redeemable noncontrolling interest during the years ended December 31, 2013, 2012 and 2011 was as follows:

| (in millions)   |          |
|---|----------|
| Redeemable noncontrolling interest at January 1, 2011   | \$ 1,188 |
| Share of net earnings                                   | 97       |
| Dividend payments                                       | (73)     |
| Currency translation                                    | —        |
| Redeemable noncontrolling interest at December 31, 2011 | \$ 1,212 |
| Share of net earnings                                   | 171      |
| Dividend payments                                       | (105)    |
| Currency translation                                    | 25       |
| Net loss and prior service cost                         | (2)      |
| Redeemable noncontrolling interest at December 31, 2012 | \$ 1,301 |
| Share of net earnings                                   | 99       |
| Dividend payments                                       | (94)     |
| Currency translation losses                             | (33)     |
| Net loss and prior service cost                         | 2        |
| Termination of rights agreement                         | (1,275)  |
| Redeemable noncontrolling interest at December 31, 2013 | \$ —     |

**Note 24.****Quarterly Financial Data (Unaudited):**

| (in millions, except per share data) | 2013 Quarters |          |          |          |
|--------------------------------------|---------------|----------|----------|----------|
|                                      | 1st           | 2nd      | 3rd      | 4th      |
| Net revenues                         | \$18,527      | \$20,483 | \$20,629 | \$20,390 |
| Gross profit                         | \$ 5,095      | \$ 5,216 | \$ 5,309 | \$ 5,187 |
| Net earnings attributable to PMI     | \$ 2,125      | \$ 2,124 | \$ 2,340 | \$ 1,987 |
| Per share data:                      |               |          |          |          |
| Basic EPS                            | \$ 1.28       | \$ 1.30  | \$ 1.44  | \$ 1.24  |
| Diluted EPS                          | \$ 1.28       | \$ 1.30  | \$ 1.44  | \$ 1.24  |
| Dividends declared                   | \$ 0.85       | \$ 0.85  | \$ 0.94  | \$ 0.94  |
| Market price:                        |               |          |          |          |
| — High                               | \$ 93.61      | \$ 96.73 | \$ 91.40 | \$ 91.81 |
| — Low                                | \$ 84.33      | \$ 86.05 | \$ 82.86 | \$ 83.81 |

| (in millions, except per share data) | 2012 Quarters |          |          |          |
|--------------------------------------|---------------|----------|----------|----------|
|                                      | 1st           | 2nd      | 3rd      | 4th      |
| Net revenues                         | \$18,022      | \$20,037 | \$19,592 | \$19,742 |
| Gross profit                         | \$ 5,006      | \$ 5,454 | \$ 5,336 | \$ 5,208 |
| Net earnings attributable to PMI     | \$ 2,161      | \$ 2,317 | \$ 2,227 | \$ 2,095 |
| Per share data:                      |               |          |          |          |
| Basic EPS                            | \$ 1.25       | \$ 1.36  | \$ 1.32  | \$ 1.25  |
| Diluted EPS                          | \$ 1.25       | \$ 1.36  | \$ 1.32  | \$ 1.25  |
| Dividends declared                   | \$ 0.77       | \$ 0.77  | \$ 0.85  | \$ 0.85  |
| Market price:                        |               |          |          |          |
| — High                               | \$ 88.86      | \$ 91.05 | \$ 93.60 | \$ 94.13 |
| — Low                                | \$ 72.85      | \$ 81.10 | \$ 86.11 | \$ 82.10 |

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.

During 2013 and 2012, PMI recorded the following pre-tax charges in earnings:

| (in millions)                   | 2013 Quarters |     |      |       |
|---------------------------------|---------------|-----|------|-------|
|                                 | 1st           | 2nd | 3rd  | 4th   |
| Asset impairment and exit costs | \$3           | \$5 | \$ — | \$301 |

  

| (in millions)                   | 2012 Quarters |     |      |       |
|---------------------------------|---------------|-----|------|-------|
|                                 | 1st           | 2nd | 3rd  | 4th   |
| Asset impairment and exit costs | \$8           | \$8 | \$34 | \$ 33 |

See Note 5. *Asset Impairment and Exit Costs* for additional information on these pre-tax charges.